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Don't waste my time!

The credit crunch and resulting economic fallout has already led to a marked increase in litigation. As with any downturn, losses flow and claims against the professionals involved will follow. Worrying developments in one particular area of law suggest such claims may be larger than ever before. Robbie Constance and Daniel Hemming consider recent case law which means that claimants can now recover the cost of wasted management and staff time.

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Claimants are increasingly seeking to recover for wasted management and staff time as part of their claims for business interruption caused by negligent advice, even where no additional expenditure or loss of profits is proved. Recent case law confirms that this is an increasingly recognised head of damage, and the previous burden to prove actual disruption is slowly being relaxed.

In *R+V Versicherung AG v Risk Insurance & Reinsurance Solutions SA & Others*[1], R+V had employed both external consultants and its own staff in investigating and mitigating a conspiracy perpetrated by the defendants. As one would expect, the claim for the expense of employing the external consultants was not challenged; the dispute concerned R+V's claim for the costs of internal staff time, where no loss of profits had been proved.

...the court concluded that the "*cost of wasted staff time spent on the investigation and/or mitigation of the tort*" was ...recoverable...

An earlier decision[2] had suggested that there could be no recovery of such costs in the absence of proof of additional expenditure or loss of profits, since staff, even if they had been diverted from their ordinary activities, would have been paid anyway and, therefore, the claimant had suffered no loss. In *R+V* this reasoning was rejected and the court concluded that the "*cost of wasted staff time spent on the investigation and/or mitigation of the tort*" was a recoverable head of damage in its own right. The court added the proviso that the burden fell squarely on the claimant to demonstrate with reasonable certainty that the wasted time was directly attributable to the defendant's acts. Further, there needed to be significant disruption to the claimant's business and significant diversion of staff from normal activities.

The judgment in *R+V* was approved by the Court of Appeal in *Aerospace Publishing Ltd and Midsummer Books Ltd v Thames*

Water Utilities Ltd[3]. This claim included wasted staff time in dealing with the flooding of the claimant's premises by a burst water main. The Court of Appeal rejected the part of the claim relating to the costs of employing two ex-employees on a freelance basis, whose activities had included the drafting of witness statements. These were identified as costs in the action, rather than damages. It then concluded that the earlier authorities concerning the recovery of staff time established three propositions:

1. The fact and extent of the diversion of staff from normal business activities had to be properly established by the claimant;
2. The claimant had to show that this diversion of staff had caused significant disruption to his business; and
3. Although, strictly speaking, claims ought to be cast as loss of revenue resulting from diversion of staff, it was reasonable for the courts to infer that diverted staff would have generated revenue at least equal to the cost of employing them.

In *Bridge UK.com Ltd v Abbey Pynford Plc*[4] the court developed the principle still further and allowed a claim for wasted staff time based merely on the retrospective assessment of the employee in question. The employee estimated that he had spent 128 hours in dealing with the problems created by the defendant's negligence. The court held that the claimant was entitled to recover the cost of 100 of the estimated 128 hours, making a 'discount' to allow for the imprecision of the quantification.

The evidential burden on the claimant was further relaxed in the case of *Aziz Al-Rawas v Pegasus Energy Ltd & Others*[5]. The court accepted that the claimant had failed to produce any evidence of disruption to their business, but decided that "*the application of common sense may fill the gap*". Since it was obvious that the defendant's actions would have disrupted the claimant's business there was no need for it to produce any specific evidence. Notably, the court also reaffirmed the important distinction between staff time spent on preparation of the claim itself and staff time spent in investigating or mitigating the problems caused by the defendant, confirming that the former remains irrecoverable either as damages or as costs in the litigation.

Large financial institutions that have considerable in-house technical, consultancy and legal resource are likely to … exploit these developments when pursuing claims against their external advisers

In *4 Eng Ltd v Roger Harper & Another*[6] the claimants were again able to recover damages for staff time spent investigating the defendants' fraudulent activities. However, this was not under the *Aerospace* 'business disruption' head. The claimant had initially formulated its claim as one for business disruption, seeking to recover time spent by two of its directors dealing with the matter. The claimant later located a board resolution which resolved to provide additional remuneration to the two directors for work undertaken in investigating the fraud. The court agreed that the claimant had incurred an additional liability to its directors for which it was entitled to be compensated. The change of pleading had a significant impact on the amount which was eventually recovered. The original business disruption claim had been calculated on the basis of the directors' salaries at a total of just £279,879. The claim based on the higher board approved hourly rate increased the quantum to £711,200 (of which £624,888 was eventually recovered).

