



08

A Year in Review 2007 Update

EIGHT

TWO THOUSAND



Issues and Trends Affecting the Liability
Market in England and Wales

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Introduction

A Year in Review – 2007 Update: Issues and Trends Affecting the Liability Market in England and Wales is the fifth in our annual series dedicated to the evolving issues that characterize the liability market in England and Wales. This year we consider many trends identified in previous instalments of this series, ascertain the extent to which they have become established, and explore which will persist in the future.

The continued growth in directors and officers (D&O) claims – and the global nature of such cover – is among the trends identified in last year’s report, *A Year in Review – 2006 Update: Issues and Trends Affecting the Liability Market in England and Wales* (“2006 Update”). Also, the independent regulation of companies and professions, the fact that the tail for professional liability business appears to be shortening, and the growing criticism by the courts of the continued expense and complexity of litigation were prominent in the 2006 Update.



This year, we report on what new issues and trends arose in the liability market in England and Wales in 2007 and look to what the rest of 2008 may hold.

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Directors and Officers

Overview

The partial coming into force of the Companies Act 2006 and the impact it would have on companies and their directors was of prime importance to UK-related D&O liability in 2007. While a number of provisions are now law, no significant cases have been reported under the new legislation. The criminal trial and conviction of the former directors of Independent Insurance was high-profile, while amongst developments in the extradition cases reported in our 2006 Update, the long-running “NatWest Three” saga concluded in 2007 with guilty pleas for all three bankers.

In Continental Europe, developments in class action laws continue, and the first pan-European class settlement of securities fraud claims was agreed under Dutch law.¹

Class actions are increasing again in the United States, with directors in the line of fire. However, the seminal securities law case of *Stoneridge Investment Partners LLC v Scientific Atlanta* (“Stoneridge”) was recently decided by the US Supreme Court in favour of “big business.”

Subprime lending and the resulting credit crunch, the dominant topic of the year in the US financial market, has also led to significant potential exposure of directors and officers.

Legislative Developments

The Companies Act 2006

As reported in the 2006 Update, the key aspects of the Companies Act 2006 (“the Act”) relevant to D&O liability included the codification of directors’ duties, expanded reporting requirements for directors and officers, and the establishment of the ability of shareholders to bring derivative actions against directors and officers.

Many of the directors’ statutory duties came into force on 1 October 2007, while those relating to directors’ conflicts of interest are due to come into force on 1 October 2008.

The new procedure for making so-called “derivative” claims (i.e., a claim made by an individual shareholder against a director or officer on behalf of the company) came into force on 1 October 2007.

Other provisions of the Act that have come into force include changes to a director’s liability to the company for directors’ reports, as outlined in section 463 of the Act and implemented in January 2007; an expansion of the content requirements for the business review in a quoted company’s annual directors’ report; and transparency obligations for quoted companies under sections 1265 to 1273 of the Act.

As a result of the changes to transparency obligations, Financial Services Authority (FSA) rules implementing the EU Transparency Obligations Directive took effect from 20 January 2007 and were added to the Disclosure Rules (now renamed the Disclosure and Transparency Rules). Consequential changes have also been made to the Listing Rules.

¹ Royal Dutch/Shell Transport Securities Litigation – awaiting approval by the Amsterdam Court of Appeals.

Under the new rules, responsible persons within a listed company are required to state publicly that the annual financial statement, the annual management report, and the half-yearly management reports give a true and fair account. It is up to the company to decide who will take responsibility for the statements or reports.

The Act now allows auditors to limit their liability by agreeing to a cap with their clients. These new provisions could have an impact on directors and officers, as claimants seek alternatives to auditors' deep pockets.²

The Corporate Manslaughter and Homicide Act

The Corporate Manslaughter and Homicide Act received Royal Assent on 26 July 2007, and the majority of it came into force from 6 April 2008.

The act will introduce corporate fines, remedial orders, and publicity orders if the way in which a company's activities are managed or organised causes a person's death and amounts to a gross breach of a relevant duty of care owed by the organisation to the deceased. A director cannot be found criminally liable under this act but remains susceptible for breaches of health and safety regulations if he contributed to the breach through consent, connivance, or neglect.

The Fraud Act 2006

The Fraud Act came into force on 15 January 2007. The offence of fraud can be committed in three ways: by false representation, failing to disclose information, or abuse of position. The Fraud Act also creates new offences for obtaining services dishonestly; possessing, making, and supplying articles for use in frauds; and fraudulent trading applicable to non-corporate traders. The legislation is intended to criminalise the conduct of the fraudster rather than the consequences of the fraudster's activities. It is speculated that the broad definition of fraud will lead to more individuals being convicted of fraud.

Extradition

The most highly publicised extradition proceedings since the Extradition Act 2003 came into force is the case of the Natwest Three. It concluded on 29 November 2007. All three defendants entered into plea bargains with US prosecutors. In return for guilty pleas to one count of wire fraud, each will serve 37 months in prison. This case exemplifies the dangers faced by UK directors and officers and has illustrated the very real dangers of long-arm US justice. It follows the case of Nigel Potter, former CEO of Wembley PLC, who has recently returned to the UK following a three-year jail term in the United States for wire fraud.

In one of the most eagerly awaited extradition decisions, Ian Norris has taken a US application for his extradition to the House of Lords – and won.³ The key issue before the Law Lords was whether to allow extradition for cartel activity, specifically criminalised under the Enterprise Act 2002, for acts amounting to “conspiracy to defraud” committed before the introduction of the Enterprise Act. The case was decided in

² See pages 12 & 13 of this year's review.

³ Norris v United States of America [2008] UKHL 16.

Norris's favour. The decision will be crucial to other directors and officers of companies, as the Serious Fraud Office (SFO) was awaiting the outcome before deciding whether to pursue further prosecutions.

There appears to be no respite in sight for UK executives as US prosecutors continued to pursue all alleged wrongdoers aggressively, including a 77-year-old former hotel executive, Stanley Tollman, for bank fraud charges dating back some 17 years, as well as 10 British Airways executives in relation to the price-fixing of fuel surcharges.

FSA, SFO, and OFT Investigations, Prosecutions, and Fines for Individuals

Financial Services Authority

In 2007 there were numerous examples of prohibition orders and fines made against individual directors and officers under sections 56 and 64, respectively, of the Financial Services and Markets Act 2000. While not groundbreaking in terms of severity, the frequency has ensured that D&O carriers continue to incur sometimes significant associated legal costs.

Serious Fraud Office

The SFO continues to pursue individuals for fraud-related crime, and in 2007, it was heavily involved in the “conspiracy to defraud versus cartel activity debate” (see “Extradition” above). The SFO also concluded one of the biggest criminal prosecutions in the D&O sector in recent times (i.e., the trial of the directors of Independent Insurance).

On 24 October 2007, Michael Bright,⁴ Philip Condon, and Dennis Lomas, directors of Independent Insurance, were sentenced to seven, three, and four years' imprisonment, respectively, for conspiracy to defraud. Mr Bright was also disqualified from being a director of a company for twelve years, while Messrs Condon and Lomas were each disqualified for ten years.

The actions which constituted the offences were not in themselves the cause of the demise of the business, but they were an attempt to disguise the true financial position of the company. Rather than showing a £22m profit, the annual accounts for the year 2000 should have recorded a loss of at least £180m.

Office of Fair Trading

In December 2007, the first charges were brought by the Office of Fair Trading (OFT) against individuals relating to criminal cartel activity under the Enterprise Act 2002. Three UK executives were arrested in the United States as part of alleged cartel activity relating to marine hose. As part of a plea bargain, the individuals were allowed to return to the UK, where they were arrested and subsequently released on bail.

This case is relevant not only for directors and officers trading in the United States, it also has wider international implications, given that the investigation involved a number of international bodies. The European Commission is also investigating the behaviour of the individuals pursuant to EU law.

⁴ R v Bright (Michael John) [2008] EWCA Crim 462 (dismissed upon UK appeal).

International

United States

There were 166 securities class action lawsuit filings in 2007, a 43 percent increase from the 116 filings in 2006. The 2007 annual total remains 14 percent below the average for the 10-year period ending December 2006.⁵ Filings in 2007 increased significantly in the second half of the year, the upturn caused in large part by the subprime crisis⁶ and associated stock market volatility. It is perhaps too early to tell whether this upward turn in filings categorically proves that there has been no permanent decline in securities lawsuit filings due to the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) and other factors.

The rise in dismissal rates has been a consistent trend since the beginning of the 1990s. By 2007, the case dismissal rate stood at 41 percent, rising from an average of 35 percent in the five years ending in 2001 – and almost double the preceding average rates.⁷

On 15 January 2008, the US Supreme Court ruled in *Stoneridge* that section 10(b) of the Securities Exchange Act 1934 does not extend the right to a victim of fraud to pursue a private civil claim against “aiders and abettors.” *Stoneridge* alleged that a cable company, Charter, had fraudulently inflated the price of its stock. Charter paid Scientific Atlantic, the seller of its television set-top boxes, an above-normal price for the boxes. Scientific Atlantic then returned the extra payments as advertising fees, and Charter fraudulently accounted for them as revenue. A private civil claim could not be pursued against Scientific Atlantic although aiders and abettors are still exposed to enforcement action by the Securities and Exchange Commission (SEC), as well as civil action under state law (as opposed to the federal securities laws) in state courts.

There was particular concern that a ruling in the claimant’s favour would have led to a large number of claims against secondary actors such as auditors, accountants, and banks and triggered a huge number of subprime-related satellite claims, as well as increasing potential awards in some of the most significant D&O cases, such as *In re Enron Securities Litigation*⁸ and *In re Healthsouth Securities Litigation*.⁹ The decision of the Supreme Court appears to have prevented this kind of spiralling litigation for the time being.

The New York Stock Exchange (NYSE) continued to see a decline in initial offerings by foreign companies in 2007. Factors cited include the cost of compliance with Sarbanes-Oxley, the cost of US-based investment banks’ services, and, in no small part, the cost of litigation in the US. While non-US companies have been shunning the NYSE for the FTSE, AIM, and the Hong Kong Securities Exchange, foreign investors, particularly from the EU, appear to be more willing than ever to participate in US-based litigation. Recent decisions by the Supreme Court have not helped matters. In March 2007, a decision *In re Vivendi Securities Litigation*¹⁰ confirmed that a class consisting of English, Dutch, and

⁵ Cornerstone Research Securities Class Action Case Filings.

⁶ Twenty-three of the 100 filings in the second half of 2007 were associated with subprime issues – see <http://securities.cornerstone.com/pdfs/YIR2007.pdf>.

⁷ Cornerstone Research Securities Class Action Case Filings.

⁸ *In re Enron Securities Litigation* 01-CV-3624.

⁹ *In re Healthsouth Securities Litigation* CV-03-BE-1501-5.

¹⁰ *In re Vivendi Universal SA Securities Litigation* 02-CV-05571.

French shareholders could be certified as class participants in an action against the French company, Vivendi Universal. Some reports also suggest that securities litigation against foreign companies has increased in 2007, but this needs to be balanced with the upturn in securities filings for the year.

The US Plaintiffs' Bar has continued its search for foreign plaintiffs not only in the United States – with foreign-based institutional investors (predominantly hedge funds and pension funds) increasingly taking a leading role in class actions based in the United States – but also in actions in the EU resulting in the first ever European securities class action settlement.

Europe

Legislation

Germany was again at the forefront of D&O exposure in 2007, but it was an unexpected move by the Romanian legislature that caused a stir when Romania became the first European country to impose mandatory D&O insurance on companies. The Romanian Companies Law,¹¹ introduced in December 2006, requires all directors of joint stock companies in Romania to purchase D&O coverage. This includes public and private companies with Romanian-registered shareholders and subsidiaries that are incorporated in Romania and whose shares are either completely or partially owned by a foreign parent company.

On 1 January 2008, Germany's new insurance contract law came into force. The law applies to every insurance contract concluded on or after that date. This is the most radical overhaul since the introduction of insurance contract law 100 years ago and brings with it some dramatic changes. One of the many modifications has interesting ramifications for D&O insurance.

As in the UK, most third-party liability insurance contracts in Germany previously contained provisions that would preclude recovery under the policy if an insured either admitted liability or assigned its rights of indemnity under the policy to a third party. Both of these provisions are now expressly declared to be invalid under German law.

Since claims by a company against its D&O policy (so-called "Insured vs. Insured claims") are the most common form of exposure to directors in Germany, the implications of the new insurance contract law are of particular importance for this type of liability insurance.

Case Law

On 11 April 2007 Royal Dutch Shell Plc¹² agreed to pay US\$352.6m (£179.1m)¹³ to settle a securities fraud claim by European shareholders who accused Shell of defrauding them by overstating its reserves. The Amsterdam Court of Appeal's declaration to make the settlement binding on all European shareholders is still outstanding. The Court hearing is expected take place in the second half of 2008.

¹¹ Law No. 441/2006.

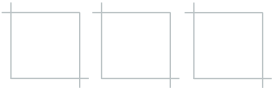
¹² Royal Dutch Shell Transport Securities Litigation CV-04-374.

¹³ Conversion is based on the US Dollar and British Pound exchange rate on 11 April 2007, as reflected on <http://www.oanda.com>.

In January 2007, Peter Hartz¹⁴ (former board member in charge of Human Resources for Volkswagen) entered a plea bargain related to the bribery scandal that engulfed the German car manufacturer in 2005. The plea has resulted in a €576,000 fine and a suspended two-year sentence. Press reports suggest that D&O insurers have negotiated a settlement worth approximately €4.5m.

In *Jack White Productions AG v Jack White*, Jack White Productions (JWP), a music label, has accused its founder and former CEO of insider trading when selling his shares in the company for some €9m in 2006. Mr Horst Nußbaum, aka “Jack White,” denies the allegations that he was aware at the time of the sale that financial statements regarding JWP’s US subsidiary “HoT” quoting a €2.2m turnover were incorrect.

In *Leo Kirch v Deutsche Bank and Rolf Breuer*,¹⁵ Leo Kirch is pursuing Deutsche Bank and its former chief executive officer, Rolf Breuer. Kirch alleges that Mr Breuer is responsible for the collapse of Kirch’s media group, after Breuer made public statements doubting the creditworthiness of one of Kirch’s companies. The German Federal Court held Deutsche Bank liable for Kirch’s companies’ losses. The Federal Court also agreed that the CEO was subject to the same duties of care towards Kirch’s company as the bank itself, and consequently found that Breuer was personally liable to the company. The amount of damages is now the subject of proceedings before the Munich Regional Court. Kirch is demanding somewhere in the region of €1.6bn to €3.7bn.



¹⁴ Verdict by the LG Braunschweig (Matter No 6 KLS 48/06). Valid Since 02-02-2007.

¹⁵ German Federal Court (BGH) Verdict of 24-01-2006.

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Errors and Omissions

The Professions Generally: Regulatory/Standards Reviews

Actuaries: The Morris Report

The 2006 Update reported on the continued fallout following the Treasury-commissioned Morris Review of the Actuarial Profession which, amongst other things, recommended that the Financial Reporting Council (FRC) should take on two new functions: setting actuarial standards and overseeing the regulation of the actuarial profession.

As part of this drive to promote competence and transparency, and to develop a new structure for actuarial standards, the Board for Actuarial Standards (BAS), the new standard-setting body established by the FRC, launched two major consultations in 2007. The first, published in April, proposed a new concept of Standard Actuarial Principles and Techniques (SAPT) which would apply to actuarial information that meets certain core principles, including objectivity, reliability and materiality, relevance and decision usefulness, and consistency and comparability. Then, in November, the BAS consulted on a new Conceptual Framework which will underpin the setting of standards for developing actuarial information that is complete, transparent, and comprehensible. The consultation period ended at the beginning of 2008, following which a Draft Conceptual Framework was published for further consultation.

Surveyors: The Carsberg Report

In June 2007, following three years' work involving an independent root and branch review of the Royal Institute of Chartered Surveyors' (RICS) regulatory framework by Sir Bryan Carsberg, RICS launched a principles-based regulatory regime, issuing a 56-page book of detailed regulations and introducing a short set of principles prescribing requirements on matters that are dealt with at the firm level. As reported in the 2006 Update, this major shift had overwhelming member support. Whilst the regime currently applies only in the UK, RICS is planning to roll out the simple, principles-based approach to other countries in which RICS firms operate over the next few years.

