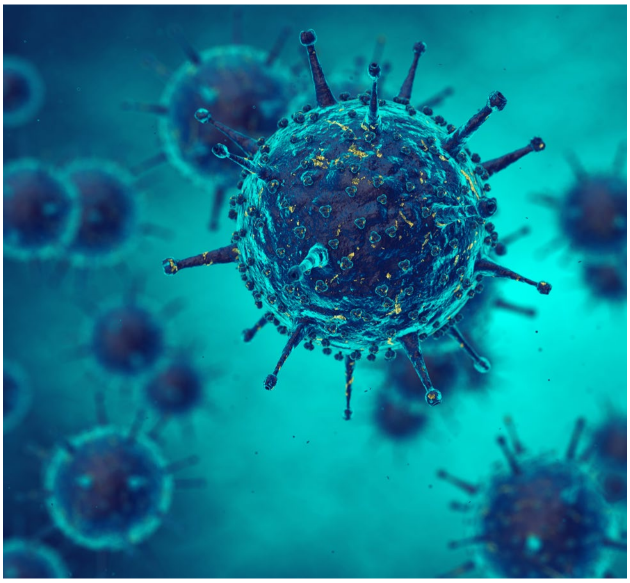
MARSH JLT SPECIALTY

INSIGHTS | DECEMBER 2020

Risk Dimensions

Welcome to the second edition of our law firm newsletter. In this edition, we discuss litigation funding opportunities in a pandemic, provide a roundup of cases from 2020 that may shape the future direction of claims against the legal profession, and highlight some risks that may emerge from the end of the stamp duty holiday.



COVID-19: Litigation Funding Opportunities in a Pandemic

The volume of litigation normally increases during tough economic times. The global pandemic will undoubtedly see a rise in insolvencies, fraud, and breaches of contracts. This will ultimately mean there is more need to pursue litigation to recover sums owed as, although genuine disputes will always arise, in this climate debtors may more often resist payment with spurious claims.

Equally, the costs of litigation are increasing and funding defended litigation to trial can be high. However, the costs of losing can be even greater. In fee-shifting jurisdictions such as the UK, the losing party will have to pay their opponent's costs as well as their own. Therefore, many businesses may simply forego pursuing meritorious claims in order to conserve their legal spend/risk.

Due to the pandemic's widespread effects, businesses across all sectors will feel cashflow pressures. Most will require money simply to keep their businesses afloat. Using litigation to enforce one's business rights could be considered an unnecessary risk and drain on capital, despite the potential upside of a successful litigation. It can be hard to convince those with financial responsibility that investing the company's hard-won profits without creating any tangible asset, with only a chance of recovery, is a wise step. Recently, 72% of in-house lawyers reported that their companies have failed to pursue a meritorious claim "for fear of adversely impacting the bottom line"[1]. This may have a short-term cashflow benefit, but the long-term impacts of simply writing off a loss can be more damaging.

However, a number of options allow businesses to take legal spend off the balance sheets and free up vital cash, while not accepting a loss caused by another party.

Detailed below are practical solutions that businesses can use to manage the cashflow demands of litigation, without compromising their rights. Many litigators are familiar and up to date with all of them, but adoption is still not that high, which suggests that law firms' clients still need to get comfortable with this kind of risk transfer.

1 https://burfordcapital.com/media/1662/2019-legal-finance-report.pdf

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Third-party funding

Some professional finance companies will fund litigation or arbitration in exchange for a share of the winnings. Lending is non-recourse, meaning that if the case is unsuccessful the investment is written off. The sums available can range from a few hundred thousand pounds to tens of millions on a single case, and even more across a portfolio of cases.

Funders will typically seek a return of between 15%–40% of the damages of a successful case. There are a number of funders in the market (around 30 in the UK alone), which will each have their own appetite and remuneration structure. As recently as March 2020, the top 15 litigation funders in the UK were reportedly holding around £1.9 billion of assets (up from £1.3 billion in 2017/2018)[2].

Finding the right funder can be difficult and requires skill. Some law firms will have preferred relationships, but this will not necessarily mean they are the right funder or even the most competitively priced. Furthermore, presenting a case to the funder in the right manner will affect the likelihood of acceptance, and potentially the terms offered.