This last decision creates obvious cause for concern. It could pave the way for larger claims to include the time costs of existing staff engaged in investigating or mitigating problems as a new and separate liability for damages. Claimants will argue that this is fair compensation reflecting the costs which would otherwise be incurred hiring external consultants. Others may create sham devices to give the appearance of additional costs with which to exaggerate their claim and increase nuisance or negotiation value. We await with interest the judicial consideration this case receives and the treatment of wasted staff time in claims against accountants and other professionals arising out of the credit crunch. Large financial institutions that have considerable in-house technical, consultancy and legal resource are likely to seek to exploit these developments when pursuing claims against their external advisers.

On the bright side, the distinction remains clearly drawn between costs incurred in investigation and mitigation and costs incurred dealing with the claim and litigation itself. There is no immediate danger of the courts allowing recovery for the time of staff spent, for example, preparing witness statements. Further, the requirement that there must be a significant disruption to the claimant's business should remain a barrier to some claims under this head. Though the courts appear willing, in clear cases, to infer this from other evidence, it should still be difficult to establish where the claimant operates a very large business and where the problem only effects a discrete part of it. Much will depend on claimants having the foresight to keep complete contemporaneous records of “wasted” staff time. However, in these unprecedented times claims seeking to recover substantial sums for wasted management and staff time are increasingly likely to succeed.

[1] [2006] EWHC 42
[2] *Admiral Management Services Ltd v Para-Protect Europe Ltd* [2002] 1 WLR 2722
[3] [2007] EWCA Civ 3
[4] [2007] EWHC 728
[5] [2008] EWHC 617
[6] [2008] EWHC 915

Casenotes

Notifying a circumstance – Kidsons revisited

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The Court of Appeal recently handed down its judgment in the *Kidsons* case[1]. In 2007 the High Court held that Kidsons, a former firm of accountants, failed to adequately notify its professional indemnity insurers in relation to a number of claims involving tax planning advice. See our November 2007 Update for a report on the first instance decision.

The issue was whether Kidsons had adhered to the terms of its policy. The notification clause required Kidsons to notify underwriters "*as soon as practicable of any circumstance of which they [the Insured] shall become aware during the [policy period] which may give rise to a loss or claim against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after expiration of the [policy period] shall be deemed for the purpose of the Insurance to have been made during the [policy period]*".

A Kidsons employee had highlighted a number of issues regarding the implementation and design of a number of tax planning products to senior Kidsons employees. Kidsons later purported to make a number of notifications of circumstances.

The Court of Appeal largely upheld the High's Court decision, but its judgment addressed two important issues: first, how to make a valid notification and secondly, when a notification needs to be made (ie when did the circumstance arise).

Rix LJ held that a valid notification required that the recipient be left "reasonably clear" that the communication was intended to be a notification of circumstances. Kidsons had made a valid notification based on Rix LJ's formulation, but the notification referred only to the "implementation" of their tax planning schemes, failing to cover the schemes' inherent merit or design. This in turn has created fresh uncertainty as to which claims, or parts of claims, are covered, dependent on the distinction (if any) between design and implementation.

On the second issue, the parties in Kidsons agreed on the circumstance which required notification. However, the Court of Appeal commented on this point, stating that the requirement to notify "*as soon as practicable of any circumstance of which they [the Insured] shall become aware*" was an objective determination. Rix LJ doubted whether the internal concerns raised by the employee, without objective support, such as counsel's opinion or an internal investigation, were enough to equate to a circumstance when taken in isolation.

The Court of Appeal's judgment remains pro-insurer but serves as a stark reminder to notify circumstances fully and soon after a 'circumstance' arises.

[1] *HLB Kidsons (A Firm) v Lloyds Underwriters & Ors* [2008] EWCA Civ 1206

Costs guidance – conduct is vital

The High Court has recently set out some basic costs principles in the context of the long running Wembley stadium dispute[2]. Multiplex was the main contractor on the Wembley project and brought a claim against its sub-contractor Cleveland Bridge UK Ltd (CBL). Judgment had been given on the preliminary issues, but arguments continued regarding quantum and costs.

A number of offers to settle had been made by both parties, but there were no global offers made by either party, nor did CBL make any Part 36 offer. The Court awarded Multiplex, the overall "winner" in the dispute, 10% of its costs, which the Court doubled to take account of CBL's behaviour. The Court was particularly influenced by CBL's failure to make a global offer.

A number of pointers on costs can be drawn from the broad principles laid down by Jackson J:

- As a general rule, the successful party should recover its costs in full, although this is only a starting point.
- In many cases, the court can and should reflect the relative success of the parties on difficult issues by making a proportionate costs order.
- The court will have regard not only to any Part 36 offers made, but also to a party's approach to settlement and general conduct in the litigation.
- A heavier onus rests on the defendant to make an offer.