The greater separation of the regulatory and representational functions of RICS, also recommended by Sir Carsberg to improve the self-regulation of the profession, has been implemented with the establishment of a Regulatory Board with a majority lay membership (superseding the Transitional Regulatory Board of 2006) to oversee the implementation of the regulatory regime.

The Surveyor Ombudsman Scheme (SOS), which began as a pilot scheme in Scotland in 2004, went nationwide on 1 June 2007 and now provides a compulsory redress scheme for RICS member firms. The Ombudsman can make awards of up to £25,000 (including VAT) for loss, expense, stress, and inconvenience.

Solicitors and Other Providers of Legal Services: Introduction of SRA, the Clementi Report, and the Legal Services Bill

The regulation of solicitors and other providers of legal services changed significantly in 2007. Following the Clementi Review, which recommended a clear division between the representative and regulatory functions of the Law Society, the Solicitors Regulation Authority (SRA) was established in January 2007. The Law Society now represents the profession on issues of relevance to it. The SRA is responsible for, amongst other things, rules of professional conduct, matters of ethics, monitoring solicitors firms, intervening in solicitors firms, referring solicitors to the Solicitors Disciplinary Tribunal (SDT), and running a compensation fund.

Since its establishment, the SRA has been flexing its regulatory muscles in a number of ways, including investigating and writing to all solicitors about the circumstances in which referral fees can be accepted (many firms were found to have been in breach of the code for referral fees), investigating solicitors who were reported to be dealing with unauthorised claims management companies and who under the Compensation Act 2006 could face disciplinary sanctions for so doing, introducing a new principles-based code of conduct, and in making public the details of regulatory investigations into solicitors begun after 1 January 2008.¹⁶

The Legal Services Act finally received Royal Assent on 30 October 2007. The act creates the Legal Services Board (LSB) to supervise the regulation of legal services by all approved regulators, such as the SRA and the Bar Standards Board. It is currently anticipated that the LSB will not be empowered to supervise the approved regulators until early 2010.

The Medical Profession: The Future of Regulation of Health

Following the publication of *Trust, Assurance and Safety – the Regulation of Health Professionals in the 21st Century* in February 2007, and as anticipated in the 2006 Update, the government has legislated to make fundamental changes to the way in which the medical profession in the UK is regulated. The proposed Health and Social Care Bill had its second reading in the House of Commons in November 2007 and completed its Committee Stage at the end of January 2008. It is expected to receive Royal Assent in the summer of 2008.

This new legislation will change the way in which doctors are regulated in the UK. In “fitness to practise” cases, the General Medical Council (GMC) will lose its authority to adjudicate and the civil standard of proof (the balance of probabilities) will be adopted by a separate body, the Office of the Health Professions, and will replace the current criminal standard (beyond reasonable doubt).

In addition, the government has proposed that all members of the GMC should be appointed by the Public Appointments Commission and that elections for the medical members by the profession should cease.

¹⁶ Solicitors Regulatory Authority, <http://www.sra.org.uk>.

Personal Investment Advisers

New conduct of business rules for financial advisers, insurance intermediaries, and mortgage brokers came into force with effect from 1 November 2007 as part of the implementation of the Markets in Financial Instruments Directive. The rules are a substantially slimmed-down version of the old conduct of business rules and remove many of the specific constraints placed on financial advisers. They also contain new complaints-handling rules, permitting firms more discretion. Nevertheless, most of the core requirements of the old rules remain.

Lord Hunt of Wirral has published his independent review of the Financial Ombudsman Service (FOS), focusing on the openness and accessibility of the FOS to customers and stakeholders. The two principles at the heart of the report's 73 conclusions and recommendations are that the FOS should become more personalised and more predictable. However, in November 2007, the House of Lords' select committee on regulators called for a more extensive review of the FOS by the National Audit Office, concerning the economy, efficiency, and effectiveness of the FOS and the extent to which it acts as a pseudo-regulator.

The FSA is reviewing the prudential rules for personal investment firms. It issued a discussion paper in July 2007, requiring responses by January 2008. This review is closely linked to the Retail Distribution Review (RDR). Detailed proposals for consultation are to be published later in 2008, along with proposals from the RDR.

A review by the FSA, announced on 3 December 2007, found that firms are not doing enough to ensure that their appointed representatives are treating customers fairly in the sale of general insurance, mortgage, and investment products. As a result, four firms are being considered for referral to enforcement, and follow-up visits will be made in 2008 to 11 firms identified as needing significant remedial action, to see that they have addressed the failings identified.

The Professions: Specific Developments of Note

Actuaries

Pension provision in the UK has been a hot topic in recent years, with a clear trend of increasing claims against pension advisers and trustees. Concerns about actuaries' liabilities have focused on the risks associated with their advisory work in connection with pension consultancy firms, and the risk of contribution claims associated with a failure to clarify terms of engagement. Despite this, there have been no reported cases of any significance this year.

In March 2007, the disciplinary tribunal of the Institute of Actuaries found all three former directors of Equitable Life (Roy Ranson, Chris Headdon, and Alan Nash) guilty of breaches of The Actuarial Profession's Guidance Notes.

Of the many charges, the tribunal found that there had been a failure to provide appropriate information to Equitable's board and that policyholders had been given a misleading impression of Equitable's strength. The measures taken by the Institute were notable for their severity. One director was expelled from the Institute, another had his practising certificate suspended until 2010, and the third received a sharp admonishment.

Auditors and Accountants

Companies Act

Those sections of the Companies Act 2006 ("the Act") dealing with accounts, reports, audits, and statutory auditors are to come into force in 2008. As anticipated in the 2006 Update, of interest to accountants' liability insurers is the fact that for the first time auditors will be able to limit their liability to companies whose accounts they audit by using liability limitation agreements (LLAs). To be effective, the LLAs will have to be "fair and reasonable in all the circumstances of the case." An LLA will only be valid for one audit year and must be approved by the shareholders of the company (although a court can override the terms of an LLA even if it was so approved). In 2007, the FRC produced draft guidance on the use of LLAs. It is anticipated that a finalised version of this guidance will be available during the first half of 2008.¹⁷ Perhaps as a reflection of the large number of corporate collapses in recent years, the Act imposes stricter requirements on auditors when resigning. They will have to give the company and its members a statement of the circumstances connected with the termination of their appointment or a statement of "no circumstances."

EU Directive

Last year, the government considered what changes, if any, were required to UK law to ensure compatibility with the EU Directive on Statutory Audits of Annual and Consolidated Accounts. Few changes were thought necessary, but amongst those to be implemented is that the outgoing auditor will have to provide the incoming auditor with access to all relevant information concerning the audited entity. This presumably includes the outgoing auditor's working papers.

FRC Report

Market concerns over the implications of one of the "Big Four"¹⁸ accountancy firms no longer carrying out audit work led to the FRC's publishing a report in 2007.¹⁹ The report suggests that, to achieve increased choice, non-Big Four firms will have to be prepared to offer audits to public interest entities, and those entities will have to select non-Big Four firms to carry out their audits.

¹⁷ Financial Reporting Council. *Guidance on Auditor Liability in Limitation Agreements*, June 2008.

¹⁸ The "Big Four" consists of Deloitte, PricewaterhouseCoopers, Ernst & Young, and KPMG.

¹⁹ <http://www.frc.org.uk/press/pub1420.html>.

Disciplinary Proceedings

Disciplinary proceedings against auditors featured heavily in 2007. The Joint Disciplinary Board handed down the second largest financial penalty in history when it fined PricewaterhouseCoopers £495,000, plus £1m in costs, for its involvement in the TransTec affair after the firm admitted failing to have appropriate procedures to obtain audit evidence regarding TransTec's fraudulent accounting. The Accounting Investigation and Discipline Board (AIDB) did not fare so well after it brought charges against PricewaterhouseCoopers in relation to its audit of the Mayflower Corporation, though. The charges were dismissed, and the AIDB faced a bill for costs of nearly £1m.²⁰

Public Hearings

As part of a commitment to greater transparency, the Institute of Chartered Accountants of England and Wales (ICAEW) is to hold most disciplinary hearings in public, with effect from 1 January 2008. The chair of the tribunal will have the power to exclude the media and the public from all or part of any particular hearing.²¹

Cases

Cases of interest involving accountants and auditors in 2007 included the successful defence by Ernst & Young, both at first instance and on appeal, in the case brought by Man Nutzfahrzeuge AG against it and Freightliner.²² Of interest in this case, notwithstanding Ernst and Young's victory, was the statement by the Court of Appeal that the auditor of the accounts of a subsidiary company could owe a special audit duty of care to the parent company if the auditor knows that the parent company is going to rely on the report for the purposes of negotiating a sale of the subsidiary. Also of interest was the case of *Moore Stephens v Stone and Rolls*²³ ("Stone"), which addressed the principle of whether an entity could benefit from its own wrongdoing. Notwithstanding that Stone, through its owner, had committed letter of credit fraud against various banks, the judge at first instance refused to strike out a claim by Stone that Moore Stephens ought to have discovered the fraud. The banks sued Stone and its owner in deceit and were awarded substantial damages. Stone's claim brought by its liquidators against auditor Moore Stephens was struck out by the Court of Appeal on the grounds that its claim relied on its own illegality.

Surveyors

Property Market

In the 2006 Update, we noted the influence of claims against surveyors of the state of the property market and the substantial growth in property prices during that year.

This trend continued in the first part of 2007. It was a record year for gross mortgage lending, with volumes rising by 5 percent to close to £364bn, according to the Council of Mortgage Lenders. However, overall, the share of lending for house purchases decreased, and re-mortgaging share increased. The residential market peaked in August, and

²⁰ <http://www.frc.org.uk/aidb/tribunal/PWCandDonnellycosts>.

²¹ The Institute of Chartered Accountants in Ireland has also been in the forefront, as it first held a public disciplinary hearing in 1999. The Chartered Institute of Public Finance and Accountancy ("CIPFA") followed with its first public hearing in August 2001 and the Chartered Institute of Management ("CIMA") followed in February 2003. This leaves the Institute of Chartered Accountants of Scotland ("ICAS"), the world's first professional body of accountants, as the only member of the Consultancy Committee of Accountancy Bodies which holds proceedings in private.

²² *Man Nutzfahrzeuge AG v Ernst & Young* [2007] EWCA Civ 910.

²³ *Stone and Rolls Ltd (In liquidation) v Moore Stephens (a firm)* [2007] EWCH 1826 (Comm).

towards the end of 2007 market activity was affected by financial market dislocation influenced by the subprime mortgage crisis in the United States. Mortgage approvals fell sharply, and in the final months of the year even gross lending fell below the levels of the prior year.²⁴

By December 2007, surveyor confidence in sales and house prices reached the lowest level in a decade, and surveyors reported price falls across all regions in England and Wales, with the heaviest falls taking place in the West Midlands and East Anglia.²⁵ Since the 1996 “South Australia” case,²⁶ surveyors have not been liable for losses caused by fluctuations in the property market. They are potentially liable only for losses that arise as a consequence of the information they provide by way of the valuation being wrong. The state of the property market is of primary interest to surveyors and their insurers as falling values and increasing numbers of repossessions bring valuations under scrutiny.

With lenders maintaining tightened lending criteria, the market continuing to fall in successive months in 2008, and repossessions steadily rising, conditions are ripening for a significant increase in the number of claims against surveyors over valuations.

There is also evidence of an increase in mortgage fraud which will have an inevitable impact on surveyors and their professional indemnity (PI) insurers.²⁷

Cases

Two high-profile cases arose from the deliberate undervaluation of properties by Ian McGarry, a director of Dunlop Haywards Ltd (a subsidiary of Erinaceous Group). In the first case, *Nationwide Building Society v Dunlop Haywards Ltd*,²⁸ the claimant was awarded summary judgment in its claim, which was based on the tort of deceit. The second case, *Cheshire Building Society v Dunlop Haywards Ltd*,²⁹ had the same result, with an interim award on judgment of £10m. An SFO investigation is ongoing.

HIPs

Sellers became obliged to provide Home Information Packs (HIPs) on the sale of homes with four or more bedrooms from 1 August 2007, for those with three or more bedrooms from 10 September 2007, and for all properties from 14 December 2007. The pack includes an Energy Performance Certificate, a sale statement, and searches and evidence of title. Contrary to the original concept of the HIP, the Home Condition Report is an optional, rather than compulsory, feature.

Estate Agents

With effect from 1 August 2007, estate agents in England and Wales marketing properties which need HIPs are required under the Housing Act 2004 to belong to an approved HIP redress scheme. Agents not complying with this requirement face penalty charges (currently set at £200) and could be banned by the OFT from practising as estate agents.

²⁴ Council of Mortgage Lenders market commentary.

²⁵ RICS Market Survey December 2007.

²⁶ *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191.

²⁷ “Banks crack down on mortgage fraud.” FT.com, 15 December 2007.

²⁸ *Nationwide Building Society v Dunlop Haywards Ltd* [2007] EWHC 1374.

²⁹ *Cheshire Building v Dunlop Haywards* [2008] EWHC 51.

The majority of estate agents belong to the National Association of Estate Agents (NAEA), and its members must subscribe to the redress scheme run by the Ombudsman for Estate Agents (OEA). The OEA can make financial awards of up to £25,000.

The Consumers, Estate Agents and Redress Act 2007, requiring all estate agents to belong to a redress scheme, will come into force 1 October 2008. Once that happens, the HIP's redress scheme provisions in the Housing Act 2004 and related secondary legislation will be repealed, and estate agents will only have to belong to one redress scheme (rather than one for HIPs and another for the rest of their work).

Architects

Two major sets of consultant terms were launched in 2007. The Royal Institute of British Architects (RIBA) published a new suite of documents for both architects and consultants generally, with different forms for larger, smaller, and domestic projects, and taking into account the involvement of sub-consultants. The aim was to make the contract terms simpler and more consumer-friendly, but early indications suggested a slow take-up, with clients continuing to distrust any standard wording produced by a consultant institute body. In particular, clauses capping liability and ousting the operation of joint and several liability, and a wide scope to claim additional fees, were unpopular with clients. The Construction Industry Council, meanwhile, introduced its new documentation, designed for professional clients commissioning major commercial property projects. This also comprised a series of interlocking documents dealing with appointment terms, defining third-party rights, and providing for collateral warranties. This set of documentation, too, suffered from being an industry standard and from seeking certain limitations (such as a cap on liability in the appointment, and net contributions in the warranty form).

However, the fact that major organisations within the industry were promoting the concept of limited liability has meant that contracting parties are now increasingly frequently discussing the wisdom (for both sides) of selecting a level of insurance which is considered to be a sensible pre-estimate of likely loss, and then agreeing that this should also be the upper limit of the consultant's liability. The New Engineering Contract, now in its third iteration, appears to have support both from consultants (who welcome its clarity as to what constitutes a basic service and what attracts an additional fee) and commissioners of projects. It was the form of contract selected by the Olympics Delivery Authority, and throughout 2007 it was frequently presented to architects tendering in connection with state of the art facilities for the 2012 Olympics, with an estimated value of £2.4bn.³⁰ The document uses simple language, brings to the fore the importance to a successful project of strong project management, and is characterised by a presumption of cooperation between the parties and early signalling of problems. There is a series of core and secondary clauses, one of which relates to partnering (which continues to be a popular method of project procurement).

³⁰ Sir Michael Latham – NEC users group newsletter.

Labour Shortage and Architects' Duties

Through 2007, labour shortages in the construction industry reached their highest levels since 2005, with more than 50 percent of Master Builder Federation members reporting difficulties in recruiting, particularly plasterers, carpenters, and bricklayers.³¹ It is a problem that has been a blight on the construction industry for some time, with an estimated 88,000 recruits needed each year in the five years from mid-2005.³² Scotland was particularly affected, being unable seemingly to enjoy the same access to labour from Continental Europe as elsewhere in the UK.

By the last quarter of 2007,³³ the position appeared to have improved and shortages to have eased. Pressure on all members of construction teams continued with a marked increase in workload, particularly in relation to housing repair and maintenance work and non-residential work. Even with several increases in interest rates causing an anticipated slow-down in consumer-driven construction sectors, activity levels in 2007 remained high.

The vacillations in labour availability and increased material costs led to a more aggressive squeeze on consultants' fees, against a background of a need for increased vigilance during contract administration. With commercial properties, in particular, becoming ever more sophisticated in their service requirements and environmental legislation placing a responsibility on all parties for "performance" of buildings, there was an increase in the appointment of architects under a joint architect/engineer engagement, and generally, it has become necessary for architects to be more fully conversant with the details of engineering services and how they are to be incorporated.