Funding the enforcement of awards/ judgments

Winning the dispute often does not guarantee financial benefit. Almost two-thirds (65%) of in-house lawyers have reported that their companies hold unenforced judgments of US$20 million or more[3]. Even more in-house lawyers (72.4%) see as an "important or very important benefit of legal finance", that it can be used to "finance pursuit of unpaid judgment debts"[4].

Litigation funding companies can provide finance to enforce judgments even if they have not funded the main action. Some funders specialise in this specific area of work and have specialist asset-tracing and enforcement teams.

Monetising/selling awards

In addition to financing enforcement, some litigation funders can advance some of the funds against an award or even purchase a judgment outright. This can immediately benefit a business's cashflow and financial position. Selling a judgment or arbitration award also provides certainty and removes the risk of not recovering anything.

Portfolio debt recovery schemes

This practice – where a whole portfolio of book debt is funded in one deal – is becoming more commonplace. The client has no upfront costs but many more debts can be actively pursued (rather than being written off, or collection delayed until budgeting allows). In this scenario, the client will retain at least 70% of all recoveries. Marsh JLT Specialty itself has provided a number of large corporate clients (including law firms) with fully funded debt recovery solutions.

Litigation insurance options

A number of insurance-backed solutions exist that can alleviate risk and cashflow issues. For example, if a business's external legal team is willing to work on a contingent basis, with the fees dependent on a successful outcome, it is possible to provide an insurance policy for some of the contingent fees if the case fails. Therefore, the cashflow burden on the business is removed, but the law firm still has the certainty of getting some payment in the event that the claim fails.

In the UK and other common law jurisdictions, the loser has to pay their opponent's legal costs. Insurance is available to cover this. In some instances, the premium for the insurance can be fully deferred and contingent, meaning that it is only payable if or when the claim wins. If the case loses, the premium would not be payable but would still respond.

In a climate where unsuccessful litigation can increasingly lead to claims, especially where adverse costs are involved, adverse costs insurance somewhat reduces the risk of unhappy client litigation arising.

Conclusion

Businesses do not need to be discouraged from enforcing their commercial rights by the potential costs. Cashflow burdens should no longer be a reason that a dispute is not pursued. Funding and insurance-backed solutions can remove the cost and risk of litigation.

Law firms have a duty to ensure their litigation clients' best interests are protected by obtaining competitive pricing and options. This demonstrates compliance with regulatory obligations, including the Insurance Distribution Directive. If you require assistance with any of these issues, please contact your usual local Marsh representative.

Author: Sanjay Desai, Head of Litigation Insurance and Litigation Funding, Marsh JLT Specialty

2 https://www.cityam.com/uk-litigation-funders-boost-assets-to-1-9bn/

3 https://burfordcapital.com/media/1662/2019-legal-finance-report.pdf

4 Ibid.

The Legal Profession – Are we Awaiting an Avalanche of Claims?

Although COVID-19 is a medical rather than a financial crisis, the pandemic's economic impact will clearly be considerable, whatever form any recession takes. Experience tells us that recessions result in an uptick in claims against professionals – whether by financial institutions trying to cap their exposures to a falling or collapsing housing market, or clients looking more closely at the outcome of transactions where the money supply is squeezed. Professionals (and their insurers) become a predictable target.

With record-low base rates and a suspension of certain stamp duties, the housing market is extremely active. Are mistakes more likely due to fee earners working predominantly from home? It is hard to say, but concerns remain, particularly when conveyancers are under pressure from clients that are anxious to complete before the stamp duty holiday ends. It is also unclear whether other disciplines are likely to be more susceptible to error while home-working: for example, supervision of junior fee earners will never be as easy when conducted remotely.

Below, we look at cases over the last year that may shape the direction of claims against the legal profession, and the available defences.

SAAMCo – what is the extent of solicitors' liability?

Practitioners will be aware of the SAAMCo principle from the mid-1990s, but how is it applied 13 years on?

