serle**speak**
ISSUE NO.11

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

Illegality and Professional Negligence

NO ONE CAN FOUND A CAUSE OF ACTION ON HIS OWN CRIMINAL CONDUCT. TO WHAT EXTENT IS THIS PRINCIPLE APPLICABLE IN A PROFESSIONAL NEGLIGENCE CONTEXT?

Suppose I engage an accountant to complete my annual tax return. Suppose also that I have earned fees of £500,000 (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 or for breach of contractual duty. That is because of the principle of ***ex turpi causa non oritur actio*** – no one can found a cause of action on his own criminal conduct.

In its simplest form, *ex turpi causa* operates as a rule that the court will not enforce a contract which is contrary to statute or entered into with the intention of committing an illegal act. However, as was made clear 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: (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* at [24] & [27-28]); and (iii) the defence will not succeed unless there is a very close connection between the claimant's misconduct and the claim which he

CONTINUED

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 etc. 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 996(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 *Iesini v Westrip Holdings Ltd* [2011] 1 BCLC 498, such a derivative claim could be brought in negligence against a third party irrespective of whether there was also a breach of duty by one of the company's directors.

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.

DANIEL LIGHTMAN'S article, *"Two Aspects of the Statutory Derivative Claim"* [2011] LMCLQ 142, was cited with approval in *Universal Project Management Ltd v Fort Gilkicker Ltd*, where Briggs J stated *"Neither Lord Millett nor any of the other academic writers who have concluded that the 2006 Act abolished multiple derivative actions have addressed the simple point of construction advanced by Mr Lightman..."*

CONTINUED

makes. The authorities do not, though, speak with one voice as to how close the connection must be: In *Clunis v Camden and Islington Health Authority* [1998] QB 978 Beldam LJ suggested that the defence only operated if the claimant was forced of necessity to plead or rely upon the illegality in order to advance his claim (at 987C), whereas in *Cross v Kirby* (2000) (*The Times*, 5 April 2000) the same judge said strict satisfaction of any "reliance" test was unnecessary and that "*the principle applies when the claimant's claim is so closely connected or inextricably bound up with his own criminal or illegal conduct that the court could not permit him to recover without appearing to condone that conduct.*"

In *Scullion v Bank of Scotland (t/a Colleys)* [2010] EWHC 572 (Ch) it was argued that a valuer could, in answer to a tortious claim, avail itself of an *ex turpi causa* defence where the claimant had made false declarations on his mortgage application form. In that case, the Judge (Richard Snowden QC) accepted that a sufficiently "*close connection*" was made out saying: "*As Mr Scullion's claim is a tort claim which depends upon proof of loss and the starting point of his claim for loss is the loan which he obtained... it seems to me that Mr Scullion's application...is inextricably linked to his claim.*" But the valuer failed to establish that Mr Scullion had deliberately misled the mortgagees.

For the defence to apply in respect of a professional negligence claim where there is a contractual relationship between claimant and defendant, it appears illegality relating to an underlying transaction may be insufficient. Whilst an *ex turpi causa* defence will succeed where the illegality is in the performance of the contract sued under itself, if the contract is only remotely connected with an unlawful transaction and rests upon an independent and legal consideration the defence will fail (see *21st Century Logistic Solutions Ltd v Madysen* [2004] EWHC 231 (QB) per Field J).

Where precisely the line is to be drawn in respect of contracts for professional services which are collaterally (or remotely) connected to unlawful transactions still remains to be fully explored by the courts. Although Briggs J (as he then was) suggested that *Lexi v DTZ* [2010] EWHC 2290 (Ch) might clarify this point, the case settled shortly before trial.

ANDREW BRUCE is recommended for his professional negligence work and has considerable experience of claims involving solicitors, architects, surveyors, accountants, and auctioneers. Andrew was instructed in *Lexi v DTZ*.

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 NEGLIGENT 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.

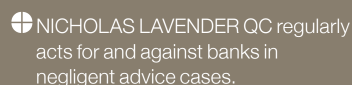
Even more striking is the decision of Teare J in *Zaki v Credit Suisse (UK) Ltd* [2011] 2 CLC 523. The Judge found that: (a) certain investments which were recommended by the defendant bank to its customer were unsuitable for the customer; but (b) if he had been advised that they were unsuitable, the customer would still have gone ahead and bought them. (This finding was not challenged on appeal: *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 2008 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 *Amstrad Plc v Seagate Technology Inc* (1997) 86 BLR 34), 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"

The Court of Appeal held that the tax credits should be taken into account, and that the correct measure of damages was the difference between: (a) the price paid, net of the tax credits received; and (b) the true value, net of the tax credits which would have been received if the claimant had bought the property for this amount. The effect was to reduce the damages awarded from about £18m to under £12m.



NICHOLAS LAVENDER QC regularly acts for and against banks in negligent advice cases.

Standards of professional competence are under increasing scrutiny

R is for Risk. A is for Avoiding it.

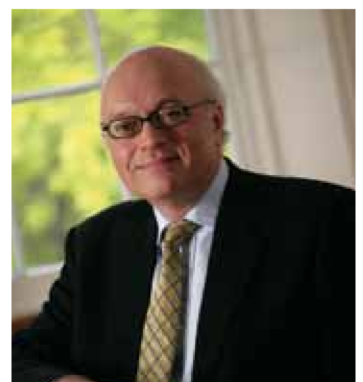
IN THE HARSH WORLD OF REAL PROPERTY TRANSACTIONS SINCE THE EVENTS OF 2008, THERE ARE TWO CERTAINTIES. STANDARDS OF PROFESSIONAL COMPETENCE ARE UNDER INCREASING SCRUTINY AND MISTAKES ARE EXPENSIVE.

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.

Avoiding these risks means ensuring that letters (or emails) do not create a trap later on



ANDREW FRANCIS regularly advises on professional negligence claims in a property context.

Chambers news

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, Kuldip Singh QC, Frank Hinks QC, Dominic Dowley QC, Philip Jones QC, Jonathan Adkin QC, William Henderson, Daniel Lightman, Tim Collingwood, Giles Richardson, Dakis Hagen and Robin Rathmell. The Citywealth Leaders List is the result of a year long ongoing programme of peer recommendation and verification ensuring that the leading advisers and managers in the wealth sector are included.

Awards

We are very pleased to announce that Serle Court is one of only 3 sets nominated as Chancery Set of the Year at the Chambers and Partners Bar awards. Serle Court was also one of only 5 sets named as a finalist for Chambers of the Year at the 2013/14 STEP Private Client Awards.

Conferences and Seminars

We hosted a very successful conference in Jersey in June.

The Serle Court speakers included: Frank Hinks QC, Elizabeth Jones QC, Lance Ashworth QC, Nicholas Lavender QC, Michael Edenborough QC, John Machell QC, William Henderson, 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.

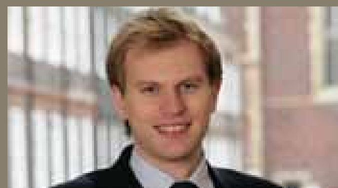
LinkedIn

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 service 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 deals with the firm is led to believe that the person being held out is in fact a true partner. However, it seems to us, at least in the ordinary situation, that this does not involve dishonesty or fraud: 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 dishonesty 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 3251 (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.

JOHN MACHELL QC and JAMES MATHER have advised a number of lenders and insurers on partnership and LLP coverage issues.