Overseas Projects and Claims-Made Insurance Arrangements

In anticipation of a domestic downturn, architects seeking projects overseas, often in association with a local consultant to attend to such matters as planning and building regulation applications, found that they faced strict statutory obligations relating to such matters as health and safety, as well as time. Also, many clients in, for example, the United States or the Middle East expect to be named as additional insureds under their appointed architects' policies. This is not something that a professional indemnity insurance policy (renewable annually and written on a claims-made basis) can ordinarily accommodate, and creative solutions such as fronting policies or specific single project insurance policies are needed.

Defence to Negligence Revisited

In *Baxall Securities v Sheard Walshaw*³⁴ ("Baxall"), the Court of Appeal established that where a party has a reasonable opportunity to discover an architect's negligence (here the omission of weir overflows in a drainage system as an alternative means of water egress) this served to break the chain of causation. In the case of *Pearson Education Limited v The Charter Partnership Limited*³⁵ ("Pearson"), it was held that the Baxall case provided an unjustifiably wide means of escape from liability for defective buildings and that it was not obviously fair for an architect to be absolved from any liability in tort on

³¹ Federation of Master Builders Survey, 2007.

³² Skills Shortages in the UK Construction Industry Survey 2006. Chartered Institute of Building (CIOB).

³³ Construction Products Association and Construction Federation Survey Report.

³⁴ *Baxall Securities Ltd v Sheard Walshaw Partnership* [2002] EWCA Civ 9.

³⁵ *Pearson Education Ltd v The Charter Partnership Ltd* [2007] CA EWCA Civ 130.

the basis that another professional could reasonably be expected to discover its failure. The Court in *Pearson* felt that the *Baxall* decision could usefully receive consideration by the House of Lords.

Engineers

Engineers, too, faced scrutiny from the courts in 2007, and they continued to be the target of some of the largest claims in the construction industry. The case of *Hart v Fidler*³⁶ (“Fidler”) illustrated the dangers of taking too restrictive a view as to the scope of duty.

In *Fidler*, the Court rejected the defendant engineer’s contention that it had no obligation in relation to temporary works to an unpropped façade that had collapsed during major restructuring works. It held that, as the deficiencies in the temporary works put the permanent works in danger, it fell squarely within the defendant engineer’s duty to the claimant to point this out to the contractor.

The Court was also prepared to imply a term that the defendant should undertake “the normal site investigations to be expected of a structural engineer” and, drawing from previous authority, commented that the frequency and duration of inspections should be proportionate to the nature of the works on-site.

In *Glasgow Airport Limited v Kirkman & Bradford*,³⁷ a decision in Scottish law, the landlord (Glasgow Airport) agreed with the tenant to carry out works and entered into a building contract for the design and construction of the works. The engineers engaged by the contractor to carry out the design gave a collateral warranty to the landlord. Following the discovery of defects, the tenant sought to recover from the landlord the costs of replacing the floor slab and for disruption and loss of profits. The contractor was insolvent. The landlord sought to recover such losses from the engineer under the terms of the collateral warranty. The engineer sought to argue that the wording of the collateral warranty was such that it was not liable for any losses or damages arising from disruption and loss of profit – particularly as the warranty could be assigned twice without the landlord’s consent. The Court found that the defendant engineers were liable to indemnify all losses. Although the enforceability of net contribution provisions is sometimes queried, no issue was raised in this case as to the effectiveness of the net contribution clause to achieve an apportionment of liability.

Adjudication

Adjudication remains an enduringly popular mode of dispute resolution throughout the construction industry. The advantages of the process are well-documented: it is extremely rapid in comparison to litigation and arbitration, fairly flexible in its procedure, and can be (though not always) relatively inexpensive. However, there are correlative disadvantages. Costs may generally be lower than those likely to be incurred in litigation or arbitration, but they are usually irrecoverable, unless both parties agree to the contrary at the outset.

³⁶ *Hart v Fidler* [2007] EWHC 1058 (TCC).

³⁷ *Glasgow Airport Ltd v Kirkman & Bradford* [2007] CSIH 47.

The process may be speedy, but that almost inevitably means that claims are subject to less scrutiny and evidential burdens are lighter than in litigation or arbitration. Recent statistics from the RIBA suggest that in the region of 80 percent of adjudications are decided on the papers, somewhat limiting the scope for evidence to be tested. The same statistics suggest that referring parties are at least partially successful in over 75 percent of cases, giving support to the widely held view that adjudicators (unlike judges) are nervous of rejecting claims outright.

More fundamentally, there is growing concern that adjudication is routinely used in disputes to which it is wholly unsuited. Professional negligence claims against engineers are a clear example. These typically involve arcane issues which cannot properly be determined without careful consideration and substantial expert input. A simple invitation to the adjudicator, often without expert evidence, to infer that because problems were encountered in the project the design must have been wanting, is conceptually flawed and somewhat unjust to the responding party.

Under the Scheme for Construction Contracts (“the Scheme”) and many standard form contracts, the adjudicator’s award is intended to be of an interim nature, binding the parties only until the dispute is determined by a judge or arbitrator. Indeed, many insurance policy wordings contain an exclusion in respect of finally binding adjudication proceedings. It is possible for a professional to try to reverse an adverse award on referral to court or an arbitrator, but a finding of professional negligence is clearly discouraging, evidentially and otherwise. Moreover, the courts have in recent years shown a marked impatience with what they see as “technical” challenges to an adjudicator’s award, based on an alleged excess of jurisdiction or breach of natural justice.

That is not to say that such challenges never succeed. In *Epping Electrical v Briggs & Forrester*³⁸ and *Aveat Heating v Jerram Falkus*,³⁹ while in each case the adjudicator’s decision was issued out of time, the contract under which he was appointed purported to validate late decisions. However, the Court took the view that such a provision was inconsistent with the mandatory timetable contained in the Housing Grants, Construction and Regeneration Act 1996 and therefore that the timetable set out in the Scheme would apply.

Equally, *Bennett v Inviron*⁴⁰ illustrates the difficulties which could exist for referring parties in the common situation, whereby the parties do not execute a formal contract before works on-site commence. In this case, the referring party contended that the adjudicator had jurisdiction to determine a dispute between the parties because the contract between them was evidenced in writing by a letter of intent. The responding party disputed this, and the Court accepted its arguments, finding that the parties had not meant for the letter of intent, which was expressed to be “subject to contract,” to have contractual force, but that even if they had, the referring party would have needed to show that the letter of intent contained all of the express terms of the contract between the parties.

³⁸ *Epping Electrical v Briggs & Forrester* [2007] EWHC 49 (TCC).

³⁹ *Aveat Heating v Jerram Falkus Construction Ltd* [2007] EWHC 131.

⁴⁰ *Bennett v Inviron* [2007] EWHC 49.

A problem which has not yet been addressed satisfactorily by legislators or the courts is the increasing tactical use of adjudication to “ambush” a party by leaving it with insufficient time to prepare its defence, or simply as a shortcut to resolving a complex dispute which arises long after the project has been completed.

Insurance Brokers

Contract Certainty – The New Code of Practice

In June 2007, a new Contract Certainty Code of Practice (“the Code”) was issued by the Contract Steering Committee. This was intended to consolidate and refine forms of guidance published in the previous two years following the FSA’s contract certainty initiative. The Code applies to general insurance contracts either entered into by an FSA-regulated insurer, or arranged through an FSA-regulated insurer, and it comprises a series of contract certainty principles which are aimed at ensuring that all terms to an insurance contract, including any conditions or subjectivities, are clearly defined and understood by both the insurer and insured prior to the execution of an insurance contract. Following execution, the Code states, contract documentation setting out the contract terms must be provided to an insured promptly, within seven days for retail customers (who are said to include individuals acting in a non-business capacity) or within 30 days for other categories of client, from the later of the inception date or the final execution of the insurance contract.

The Implementation of the EU Insurance Mediation Directive into Irish Law

The failure to transpose the EU Insurance Mediation Directive properly the first time around could now leave the Republic of Ireland exposed to European Commission infringement proceedings before the European Court of Justice (ECJ) for financial loss or damage during the intervening period between the two sets of regulations, where service providers or consumers (in commercial relationships amongst themselves) suffer losses and are perhaps denied legal rights (that would have been guaranteed by the directive) purely because of the improper transposition.

Competition in the European Business Insurance Market

More than two years after deciding to investigate the health of competition in the European business insurance market, at the end of September 2007 the European Commission published its final report, which concludes that “potential market failure in respect of insurance brokerage” should be “followed up by the Commission and/or national authorities.”⁴¹ The Commission’s investigation raised three main areas of concern about a broker’s position: (i) an inherent conflict (in the broker’s role between his obligation to get the best deal for his client (the insured) and the usual practice of having the broker take on an administrative role for the insurer); (ii) the “best terms and conditions” clause (the concern is that some co-(re)insurance slips include a ‘best terms and conditions’ clause which allows participants to take the benefit of the most favourable terms (from the (re)insurer’s point of view) offered to any participant on the slip – there is often an alignment of the terms offered by co-(re)insurers at the quote stage, and this behaviour may be anti-competitive and fall afoul of EU and UK legislation); and (iii) commission rebating (that any agreements between brokers or decisions of their industry associations not to rebate commission could be anti-competitive).

⁴¹ Commission to the European Parliament. *Final Report 52007DC0056*, 25 September 2007.

Cases

Cases of note involving brokers in 2007 included *HIH Casualty & General Insurance Ltd v JLT Risk Solutions Limited*.⁴² In this case, the Court of Appeal reinforced the principle established in the original judgment that a broker has a duty of care to warn an insured of any issues arising post-placement that could affect the scope or availability of indemnity, with respect to a risk for which insurance was placed by the broker on behalf of that insured, and that the broker must not simply act as a post-box.

In *Gaughan v Tony McDonagh & Co Ltd*,⁴³ the issue of a broker's post-placement duties was revisited. It was held that the broker had no duty to validate the information provided to insurers; if validation was required, it would be for insurers to carry out. Permission to appeal to the Court of Appeal was refused. This decision will provide some reassurance to brokers about the scope of their post-placement duties. That said, brokers should note that there may be some circumstances in which they might be required (or best-advised) to seek factual verification from an insured. In *Fisk v Brian Thornhill & Son*,⁴⁴ the Court of Appeal considered the nature and scope of the duties owed by a placing broker to a producing broker amid the subsequent apportionment of loss caused to an insured as a result of breaches of these duties. This case illustrates that the courts are willing to apportion liability amongst brokers in a chain where something has gone wrong. A broker within a chain may still owe an insured a duty of care and should not give warranties without the authority to do so. Finally, the comprehensive judgment handed down by Gloster J in *HLB Kidsons v Lloyds Underwriters and others*⁴⁵ will be of great interest to brokers in its exposition of the duties of brokers in relation to the presentation of notifications to an insurance market.

Solicitors

Mortgage Fraud

In 2007, solicitors began to face a number of claims arising from mortgage fraud. The SRA Fraud Intelligence Unit indicated in 2007 that lenders were reporting three times as many incidents of fraud as four years ago. Some of the present frauds seem to have been more sophisticated than those perpetrated in the 1990s and have involved criminal gangs, for example, acquiring entire blocks of newly built flats using mortgage mules and "recycling" the properties by re-mortgaging them for ever-increasing amounts of money. The Law Society has responded to the upturn in fraud claims by issuing detailed guidance to the profession about the signs of mortgage fraud.⁴⁶ This replaces the Green Card Warning on Mortgage Fraud issued in 2001.

Trends

Many firms of solicitors who had acted for miners in obtaining compensation for industrial diseases were ordered to pay back over £100m in fees and faced fines from the SRA in 2007. The Mental Capacity Act came into force in 2007, with Lasting Powers of

⁴² *HIH Casualty & General Insurance Ltd v JLT Risk Solutions Limited* [2007] EWCA Civ 710.

⁴³ *Gaughan v Tony McDonagh & Co Ltd* [2005] EWHC 739.

⁴⁴ *Fisk v Brian Thornhill & Son* [2007] EWCA Civ 152.

⁴⁵ *HLB Kidsons v Lloyds Underwriters and Others* [2007] EWHC 1951 (COMM).

⁴⁶ 18 March 2008 <http://www.lawsociety.org.uk/productsandservices/practicenotes/mortgagefraud/522.article>.

Attorney replacing Enduring Powers of Attorney. It was predicted that solicitors might face claims, as it seems that incorrect advice may have been given that the person to whom the power of attorney was being donated should sign the appropriate forms rather than the person giving the power. Fox Hayes solicitors were fined by the FSA for approving a number of financial promotions for unauthorised overseas companies without taking reasonable steps to ensure that the promotions were clear, fair, and not misleading.

Causation Defences

Many reported cases demonstrated that, notwithstanding a finding of breach of duty on the part of a solicitor's arguments, any breaches that did not cause a loss were still successful (see *Hicks v Russell Jones Walker*⁴⁷ and *Stone Heritage Developments v Davis Blank Furniss*⁴⁸), as were arguments that the claimant was entitled to nominal damages only (see *Veitch and Veitch v Philip Avery*⁴⁹). As many claims against solicitors involve arguments of lost opportunity, the decision of the Privy Council in *Philips & Co v Stephen John Whatley* was of note.⁵⁰ The Privy Council decided that the Gibraltar Court of Appeal's assessment that a claimant had an 80 percent prospect of success in a personal injury claim should be reduced to 26 percent.

Personal Injury Claims Management Litigation

In summer 2007, a compromise was agreed by various Lloyd's underwriters who had brought proceedings against panel solicitors to recover losses suffered as a result of "after the event" (ATE) policies issued under The Accident Group (TAG) Scheme. The Lloyd's settlement related to the recovery of referral fees, following a determination in earlier proceedings that these were improper. Separately, Europ Assistance settled similar proceedings related to the recovery of referral fees and also claims in negligence. It is now understood that Winterthur/NIG, Rowe Cohen, and the vast majority of panel solicitors have also recently agreed to settlement terms. It is not inconceivable that further claims will be brought against panel solicitors by other insurers and lenders under TAG. IFS is understood to have intimated during the summer of 2007 that it would pursue claims, but nothing has materialised.

Other Claims Management Schemes

Imperial Consolidated, a Bermudian company and funder of the Claims Advance Scheme written during the 2000 to 2002 period, has brought proceedings against NIG as ATE-provider for failure to pay out. These proceedings are smaller in scope than the TAG litigation involving approximately 9,000 claims (the Winterthur/NIG TAG claims numbered over 46,000). There is potential for the panel solicitors to be drawn into these proceedings, although limitation issues are likely to arise. It is understood that potential claims have also been notified by panel solicitors involved in the Claims Direct Scheme, but as yet no claims have materialised.

⁴⁷ *Hicks v Russell Jones Walker* [2008] EWCA Civ 340.

⁴⁸ *Stone Heritage Developments Ltd v Davis Blank Furniss* [2007] EWCA Civ 765.

⁴⁹ *Veitch and Veitch v Philip Avery* [2007] EWCA Civ 711.

⁵⁰ *Philips & Co v Stephen John Whatley* [2007] UK PC 28.

Legal Services Act

The coming into force of the Legal Services Act (LSA) in October 2007 is set to change the landscape for providers of legal services. Alternative Business Structures (ABSs), businesses involving both lawyers and non-lawyers, are likely to be licensed by 2011. There was a marked increase in 2007 in the number of legal practices converting to Limited Liability Partnerships (LLPs), partly in anticipation of being able to obtain external investment. It is thought that legal disciplinary practices involving a variety of different legal service providers may be set up by the middle of 2009.⁵¹

The LSA effectively lifts the prohibition on the limitation of a solicitor's liability in contentious business agreements so far as business clients are concerned (but not in relation to consumers).

The Office for Legal Complaints (OLC) established by the LSA will be a single point of entry for all consumer legal complaints. It will allow the ombudsman to resolve complaints on the basis of what is, in the ombudsman's opinion, fair and reasonable in all the case's circumstances. This could see the OLC establish regulatory compensation law similar to the FOS. The current limit is £30,000, including compensation and costs but not interest. It is predicted that the limit may soon rise to £100,000.