The case of LIV Bridging Finance Ltd v EAD Solicitors LLP [2020] EWHC 1590 (Ch), concerned four loans paid over a 10-month period as part of short-term bridging facilities for use in the development of land. LIV, the lender, contended that it suffered loss as a result of the solicitors paying away the loan monies in breach of trust, without ensuring that they were first secured by a first legal charge over specific properties, contrary to their instructions.

Therefore, when the borrowers defaulted, LIV sustained significant losses and sued the solicitors for breach of trust, seeking recovery of the full amounts lost. The High Court confirmed that the SAAMCo principle (as elucidated in the 2018 case of Hughes-Holland v BPE Solicitors), limiting recovery of damages in certain circumstances, applies to cases of breach of trust by solicitors.

This decision is helpful to the profession – reinforcing the application of the principle that solicitors are only responsible for losses within the scope of their duty. The critical distinction remains whether a solicitor is advising on a course of action (which exposes them to greater losses), or merely providing information for the client to decide its own course (which makes those losses more capable of challenge). Importantly, this case confirms the principle extends to breach of trust – an argument often raised by claimants when client funds are involved.

Loss of chance and new evidence

In November 2019, the Supreme Court, in Jean Edwards v Hugh James Ford Simey (A Firm) [2019] UKSC 54, considered the thorny issue of the admissibility of evidence that would not have been available at the original "notional" trial had that occurred, when determining the value of a lost claim in professional negligence proceedings.

The Supreme Court unanimously ruled that a claimant had suffered a loss as a result of his solicitors' negligence, despite after-the-fact evidence suggesting that his underlying claim should not have succeeded. Although this might appear concerning, in this instance the evidence would never have been available at the time the firm was acting, and therefore the claimant had still lost the chance to recover more. This decision still leaves open the possibility of adducing evidence that would have been available, even if not commissioned by the solicitor at the material time, in order to demonstrate that a lost claim lacked value.

Duties of care to a third party

Surprising as it may seem, former clients are not the only parties who bring claims against the profession. Solicitors can also be at risk of assuming duties to others.

In a recent case on assumption of responsibility, Valley Brook Investments Ltd and another v Huam Ltd [2020] EWHC (Ch) 1715, the High Court held that a professional can owe a duty of care towards a third party (a special purpose vehicle – "SVP") that reasonably relies on the professional's work. This is so even where the third party did not exist when the professional supplied its work.

In this case, an architect had supplied drawings to the client and later engaged in informal discussions with a potential buyer of the development (the soon to be owner of the SPV), in which it was alleged that the architect stated the development could accommodate 16 units. The architect later supplied drawings to this effect to the buyer. The SPV was incorporated thereafter, for the purpose of buying the development, and it transpired that the development could not accommodate 16 units.

On the evidence, the judge decided that the number of flats that could be created had been discussed with the buyer. This, taken together with the architect having directly supplied a copy of the drawings to the buyer, led to the conclusion that the architect had assumed responsibility towards the buyer and there being a reasonable expectation of reliance. The

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professional's contemporaneous documentation was sparse and of little assistance to the judge, emphasising the importance of professionals keeping clear and contemporaneous notes of their dealings, even those that appear informal.

This underlines the need for caution. Is it likely that a yet-to-be-incorporated entity will claim reliance on the advice of a solicitor, and should the retainer letter be crafted to deal with that possibility?

Reflective loss

In July 2020, the Supreme Court handed down its landmark judgment in Sevilleja v Marex Financial Ltd [2020] UKSC 31. The court confirmed that the rule in Prudential stands (that is, where a shareholder has suffered loss in the form of a reduction in the value of its shares or a reduction in distributions, the shareholder is precluded from bringing a claim against a defendant where the company has also suffered loss and has a parallel claim against that defendant). However, this rule does not preclude a creditor or a shareholder – claiming to have suffered losses separate and distinct from those of the company – from pursuing the wrongdoer independently from the company. As such, the Supreme Court narrowed the application of the so-called rule against the recovery of "reflective" losses, overruling a number of cases which had applied Prudential more widely.

