

# professional risks

## Contingent liability – loss or no loss?

Limitation remains a hot topic for legal argument, particularly the vexed issue of when actual damage is suffered.

The recent decision in *AXA -v- Akther*<sup>1</sup> has clarified when actual damage is suffered in tort; and confirms that long-standing decisions such as *Forster -v- Outred*<sup>2</sup> remain relevant despite the decision in *Law Society -v- Sephton*<sup>3</sup>. Where a lawyer handles a transaction which is intended to have specific features, and these features are missing or defective, damage is suffered on the date of the transaction.

### The facts

The claim arose from a TAG-like scheme, where NIG provided ATE legal expenses insurance to fund claims. The scheme ran from 2000 until August 2003. Panel solicitors were obliged to (i) vet claims at the outset, to ensure they had at least a 51% prospect of success and a minimum value of £1,000; and (ii) keep the claims under review and ensure that they continued to fulfil these criteria.

AXA took an assignment of NIG's rights, and in June 2008 commenced proceedings against 78 firms, alleging negligent failure to ensure that the claims met the criteria, resulting in substantial losses. The solicitors argued that about one-third of the claims were statute-barred. Limitation was heard by Flaux J as a preliminary issue.

### The arguments

The question was when the cause of action accrued and time began to run. The solicitors argued that NIG suffered actual damage when the ATE policies were entered, and that time on each claim ran from the inception of the ATE policy.

AXA relied upon *Sephton*, arguing that as a result of the solicitors' negligence, NIG incurred a potential liability which may, or may not, accrue; and that loss would not be suffered until the contingency occurred. AXA argued that the liability of NIG was wholly contingent; and that the contingency should be ignored in assessing when actual damage had been suffered.

### The decision

Where NIG were committed to ATE policies in cases where the prospects of success from the outset were less than 51%, they were exposed to the risk of a costs liability at that point, and suffered loss at the inception of the policy.

In cases where the solicitors failed to keep the claims under review, and they subsequently fell below the 51% threshold or the £1,000 minimum recovery, damage was suffered when the solicitors failed to notify NIG that the claims no longer met the criteria; and exposed them to greater risk.

The relevant claims were held to be statute-barred.

### Lessons to be learnt

- Each case is to be determined on its facts. However the basic principle is that, in a professional negligence claim, the client suffers loss if he does not get what he ought to have received.
- The fact that a claimant's loss is contingent upon a future event does not mean that loss is only suffered when the contingency occurs.



- If a solicitor is retained to take particular steps to ensure that a transaction is free from certain problems, then damage is suffered when the transaction completes with the defect in place. The cause of action is not left in limbo until the contingency occurs.
- *Sephton* can be distinguished, as applying to cases where a claimant was exposed to a purely contingent liability standing alone. That was not the case for NIG.
- For insurers, the decision is relevant because it sets out the limited application of *Sephton*; and reinforces that earlier decisions such as *Forster* and *Nykredit*<sup>4</sup> remain relevant in assessing when a claimant suffers loss.
- Limitation is, and will continue to be, a key issue for parties, insurers and the court.

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1. *AXA Insurance Ltd -v- Akther & Darby* [2009] All ER 285

2. *Forster -v- Outred* [1982] 1 WLR 86

3. *Law Society -v- Sephton* [2006] 2 AC 543

4. *Nykredit -v- Edward Erdman* [1997] 1 WLR 1627

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Withdrawing from a mediation could be costly

Jamie Monck-Mason  
Page 2



A technological risk worth writing?

Peter Causton  
Page 3



The TCC: The Too Costly Court?

Jonathan Anslow  
Page 4

## Welcome

Welcome to Hill Dickinson's professional risks Autumn 2009 newsletter. In this edition we cover a range of issues, including claims against IT professionals and developments in the Technology & Construction Court. We hope you find the articles of interest.

On 26 November 2009 we will be holding our annual North West seminar at Manchester Art Gallery, followed by drinks and canapés. We are delighted that Nick Bacon of 4 New Square has agreed to be our guest speaker. Controlling the cost of claims has always been a key issue but in a climate of ever increasing CFAs and ATEs it has become paramount. From his position as a member of the working group, Nick will be able to give us a unique insight into Jackson LJ's ongoing review of civil costs, in advance of the final report planned for December 2009. If you would like to attend please contact Fleur Rochester at fleur.rochester@hilldickinson.com.

We recognise that 2009 has been a challenging year for insurers and professionals alike, particularly in light of the volume of claims being intimated by lending institutions. We are working with a number of clients to help minimise the impact on professional firms and to cost-effectively handle the claims for insurers. We are able to offer a variety of fee options and service agreements. If you feel we could assist your organisation please do contact us.