Barristers

As reported in the 2006 Update following the abolition of immunity from suit for barristers in the decision of the House of Lords in *Hall v Simons*⁵² in 2000, barristers are now facing claims which once might have been covered by immunity.

In *Awoyomi v Radford*,⁵³ a preliminary issue was heard on the question of whether a claimant's action (which related to criminal proceedings which were heard in 1995) was statute-barred. The proceedings against the defendant barrister commenced only in 2006. The claimant sought to argue that, because the barrister had been immune from suit until the House of Lords decision in 2000, the proceedings had been issued in time. The Court ruled that the barrister had not enjoyed immunity in 1995 so that the claim was statute-barred.

The courts are increasingly being required to consider the role played by barristers and the division of responsibility in claims where solicitors are also sued. One example was the case of *Pritchard Joyce & Hinds v Batcup*.⁵⁴ The claimant claimed damages against the solicitor and barrister, as a claim for compensation could not be pursued due to a missed limitation period. The Court ruled that counsel should bear 75 percent of the loss and the solicitors 25 percent. In that case, the Court found that the solicitors looked to counsel for guidance on key strategic issues.

It is anticipated that legal disciplinary partnerships will be available from the middle of 2009. There is currently a provision in place preventing barristers from entering into partnerships. Rule 205 of the Bar Code of Conduct says that practising barristers must not supply legal services to the public through or on behalf of any other person (except

⁵¹ The SRA is currently reviewing the Minimum Terms to cater for this.

⁵² *Arthur J S Hall & Co v Simons* [2000] 3 All ER 673.

⁵³ *Awoyomi v Radford* [2007] EWHC 1671 (QB).

⁵⁴ *Pritchard Joyce & Hinds v Batcup* [2008] EWHC 20 (QB).

as an employed barrister). The Bar Council does have the power to amend the code, should it consider this necessary. We understand this is something that the Bar Council is considering.

Personal Investment Firms

Trends

The annual review of FOS, published in May 2007, provided a broadly positive message for financial advisers as the number of new cases fell. The number of new non-endowment cases continued to fall, reaching a four-year low of 12,429, a reduction of 21 percent on the 2005 to 2006 figures. Within that timeframe, cases relating to pensions dipped by around 10 percent to 3,687, and income draw-down cases (which tend to involve substantial compensation) plummeted by 73 percent to 142. Mortgage endowment cases fell for the first time in two years, from 69,149 new cases in 2005 to 2006 to 43,134 new cases in 2006 to 2007, a reduction of 38 percent.

Cases

The cases of *Bunney v Burns-Anderson Plc*⁵⁵ and *Cahill v Timothy James & Partners Ltd*⁵⁶ concerned, amongst other things, whether it was possible to challenge the legality or validity of an FOS decision outside of the judicial review process. It clarified that if FOS requires a firm to pay compensation by reference to a formula, this is a monetary award (albeit unquantified), rather than a direction and is limited by FOS's £100,000 cap. Even if FOS makes a direction this too will be subject to the statutory cap.

In *R (on the application of Bruce) v FOS*,⁵⁷ in 2007, the High Court held that the process carried out by FOS had not breached the principles of natural justice in circumstances in which FOS had upheld a customer's complaint in relation to a firm which was dissolved when a partner who was unaware of the claim had not had the opportunity to make representations.

Walker v Inter-Alliance Group plc (in administration) and Scottish Equitable,⁵⁸ in the High Court in July 2007, was an example of a case of a product provider being found liable despite the involvement of an independent financial adviser. An employee successfully sued the product provider over bad advice to transfer his pension from his employer's final salary pension scheme into a money purchase scheme.

*Clifford Shore v Sedgwick Financial Services Ltd & Another*⁵⁹ in the High Court dealt with the date of accrual of cause of action for limitation purposes. It was held that the relevant date for limitation was when the loss was actually suffered and the claimant made worse off, not the date of negligent advice. This is particularly relevant for financial products, where these two dates are usually different.

FSA Action

In October 2007, the FSA, assisted by four police forces, arrested two men in connection with an investigation into Universal Management Services, which it believed had been helping illegal overseas "boiler rooms" (i.e., typically, unregulated overseas operations

⁵⁵ *Bunney v Burns-Anderson Plc* [2007] EWHC 1240 (Ch).

⁵⁶ *Cahill v Timothy James & Partners Ltd* [2007] EWHC 1240 (Ch).

⁵⁷ *R (on the application of Bruce) v FOS* [2007] EWHC 1646 (Admin).

⁵⁸ *Walker v Inter-Alliance Group plc (in administration) and Scottish Equitable* [2007] EWHC 1858 (Ch).

⁵⁹ *Clifford Shore v Sedgwick Financial Services Ltd & Another* [2007] EWHC 2509 (Admin).

which target investors using high-pressure tactics to sell overpriced or worthless shares). The arrests were part of the FSA's first criminal investigation into boiler room activities. On 25 September 2007, the FSA had presented winding-up petitions to the High Court against Chesteroak Limited and Bingen Investments Limited, alleging their assistance of boiler rooms, leading the companies to be placed into compulsory liquidation.

On 11 February 2008, an unauthorised stockbroker, William Anthony "Robin" Radclyffe, was sentenced to 15 months' imprisonment for offences of dishonesty stretching over seven years, following prosecution brought against him by the FSA. Mr Radclyffe pleaded guilty to 15 offences under the Theft Acts, the Financial Services Act 1986, and Financial Services and Markets Act 2000, with a further 34 offences taken into consideration.

At the end of 2007, the FSA prohibited two brokers, Jeffrey Ronald Butler and Nicholas Brown, and two underwriters, John Hubert Whitcombe and Christopher Reginald Colin Henton, from conducting business because of their dishonest involvement in reinsurance business that funneled very significant losses into Sphere Drake Insurance Limited.

Also at the end of December 2007, the FSA fined Norwich Union Life £1.3m for not having effective systems and controls in place to protect customers' confidential information and to manage its financial crime risks. These failings had resulted in a number of actual and attempted frauds against Norwich Union Life's customers.

Key Issues for 2008

The predicted slowing of the global economy and tightening of markets may highlight weaknesses in financial markets and firms. These weaknesses may, in turn, give rise to corresponding collapses of firms and complaints and claims, as inadequacies and problems come to light.

The area of Payment Protection Insurance (PPI) should also be watched. The FSA has continued to apply pressure to this market as it proceeds with its efforts to clean it up. The FSA's agreement with the industry regarding the treatment of single-premium PPI policies may precipitate a wave of mis-selling complaints, which some commentators have suggested could overshadow the endowment mis-selling debacle. HFC Bank was fined almost £1 million by the FSA in January 2008 over the way it sold the cover.⁶⁰

Medical

Claims Generally

There has been a slight decrease in the number of clinical negligence claims brought against the National Health Service (NHS) from the number of claims in the 2005 to 2006 period, falling from 5,697 to 5,426 for the 2006 to 2007 period. This represents a decrease of 4.8 percent against a 1.6 percent increase in 2004 to 2005. Similarly, there has been a fall of 5.8 percent in the number of non-clinical claims over the same period.⁶¹

⁶⁰ A London law firm is reputed to be trying to gather claimants to bring a class action against HFC Bank – The Guardian 10 May 2008.

⁶¹ NHSIA Report August 2007.

The National Health Service Litigation Authority (NHSLA) had 18,493 “live” claims as of 31 March 2007. The average claim is now settled in an average of 1.5 years from the date of notification to the NHSLA to the date when compensation is agreed or the claimant discontinues the claim. Ninety-six percent of the NHSLA’s cases are settled out of court via alternative dispute resolution (ADR). Fewer than 50 clinical negligence cases a year are contested in court.

In 2006 to 2007 the NHSLA made payments totalling £613.3m, compared to £591.5m in the period 2005 to 2006.

As of 31 March 2007, the NHSLA estimated that it had potential liabilities of £9.2bn as against £8.22bn the previous year. This figure represents the estimated value of all known claims, together with an actuarial estimate of those incurred but not yet reported, which may settle or be withdrawn over future years.

The costs with respect to clinical negligence claims have risen from £560.3m in 2005 to 2006 to £579.3m in 2006 to 2007. The figures for non-clinical claims are £33.9m for 2006 to 2007 and £31.3m for 2005 to 2006.

Ogden Tables – Sixth Edition

In May 2007, the Sixth Edition of the Ogden Tables was published, giving the most detailed guidance yet on how the courts should assess awards for damages in personal injury and fatal accident cases. The aim of the Tables is to provide a realistic estimate of discounted future earnings, allowing for the chances that a claimant might die before retirement age, and might also spend time not working as a result of sickness or unemployment, for example. Importantly, the Sixth Edition includes a new methodology for the calculation of loss of future earnings. There are small increases in the multipliers in the Tables (based on increased life expectancy) and Reduction Factors (RFs) for employment risks given as averages for broadly defined groups based on gender, educational achievement, disability, and employment status. The intention is for the Tables to be a starting point and that the courts will use their discretion to adjust the RFs according to the circumstances of a particular case, with the result being that awards for future losses of earnings are less predictable.

Although claimants have adopted the new edition’s approach to calculating losses of earnings, so far the guidelines have not been applied rigidly by the courts. Recent case law suggests that whilst the new approach sets parameters for multipliers, the courts are still prepared to hear expert medical and other evidence on how the individual claimant fits within the definitions of disability and employability – and hence reach their own findings as to the likely extent to which a claimant’s future earning capacity has been compromised by reason of the injury (*Kyle Hunter v The Ministry of Defence*, *Gerald Lane v The Personal Representatives of Deborah Lake (Deceased)*, and *Conner v Bradman and Company Ltd*⁶²).

⁶² *Conner v Bradman and Company Ltd* [2007] EWHC 2789 (QB).

Law on Damages

In May 2007, the Department for Constitutional Affairs published their consultation paper proposing reform to the civil law on damages. It considered issues arising from a number of Law Commission reports, including recommendations for changes to the Fatal Accidents Act 1976 concerning claims for damages where a person's death has been caused by the negligence of another person.

It sought views on the principles surrounding the ability of people to claim damages for the cost of private medical treatment under section 2(4) of the Law Reform (Personal Injuries) Act 1948 and on the interface between the public and private provision of care and accommodation services. It also considered the law on claims for psychiatric illness, aggravated and restitutionary damages, and the treatment in damages awards of collateral benefits, gratuitous care and services, and accommodation expenses. The consultation period closed at the end of July 2007, and a summary of the responses is expected this year.

Expert Witnesses

Medical

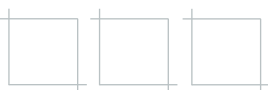
Expert immunity continued to dominate the expert witness arena in 2007. The Court of Appeal's decision in *Meadows v General Medical Council*⁶³ established that medical expert witnesses are accountable to the General Medical Council (GMC) for their conduct as experts. In 2007, Dr Alan Williams, a pathologist who gave evidence at the trial of Sally Clark, was found guilty of serious professional misconduct, and conditions were imposed on his medical registration. He had not included in his pathology report important evidence that should have been disclosed overtly for consideration by the jury. The decision was subsequently upheld by the High Court.⁶⁴ The Court of Appeal also recognised in *Raschid v GMC*⁶⁵ that the GMC fitness to practise panels have special expertise, and the courts should have a high threshold for overturning their decisions.

The Health and Social Care Bill, currently before Parliament, includes provisions to remove the adjudication role from the GMC. It will be given to the Office of the Health Professions Adjudicator.⁶⁶

In October 2007 the GMC produced their own guidance for expert witnesses, the British Medical Association (BMA) Expert Witness Guide, to assist BMA members who undertake expert witness work.

Experts' Liability for Costs

In *Admiral Insurance Services Ltd v Christopher Eric Daniels*,⁶⁷ the court held that an expert witness had been in flagrant dereliction of his duty to the court in not examining a vehicle for which he prepared a damage assessment report for an insurance claim, and that as a consequence he was jointly and severally liable for the insurance company's costs of defending the main action where the vehicle had in fact sustained no damage.



⁶³ *Meadows v General Medical Council* [2006] EWCA Civ 1390.

⁶⁴ *Williams v General Medical Council* [2007] EWHC 2063.

⁶⁵ *Raschid v GMC, Fatnani v GMC* [2007] EWCA Civ 46.

⁶⁶ See page 10 of this review.

⁶⁷ *Admiral Insurance Services Ltd v Christopher Eric Daniels* County Court (Cambridge) [2007] unreported.

4

Environmental Liability

United Kingdom

Statistics

In last year's review we highlighted the fact that the number of criminal sanctions against polluters was increasing. This trend is continuing, and the fines are going up. The courts are taking environmental damage more seriously. A recent report by the Environment Agency⁶⁸ (EA) has revealed that successful prosecutions against companies in 2006 resulted in more than £3.5m in fines (an increase of 23 percent from 2005), with an average of £11,800 per business, compared to £2.7m and an average of £8,600 in 2005. Thames Water Utilities Ltd received the highest cumulative fine at £191,600. A total of 380 individuals, including 29 company directors, were successfully prosecuted. Six directors were fined £5,000 or more, and five received other penalties, including two custodial sentences totalling 14 months.

In 2006 the EA investigated 34 major cases which involved "serious, prolonged and deliberate criminal behaviour."⁶⁹ In addition, two criminal anti-social behaviour orders were made against two separate offenders in respect to separate incidents.

Chemicals

Businesses in the chemical sector release a large number of chemicals into the atmosphere and water. Releases into air, particularly lead and sulphur dioxide, decreased in 2007. Most releases into water are also falling.⁷⁰ The EA's "Chemicals Sector Plan" was introduced at the end of 2005 and identified high-level environmental objectives. The reduction in releases in 2007 is thought to be an indication that the targets in the plan are achievable.

WEEE Regulations

On 1 July 2007, the Waste Electrical and Electronic Equipment (WEEE) Regulations 2006 came into effect in the UK. The aim of these regulations, which transpose the WEEE Directive into UK law, is to reduce the amount of WEEE going to landfill for disposal. This will be achieved by promoting the separate collection of WEEE and its reuse, recycling, recovery, and environmentally sound disposal. This approach saves energy and resources and keeps hazardous materials from going to landfill. It applies to a huge spectrum of products and imposes new obligations on any organisation involved in electrical and electronic equipment supply, use, or recycling.

Europe

The Environmental Liability Directive

The 30 April 2007 deadline passed for the transposition of the highly controversial EU Environmental Liability Directive (ELD) mentioned in the 2006 Update, and the UK government has wrestled with the implementation of the ELD through 2007. The ELD seeks to

⁶⁸ Environment Agency: September 2007: Spotlight on Business Environmental Performance in 2006.

⁶⁹ Ibid.

⁷⁰ Ibid.

establish a framework within the EU for the prevention and remediation of damage to protected species and natural habitats, water, and land. With a complex system of law relating to environmental liability already in place in the UK, the government has the difficult task of incorporating the ELD's requirements into this existing law in a way that is acceptable to environmental groups, environmental regulators, and businesses. It is now anticipated that the ELD will finally be implemented in the UK in 2008.

REACH

Registration, Evaluation and Authorisation of Chemicals (REACH), a new set of European chemical regulations, came into force in June 2007 and will help to reduce the risks and impact of dangerous chemicals in the environment. REACH will apply to any business that uses chemicals, as well as the entire supply chain that supports it. Manufacturers, importers, distributors, and professional users who market or use chemicals will have to make sure that those chemicals are registered with the European Chemicals Agency in Helsinki. Failure to comply with REACH carries criminal sanctions.

The EU Commission estimates the total cost to industry, including downstream users and the cost of substitutions, to be between €2.8bn and €5.2bn. Although REACH will have a positive effect on chemical safety, the sheer number of existing chemical substances being tested, possibly for the first time, may lead to surprises. Where a widely distributed chemical is found to be causing health or environmental problems which were previously unknown, for example, there could be a resulting liability for manufacturers, importers, or users of the substances, as well as the potential for expensive product redesign.

The UK is required to have an enforcement and penalties regime in place no later than 1 December 2008. The Department for Environmental, Food and Rural Affairs (DEFRA) has consulted on the criminal sanctions that will apply in the UK.⁷¹ The consultation considers who should carry out enforcement of REACH's requirements, the powers they will need (e.g. to obtain information, carry out inspections, collect evidence, issue enforcement notices), and the level and type of penalties for breaches of REACH requirements.