In the first judgment to consider Marex, the High Court in Broadcasting Investment Group Ltd v Adam Smith [2020] EWHC 2501 (Ch), applied the principles laid down in Marex, finding that the shareholder's claims were reflective of the company's losses and, thus, were to be struck out. However, the claim by the individual, who was a second – or further – degree shareholder, was not struck out, as Marex had made it clear that the rule only bars claims by shareholders in the loss-suffering company itself.

It remains to be seen whether this troubles the profession; but it does expose professionals to a potentially wider group of potential claimants.

Conflict of interest

Claims can often involve an allegation of conflict of interest. However, disputes can also arise in relation to the holding of confidential information.

In Glencairn IP Holdings Ltd v Product Specialities Inc (t/a Final Touch) [2020] EWCA Civ 609, the Court of Appeal has provided helpful guidance on the circumstances in which a law firm can be restrained from acting for a defendant where, in earlier similar litigation, the firm acted for another defendant against the same claimant, and that earlier litigation was settled.

The somewhat unusual application was made on the basis that the law firm, Virtuoso Legal, had obtained information confidential to Glencairn IP Holdings Ltd, following its settlement of the earlier litigation, and that there was a risk this information would be passed to Virtuoso's client, Product Specialities Inc (t/a Final Touch). (This differs from the circumstances in which such an application is usually made – namely where a law firm has obtained confidential information while acting for the applicant (rather than simply against it) and then acts for a new client with an adverse interest.)

This judgment provides helpful clarification on the scope of application of the Bolkiah test. A “true fiduciary relationship”, such as that between solicitor and client, justifies the imposition of the strict approach in Bolkiah, but a more limited relationship does not. In the latter case, the burden of demonstrating a risk of misuse of confidential information will remain with the applicant, and the onus will not be on the law firm to show that there is no risk of prejudice.

Illegality – does the defence remain?

The global financial crisis of 2008 uncovered a litany of mortgage fraud. We may see the same again, but fraud becomes ever more sophisticated and solicitors may face claims by clients they later realise may not be what they seem.

It is a well-established principle that claimants are barred from recovering where their claim is marked by illegality. The illegality defence has come back into focus over recent years after the Supreme Court's decision in Patel v Mirza [2016] UKSC 42, in which the court identified a number of factors that may be relevant to the assessment of whether the defence should operate to prevent a claim:

- The underlying purpose of the prohibition that has been transgressed, and whether the purpose would be enhanced by denying the claim.
- Any other relevant public policy on which the denial of the claim may have an impact.
- Whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts.

In doing this, the Supreme Court allowed the courts to take a discretionary approach, based on individual factors and policy considerations.

Two recent decisions allow us to see how the courts are interpreting the Supreme Court's guidance for the illegality defence. In particular, they highlight how fact-specific, and sometimes narrow, the illegality defence is.

On 3 November 2020, the Supreme Court, in Stoffel & Co v Grondona [2020] UKSC 42, applied the test in Patel and declined to bar a claim against a law firm for negligence in the context of a mortgage fraud. In doing so, the court upheld the decisions made in the lower courts (though only the Court of Appeal decision had applied Patel), and considered the degree of connection between the illegal conduct and the retainer needed for the doctrine to apply. However, the decision does not establish any principle that claims against professionals tainted by illegality can proceed; rather that the policy considerations at play on the facts did not produce the necessary incoherence in the law required.

In Day v Womble Bond Dickinson [2020] EWCA Civ 447, the Court of Appeal applied Patel v Mirza, where a claimant alleged that the defendant law firm had acted negligently in defending him in criminal proceedings, and, in particular, had not raised an abuse of process defence. The court barred the claim on the basis that it would be an abuse of process under the civil procedure rules to allow a collateral attack on the subsisting conviction; the proper approach for an aggrieved defendant is to pursue an appeal through the Criminal Appeal Courts.

Applying Patel v Mirza, the court concluded that this was a fair and proportionate result as it “avoids an abusive collateral attack on the appellant's conviction; and it avoids both inconsistency and incoherence”. No public policy considerations existed that “strongly” suggested a different outcome. In this case (in contrast to Stoffel), the claim was inextricably linked to the criminal conduct and the claim could not succeed without the court undermining a criminal conviction.

