WHEN CAN DERIVATIVE CLAIMS BE BROUGHT IN PROFESSIONAL NEGLIGENCE?

IN WHAT CIRCUMSTANCES CAN A DERIVATIVE CLAIM – A CLAIM BROUGHT ON BEHALF OF A COMPANY BY ONE OF ITS SHAREHOLDERS (OR BY A SHAREHOLDER IN ITS PARENT COMPANY – A DOUBLE, OR MULTIPLE, DERIVATIVE CLAIM) – BE BROUGHT CLAIMING DAMAGES FOR NEGLIGENCE BY A THIRD PARTY, SUCH AS THE COMPANY’S LEGAL OR FINANCIAL ADVISER?

The answer depends on the nature of the derivative claim which is brought. There are now three types of derivative claim, and the position is different for each.

First, under the statutory derivative claim, which was created by Part 11 of the Companies Act 2006 (“the 2006 Act”), derivative proceedings may be brought against a third party only where the damage suffered by the company arose from an act or omission involving negligence, default, breach of duty or breach of trust by a director (or former or shadow director) of the company. Whilst a derivative claim under Part 11 of the 2006 Act could be brought against a third party professional as well as, or instead of, against the relevant director, it is only available where there has been a breach of duty of et al. by at least one of the company’s directors. This limitation was justified by the Law Commission on the basis that “to allow shareholders to have involvement in whether claims should be brought against third parties in our view goes too far in encouraging excessive shareholder interference with management decisions. This is particularly important as we are proposing that derivative actions are to be available in respect of breaches of directors’ duties of skill and care.”

Second, the relief which the court can grant in relation to an unfair prejudice petition presented under section 994 of the 2006 Act expressly includes (at section 994(2)(c)) an order authorising civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct. As Lewison J pointed out in Lewison v Westrip Holdings Ltd [2011] 1 BCLC 116, no person could have a personal stake in the claim. It appears that negligence would be insufficient for that purpose.

Finally, as Briggs J recently held in Universal Project Management Ltd v Fort Gilkicker Ltd [2013] 3 WLR 164, multiple derivative claims, which fall outside the ambit of the statutory derivative claim, continue to exist at common law notwithstanding the introduction of the statutory derivative claim. By the same reasoning, derivative claims in respect of overseas companies also continue to survive at common law. However, the circumstances in which third party professionals are likely to face multiple derivative claims or derivative claims in respect of overseas companies are likely to be limited. This is because such claims can only be brought where the derivative claimant can show there to be a “fraud on the minority” exception to the rule in Foss v Harbottle – i.e. at the very least a breach of fiduciary duty. It appears that negligence would be insufficient for that purpose.

Suppose I engage an accountant to complete my annual tax return. Suppose also that I have earned fees of £200,000 (this is, after all, an imaginary situation). But, in order to seek to pay less tax, I tell my accountant my receipts were only £250,000 and only provide him with fee notes for a 6-month period. My accountant fails to query this despite my expenses covering the full 12-month period. When HMRC uncovers my fraud and charges me the shortfall and fines me, I cannot sue my accountant in negligence for breach of duty. Whilst the precise parameters of the ex turpi causa policy are not clear, what does seem settled is that: (i) the defence can apply to claims in tort; (ii) the defence only applies where the claimant was personally at fault and where his conduct involves some “moral turpitude” (see Lord Phillips in Stone & Rolls Ltd v Moore Stephens [2009] 1 AC 1391, it also operates to prevent a claimant claiming compensation for the adverse consequences of his own wrongdoing). Whilst the precise parameters of the ex turpi causa policy are not clear, what does seem settled is that:

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I am very pleased to introduce this new edition of Serlespeak on professional liability. In my own article I consider how far the defence of illegality (ex turpi causa) can apply in professional negligence claims. Nicholas Lavender QC then discusses recent cases on issues of causation, remoteness, and quantum in the context of such claims, while Andrew Francis examines what recent cases reveal about the standard of care required in real estate transactions. John Machell QC and James Mather have jointly contributed a piece on the extent to which indemnity insurance cover may be declined on the ground of sham partnership. Finally, Daniel Lightman takes a look at the circumstances in which a professional may face a derivative claim brought on behalf of a company.

Andrew Bruce
Causation, Remoteness and Quantum

OFTEN THE MOST DIFFICULT AND COMPLEX ISSUES IN PROFESSIONAL NEGLIGENCE CASES ARE THOSE CONCERNING QUANTUM. SOME RECENT JUDGMENTS ILLUSTRATE THE APPLICATION OF THE PRINCIPLES OF CAUSATION AND REMOTENESS IN NEGATIVE ADVICE CASES.