Liability for Environmental Clean-up Costs

In *Bartoline Limited v (1) Royal & Sun Alliance Insurance Plc (2) Heath Lambert Limited*⁷² the High Court was required to consider whether environmental clean-up costs were covered under a public liability insurance policy. In this case, the pollution resulted from foams which had been used to fight a fire at Bartoline's warehouse. The EA used various emergency clean-up measures and then sent Bartoline the bill. Bartoline subsequently claimed these and its other clean-up costs under its public liability policy. The Court held that these costs were not recoverable under the terms of the policy.

⁷¹ <http://www.defra.gov.uk/environmental/chemicals/reach/pdf/reachconsult2007>.

⁷² *Bartoline Limited v (1) Royal & Sun Alliance Insurance Plc (2) Heath Lambert Limited* [2006] EWHC 3598 (QB).

Climate Change

The issue of climate change continues to dominate the international arena. In February 2007, the Intergovernmental Panel on Climate Change (IPCC) produced what is probably the most authoritative report yet on climate change.⁷³ Its report suggests that global warming is destined to have a far more destructive impact than previously estimated and that it will take effect earlier than predicted.

Past assessments by the IPCC have suggested such scenarios are “likely” to occur this century. Its latest report – based on sophisticated computer models and more detailed observations of snow-cover loss, sea-level rises, and the spread of deserts – is far more robust and confident. Now the panel writes of changes as “extremely likely” and “almost certain.”

The UK government states that it is committed to addressing both the causes and consequences of climate change. In March 2007 it published the Climate Change Bill. Current proposals include unilaterally setting a long-term target for reducing CO₂ emissions through domestic and international action by 60 percent by 2050 (with an interim target for 2020 of a reduction of between 26 percent to 32 percent), implementing a system of carbon management based on statutory five-year carbon budgets set out in secondary legislation, and establishing a committee on climate change which would be an independent body designed to improve the institutional framework for managing carbon in the economy.

Climate change also presents significant risks for companies. Actions against carbon-intensive businesses by those who have suffered climate change-related damage could be possible in the future.

The State of California’s lawsuit brought against the “Big Six” US car manufacturers, which was reported in the 2006 Update, was dismissed by a district court in September 2007, ruling that the case presented a “political question” unsuitable for resolution by the courts. Attention had, however, already been turned towards the federal government, with California filing a lawsuit in August 2007 against the US Environmental Protection Agency (EPA) in an ongoing battle between states and the federal government over the authority to regulate greenhouse gas emissions from vehicles. Following the introduction of the Companies Act 2006, directors of companies need to ensure that environmental issues, including those affecting climate change, are taken into account as part of their decision-making process.



⁷³ IPCC Fourth Assessment Report: Climate Change 2007.

5

Employers' Liability, Employment Practices Liability, and Public Liability

Asbestos

Statistics

The number of asbestos-related deaths in the UK continues to rise. The Health and Safety Executive (HSE) has published statistics about the numbers of work-related illnesses and deaths occurring in the period 2006 to 2007.⁷⁴ The report confirms that deaths from mesothelioma have increased from 153 in 1968 to 2,037 in 2005. An estimated 4,000 cancer deaths are thought to be due to asbestos exposure and the HSE estimates that the annual number of work-related deaths is likely to be in excess of 6,000.

There were 134 deaths from asbestosis (as an underlying cause) and 210 deaths from other types of pneumoconiosis, mostly due to coal dust and silica.

The HSE claims that the statistics show mesothelioma deaths are decreasing in relation to men aged under 55, which is likely a result of more recent controls in relation to asbestos. However, the number of deaths caused by mesothelioma are continuing to rise overall, and projections suggest that they will not peak until about 2011-2015.

Pleural Plaques

In the 2006 Update, we reported on the decision in *Grieve and Others v FT Everard & Sons Ltd and British Uralite Plc and Others* in which the Court held that claimants claiming in relation to pleural plaques (i.e., concentrated thickening of the area covering the lung) were entitled to compensation. The Court of Appeal subsequently reversed that decision and cited policy reasons against such claims. On 17 October 2007 the House of Lords⁷⁵ unanimously upheld the Court of Appeal decision by finding that pleural plaques do not constitute "damage" and therefore did not merit compensation.

The House of Lords stipulated that proof of damage was an essential element in a claim of negligence and pleural plaques (which alone cause no symptoms, do not shorten life expectancy, or increase the likelihood of the individual developing other diseases) did not amount to damage. Neither did the risk of future illness or anxiety about the possibility of that risk materialising amount to damage for the purposes of creating a cause of action. Whilst these opinions make it very clear that claimants will not be able to recover damages for pleural plaques alone under the law of negligence, the majority of the Law Lords expressly noted the possibility that claimants diagnosed with pleural plaques who had been negligently exposed to asbestos during the course of

⁷⁴ Health and Safety Statistics 2006/07.

⁷⁵ *Grieve and Others v FT Everard & Sons Ltd and British Uralite Plc and Others* [2007] UKHL 39.

their employment could frame contractual claims in the future. There is, however, scepticism as to whether such claims would generate sufficient damages to make them worth pursuing. It is possible that a right to claim may in the future be incorporated into legislation.

Scotland

Towards the end of 2007, the Scottish Government announced its intention to introduce a bill to reverse the *Grieves* decision in the House of Lords and allow the claimants to claim compensation for pleural plaques. The provisions of the bill would take effect from the date of the judgment (i.e., it would be retrospective in effect).

Pensions

As anticipated in the 2006 Update, the government continued to press ahead in 2007 with its programme of reform of the UK pensions system. The first phase of the reforms was completed with the Pensions Act becoming law in July 2007. The Pensions Act reforms the state pensions system relating to the Basic State Pension and the State Second Pension, and it changes some of the qualifying conditions for both. It also gradually increased state pension age, between 2024 and 2046, to 68 for men and women, reflecting increasing longevity and making the state pension affordable in the long-term. The act created the Personal Accounts Delivery Authority (PADA) to advise on the introduction of the Personal Accounts Scheme, which is a new, simple, low-cost pension savings vehicle.

The second phase of the Pensions Bill was introduced to Parliament on 5 December 2007. This bill includes measures aimed at encouraging greater private saving, including a duty on employers from 2012 to enroll their eligible employees into a good-quality workplace pension scheme and provide a minimum contribution. It also allows for the establishment of the Personal Accounts Scheme (see above), and proposes to give executive powers to PADA, which will allow it to devise the scheme at arm's length from the government. The bill also proposes means of easing the burden of regulation placed on employers through measures such as reducing the cap on the revaluation of deferred pensions. The Pension bill 2008 is due to become law in April 2008.

Employment Bill

At the end of 2007, the government published the Employment Bill, which contains proposals to reform the existing law covering industrial relations and employment protection. The bill follows an independent review of employment dispute resolution undertaken by Michael Gibbons and an associated government consultation paper "Resolving Disputes in the Workplace." Under current proposals, the bill will effectively repeal the standard disciplinary and grievance procedures in the Employment Act 2002, along with their enforcement provisions. In their place, employers and employees alike will be expected to comply with codes of practice for resolving disputes developed by the Advisory, Conciliation and Arbitration Service (ACAS). If either party unreasonably fails to follow the codes of practice, employment tribunals will be able to increase or reduce compensation by up to 25 percent, depending on who was at fault.

Further, the bill introduces a new fast-track procedure for settling monetary disputes. Cases determined within this system will be decided without a hearing, provided that both parties agree.

The proposed changes also allow tribunals to award compensation for financial loss for certain types of monetary claim (such as unlawful deduction from wages or non-payment of redundancy pay). This envisages that, in appropriate circumstances, bank charges or interest payments may be recoverable, consequently increasing the potential damages payable in this type of claim.

The bill also changes the relevant law to enshrine the judgment of the European Court of Human Rights in *Aslef v UK*,⁷⁶ a case concerning the expulsion by a union of a BNP member for views and activities contrary to the union's rules, in which ECHR found UK law to be incompatible with European law. The bill provides clearer rights for trade unions to terminate membership.

The bill, which will eventually be known as the Employment Act 2008, received its first reading in the House of Lords in early December 2007, and at the time of writing, it is at its second committee stage. It is currently anticipated that the bill will receive Royal Assent in summer 2008 and will then take effect in spring 2009.

Smoking Ban

On 1 July 2007, the much-anticipated smoking ban came into force in England and Wales. Under the Health Act 2006, it is now a criminal offence to smoke or to permit smoking in all workplaces and public places including vehicles. Employers will now be criminally liable and exposed to fines if they fail to enforce the ban. It seems unlikely that there will be a significant increase in smoking-related claims as a result of the ban, although there might be an increase in whistleblowing-type claims by staff who are victimised for exposing other members of staff who are flouting the ban.

Age Discrimination

As reported in the 2006 Update, regulations prohibiting direct and indirect discrimination, victimisation, and harassment on the grounds of age in the context of employment and training came into force more than a year ago, in October 2006, with the implementation of the Employment Equality (Age) Regulations 2006 ("the Regulations"). The Regulations contain a number of important exceptions. Shortly after the Regulations came into force, a challenge was launched by Age Concern (through its membership organization Heyday), which argued that the UK's compulsory retirement provisions were contrary to European Law and that a default retirement age is not permissible. In *Age Concern v Secretary of State*⁷⁷ (better known as "Heyday"), two aspects of the recent regulations have been challenged. The first is the default retirement age of 65, at which any employer can require employees to retire. Heyday argues that this is not permitted by the Equal Treatment Directive ("the Directive").

⁷⁶ *Aslef v UK* [2007] 1 RLR 361.

⁷⁷ *Age Concern v Secretary of State* [2007] EWHC 3090 (Admin).

The second challenge concerns the UK's approach to direct age discrimination. The regulations state that this is permitted if it is "a proportionate means of achieving a legitimate aim." Heyday points out that the framework directive gives a list of specific examples of what might be justifiable direct discrimination, and it goes on to argue that the directive requires each EU member state to come up with a specific list of particular instances – for example, imposing a minimum or maximum age for health and safety reasons.

In December 2006, the High Court referred Heyday's challenge to the ECJ and a European ruling on this issue is currently awaited. Once the ECJ's decision is handed down, which is unlikely to be before 2009, the UK government may have to consider whether the Regulations fail to give effect to the Directive because an employer can forcibly retire an employee aged 65 or above as long as it follows the correct procedures. The President of the Employment Tribunals has ordered that all existing and future claims of this nature be stayed pending the ECJ's decision.

One of the most high-profile discrimination cases in 2007 involved an age discrimination claim brought against an international law firm by one of its former partners in relation to changes made to its pension arrangements.⁷⁸ This case was the first major test of age discrimination regulations. The former partner lost his case, it being held that the law firm was entitled to make the pension arrangements in the manner it had.

The collection of details on age discrimination cases only became a requirement from October 2006, so it is difficult to identify to what extent the volume in claims increased during the 12-month period prior to the introduction of the legislation. A total of 972 age discrimination claims were brought in the first six months following the introduction of the Regulations in October 2006. Of the 135 claims disposed of in this period, 38 percent were withdrawn, 41 percent conciliated through ACAS, and 8 percent struck out.

Bullying and Harassment

The Advocate General, giving his opinion in *Coleman v Attridge Law and Steve Law*,⁷⁹ has recommended that the ECJ hold that employees who are not themselves disabled should be protected by law if they suffer discrimination or harassment because they are associated with a disabled person.

Gender Discrimination

The Sex Discrimination Act 1975 is to be amended to implement both the EU Gender Directive and certain aspects of the EU Equal Treatment Amendment Directive.

The Gender Directive (2004/113) implements the principle of equal treatment between women and men in the access to and the supply of goods and services which are available to the public. Although the Gender Directive does not explicitly cover employment, the Discrimination Law Review, which sets out the government's proposals for a single Equality Bill, covers the UK's proposed implementation. The directive requires some amendments to the Sex Discrimination Act 1975, which will be accomplished by amending the regulations. The original deadline for implementation was 21 December

⁷⁸ *PJ Bloxham v Freshfields Bruckhaus Deringer* [2007] (Employment Tribunal).

⁷⁹ *Coleman v Attridge Law and Steve Law* [2007] 2 CMLR 24.

2007, though this has been postponed as more work is needed on drafting the amending regulations. The regulations are likely to impact a number of areas of sex discrimination legislation, and may require employers to revisit their policies and practices.

Statistics on Employment Tribunal Claims

The number of claims brought in employment tribunals increased by more than 15 percent from 2005 to 2006, reaching 132,577. The claims in 2007 covered nearly 240,000 separate jurisdictions or complaints. Nineteen percent of claims were for unfair dismissal (average award £7,974), and 16 percent related to gender, race, or disability discrimination. There were more than 44,000 Equal Pay claims. The average awards for successful discrimination claims were £14,049 (race), £15,059 (disability), and £10,052 (gender).⁸⁰

Alternative Dispute Resolution

Statistics

The use of Alternative Dispute Resolution (ADR) continues to increase steadily. In November 2007, the Centre for Effective Dispute Resolution (CEDR) published a Third Mediator Audit, the result of a wide survey of mediators and lawyers of varying affiliations, indicating a 33 percent increase in the number of mediations per year.⁸¹ CEDR's findings show year-on-year growth since 2003 of around 15 percent. The settlement rate on the day of or shortly after remains high at 88 percent, if slightly lower than the surprisingly high figure of 93 percent reported in 2005. CEDR's report shows evidence for the first time of the emerging and significant impact of mediation schemes, including court-connected models such as the Court of Appeal Mediation Scheme and organisation-specific schemes such as those operated by many major employers.

Other ADR providers also report higher levels of settlement. Littleton Chambers, a prominent London mediation provider, reports a 4 percent increase in the number of successful mediations in 2007 compared with the previous year.

The Ministry of Justice reported a slight decrease in the use of mediation in government departments and agencies, including the National Health Service Litigation Authority (NHSLA), with 331 cases mediated leading to 225 settlements⁸² – in the context of 18,493 live NHSLA claims in March 2007.⁸³ The use of ADR may be increasing, but there is clearly room for further growth.

Measures to encourage litigants to mediate – including reform of the Civil Procedure Rules (CPR) – were considered in a mediation “summit” organised by the Ministry of Justice, Civil Justice Council, and Civil Mediation Council in November 2007. Proposals included provisions for a defendant to make a mediation offer rather than file a defence and the introduction of a mediation code. The proposals fall short of making mediation compulsory at any stage of legal proceedings.⁸⁴

⁸⁰ ETS Statistics 2006/7.

⁸¹ The Third Mediator Audit. 8 November 2007. CEDR.

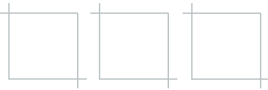
⁸² Ministry of Justice. The Annual Pledge Report 2006/07.

⁸³ Information on Claims. November 2007. NHS Litigation Authority.

⁸⁴ The EU Mediation Directive is due to be implemented in 2008. It is unlikely to have significant impact except possibly on the use of mediation in relation to cross-border disputes in Europe.

Case Law

The principle of costs penalties being applied to parties to litigation who fail to engage reasonably in ADR pre-action is becoming firmly established through judicial authority. It is often less a question of whether penalties will be applied but rather their proper extent. In *P4 Limited v Unite Integrated Solutions Plc*⁸⁵ the successful defendant was denied a proportion of its costs in the main action because of its failure to provide relevant information at an early stage in the proceedings and prior to formal disclosure. The Court of Appeal decided in *Straker v Tudor Rose*⁸⁶ that it was wrong to reduce the recovery of a successful party's costs to nil for a failure to engage in pre-action negotiations in accordance with the spirit of the Pre-Action Protocol, but the Court upheld the principle of costs penalties being applied, allowing the claimant to recover a small proportion of pre-action costs and 60 percent of its costs of the proceedings.



⁸⁵ *P4 Limited v Unite Integrated Solutions Plc* [2007] CILL 2422 TCC.

⁸⁶ *Straker v Tudor Rose (A Firm)* [2007] EWCA Civ 368.

6

Litigation Funding

Third-Party Funding

At the start of 2007, a £90m negligence claim brought against a mid-tier accountancy firm⁸⁷ using independent litigation funding drew attention to a trend of the growing availability of specialist third-party funding to pursue litigation. The claim against Moore Stephens over its role as auditor to Stone & Rolls, a collapsed British company, was reported as groundbreaking – the largest claim to date brought with the help of third-party litigation funding.

