Browne Jacobson

Contingent loss in negligence claims

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The relevance of the issue

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Section 2 of the Limitation Act 1980 (the **Limitation Act**) provides that the normal period of limitation for an action founded on tort is six years from the date on which the cause of action accrued. In turn, a cause of action accrues when legally recoverable loss or damage is first sustained.

Most of the time, loss will become apparent within the primary limitation period. However, this is not always so and the law has developed a number of mechanisms to ensure fairness. A number are statutory and are contained with the Limitation Act; for example sections 14A (latent damage) and 32 (fraud, concealment and mistake).

Contingent loss is distinct in the sense that it delays the commencement of primary limitation rather than extending or excluding such. It often arises in the same circumstances as, or in conjunction with, section 14A (although this is not necessarily so). However, it has the significant practical advantage for a claimant of availing a six year limitation period rather than the three years provided for by section 14A. Accordingly, it often comes into play where a claimant has (often, based upon the authorities, inexplicably) left it too late to rely, certainly safely, upon section 14A.

The development of the modern law

The development of the modern can be traced back to the case of Forster v Outred & Co [1982] 1 WLR 86. The case concerned a mother who, having received negligent advice from her solicitor, charged her property to secure a business loan which was made to her son. The relevant deed was signed in February 1973. Her son's business venture failed and, in late January 1975, Mrs Forster was called upon to pay approximately £70,000. Payment was made in late August 1975, with proceeding issued against her solicitors in March 1980. This gave rise to the question whether she had suffered damage when she (a) charged her farm, or (b) was called upon to provide repayment (or face the prospect of enforcement action against her property).

The Court of Appeal concluded that Mrs Forster's cause of action accrued when she charged her property as security for the loan. The essential reasoning was that as soon as Mrs Forster signed the mortgage deed, the value of her property was diminished because it was encumbered. It followed that actual damage was sustained at this point, whilst further loss occasioned by her son's default remained contingent.

Over the next twenty years, *Forster* was followed in a number of cases including D. W. Moore & Co. Ltd. v. Ferrier [1988] 1 WLR 267*,* Bell v Peter Browne & Co. [1990] 2 QB 495 and Knapp v. Ecclesiastical Insurance Group plc [1998] PNLR 172. These cases all involved transactions where, in essence, the package of rights acquired by the claimant following the transaction were less valuable that they should have been (including an employment contract containing a defective restrictive covenant and a voidable fire insurance policy). In each case, it was found that damage was caused at the time of the transaction, although further loss remained contingent, with the effect of the transaction characterised as akin to the acquisition of a defective product.

The next significant milestone came in 2006 with the House of Lords' decision in the case of Law Society v Sephton & Co [2006] UKHL 22. The case concerned negligence by a firm of accountants, Sephton & Co, which allowed a solicitor (Mr Payne) to misappropriate funds from his firm's client account undiscovered for over six years between 1990 and 1996. Those misappropriations eventually led to claims being made against the Solicitors' Compensation Fund.

As to the chronology, the first client complaint was made in April 1996, prompting investigation by the Law Society. On 17 May 1996, the Society's investigating accountant discovered the accounting irregularities and, on 20 May 1996, Mr Payne's firm was subject to intervention. The first claim against the Compensation Fund was made in July 1996 and, between October 1996 and January 2003, payments totalling approximately £1.25M were made from the Fund.

The Society intimated a claim against Sephton & Co in October 1996 but did not issue proceedings until 16 May 2002. This was within six years of the date of discovery, but more than six years after the misappropriations. Sephton & Co argued that the Society's claim was statute barred on the basis that damage was suffered at the time of each misappropriation because this gave the client a right to claim against the Fund, and in turn, the liability constituted damage. The court disagreed and found that the mere possibility of an obligation to pay money in the future is not of itself damage. Damage was suffered by the Society when claims were made. The court (in a helpful and readily understandable judgment) approved the proposition that the mere entry, as a result of negligence, into a transaction which a claimant would not otherwise have entered is not of itself loss or damage, although in practice, such cases will often give rise to immediate loss (Lord Hoffman, at para. 31). Lord Mance, who took a practical approach to the issue, recognised (Paras 77 & 78) the possibility of valuing risk, but stressed the need to show a change of legal position or the diminution in value of a particular asset to substantiate a claim that damage has been sustained.

Despite speculation that Sephton would serve to widen the scope of contingent loss, this has not transpired. Rather, it has been conservatively interpreted and has been distinguished in a number of subsequent cases such as Shore v Sedgwick Financial Services Ltd [2008] EWCA Civ 863, Pegasus Management Holdings SCA v Ernst & Young [2010] EWCA Civ 181 and Halsall v Champion Consulting Ltd [2017] EWHC 1079 (QB). In short, all were 'wrong transaction' cases where the court found that the claimant's cause of action accrued at the time of the transaction (although further loss remained contingent).

Recent developments

Against the above backdrop, the recent case of (1) Sir Christopher Evans, (2) Lady Ann Evans v Pricewaterhouse Coopers LLP [2019] EWHC 1505 (Ch) provides a reminder of the difficulties involved in distinguishing between risk and damage.