However, the Court of Appeal did accept that Mr Day could, at least theoretically, claim for the additional legal costs incurred, which were higher than they would have been if the case had proceeded in the Magistrates Court. Those costs were not part of the punishment imposed by the criminal court, and would not necessarily have been caused by the illegal conduct.

Swift v Carpenter: the future of accommodation claims

Finally, what might be seen as a decision that need concern only personal injury lawyers bears some examination given the possible ramifications. The Court of Appeal recently handed down judgment in Swift v Carpenter [2020] EWCA Civ 1295, addressing what has long been viewed as an unsatisfactory approach to the calculation of awards for accommodation needs in personal injury and clinical negligence litigation.

Ms Swift was aged 39 at the time of the accident, and suffered serious injuries to her lower limbs. Unfortunately, her injuries meant that she had to undergo a below-knee amputation to her left leg, and needed a metal plate inserted in her right foot. She was left with significant ongoing symptoms, including incurable phantom limb pain where her left lower leg was amputated, and pain and stiffness in her right foot. The judge at first instance made an award for general and special damages in the sum of £4,098,051.

Due to the extent of her injuries and ongoing limitations, Ms Swift required a more expensive property, which would be suited to her specific needs. The judge found that Ms Swift's accommodation needs would be met by a property valued at £2,350,000, the purchase of which would require additional capital investment of £900,000 in excess of the value of the claimant's current home of £1,450,000. However, the judge held that she was bound by the longstanding approach to accommodation claims as laid down in Roberts v Johnston, and awarded nothing for the additional capital cost of Ms Swift's property.

The Court of Appeal's approach to solving the problem of overcompensation was to award a sum that was equivalent to income, which would have been achieved had the capital used to purchase the property instead been invested in risk-free investments. Since 2001, this has seen the courts calculate accommodation awards using the prevailing discount rate, at that time 2.5%. Of course, in 2017 a negative discount rate of -0.75% was announced. Although this meant that the value of claimants' future loss claims increased overnight, one (perhaps unintended) consequence was that accommodation claims went the other way; potential awards were suddenly wiped out due to the impact of a hypothetical negative return on risk-free investments. This remained the case when the discount rate was changed to -0.25% in 2019.

It was held that Ms Swift should be awarded the additional capital cost of the new property, less the value of the reversionary interest. The court concluded that the value of the reversionary interest is to be calculated by reference to a "market valuation", adopting an investment return of 5% per annum across the claimant's expected lifetime (applying the appropriate life multiplier).

As a result, the decision at first instance with regard to Ms Swift's claim for accommodation costs was overturned and she was awarded £801,913.

The means that claimants with specific accommodation needs can now expect the overall value of their injury claim to increase. In many cases this will be by a very considerable margin. It should be noted that the Court of Appeal stated that in some instances, such as cases with short life expectancy, a different approach may be justified.

In this context, we would expect to see claims against legal professionals alleging the loss of a chance to obtain a higher settlement, whether that be:

- Against practitioners who fail to take into account (or challenge where appropriate) the new guidance when settling schedules of loss and negotiating settlements following the handing down of the Swift judgment.
- Against practitioners who ought to have known that the Swift claim was to go before the Court of Appeal as a test case addressing the methodology of calculating accommodation claim, and who failed to advise their claimant clients to delay settling their claims until the outcome of the appeal was known.