Third-party funding may be by way of donation, as in the case of *Hamilton v Al Fayed*,⁸⁸ or by a commercial funder in exchange for a share in the damages should the claim be successful.

The result of the growing acceptability of funding on a commercial basis is a sharp rise in the availability of third-party funding for litigation. The year 2007 brought Europe's largest insurer to London to set up a third-party litigation fund, as well as the launch in July 2007 of a specialist broker, Calunius Capital. As has been widely reported, hedge funds and private equity funds have entered the third-party funding market in the UK, and Australian litigation funder IMF is expanding its activities to the UK and Europe.

The UK is, however, somewhat behind other jurisdictions (such as Australia) where third-party funding has gained approval at the highest judicial level.⁸⁹

It is inevitable that regulation will follow. In February 2008, the Civil Justice Council of lawyers, judges, insurers, funders, and regulators convened to consider changes to the costs regime to ensure funders will not “cut and run” and, perhaps even more significantly, concluded that regulation was required to prevent a repeat of the “costs wars” that have plagued the development of conditional fee agreements. At the time of this writing it was being proposed that the entity responsible for regulating claims farmers should also regulate commercial third-party funders.

After the Event Insurance

April 2007 saw the Ministry of Justice publish its consultation on case track limits. This resulted in proposals that ATE insurance should be sought only after a defendant had denied liability. The consultation ended in July 2007 and the papers summarising responses are expected to be published in 2008.

The Law Society, Association of Personal Injury Lawyers (APIL), Motor Accident Solicitors Society (MASS), and Legal Expenses Insurance Group have warned that the proposals undermine access to justice and may result in a destabilisation of the market and a huge increase in premiums.

⁸⁷ *Stone & Rolls Ltd in liquidation v Moore Stephens and Another* [2007] EWCH 1826.

⁸⁸ *Hamilton v Al-fayed* [2002] EWCA Civ 665.

⁸⁹ *Campbells Cash and Carry Limited v Fostif Pty* [2006] HCA41 followed and approved in *Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd* [2006] HCA42 as reported in the 2006 Update.

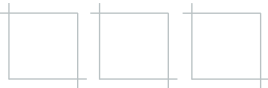
Defence interests, such as the Association of British Insurers, backed the proposals, stating that the reforms may enable the ATE insurance market to move towards a more risk-based approach, with individual premiums reflecting individual risk levels.

Regulation of Claims Farmers

As reported in the 2006 Update, the Compensation Act 2006 (“the Act”) provided a statutory framework for regulating the claims management industry. Since the Act has been in force, it has been suggested that it complements the Solicitors Regulation Authority’s powers and has resulted in improved enforcement.⁹⁰

However, critics have argued that there has been a growth in “case-trafficking” by unregulated personal injury claims management companies since the introduction of licensing and registration provisions under the Act, with some law firms failing to declare the commissions they receive. It has also been suggested that part of the problem is that there is a plethora of regulators but too little enforcement.⁹¹

In October 2007, the APIL warned the Ministry of Justice that it should impose stricter advertising rules on claims management companies to ensure consumers do not mistake them for firms of solicitors.⁹²



⁹⁰ Law Society’s Gazette L.S.G. (2007) Vol.104 No.39 Page 14.

⁹¹ Law Society’s Gazette L.S.G. (2007) Vol.104 No.37 Page 14.

⁹² Law Society’s Gazette L.S.G. (2007) Vol. 104 No 41 Page 1.

7

Procedural Developments

Performance of the Courts of England and Wales: Statistics and Trends

Eleven years after the publication of Lord Woolf's *Access to Justice* report the courts continue to implement reforms aimed at reducing the cost and timescale of litigation. Despite a steadily increasing volume of proceedings issued in most courts since 2003, the timescale for litigation measured from issue of proceedings to trial is being maintained.

Judicial statistics published by the Ministry of Justice⁹³ and statistics relating to clinical negligence claims published by the NHSLA are useful indicators. In the county courts in 2006, the average time for a claim to reach trial remained the same as in 2005 – 52 weeks⁹⁴ – measured from the date of issue of proceedings. For the same period, the number of proceedings issued⁹⁵ increased by 6.6 percent. For the 2006 to 2007 period the NHSLA similarly reported no change in the average time taken to dispose of a claim.⁹⁶

Recommendations to create a clearer structure for trials of complex commercial cases in order to reduce their length and cost were issued by the Commercial Court in a report by its Long Trials Working Committee. This was a response to criticism of procedure and case management of the BCCI/Bank of England and Equitable Life trials. The proposals, which seek to set more focused parameters for disclosure and the content of witness statements, and impose limits on the length of statements of case and oral and written arguments, were trialled in the second half of 2007. The recommendations will be applied to all cases (not only to long or complex cases) issued in the Commercial Court from 1 February 2008 and to existing cases with a Case Management Conference after that date.

One of the major criticisms of the Woolf reforms was the courts' failure to tackle the growing problem of costs, particularly in personal injury claims. The number of personal injury claims has grown at a rate of 3 percent per annum in the decade 1996 to 2006, and the total cost paid by UK motor insurers has risen in a similar period by 9.5 percent each year.⁹⁷ The government's wide-ranging consultations in 2007 on reforming the personal injury claims system may lead to faster and more cost-efficient resolution of claims. The consultation paper "Case Track Limits and the Claims Process for Personal Injury Claims," issued by the government in April 2007, sets out a detailed new process in which personal injury claims (excluding medical negligence) of up to £25,000 are to be handled within strict time limits and with staged fixed costs throughout the process.

⁹³ Since May 2007, judicial statistics previously published by the Department for Constitutional Affairs have been published by the Ministry of Justice.

⁹⁴ Ministry of Justice. *Judicial and Court Statistics 2006*.

⁹⁵ Total number of proceedings issued including money and non-money claims and insolvency petitions but excluding family.

⁹⁶ Information on Claims. November 2007. NHS Litigation Authority.

⁹⁷ International Underwriting Association and the Association of British Insurers.

This new super fast-track process envisages an out-of-court claim being sent to the defendant (or insurers) within five working days of instructions being taken, and it includes the defendant's decision on liability being communicated within periods of 15 days in road traffic cases or 30 days for employer and public liability claims. If an admission is secured, it is intended to be binding, and the claim will be valued and resolved in a standardised way. Fixed sums have been proposed for certain heads of special damages to reduce delay and costs.

A proposal has been made to increase the small claims track limit for personal injury claims from £1,000 to £5,000 (thus making these cases non-costs bearing). This has been opposed by claimant personal injury lawyers who say that most claimants would not be able to secure legal representation to pursue their claims. The summary of the responses to the proposals is due to be published in 2008. It is predicted that the current small claims track limit of £1,000 will be retained in personal injury cases.

Costs

Decisions on costs made in the courts in 2007 have shown some progress towards more effective litigation costs management. The use of estimates to limit costs awards has been revived in particular circumstances. The revised CPR Part 36 allows for greater discretion in awarding disproportionate and unreasonably incurred costs, and a system of pre-emptive orders to avoid the costs of litigation spiralling out of control is emerging slowly.

Leading firms of city lawyers are currently responding to a consultation whereby lawyers would provide a figure for their costs at the outset of litigation which could not be exceeded.

Estimates of litigants' future trial costs (as well as a statement of costs already incurred) are required to be filed by the parties at the allocation stage. Paragraph 6.6 of the Costs Practice Direction gives the court the power to consider costs estimates when assessing the reasonableness of any costs claimed. A Court of Appeal decision in 2003 severely restricted the potential costs management benefit of this power,⁹⁸ but at the same time gave guidance on the application of paragraph 6.6, namely that a litigant must provide a reasonable explanation for a substantial difference between the estimate and the costs claimed and that a paying party must show that it placed reliance on the estimate.

In 2007, in *Tribe v Southdown Gliding Club Ltd and Others*⁹⁹ the paying party succeeded in limiting his liability for costs to a level based on the estimate given by that receiving party. Mr Tribe suffered severe injuries in a glider accident. He commenced proceedings against the company from which he had hired the glider, the owner of the glider, and the inspector and maintainer of the glider. When filing the allocation questionnaire, two of the defendants estimated their costs to trial at £50,000. Mr Tribe took out ATE insurance with an indemnity limit of £100,000.

⁹⁸ *Leigh v Michelin Tyres Plc* [2003] EWCA Civ 1766. It was held that a low costs estimate did not prevent a litigant claiming much higher costs which would be assessed under the usual principles.

⁹⁹ *Tribe v Southdown Gliding Club Ltd and Others* Unreported [2007] WL2186955.

Liability was denied, but following the meeting of liability experts, it became clear that the claim was unlikely to succeed. Mr Tribe served a Notice of Discontinuance entitling the defendants to their costs.

Two of the defendants claimed a total of £244,509 in costs. No adequate explanation was given for the discrepancy. Mr Tribe asked the Court to limit the costs claimed to the amounts on the allocation questionnaire. It was held that although the costs estimate on the allocation questionnaire was low, it was not so low as to have been unreasonable for Mr Tribe to have relied on it. The Court was satisfied that had Mr Tribe been aware of the magnitude of the potential costs claim against him, he would have purchased additional insurance cover. The relevant defendants' costs were limited to £70,000.

From 6 April 2007, a Part 36 offer to settle a claim, made with the requisite conditions including payment to the claimant within 14 days if accepted, no longer required payment of money into court. The potential costs protection of Part 36 offers was thereby extended to claims in the pre-action stage and to non-monetary claims. The wording of the new Part 36 permits the court to look at all the circumstances to see whether a claimant acted reasonably in not accepting an offer and not just whether a claimant beat an offer.

Last year, there was progress in pre-emptive costs control in the form of costs capping orders (CCOs). CCOs give judges the power to limit a party's recoverable costs at an early stage of litigation. There is no explicit power within the CPR to make a CCO, and although the existence of the jurisdiction to make a CCO has not been in doubt since *AB v Leeds Teaching Hospitals NHS Trust*,¹⁰⁰ its potential use was severely curtailed by a Court of Appeal decision in 2003,¹⁰¹ limiting its use to cases where there was a substantial risk that costs might get out of control. CCOs have rarely¹⁰² been used outside the arena of defamation¹⁰³ and group litigation.¹⁰⁴

In 2007, there were two significant decisions on CCOs: the Court of Appeal decision in *Willis v Nicolson*,¹⁰⁵ and the first instance decision of MacDuff HHJ in *Dawson v First Choice Holidays*.¹⁰⁶ In *Willis v Nicolson* a CCO was made against an individual litigant in a personal injury action. The claimant was pursuing a claim for serious injuries suffered in a road accident with recoverable damages likely to be in the region of £3.3m. The claimant's costs were initially estimated at £250,000. Eight months later, when the costs incurred had already reached £450,000, future costs were capped at the amount of the claimant's estimate of £459,496. Field J considered the costs already incurred as "truly remarkable."

¹⁰⁰ *AB v Leeds Teaching Hospitals NHS Trust* [2003] EWHC 1034 (QB).

¹⁰¹ Gage LJ in *Smart v East Cheshire NHS Trust* [2003] EWHC 2806 (QB) said that the function of a CCO is to place a prospective limit on recoverable costs when "there is a real and substantial risk that without such an order costs will be disproportionately or unreasonably incurred; and that this risk may not be managed by conventional case management and a detailed assessment of costs after a trial."

¹⁰² Hallett J in *Sheppard v. Essex SHA* [2005] EWHC 1518 (QB) imposed a costs cap in a clinical negligence claim (non-group) "that fell outside the ordinary run of litigation" so that the Smart test did not apply at all.

¹⁰³ See for example *King v Telegraph Group Limited* [2004] EWCA Civ 613.

¹⁰⁴ See for example, *AB v Leeds Teaching Hospitals NHS Trust* [2003] EWHC 1034 QB and *Various Ledward Claimants v Kent & Medway HA* [2003] EWHC 2551 QB.

¹⁰⁵ *Willis v Nicolson* [2007] EWCA Civ 199.

¹⁰⁶ *Dawson v First Choice Holidays and Flight Limited* (unreported).

In *Dawson v First Choice Holidays* His Honour Judge MacDuff capped the claimants' future costs in a group action at 30 percent of the £726,000 estimate filed at allocation stage. Amongst a "multitude of factors" against the claimants was the fact that the claimants' solicitors were unable to provide a detailed breakdown of their costs, the level of which the judge described as "breathtaking," and the total costs to trial would have been disproportionate to the level of anticipated damages.

Periodical Payment Orders

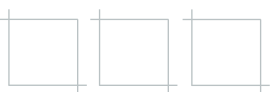
In the 2006 Update we reported on cases focused on indexation of periodical payment orders (PPOs) to cater for inflation and the test cases anticipated in *Flora v Wakom (Heathrow) Ltd.*¹⁰⁷ The principal issue was the index which should be applied to a PPO in respect of future care and case management costs.

The Court of Appeal heard four test cases, and on 17 January 2008, it handed down its unequivocal decision, frequently referred to as the *Thompstone* decision.¹⁰⁸ In a single judgment the Court of Appeal held that in each of the four cases the judges at first instance had properly indexed the PPO for future care and management costs by reference to the *Annual Survey of Hours and Earnings: Occupations Earnings for Care Assistants and Home Carers* (ASHE 6115). The argument made by the NHSLA – that PPOs should be linked to the retail price index as referred to in the legislation – led to the court making a general statement of principle:

*"We hope that as a result of these proceedings the National Health Service and other defendants in proceedings that involve catastrophic injury will now accept that the appropriateness of indexation on the basis of ASHE 6115 has been established after an exhaustive review of all the possible objections to its use, both in itself and as applied to the recovery of costs of care and case management. It will not be appropriate to re-open that issue in any future proceedings unless the defendant can produce evidence and argument significantly different from, and more persuasive than, that which has been deployed in the present cases. Judges should not hesitate to strike out any defences that do not meet that requirement."*¹⁰⁹

Of equal significance is that the decision establishes the principle that the form of compensation award the claimant should receive will be that which best meets a claimant's needs. Any split between lump sum and PPOs and the index to be applied must be that which best suits the claimant's needs, which are not restricted to "foreseeable necessities" and may include flexibility for the future. The claimant is expected to call and instruct an independent financial adviser whose expert advice will be given great weight by the court.

The upshot is that the court has the power to order PPOs, regardless of whether either party objects, and defendants may find themselves funding increasing periodic payments and keeping books open over a longer period of time.



¹⁰⁷ *Flora v Wakom (Heathrow) Ltd* [2006] EWCA Civ 1103.

¹⁰⁸ *Tameside & Glossop Acute Services NHS Trust v Thompstone* [2008] EWCA Civ 5.

¹⁰⁹ *Ibid.*

8

Coverage Issues Relating to Liability Insurance and Reinsurance Contracts

Cases

There were several decisions in 2007 relating to coverage issues affecting liability (re)insurance. Gloster J's judgment in *HLB Kidsons v Lloyds Underwriters*¹¹⁰ addressed the issue of the effect of a clause in a professional indemnity insurance policy issued to accountants which required notification of circumstances as soon as practicable. A number of issues important to the liability market were addressed in the comprehensive judgment, the effect of which was to deny cover to the accountants. We understand that the judgment is subject to appeal to be heard during 2008.

The decision in *Kajima UK Engineering Ltd v Underwriter Insurance Company Limited*¹¹¹ took a narrow interpretation of the notification made by the claimant engineering company to its professional indemnity insurers. The engineers had been involved in the design and construction of a block of flats. They notified their insurers that "accommodation pods were settling and moving excessively, causing adjoining roofing and balconies and walkways to distort under differential settlement." The professional indemnity policy expired. In the following years, it was established that there were a number of increasingly serious and extensive problems, some of which were in the physical areas of the matters notified. The Court held that the notification had only been effective in relation to the specific circumstances notified.

The case of *Brit Syndicates v Italaudit SPA*, reported in the 2006 Update, was heard by the House of Lords at the beginning of 2008. The Lords reversed the decision of the Court of Appeal and found that the non-disclosure by one insured (in this case, Grant Thornton Italy, which had undertaken an audit of a subsidiary of Parmalat) did not operate to deprive the "innocent" insured of cover.