### Ruth Lawrence

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## Stop press

We are delighted to welcome John Barlow, who has joined us from Chadbourne & Park as a partner in the London office.

John advises financial institutions and project companies on political risk, sovereign guarantee, credit default and protracted payment insurances, including recoveries under such policies. John handles claims in the areas of fidelity, computer crime, professional indemnity and directors' and officers' insurance; and also designs products for the London market which reflect the changing risks and opportunities in the financial sector.

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# Withdrawing from a mediation could be costly

## Introduction

Technology and Construction Court (TCC) judges have long been willing to penalise a party which unreasonably refuses to mediate. However, in Roundstone Nurseries Limited -v- Stephenson Holdings Limited<sup>1</sup>, the court went one step further, imposing a costs penalty on a party who withdrew from a mediation for bona fide reasons, shortly before it was due to take place.

## The facts

The claimant served proceedings close to the expiry of the limitation period, without first complying with the pre-action protocol. The parties agreed a stay, to allow the protocol process to be completed and to adopt alternative dispute resolution. It was agreed that a mediation would take place. The defendant obtained a preliminary expert report, and advised the claimant that it was important that a third party should attend the mediation, to have any prospect of success. The defendant wrote to the third party, seeking their agreement to attend the mediation. The third party responded that they needed further information, including the defendant's expert report, before committing to a mediation.

The defendant failed to produce the expert report, and two weeks before the mediation was informed by the third party that it would not be attending the mediation. The report was then served, but the third party could not be persuaded to attend.

The defendant suggested to the claimant that the mediation be rescheduled, to give the third party an opportunity to consider the claim; and made plain that they would not be attending the mediation, which was then cancelled.

The claimant made an application to the court seeking an order that the defendant pay its costs thrown away by the cancelled mediation.

## The decision

There were two key questions that the court had to address:

*Did the court have jurisdiction to make an order in respect of any part of the costs of the mediation?*

The court held that this depended on the type of mediation process that has been agreed by the parties. If the mediation is part of the protocol process, and the parties have not agreed to bear their own costs of the mediation, the court is likely to have the necessary jurisdiction. If, however, the mediation is a stand-alone process, or the parties have agreed to bear their own costs of the mediation, the court is unlikely to have the necessary jurisdiction.

In this case the court held that it did have jurisdiction.

*Should the court exercise its discretion in awarding the claimant its wasted costs?*

The court held that the defendant was wrong to cancel the mediation because it was part of the protocol process, in which the parties were obliged to participate. The mediation had been arranged before there was any question of inviting the third party to participate; and it was not unreasonable for them to refuse to attend.

Consequently the court ordered that the defendant pay the claimant's costs thrown away by the late cancellation of the mediation.

## Lessons to be learnt

- When agreeing to mediate, a party should consider whether they want to agree that they will bear their own costs of the mediation. If they do agree, it is unlikely that the court will have jurisdiction to award one party any part of the costs of the mediation.
- If participation in the mediation is subject to any conditions, such as a third party agreeing to participate or documents/information being received from a party by a certain date, this should be made clear when the agreement to mediate is made.
- If those conditions are not then met, and the party withdraws, it is unlikely that the court would make a costs order against that party for refusing to participate.

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1. [2009] EWHC 1431





## A technological risk worth writing?

When most people refer to a professional indemnity claim, they are thinking about a claim against a traditional professional, who normally carries compulsory insurance. However, businesses are increasingly reliant upon IT systems; and those that supply and maintain them are often the last to consider the need for professional indemnity insurance.

### Common types of claim

When something goes wrong, IT businesses can often be exposed to large claims, as varied as the different types of business being carried out. Examples include:

#### 1. Internet Service Providers (ISPs)

ISPs often host websites for clients, and services include archiving and back-ups in addition to internet access. If the website does not function properly, or the service fails to deliver, they can face a claim.

#### 2. IT projects and software development

Systems developers and project managers are involved in projects which include analysis and design, user sign off, programming, implementation and user acceptance. Disputes arising from IT projects often involve an analysis of complex contractual arrangements and fulfilment issues arising over a long period

and can be costly. The security software market grew last year, indicating continuing concerns regarding data security.

Claims can arise from the provision of bespoke or off the shelf software solutions, when the customer frequently complains that the software is not fit for purpose. The customer may sue for breach of contract or negligence and claim the cost of a replacement system and loss of business.

### 3. Outsourcing

Outsourcing has become a common source of complaint. Companies outsource their payment processing, so as to manage the transfer of funds from a customer or bank to an e-commerce site. If the payment processing malfunctions then there can be a claim.