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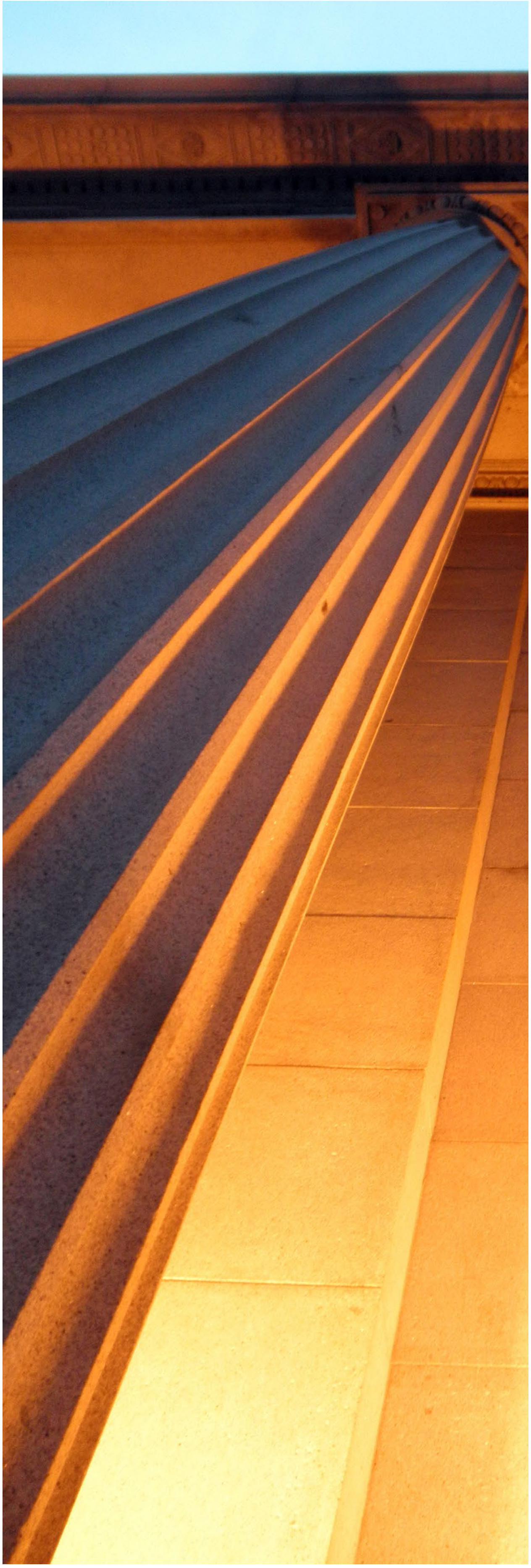

WARNING: Stamp Duty Holiday Deadline 31/03/2021

Deadline: Ensure that your client is aware of the deadline, and knows they will need to pay stamp duty if a transaction is not completed before the end date.

Known issues: In some areas, local authority searches are taking a long time and the average time taken to buy a property has increased significantly, so it may not be possible to complete before the exemption ends.

Budgeting: Clients should budget conservatively, on the basis that stamp duty will be payable. Completion and other notes of required funds should consider this.

Capacity: Expect a client surge in demand, in order to beat the deadline. Ensure that you have capacity to deal with the transactions you take on, with appropriate supervision in place. Take into account that disruption and delay can arise for many reasons, which can't necessarily be predicted. These uncertainties (including potential staff shortages without much notice, due to pandemic issues), can reduce your effective capacity directly and indirectly – for example, do you have a backup plan if one or two members of the accounts department are away?

Delay: Manage transactions promptly. Clients could pursue a claim against you if there are avoidable delays and they miss the end date or if a chain collapses due to stamp duty becoming payable.

Valuation: Some are predicting that the end of the stamp duty relief will lead to a reduction in the value of some properties, which become subject to stamp duty or different levels of duty. Although you do not advise on the transaction's financial viability, clients may need to be informed that the property's value could possibly decline after completion because of this – at least in the short term – and because overall demand or availability of mortgages may vary after stamp duty is reimposed.

Records: Remember to make records of the advice you provide to your clients about this and any other issues.

Charging: Clients will need to be told beforehand that fees are payable whether the transaction completes or not. The mortgage advance can only be released if the firm has cleared funds to pay the eventual stamp duty and HM Land Registry fees at completion, or accepts responsibility to pay them. The UK Finance Mortgage Lenders' Handbook for Conveyancers (clause 10.4) states: "You are only authorised to release the loan when you hold sufficient funds to complete the purchase of the property and pay all stamp duty land tax and registration fees to perfect the security as a first legal mortgage or, if you do not have them, you accept responsibility to pay them yourself."

We hope you enjoyed this edition. Currently our Risk and Error Management team is working closely with various clients to support their risk management efforts. If you would like to hear more about our service please get in touch with your normal Marsh JLT Specialty contact, or contact our team directly:

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