The claimants in Bateson v Savills Private Finance Ltd [2013] PNLR 20 proved negligence, but not causation. In 2005 the claimants remortgaged seven investment properties. The defendant mortgage brokers negligently failed to advise the claimants: (a) to ascertain whether there were any redemption penalties payable on their existing mortgages; and (b) that the new mortgage recommended by the defendants was an "aggregate" mortgage of all seven properties, instead of seven individual mortgages.

The claimants contended that they would not have remortgaged if they had been advised of these matters, and that they would have been better off as a result when their business fell into financial difficulties (compounded by the effects of the property crash in 2008). Judge Gosnell did not accept either of these contentions, finding instead that: (a) the claimants chose to proceed with the remortgage after being informed by their solicitors of the redemption penalties; (b) they would also have chosen to proceed if they had been told that the new mortgage was an "aggregate" one; and (c) he was not satisfied that the claimants would have been any better off if they had not remortgaged: they would still have fallen into arrears and enforcement action would still have been necessary.

Even more striking is the decision of Teare J in Zaki v Credit Suisse (UK) Ltd [2013] 1 BCLC 640. The defendant bank in Rubenstein v HSBC Bank Plc [2013] 1 All ER (Comm) 915 also gave negligent advice when recommending an investment (a Premier Access Bond). The defendant wrongly stated to the claimant that the Bond was "the same as cash deposited in one of our accounts". However, following the financial crisis of 2008, the claimant was only able to realise about 86% of his original investment. The claim failed at first instance because Judge Havelock-Allen held that the claimant's loss was too remote, on the basis that in 2005 the financial crisis of 2008 and its effects on the Bond were not reasonably foreseeable. But the Court of Appeal overturned this, finding instead that the risk of a fall in value in the Bond was foreseeable, albeit that the extent of the fall in markets in 2009 may not have been.

Finally, the Court of Appeal's decision in Capita Alternative Fund Services (Guernsey Ltd) v Drivers Jonas [2013] 1 EGLR 119 addresses a point which is often overlooked in commercial cases, but which can have a significant effect on quantum (as in Amaturo Plc v SeaGate Technology Inc [1997] 86 BLR 54), i.e. that the effect of taxation may well be relevant to the assessment of damages. The claimant, acting as trustee for underlying investors, bought a development in reliance on the defendants' negligent over-valuation. Eder J awarded as damages the difference between the price paid and the true value of the property, with no allowance for the substantial tax credits received by the investors.

The effect of taxation may well be relevant to the assessment of damages.

Nicholas Lavender QC regularly acts for and against banks in negligent advice cases.
Three recent cases involving land transactions demonstrate this in three specific ways. First, delay is costly in terms of loss of rights, and damages. Secondly, all communications (especially notices to complete) must be undertaken carefully. Finally, the general concept of risk where property rights and obligations may be in issue requires heightened awareness of specific risks.

The cost of delay is demonstrated by John Grimes Partnership Ltd (“JGP”) v Gubbins [2013] EWCA Civ 37. The 11 month delay by JGP in producing a highway report for a development site led to an award of damages based (inter alia) on the reduction in the market value of the site during that period. JGP were held to have assumed responsibility for loss attributable to changes in the property market. That loss was within the rules of remoteness. Allied to this first point is the risk of loss due to changes in the market value of property where there has been an ineffective last minute exercise of an option. The loss of the right to acquire property at a certain price is usually disastrous. The force of the second point is shown in Clarke Investments Ltd v Pacific Technologies [2013] EWCA Civ 750. This case shows how letters sent between contract and completion must be carefully drawn, with their effect fully assessed before despatch, and notices to complete, as “a powerful weapon in the hands of the conveyancer” must be handled with care. Avoiding these risks means ensuring that letters (or emails) do not create a trap later on and that weapons such as notices to complete are not deployed when they could explode later in the hands of the sender. Herrmann v Withers LLP [2012] EWHC 1492 (Ch) demonstrates the third point: the need to avoid giving unequivocally favourable advice where risks exist undermining such advice. It was held that advice about access to Ovington Square was not couched in sufficiently cautious terms. The risk is heightened by the Judge’s finding that those who undertake specialist “high end” property work are expected to maintain a higher standard than those who may be less specialist, or in the words of the Judge “a small country firm”. The concern is that in this harsh world, even a small country firm will be expected, in practice, to assess risk and advise and act in the same way as its bigger cousins.

So where do we go from here? The key lies in the word “avoidance” and within that word lies the concept of “prevention”. Risk can be avoided if we have systems in place to ensure that real property transactions do not end up with our competence under scrutiny. The three cases above all demonstrate what we can do to avoid that.