Businesses also outsource processes such as call centres, human resources, accounts and payroll. IT and business outsourcing is set to increase amongst retailers struggling to cut costs in a recession. Co-location companies place the customer's own equipment in 'rack space' in their own facility, supplying power and storage. Some companies provide 'managed services' whereby they monitor and maintain computers, networks and software, whether or not the actual equipment is in-house. If the technology fails, claims will arise.

### Policy wording

When claims arise there are often complex policy issues to consider. Policy wordings vary and the most comprehensive will include claims for breach of intellectual property, virus transmission and, of course, breach of contract.

However, it is important to check exclusions carefully, as a claim may not be covered in certain circumstances. Common exclusions include:

- If the IT business was aware at the time of entering into the contract that they did not have sufficient resources to perform the contract
- Breach of a warranty or guarantee
- Claims for consequential losses or loss of profits by the customer
- If the IT business designed or manufactured the hardware
- If the claim relates to the disclosure of the customer's confidential information
- Defects caused by a third party supplier or manufacturer

- Damage to electronic data
- Costs involved in the repair or replacement of software or hardware
- Claims arising out of a joint venture or disputes with distributors, manufacturers or sales agents
- Claims arising out of the operation of any employee benefit scheme, gambling or lotteries

IT businesses often turn to their insurers late in the day, once a dispute has been in existence for some time. Concerns include late notifications and admissions of liability under the terms of the policy.

### Risk management

Before underwriting a particular risk, insurers need to understand how the IT business operates; and whether it has procedures in place to deal with contract certainty, as claims often arise as a result of disputes over specification and contractual obligations.

Brokers must be alive to the restrictions in a policy, and ensure that it meets the IT professional's requirements; and that the IT professionals are aware of the policy conditions.

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## Stop press

The House of Lords have recently held<sup>1</sup> that where a company is a 'one-man band', and that man has been dishonest, the fraud is to be imputed to the company. The company does not have a cause of action against its auditors for failing to detect the fraud, since its alter ego was responsible for perpetrating the fraud. In short, you can't bring a claim arising from your own dishonesty.

If no duty of care is owed to creditors, it raises the issue of whether auditors have any responsibility where they fail to detect frauds by one-man band companies operating illegal operations, such as Ponzi schemes. This will no doubt be re-visited in the light of Madoff-style frauds over the coming months. Watch this space.

1. Stone & Rolls Ltd (In Liquidation) -v- Moore Stephens [2009] UKHL 39



## The TCC: The Too Costly Court?

Over the last decade there has been mounting concern about the cost of civil litigation. In May, Jackson LJ published his Preliminary Report on Civil Litigation Costs. Chapter 34 of the report deals specifically with Technology & Construction Court (TCC) litigation but other sections of the report are also of relevance.

### Proposals affecting cases in the TCC

The key matters under consideration that may impact on TCC cases are:

- Deferring the pre-action protocol so it is carried out after issue of the claim form, in order to allow the process to be supervised by the court
- Sanctions, including wasted costs orders, if witness statements are not concise
- A presumption that expert evidence on quantum be given by a single joint expert
- Stopping success fees and ATE premiums being recovered from the defendant
- Allowing contingency fees based on a percentage of damages, provided that the burden falls on the claimant and not the defendant
- Fixing, or imposing caps on, the costs of particular stages of litigation

### The benefit to defendants in the TCC

The main effect of these changes should be to reduce the costs a successful claimant can recover from a defendant by:

- Enabling the court to take a more active role in managing the costs of the parties
- Encouraging claimants to take a more active role in managing their solicitors' costs
- Making successful claimants pay more of their own costs

By deferring the pre-action protocol until after the issue of the claim form, claimants should give more consideration to the merits of their claim before initiating the protocol process, particularly if the court is given the power to award the defendant its costs if the claimant decides not to serve the claim form.

It is unclear whether the court will be given this power but, if so, it would be a very positive development for defendants, who should see the number of spurious claims they have to defend, through the protocol process, significantly reduced.

### Will there be any detriment to defendants?

One concern is that expert evidence on quantum may be given by a single joint expert, which could mean that quantum is not as heavily scrutinised. That is not to say that the single joint expert will not act independently, but simply that his findings will not be challenged by another expert.

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## Editors' message

We hope that you find this newsletter informative, and would welcome any feedback you have on the contents, or suggestions for future articles. If you would like to contribute to future editions as a guest contributor, please contact Christopher Stanton.

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## About Hill Dickinson

The Hill Dickinson Group offers a comprehensive range of legal services from offices in Liverpool, Manchester, London, Chester, Piraeus and Singapore. Collectively the firms have more than 1,100 people, including 160 partners.

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