The basic facts of the case were that the claimants wanted to sell some shares. However, doing so would create a large, and taxable, capital gain. On the basis of advice from the PwC, the claimants entered into a 'round the world' tax avoidance scheme; the essence of which was that the relevant trust would reside for part of the tax year in an overseas (low tax) jurisdiction, sell the shares, and then move back to the UK without incurring a tax liability on account of the relevant double taxation treaty. The identity of the appropriate overseas jurisdiction was considered during late 2000 and early 2001, with Canada eventually being chosen over Mauritius for, it seems, largely presentational reasons (described contemporaneously by PwC as reducing the 'smell factor'). In April 2001, Canadian trustees were appointed. The share sale took place in August 2001. Finally, on 18 December 2001, the scheme was completed by the trust moving back to the UK upon the claimants being appointed as trustees.

Subsequently, in 2005, the HMRC opened an enquiry into the claimants' tax return for the 2001/2002 year. In December 2013, the HMRC's Canadian equivalent wrote to the HMRC confirming that it did not consider the trust to have been resident in Canada and, in any event, the UK could, on account of the terms of the relevant double taxation treaty (essentially, granting the respective tax authorities discretion to agree between themselves the applicable jurisdiction), tax the gain. In March 2014, the HMRC issued a notice to the claimants requiring back payment of tax of approximately £2m. The claimants appealed the decision, which was confirmed during stages of the appeal process in June 2014 and September 2014. Finally, on 29 November 2016, the claimants concluded settlement with HMRC for approximately £3.3m on account of the tax liability and interest.

Proceedings were issued against PwC shortly thereafter in December 2016. The claimants sought the recovery of the sum paid to HMRC, in additional to various incidental expenses. In response, PwC applied to strike out the claim and/or for summary judgment on the basis that the claim was obviously time-barred. The crux issue with regards to contingent loss was whether damage had been suffered at the inception of the tax avoidance scheme (which it said was doomed from the outset) or a later point; either when the Canadian Revenue Agency confirmed that the UK tax regime would apply, or when the HMRC issued a demand for payment.

PWC argued that this was a 'wrong transaction' case and analogous with the likes of Pegasus. Accordingly, damage was suffered at the inception of the scheme at which point the claimants acquired, essentially, the 'wrong product' and there was an immediate detrimental change to their position, including on account of the loss of commercial flexibility. In contrast, the claimants relied upon Sephton and argued that loss was purely contingent until the decision was taken to charge UK tax.

Given the nature of the application, the judge was not required to reach a conclusion beyond whether the issue was arguable. The judge acknowledged that in a 'wrong transaction' case, damage would usually be sustained at the time of the transaction. However, she was unconvinced on the evidence before her that this was the case in the specific instance. She drew a distinction with Pegasus and other similar cases on the basis that here nothing was acquired pursuant to the transaction (unlike the scenario where an asset is acquired for market value but without requisite characteristics – such as to avoid tax, as was the case in Pegasus and Halsall). Whilst the judge acknowledged the possibility that the claimants' commercial options may have been restricted because of the scheme, and this may have caused damage, she was not satisfied that this had been demonstrated. Accordingly, she concluded that it was arguable that the claimants were exposed, at the time of the scheme, to a pure contingency and that all that they took on at the time was a risk that tax might be charged. Whether, in fact, they were charged, depended upon the discretion and the agreement reached between the two tax authorities.

Comment and take-away points

The decision is interesting because it acutely demonstrates the sometimes extremely difficult exercise involved in distinguishing between risk and damage. Whilst not yet the subject of full argument, the facts in this case, perhaps more so than those considered within any of the other leading authorities, appear to render the outcome finely balanced.

On one hand, a compelling argument can be made concerning the scheme's lack of effect upon any tangible asset, and the fact that the risk faced by the claimants was not a direct consequence of the transaction but emanated from the exercise of discretion by third parties (as in Sephton, where that discretion was to make a claim). On the other hand, it is clear that practical measures were taken upon the commencement of the scheme. This, one presumes, involved both cost and a change of the claimants' position. Further, it is arguable that the approach of the respective tax authorities, whilst not necessarily prescriptive, was capable of objective assessment. If the case reaches trial, the High Court is likely to be faced with a difficult task.

Beyond mere academic interest 'take away' points from a defendant perspective are threefold:

1. Any argument concerning contingent loss takes place against a backdrop that the courts are, as a matter of both policy and approach, concerned to "*advance, rather than retard the accrual of a cause of action*" (Lord Nicholls of Birkenhead, Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2) [1997] 1 WLR 1627, 1630). As such, defendants are always, adopting a common metaphor, 'pushing against an open door'.

2. However, whilst the door may be 'unlocked' it still needs to be opened by a defendant. *Evans*, serves as a reminder as to the crucial importance of focusing (be it in pleadings and/or evidence) upon demonstrating that actual damage has been sustained. It has been clearly established that damage does not flow automatically from entry into a transaction or agreement that would not otherwise have been entered, or mere risk. As neatly summarised by Judge Elizabeth Cooke in Evans *"A risk can be valued, but a risk by itself is not damage"* (Para 51).

3. In practical terms, it has often proved fruitful for defendants to demonstrate, if possible, an immediate impact upon a particular asset. As seemingly envisaged by Lord Mance in Sephton, there is no reason why this should not entail a complex valuation exercise. However, to be successful, the exercise needs to lead back to demonstrating impact upon the value of an asset. An alternative is to characterise the claimant's position as akin to having purchased a defective product.

Contact

Nicholas Saunders

Legal Director

nick.saunders@brownejacobson.com

+44 (0)330 045 2731

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