The court confirmed that the ruling in *Lisa Carver v BAA plc*[3] (see our May 2008 Update) on the application of the new Part 36 rules can be applied to settlement offers in general. In *Carver* the claimant beat the defendant's Part 36 settlement offer by a minimal amount. The court ruled that although the claimant had beaten the offer numerically, she had not succeeded in obtaining a "*more advantageous*" judgment as required under the new Part 36 rules. In *Multiplex*, the court confirmed that if a party makes an offer under Part 36 or a settlement offer in relation to which the court has a discretion as to costs, and that offer is nearly but not quite sufficient, and the other party rejects that offer without any attempt to negotiate, it may be appropriate to penalise the second party in costs.

Above all the decision illustrates that costs orders can be unpredictable and parties need actively seek to settle proceedings at a realistic level to maximise costs protection.

[2] *Multiplex Constructions (UK) Limited v Cleveland Bridge UK Limited and Another* [2008] EWHC 2280 (TCC).
[3] [2008] EWCA Civ 412.

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FRC warns that accounts must show liquidity risks

The Financial Reporting Council (FRC) has warned that executives must pay more attention to the risks disclosed in their accounts this year, due to the difficult market conditions that have left many companies close to liquidity problems. JJB Sports, Woolworths (to which administrators have now been appointed) and Taylor Wimpey have all recently reported "*material uncertainties that may cast significant doubt*" on their ability to remain a going concern. Although such a disclosure does not mean that a company can no longer continue trading, it does serve to warn of problems in the future.

The FRC has already identified goodwill accounting as a particular area of concern. Companies must write off some goodwill if the acquisition is thought to have permanently fallen in value. It is expected that a full report will soon be issued on this topic.

Northern Rock decides not to pursue claims against directors or auditors

The former Chief Executive of Northern Rock and many of his fellow directors have escaped legal action following the collapse of the bank. The nationalised bank also announced that it would not sue its auditors, PricewaterhouseCoopers. The Chairman of Northern Rock confirmed that the move had the full backing of the Government and he explained that there were "*insufficient grounds*" to sue the directors. No action was said to be "*warranted*" against the auditors. Interestingly, the two hedge funds suing over Northern Rock's collapse, RAB Capital and SRM, are now suing the Government, not the former directors or auditors.

FRC publishes revised guidance on audit committees

The FRC has published revised guidance to listed companies on the composition, role and responsibilities of the audit committee. The guidance highlights the risks which can occur when an external auditor leaves the market. It also suggests that more information should be given in a company's annual report detailing how an auditor was selected, as well as providing guidance on the considerations which need to be made when engaging firms from more than one network to work on the audit.

Lord Justice Rupert Jackson to head civil litigation cost review

Jackson LJ has been appointed to head a review of civil litigation costs. He will be assisted by members of the judiciary, representatives of the wider legal profession and an economist. The panel is expected to submit its recommendation to the Master of the Rolls by December 2009. It will consider whether procedural changes to the costs system could bring about more proportionate costs, as well as looking at the effect case management procedures have on costs. According to Robert Musgrove, chief executive of the Civil Justice Council, the timing of the review is inevitable as we approach the tenth anniversary of the Woolf Reforms.

European Commission adopts changes to mitigate consequences of financial turmoil

Following unanimous consent of Member States, the Commission has adopted amendments to accounting standards. The amendments are intended to mitigate the consequences of the volatile financial markets and to ensure that European companies have the same flexibility as their US counterparts to reclassify assets held-for-trading into the held-to-maturity category. These changes will apply from the third quarter of 2008.

The Commission has also decided to adopt the consolidated text of all International Financial Reporting Standards (IFRS) in force in the EU. This will simplify and dramatically reduce the administrative burden on EU businesses.

The International Accounting Standards Board has published guidance on the application of fair value measurement when markets become inactive, and this has been welcomed by the Commission. Like other recent changes this puts the EU on a "*level playing field*" with the US.

RPC news

We are delighted to announce that our financial services and regulatory team has been strengthened by the arrival of new Partner, Steven Francis. Steven joins RPC from the FSA where he was a manager of one of the FSA's wholesale enforcement teams dealing with cases of criminal insider dealing and market abuse, and investigating the control environments within large banks and investment insurance firms. Steven was previously a partner in DLA Piper's regulatory group and has dealt with criminal and regulatory investigations brought by a range of state agencies, including the FSA, the Serious Fraud Office, the police and the Health & Safety Executive.

Our next Breakfast Briefing is on Wednesday, 11 March 2009. Details of the topic and speakers will follow but please note the date for now. For more information, please contact us at seminars@rpc.co.uk.

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Accountancy Update is a summary of recent developments. It should not be regarded as a substitute for advice on how to act in any particular case. For further information please contact one of the editors.
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