Andrew Francis regularly advises on professional negligence claims in a property context.
People
Congratulations to David Blayney and Jonathan Adkin who were both successful in this year’s Queen’s Counsel appointment round.
We are delighted to announce that our present pupils Zahler Bryan and Emma Hargreaves have both been offered tenancy and have accepted. They will become members of Chambers in October 2013 when they have completed their pupillages.

Directories
The 8th edition of the Citywealth Leaders List has now been published and recommends 12 Serle Court members as prominent barristers in the field of trusts: Alan Boyle QC, Kulip Singh QC, Frank Hinks QC, Dominic Dowley QC, Philip Jones QC, Jonathan Adkin QC, William Henderson, Daniel Lightman, Tim Collingwood, Giles Richardson, Simon Hattan, Jennifer Haywood, Dakis Hagen, Prof. Jonathan Harris and Sophie Holcombe.

The conference covered a wide range of issues including: recent cases involving attacks on asset protection structures; the recent decision in Pitt v Holt and Futter v Futter; and firewall legislation, including comparison of the position in Jersey with developments in other offshore jurisdictions. There were also three case studies covering: a Jersey trust and topical questions facing a Jersey trust lawyer; bribery and the remedies available to a party whose employee has been taking bribes; and claims against financial advisers and the issues which can arise when trust investments perform badly.

Our autumn seminars and conferences include a roadshow to Norwich covering property and commercial matters on 14 October and 3 events in November: a landlord and tenant event jointly hosted with Shoosmiths and Savilles, a family case study and a property update seminar.

LinkedIn
We have set up three discussion groups on LinkedIn to enable Serle Court members and clients to discuss topical issues in Partnership and LLP Law, Fraud and Asset Tracing, and Contentious Trusts and Probate; please join us.

Edited by JONATHAN FOWLES

Dishonest holding out and sham partnerships

THE PROPERTY CRASH HAS GIVEN RISE TO A NUMBER OF NEGLIGENCE AND FRAUD CLAIMS AGAINST FIRMS OF SOLICITORS, SOME OF WHICH HAVE THROWN UP KNOTTY PARTNERSHIP LAW COVERAGE ISSUES.

Where (as is often the case) the principals are unable to satisfy a judgment, the claimant (usually an institutional mortgage lender) needs to rely on the firm’s insurance to make a recovery. Many of the claims concern small informally run firms where the firm’s insurer can show that the relevant fee earner was dishonest. Under the SRA Minimum Terms and Conditions of Professional Indemnity Insurance (SRA Indemnity Insurance Rules 2012), the policy may (and invariably does) exclude liability to indemnify any particular person to the extent that liability arises from dishonesty or a fraudulent act or omission committed or condoned by that person. But the insurance must nonetheless cover any insured who is innocent of the fraud.

In some cases, the insurer has sought to avoid responding to a claim in a two principal firm on the basis that the solicitor who was not involved in the wrongdoing was not a true partner, but dishonestly held himself or herself out to be a partner. If such a contention is well founded, it would permit the insurer to decline cover altogether on the basis that there are no non-dishonest insureds.

For our part, we find the concept of dishonest holding out slightly odd. It is, of course, possible that a person is held out as a partner in circumstances in which he or she – honestly but wrongly – believes that he or she is a true partner or is negligent as to his or her status, but in many situations a person knows that he or she is, in truth, not a partner but is content nevertheless to be held out to the world at large as if he or she was. This is extremely common in professional services firms. In a sense, holding out by a person who knows that he or she is not a partner involves a deliberate deception: a person who allows himself or herself to be held out as a partner, when in fact he or she is not, does so on the basis that, if a third-party deals with the firm in reliance upon the belief that the person being held out is in fact a true partner, then the person held out is liable as if he or she was.

The third-party, therefore, gets what it bargained for. It seems to us that there are two arguments why, at least in an ordinary situation, a person held out as a partner does not lose a right to be indemnified under the dishonesty exception.

First, it seems to us arguable that the dishonest or fraudulent act has to be dishonesty or fraudulent conduct in connection with the underlying liability itself: that is, the acts or omissions actually giving rise to the liability to the third party, rather than acts or omissions giving rise to a person’s legal responsibility for the acts or omissions of some other person.

Secondly, where the insured is not responsible for the fraudulent conduct itself and has not condoned that conduct, it is not inherently dishonest or fraudulent for an insured to allow himself or herself to be held out as a partner in circumstances where he or she knows he or she is not.

In a disciplinary context, the concept of dishonest holding out or sham partnership makes more sense; but the dishonesty usually lies in whether the respondent is actually performing the role of a principal in the firm (or indeed has any involvement at all); rather than whether there is a true partnership or not: see, for example, Iqbal v SRA [2012] EWHC 2325 (Admin) and SRA v Emeana [2013] EWHC 2130 (Admin).

It remains to be seen what approach the court takes to these issues in a coverage context.