The first instance decision in *Kosmar Villa Holidays Plc v Trustees of Syndicate 1243*¹¹² caused concern amongst insurers. Kosmar failed to notify insurers of a serious accident to one of its clients until more than a year after the accident happened. This was in breach of a condition precedent under the policy which required that notice be given as soon as possible. When first notified of the accident, insurers wrote to Kosmar asking questions about it. Less than two weeks later, insurers wrote to Kosmar again, reserving their rights to rely on the condition precedent. The Commercial Court found that in not reserving their rights initially, the insurers were acting as though they were dealing with the claim and had waived the right to rely on the condition precedent. At the beginning of 2008, the Court of Appeal allowed the insurers' appeal. The Court of Appeal found that breach of condition precedent led the insurers to be automatically discharged from liability so there was no question of waiver of any rights.

¹¹⁰ *HLB Kidsons v Lloyds Underwriters* [2007] EWHC 1951 (Comm).

¹¹¹ *Kajima UK Engineering Ltd v Underwriter Insurance Company Limited* [2008] EWHC 83(TCC).

¹¹² *Kosmar Villa Holidays Plc v Trustees of Syndicate 1243* [2008] EWCA Civ 147.

In *Tesco Stores Limited v Constable*, a case involving a public liability policy, the defendant insurers successfully argued at first instance and in the Court of Appeal that a payment made by Tesco to a railway company for loss of the railway's revenue (when the railway line became unusable following the collapse of a tunnel on top of which Tesco was building a new store) amounted to pure economic loss which was not recoverable under a public liability policy.

In the reinsurance sphere, a recent decision by the Court of Appeal¹¹³ in *AIG Europe (Ireland) Ltd v Faraday Capital Ltd* has clarified an anomaly created by the decision at first instance. AIG provided D&O insurance for an Irish company specialising in electronic learning courses. AIG placed reinsurance with Faraday. The Irish company faced a class action in the United States arising from the restatement of its accounts and fall in share value. That claim was settled. AIG claimed the US\$15m policy limit from Faraday. Faraday declined liability on the grounds that AIG had failed to notify the loss in accordance with a claims co-operation clause that required the reinsured to give notice to reinsurers as soon as practicable and within 30 days at the latest. Faraday argued that AIG may have known of the loss almost 18 months before Faraday was informed of it. The Court at first instance found that "loss" meant actual loss rather than alleged loss and that the matter only became notifiable when the loss crystallised following settlement or judgment. The anomaly created by this decision was that under the claims co-operation clause the reinsured was under an obligation to co-operate and provide all information to reinsurers but only after it had settled the loss or there was a judgment. The Court of Appeal preferred the interpretation that "loss" meant alleged loss with the result that Faraday was entitled to decline AIG's claim.

Two reinsurance cases of note involved "follow the settlement clauses." In *WASA and AGF v Lexington*, the underlying policyholder was a US company which had been ordered to clean up pollution and contamination of sites in the United States. The contamination had occurred over the 37-year period between 1943 and 1980. Lexington insured the US company for these types of loss for the three-year period 1977 to 1980. For the same three-year period, WASA reinsured Lexington's insurance. The reinsurance included a follow the settlements clause. Lexington was found obliged to indemnify the US company for the clean-up costs for the entire 37-year period by a US court. Lexington sought indemnity from WASA for all of the clean-up costs and relied on the follow the settlements clause. WASA argued it was only liable for the losses sustained between 1977 and 1980. At first instance the Commercial Court accepted WASA's arguments and concluded that, notwithstanding the determination by a US court, Lexington's insurance policy covered the 37 years worth of losses. As a matter of English law WASA's reinsurance policy did not provide cover outside the three-year period. This decision left Lexington with a significant gap in cover. The Court of Appeal reversed the first instance judgment,¹¹⁴ finding that where the wording in a contract of reinsurance was the same as or equivalent to that in the underlying contract of insurance the two contracts should be given the same construction, unless there were clear indications to the contrary.

¹¹³ *AIG Europe (Ireland) Ltd v Faraday Capital Ltd* [2007] EWCA Civ 1208.

¹¹⁴ 29 February 2008.

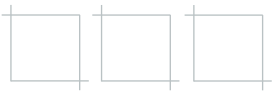
In *Aegis Electrical v Continental Casualty Company* the underlying insurance was against all risks of physical loss to an oil refinery. The reinsurance contained a follow the settlements clause but incorporated additional conditions which excluded losses caused by explosion. A claim was presented to reinsurers in relation to two settled claims. Reinsurers sought to deny cover for one of the losses on the basis of the explosions exclusion in the additional conditions. The reinsured argued that the follow the settlements provision precluded the reinsurer from disputing the factual basis on which the claim had been settled.

The Court found that the insurance and reinsurance were not fully back-to-back, partly because of the additional conditions incorporated into the reinsurance. The Court held that the reinsurer was entitled to question the factual basis of the loss.

Reform of Insurance Contract Law

As anticipated in the 2006 Update, the Law Commissions of England and Scotland continued their scrutiny of the changes deemed necessary to insurance contract law. Three issue papers were published during 2006 to 2007 (on misrepresentation and non-disclosure, warranties and intermediaries, and pre-contract law reform), and in 2007, the Law Commissions published a consultation paper on the reform of insurance contract law. More than 100 responses were submitted by the close of the consultation period in November 2007. A summary of the responses is to be published in 2008.

A distinction was drawn in the consultation paper between consumers and commercial enterprises. Amongst the proposals for consumer insureds were the abolition of the duty of disclosure and a distinction between the consequences of honest failures to disclose and negligent and dishonest ones, making the remedy proportionate to the extent of the disclosure. In business insurance it was proposed that the duty of disclosure be retained. The Commissions are consulting on whether the remedy of avoidance should be reserved for dishonest conduct alone. The Commissions are also proposing the abolition of the basis of the contract clauses whereby an insured warrants the truth of all the statements in a proposal form. The Commissions propose that an intermediary should generally be treated as acting for the insurer.



Work has already begun on the second consultation paper on insurable interests and the post-contractual duty of good faith.

9

Group Litigation

Group litigation in the UK continues to be of relatively minor significance, with future changes in European law likely to be the only way that US-style “class” actions will be implemented. This year saw several new group litigation orders granted in the UK, as well as developments in Continental Europe, including a proposed European class action settlement under Dutch law. There has been an increase in class action filings in the United States, including those related directly or indirectly to the subprime crisis and associated credit crunch.

United Kingdom

In the UK, several new group litigation orders have been issued in the past year. The majority of these orders, like the one involving the Atomic Veterans Group, involve a personal injury element. Others have involved consumers, as in the case of JJB Sports.

The JJB case settled on 9 January 2008, with the sports retailer having to pay more than £100,000 in compensation for consumers. The claim is most significant as the first brought successfully under new powers that allow “representative claims” on behalf of consumers. The claim was brought under the Enterprise Act 2002 by the consumer group Which? and heard by the Competition Appeals Tribunal. It involved consumers who had suffered as a consequence of the illegal fixing of the prices of replica football shirts.

While the claim was heralded as a success, the sum put aside by JJB is significantly less than the multi-million pound fine levied on them and other retailers in 2003 by competition regulators, which concluded that the companies had operated a price-fixing cartel. Furthermore, the case has raised procedural concerns regarding identification of claimants and distribution of the settlement monies, as group litigation in the UK still requires claimants to “opt-in” rather than to “opt-out” (as in the United States and some other countries who have true “class” actions).

In February 2008 the Civil Justice Council released research which uncovered “overwhelming evidence of the need for collective redress mechanisms”¹¹⁵ and will be recommending an opt-out class action procedure together with safeguards to avoid a proliferation of unmeritorious claims and US-style class actions.

The future of group litigation and, in particular, cases involving an anti-competition element, will likely be driven by the US plaintiffs’ firms, such as Cohen Milstein Hausfeld & Toll, which is pursuing a potential price-fixing action against Virgin Atlantic and the Grant & Eisenhofer firm, which settled the Royal Dutch Shell case.

Other consumer groups which may try to bring proceedings in the future, and which have in the last year, include those pursuing banks for excessive charges and anti-competition concerns regarding supermarkets, among others.

¹¹⁵ Civil Justice Council. *Reform of Collective Redress in England and Wales*, 8 February 2008.

One stumbling block to class actions being brought in the UK has been the availability of funding for the claims.¹¹⁶ With the emergence of larger, commercial markets for funding discussed elsewhere in this report, the situation may change.

United States

While the two biggest plaintiffs' law firms were rocked by the incarceration of key partners, reports indicate that there were 166 securities class action lawsuit filings in 2007, representing a 43 percent increase over the 116 filings in 2006. The 2007 total remains 14 percent below the average for the 10-year period ending in December 2006.¹¹⁷ A number of reasons have driven the increase, including stock market volatility and the subprime crisis.

Cornerstone Research counted 32 cases attributable to the subprime crisis, although other reports have suggested differing figures. There is also a split in opinion as to whether this crisis is "a likely 'one time' event," which "may not be indicative of future filing activity" or whether it will have some long-term ramifications for the D&O market. The United States has recently seen dozens of securities class actions issued against companies that lost share value as a result of the subprime crisis and the related credit crunch.

It is perhaps too early to tell, based on the figures from 2007, whether this upward turn in filings categorically proves that there was no permanent decline in securities lawsuit filings due to Sarbanes-Oxley and other factors.

Global Nature of D&O – EU into US and Vice Versa

In March 2007, a decision in *Re Vivendi Securities Litigation*¹¹⁸ confirmed that a class consisting of English, Dutch, and French shareholders could be certified as class participants in an action against the French company Vivendi Universal. Some reports also suggest that securities litigation against foreign companies has increased in 2007, but this needs to be balanced with the general upward trend of securities filings seen this year.

The US Plaintiffs' Bar has continued its search for foreign plaintiffs not only in the United States, with foreign-based institutional investors (predominantly hedge funds and pension funds) increasingly taking a leading role in class actions based in the United States, but also in actions based in the EU. One such action resulted in the first ever European securities class action settlement.¹¹⁹

European Union

Harmonisation across Europe in all aspects of law continues apace. Group litigation is potentially one of the most significant areas of harmonisation, with laws across the continent rarely in accordance with one another. Nevertheless, the European Commission has now voted in favour of a so-called European "Collective Redress Mechanism."

¹¹⁶ UK claimants against Vioxx have been unable to issue proceedings due to funding issues.

¹¹⁷ Cornerstone Research Securities Class Action Case Filings.

¹¹⁸ *In re Vivendi Universal SA Securities Litigation* 02-CV-05571.

¹¹⁹ See Royal Dutch Shell case, page 7.

At this early stage, such a mechanism is intended to be limited and apply only to consumer actions across Europe. It will allow consumers to seek redress without having to bring such actions on their own. Details of how such a mechanism might be implemented will need to be decided, but it is likely that any mechanism will not replicate the US system, as in many EU states contingency fees are not allowed and the loser of litigation pays the successful party's costs. Such conditions are likely to produce difficulties in bringing an action and make this less appealing than in the United States.

In April 2008, the European Commission in its white paper on private damages rejected US-style opt-out class actions as a vehicle for allowing individuals and businesses to sue over competition law breaches. It called on member states to consider modifying "loser pays costs" rules which it said were a deterrent to claims being made.



10

Education Claims

There were a number of cases relating to education before the courts during 2007. Human rights and specifically Article 9 (the right to freedom of religious expression) and Article 2 of Protocol 1 (A2P1, the right to an education) have been the primary focus of the courts this year within the context of education claims. These cases follow from the House of Lords ruling highlighted in the 2006 Update in *Ali v Lord Grey School* and *R (Begum) v Denbigh School* and have been applied in more recent cases.

The Right to Freedom of Religious Expression

In *R (on the Application of X) v Headteachers and Governors of Y School*,¹²⁰ the High Court supported the decision of a school not to allow a female pupil to wear a niqab (i.e., face veil), and the House of Lords decided that this did not infringe Article 9 ECHR. Similarly in *R (Lydia Playfoot) v Governing Body of Millais School*,¹²¹ the Court again supported the decision of the school not to allow a student to wear a silver purity ring, which she claimed was a symbol of her commitment to celibacy before marriage.

In the case of *Azmi v Kirklees Metropolitan Borough Council*,¹²² which received a great deal of publicity, the Employment Appeal Tribunal (EAT) upheld the decision of the Leeds employment tribunal that it had been lawful for a school to suspend a Muslim teaching assistant for refusing an instruction not to wear her veil when in class. The instruction to remove her veil was not direct discrimination on the grounds of religion or belief. Although it was indirectly discriminatory on that ground, it was lawful, being proportionate in support of a legitimate aim.

The Right to an Education

In *A v Essex County Council*,¹²³ the court found that pupils subject to a statement of special educational needs who had spent time away from school were unable to claim under A2P1 on the basis that they had not been denied the minimum education granted to them under that article. Although they did have a right to an education this did not extend to a right to be provided with an education of any particular type or in any particular school.

Disability Discrimination

There have also been several cases under the new Disability Discrimination Act (“DDA”), including *R v Independent Appeal Panel for Devon County Council*.¹²⁴ In this case, the High Court held that the decision of an appeal panel to uphold a pupil’s exclusion from his school in Devon was fundamentally flawed. The pupil, who assaulted a teacher, had Asperger’s Syndrome. A medical report specifically identified the danger of possible conflict with other people caused by his communication difficulties. The Court found that the panel had failed to consider issues arising under the Disability Discrimination Act 1995.

¹²⁰ *R (on the Application of X) v Headteachers and Governors of Y School* [2007] EWHC 298 (Admin).

¹²¹ *R (Lydia Playfoot) v Governing Body of Millais School* [2007] EWHC 1698 (Admin).

¹²² *Azmi v Kirklees Metropolitan Borough Council* [2007] ICR 1154.

¹²³ *A v Essex County Council* [2007] EWHC 1652 (QB).

¹²⁴ *R v Independent Appeal Panel for Devon County Council* [2007] EWHC 763 (Admin).

Race Discrimination/Victimisation

In *Appiah v Bishop Douglass School*,¹²⁵ the Court of Appeal found that, in claims of race discrimination and victimisation, the mere establishment of a difference of race and treatment was not enough to cause the burden of proof to be transferred to the defendant under the Race Relations Act,¹²⁶ and if a claimant had not at least established facts from which a prima facie case of discrimination could be inferred “on racial grounds” then no burden was transferred.

Statistics from the Office of Independent Adjudication

Litigation by students in higher education is a growing field within education law. The Higher Education Act 2004 established a new framework for the external adjudication of complaints brought by students via the Office of Independent Adjudication (OIA). One consequence of the establishment of the OIA appears to be that there have been far fewer judicial reviews against institutions. The number of complaints the OIA has received by students against universities has risen for the third consecutive year.

In 2007, applications to the OIA rose by 25 percent, to 734 from 586 in 2006. Twenty-six percent of complaints were upheld to some extent, up slightly from 2006. Compensation of £173,000 was recommended to be paid to complainants. Thirty-six percent of the complainants were postgraduates (although only 23 percent of UK students are postgraduates), and 64 percent were over 25 years old. Sixty-four percent of the complaints related to academic results and disciplinary matters. Plagiarism accounted for 11 percent. Students in subjects allied to medicine (but excluding medicine itself) formed the largest group of complainants.

The decision of the OIA is not binding, however, and issues have arisen as to whether the OIA is compliant with Article 6. Several judicial review hearings are in the process of challenging the findings of the OIA.



¹²⁵ *Appiah v Bishop Douglass School* [2007] EWCA Civ 10.

¹²⁶ 1976 s. 57ZA.

11

Product Liability

RAPEX

RAPEX is the EU rapid alert system for all dangerous consumer products, with the exception of food, pharmaceutical, and medical devices. It allows for the rapid exchange of information between member states and the Commission relating to measures taken to prevent or restrict the marketing or use of products posing a serious risk to the health and safety of consumers. Both measures ordered by national authorities and measures taken voluntarily by producers and distributors are covered by RAPEX.

The 2007 RAPEX report¹²⁷ confirmed that 1,485 restrictive measures concerning dangerous products were reported through RAPEX in the period of January 2007 to November 2007, compared with 947 notifications in 2006, representing a 57 percent increase. Of the 1,261 notifications of products posing a “serious” risk, 51 percent originated from China whilst 2 percent originated in the UK. Of the serious risk notifications, 31 percent related to a toy product and very often implied a choking or chemical risk. The second most frequently notified category of product was motor vehicles, which accounted for 15 percent of all notified products, followed by electrical products which accounted for 12 percent of notifications. Twenty-three percent of all notifications listed “injuries” as the type of risk, 15 percent listed electric shock, and 15 percent also listed choking.

Product Recall

Merck, which has been accused of delaying the recall of its Vioxx painkiller drug (which it is suggested increases the chances of a heart attack), has faced legal fees

As a result of the many toy recalls during 2007, the European Commission proposed in January 2008 to strengthen EU rules relating to the use of chemical substances in toys and the safety of toys. They also proposed to replace and or modernise the 20-year-old Toys Directive.¹²⁹ Their objectives are to:

Establish new and higher safety requirements to cope with recently identified hazards.

Strengthen manufacturers’ and importers’ responsibility for the marketing of toys.

Enhance the market surveillance obligations of member states.

The Commission proposal will now be discussed with the European Parliament and the Council of Ministers.

of US\$500m a year to defend lawsuits brought against it. In early 2008, the company offered to pay US\$4.9bn to settle 26,000 lawsuits in the United States. Potential claimants in the UK have yet to issue proceedings due to problems with funding and the limitation period has been extended by agreement. The total cost of the Vioxx problem is currently estimated at US\$8bn.

In August 2007, Mattel recalled more than 21 million potentially dangerous toys manufactured in China. By December 2007, Mattel recalled a further 155,000 toys made in Mexico because of fears that small pieces could break off and cause young children to choke.¹²⁸

¹²⁷ European Commission Health and Consumer Protection Directorate-General “RAPEX Statistics (1 January – 30 November 2007).”

¹²⁸ BBC News, 6 November 2007.

¹²⁹ Toys Directive 88/378/EEC of 3 May 1988.

Magnets

Magnets are an emerging risk in toy manufacturing. Magnets have become smaller, more powerful, and more easily detachable. With children swallowing magnets detached from toys, several accidents have occurred worldwide, as well as hundreds of consumer complaints, incident reports, and several RAPEX notifications.

On 28 February 2008,¹³⁰ member states in the General Product Safety Directive (GPSD) Committee approved a Commission proposal for toys containing magnets to carry a mandatory warning label across the EU. Regulations giving effect to the Commission Decision made in April 2008 came into force in the UK on 21 July 2008.¹³¹

Research/Studies

The University of Essex, with funding from Mobile Telecommunications and Health Research Programme, has conducted research that has shown that mobile phone masts, whether they use GSM or UMTS systems, are not responsible for the ill health they have been blamed for (e.g., anxiety, nausea, and fatigue). The study showed that only five out of 114 control participants could tell whether the signal from the masts was on or off.

New research by Israeli scientists claims that mobile phone signals can activate cell division, central to the growth of tumours, even at very low power levels. UK government guidance that mobile phone use is safe is based on the more generally accepted assumption that electromagnetic radiation from devices such as mobile phones could only cause health hazards as a result of heating. However, the new research claims that handsets can trigger potentially harmful changes to cells irrespective of temperature changes.

Acrylamide, which can form in a range of foods while they are being cooked and has been shown to cause cancers in animals, has been cleared of causing breast cancer. Following a 20-year study of 100,000 nurses, a research team in the US found that the risk of breast cancer was not affected by the amount of acrylamide-rich food consumed.

The European Commission recently ordered a rewrite of its report calling for more risk assessment of nanotechnology in order to make the report more easily understood. Nanotechnology is the science of manipulating matter at one hundred-thousandth the width of a human hair to create new materials and products. The publication of a summary of the report indicates that nanotechnology will have a big impact on the food industry, so industry players and consumers need to understand the subject. The original report, issued by the EC's Scientific Committee on Emerging and Newly Identified Health Risks in 2006, concluded that more analysis of nanotechnology is needed, as its effect on human health is still largely unknown.

¹³⁰ EUROPA article 28 February 2008, http://ec.europa.eu/consumers/dyna/rapex/rapex_archives_en.cfm.

¹³¹ *The Magnetic Toys (Safety) Regulations 2008 No. 1654.*

A University of California study has reignited the row over the safety of hormone replacement therapy (HRT) by linking it to breast cancer. Millions of women worldwide abandoned HRT after research published in 2002 linked it to an increased risk of heart attacks, stroke, and various cancers, though other studies later contradicted those findings. The new study claims the drop in breast cancer rates corresponds with the decline in the use of HRT.

More than two-thirds of young people who regularly use MP3 players may face premature hearing damage because the volume is too high, a charity has warned. A spokeswoman for the UK's Royal National Institute for Deaf People said that last September the organisation had written to 55 manufacturers of MP3 players and mobile phone manufacturers asking them to put clearer warnings on packaging about the dangers of listening to their products at high volumes.

2007 Cases

In *Ide v ATB Sales Limited*,¹³² the High Court found an importer of a bicycle liable for injuries suffered by a cyclist when the handle bars sheared. Under the Consumer Protection Act (which implements the Product Liability Directive) the claimant was not required to provide proof of what caused the weakness in the handle bars; the fact that the handle bars was defective was sufficient.

In March 2007, The House of Lords ruled that a buyer who returns defective goods for repair retains the right to reject the goods, even if those goods have been fully repaired, if the seller refuses to tell him what the fault was in the first place. In *J & H Ritchie Ltd v Lloyds Ltd*,¹³³ the appellant purchased a harrow from the respondent. This was returned for repair due to a fault that occurred. When asked what had been done to repair the item, the respondent refused to provide this information. The Court found that, as the appellants had not been given the information they needed to decide whether to accept or reject the equipment, they were entitled to reject the equipment even though the respondents had later been able to prove the repair had been carried out to a satisfactory standard.

EU Framework

The EU regulatory framework toughened in 2007. As reported in this review under Environmental Liability Regulations on the Registration, Evaluation and Authorisation of Chemicals, REACH¹³⁴ came into force in June 2007. The consequences of REACH include the fact that consumer products companies doing business in the EU may be obliged to change the formulation of their products. Testing and modelling conducted under REACH may provide evidence that a substance used in a product may pose serious hazards to humans or environmental health that were not previously known. Although it is expected that REACH may dramatically increase some businesses' product liability exposure, apportionment of these risks may be addressed by way of warranties, indemnities, or insurance.

¹³² *Ide v ATB Sales Limited* [2007] All ER (D) 238 (Jul).

¹³³ *J & H Ritchie Ltd v Lloyds Ltd* [2007] 2 All ER 353.

¹³⁴ (EC) No 1907/2006.

As a result of the General Product Safety Directive, manufacturers must notify the relevant authority of a defective product risk within seven days of recognizing it. Failure to do so could result in a fine of up to £5,000, as well as a prison sentence of up to three months. Moreover, as reported in the 2006 Update national authorities can now initiate a product recall of their own accord. Statistics show that the number of recalls in the UK has gone up significantly since the introduction of the General Product Safety Regulations 2005.

Corporate Manslaughter and Homicide Act

The Corporate Manslaughter and Homicide Act 2007 came into force on 6 April 2008. The act specifically provides that the supply of goods or services will give rise to the relevant duty of care and puts product manufacturers and suppliers in the line of fire for claims.



12

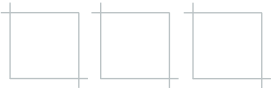
International Law: Choice of Law Applicable to Torts and Forum Shopping

Rome II

The much-debated legislative process for regulation of the law applicable to non-contractual civil liability (“Rome II”) was finally completed in July 2007. From 11 January 2009, it will be directly applicable in the courts of all member states, with the exception of Denmark, and no national implementation is required.

The objective of Rome II is not to harmonise the actual law of member states, but to harmonise the rules that determine which country’s law applies to non-contractual disputes. This will increase legal certainty on the law applicable to tortious disputes. The regulation will introduce for the first time a single set of rules throughout the EU to determine which country’s law applies to non-contractual disputes. The underlying principle of Rome II is that the applicable law should be determined on the basis of where the damage occurred rather than where the harmful act took place.

This is subject to certain exceptions, though. The law applicable to defamation and privacy will continue to be governed by the private international law of individual member states.



13

Capital Measurement and Standards

Basel II

On 1 January 2007, the FSA's final rules and guidance implementing the Capital Requirements Directive (CRD) in the UK came into effect. Basel II and CRD recognise new and continuing developments in financial products, incorporate advances in risk measurement and management practices, and assess regulatory capital charges in relation to risks.

The Basel II framework consists of three pillars. Pillar I sets out the minimum capital requirements firms will be required to meet to protect themselves from credit, market, and operational risk. Pillar II allows firms and supervisors to decide whether the firm should hold additional capital against risks not covered under Pillar I. Finally, Pillar III greatly increases the disclosures that a bank must make.

Pillar I has the greatest impact on the insurance market with respect to calculating the operational risk that a bank faces. There are three approaches that can be considered, namely: the Basic Indicator approach which is aimed at smaller institutions, the Standardised Approach, and the Advanced Measurement Approach (AMA). The AMA requires banks to use their own operational risk models to determine their capital needs and then negotiate an agreement with regulators. Banks which adopt the AMA gain the ability for capital calculation to recognise the mitigating effect of insurance in reducing operational risk exposure. If a bank holds regulatory capital to protect against operational risks and also has insurance covering some of the same risks, Basel II allows the bank to reduce the amount of capital that it sets aside. The insurance in question must meet qualifying criteria in order to provide the requisite security to allow for the reduction in capital. The Basel II committee has provided broad guidelines to help regulators decide whether insurance is adequate and comprehensive. If risk mitigation can be proved, supervisors could allow a reduction of up to 20 percent of the minimum capital requirement.

In November 2007, the US Office of the Comptroller of the Currency announced that it approved a final rule implementing the advanced approaches of the Basel II Capital Accord. Before it can become effective in the United States, the rule must also be approved by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, and it must be published in the Federal Register.

Solvency II

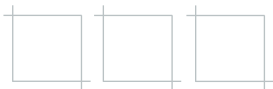
The European Commission jointly with member states is carrying out a fundamental review of the regulatory capital regime of the insurance industry. Solvency II aims to bring about a fundamental overhaul of the rules which govern European insurance companies.

Solvency II uses the concept of three pillars, reflecting the Basel II approach, namely quantitative capital requirements, qualitative risk management requirements, and supervisory review and market discipline.

In July 2007, the European Commission published a draft Solvency II framework directive. The framework directive presents the preliminary views of the EC on the supervision of insurance and reinsurance undertakings that will replace Solvency I, which dates back to 1970. This provides a good indicator of what the directive will include when implemented in 2012. Solvency II takes a risk-based approach to regulatory capital requirements, and the published directive makes it clear that the regulation will allow insurance entities to adopt modern market-based methods for the valuation of assets and liabilities. The assessment will be qualitative as well as quantitative, and it gives insurers an incentive to measure and monitor their risks and have their capital requirements determined by this risk assessment. The framework directive recognises internal models in setting both economic capital and regulatory capital requirements. In the UK, insurers are already subject to individual capital adequacy standards (ICAS) requirements which were introduced in 2004 and are accordingly at an advantage compared to other member state regulators who thus far may have no experience in supervising a regime along the lines required by Solvency II.

Group Supervision

Solvency II also aims to streamline the supervision of insurance and reinsurance groups across the EU. The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the European insurance and pension regulator, is working towards application of a common framework and peer review between supervisors to ensure consistent and harmonised application of the systems.



14

Tail of Liability Business

In the 2006 Update, we considered in outline issues which might affect the length of the tail of some of the different classes of liability business. As reported last year, factors that may influence the length of the tail include the basis on which the insurance is written (e.g., claims-made or occurrence-based; the nature of the risk written, including whether it incorporates any element of personal injury; the policy wording used; the territorial limits of the policy; the duration of the judicial process from issuing a claim to trial and any applicable limitation period; and related law).

In policies with territorial limits in the UK, claims made under, for example, professional indemnity or D&O policies, will normally be brought within six years of the date of breach (in the case of contract), six years from the date of damage, or three years from the date of knowledge (in tort). These are subject to a 15-year-long stop period. Claims arising from product liability will normally have a long stop period in the UK of 10 years from the date the product was put into circulation by the manufacturer.¹³⁵ In Scotland the limitation period is generally five years, subject to a 20-year-long stop period. The case law as to when damage is suffered or the relevant knowledge acquired has not changed significantly recently.

Policies involving cover for bodily injury and disease, such as employers' liability (EL) and public liability (PL), may have the longest tails. Such policies are written on an occurrence basis. Personal injury claims in the UK are subject to a time limit of three years from either the date on which the cause of action accrued or from the date of knowledge of the claimant to bring a claim. There is no applicable 15-year-long stop period and the UK courts can disapply any limitation period at their discretion.

A v Hoare [2008]

A landmark decision by the House of Lords at the beginning of 2008 in *A v Hoare*¹³⁶ suggests that victims of sexual abuse may be able to sue their attackers even though a claim is outside a six-year deadline. This case concerned whether a convicted rapist, who later won £7m on the lottery, could be sued by his victim. Previously, abuse claimants had six years to bring an action, but the Lords in *A v Hoare* decided that this was wrong. Instead, they found that the limitation period should be only three years but, significantly, that the courts would have a discretion to extend the period when equitable to do so.

This is likely to have implications for both employers and their insurers. A previous decision in 2002, in *Lister v Hesley Hall Ltd*,¹³⁷ ruled that sexual abuse was not necessarily outside the scope of employment – it depended upon whether there was a sufficiently close connection between the work which the employee had been employed to do and the acts of abuse. Employers could therefore be held liable (in damages) for

¹³⁵ However, see the second reference made by the House of Lords to the European Court of Justice in *O'Byrne v Aventis Pasteur SA* [2008] UKHL 34 in relation to whether the substitution of a new party outside the 10-year-long stop period is compatible with the EU Product Liability Directive.

¹³⁶ *A v Hoare* [2008] UKHL 6.

¹³⁷ *Lister v Hesley Hall Ltd* [2002] 1 AC 215.

the acts of abuse of their employees. Now, potentially, they can also be held liable for cases where the abuse occurred decades ago when the courts find it equitable to extend the three-year time limit. A judgment of the House of Lords in May 2008,¹³⁸ albeit an appeal from the Scottish Court of Session, suggests that only in exceptional circumstances will the time limit be extended, potentially curtailing the impact of Hoare on insurers.

The decision of the House of Lords in the Grieve case that claimants could not recover damages for pleural plaques may have provided some comfort to insurers. It remains to be seen whether the UK legislature will succumb to political pressure to legislate with retrospective effect that damages are recoverable in relation to this issue.



Overall, UK claims involving a personal injury element are likely to have the longest tail.

¹³⁸ Bowden (AP) v Poor Sisters of Nazareth and others (Scotland) [2008] UKHL 32.

15

Conclusions

The big economic story of 2007 was the subprime mortgage crisis in the United States and associated credit crunch. This has already had serious implications in the United States.¹³⁹ It remains to be seen how these issues will impact the UK liability market in 2008. It is speculated that new classes of claims may arise. One example is that of potential claims for negligence against the credit ratings agencies who have been rating the credit default swaps and collateralised debt obligations (CDOs) under which banks have been transferring the credit risk for subprime mortgage lending.¹⁴⁰

The number of claims being filed at court has levelled out, and the increase in the number of mediations taking place and successful resolutions of disputes at or shortly after mediation is increasing. The result is that the tail for professional liability claims has been shorter recently than in previous years. D&O claims which were highlighted as a burgeoning area in the 2006 Update have lived up to predictions. Commentators have suggested that a string of corporate collapses is likely in 2008, as debt-laden private equity deals begin to unravel.

The independent regulation identified as a key trend in 2006 has led to a change in the regulation of different professions in 2007. There is no evidence yet as to whether the independent regulators will raise standards within the professions or lead to an increase in the number of claims by proactive regulation in the manner of the FSA. Regulators could invite consumers to make claims or insist that professionals review their files and write to affected clients.

Whilst the difficulties in bringing class actions in the UK (due principally to funding problems) were highlighted in the 2006 Update and borne out in 2007, it remains to be seen whether the increased appetite for commercial litigation funding referred to in this report will assist groups of claimants in bringing class actions.

The courts' concerns about and criticism of the expense and complexity of litigation continued to be expressed in 2007. There has been an increased willingness to hold parties to costs estimates and to impose costs capping orders. With the news that the courts are consulting over the idea of fixed costs in very large cases it is clear that this issue will not be far from the top of the agenda of procedural reform.

¹³⁹ Fifty US lenders have filed for bankruptcy already.

¹⁴⁰ The heads of Citicorp and Merrill Lynch have already had to leave their jobs as a result of problems with CDOs.

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