

Accountancy Update

April 2010

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Case notes

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The Court of Appeal has ruled that without prejudice material is inadmissible as an aid to construing a settlement agreement. [More...](#)

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Firm news

Note that the date of our next Breakfast Briefing has changed! It will now take place on Tuesday 22 June. [More...](#)

Any comments or queries?

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Round-up

Our Round-up section includes reports on the FRC's appearance before the Treasury Select Committee, the appeal by Jeffrey Skilling, the former Chief Executive of Enron, and the Government's plans in the recent Budget to cut down on tax avoidance. [More...](#)

As part of our commitment to corporate social responsibility we are proud to support The Anthony Nolan Trust as our current Charity of the Year (www.anthonynolan.org.uk).

This 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 authors.

Can claimants restart the limitation clock?

We are seeing more and more attempts by claimants to argue that, having performed their original retainer, their professional advisers came under a continuing duty to provide ongoing advice, a breach of which means that the clock starts ticking again for limitation purposes. In this article, Jane Howard and Ian Gordon explore the circumstances in which a court is likely to conclude that an adviser was under a continuing duty to advise.

In common with other potential defendants, professionals have a legitimate interest in being saved from having to defend “stale claims.” Recognising this interest, the law lays down strict time-limits by when proceedings have to be issued – the general rule being that proceedings must be commenced within six years of either (i) the relevant breach of contract or act of negligence, or (ii) the date on which loss was suffered.

The law also recognises circumstances in which the fact that a claimant has a cause of action that might not be apparent at the time, and gives a would-be claimant a further three years from when it acquired (or should have acquired) knowledge of various facts relevant to its cause of action within which to bring proceedings.

However, even with this further time, claimants sometimes struggle to persuade the court that the claim has been issued in time and, in any event, for public policy reasons, the law imposes a long-stop period of 15 years from the date the negligence was committed or damage was sustained by when proceedings have to be issued.

Faced with these difficulties, we have recently seen – in the context of claims against accountants and actuaries in particular – attempts by claimants to “buy more time” by arguing that the professional was under a *continuing duty* to advise the client, a breach of which gave rise to a new cause of action and started the clock ticking all over again for limitation purposes.

This is a complex area, but how is a court likely to approach continuing duty cases, and is there anything a professional can do at the outset to minimise the scope for such arguments later being asserted?

To take the simplest scenario, attempts by claimants to say that the professional committed a fresh act of negligence by failing to tell its client that it had been negligent in its original advice, will almost certainly fail.

In *Midland Bank Trust Co Ltd v Hett Stubbs & Kemp*¹, in the context of a negligence claim against a firm of solicitors, the court concluded that:

“It is not seriously arguable that a solicitor who... has acted negligently comes under a continuing duty to take care to remind himself of the negligence of which...he is unaware.”



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It was implicit that the situation would have been different if the solicitor had later become aware of his own negligence. This was confirmed in *Ezekiel v Lehrer*² in which the Court of Appeal considered, again, the context of a claim against a firm of solicitors, that:

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“Assuming that the solicitor has the duty to advise his client that he has been negligent, or advise him to seek alternative advice to establish whether or not he has been negligent, that duty can only arise if the solicitor knew or ought to have known that he was guilty of an earlier breach of duty...”

In any event, if a professional later discovers that he has been negligent, and fails to draw this to his client's attention, it may be possible for the client to rely on the deliberate concealment provisions of the Limitation Act, which would give the client a further six years from when it discovered that the professional had concealed its negligence within which to bring proceedings.

Short of actually realising that he had been negligent, are there are other circumstances in which a professional must come under a continuing duty to advise, or a failure to do so might give rise to a fresh cause of action?

In *Parker Fine Art Ltd v Houghton*³, the court was considering a claim against a valuation surveyor who had been involved in a composite tax mitigation transaction. Having acknowledged the general proposition that a professional has no continuing duty to revise all the advice he may have given in the past, the court stated that:

“... it may perhaps be open to question whether, if advice is given on Day one, and on the very next day the adviser learns of a fact which wholly invalidates what he has advised, whether he is not under a duty to communicate that to his client”.

Whilst there was no duty to review the valuation, there might be a duty to advise if it transpired that any of the assumptions upon which the valuation had been made, and on which the plans were proceeding, were shown to be false.

Although the courts have not called it such, it seems that, in order to establish the existence of a continuing or subsequent duty to advise, it is necessary to establish a “trigger event”. A typical scenario we are coming across more and more, particularly in the context of claims against actuaries, relates to unsuccessful attempts to amend the rules of a pension scheme in accordance with instructions given by the Employer and the Trustees. Quite apart from possible negligence surrounding the initial drafting of the Deed of Amendment, we are finding that claimants are arguing that, with each subsequent actuarial valuation, the actuary came under a fresh duty to consider whether the original attempted change had been effective and, if not, to advise its clients accordingly.

It is not difficult to see how such a question might also arise in the context of claims against accountants and other professional advisers.

In *New Islington & Hackney Housing Association v Pollard Thomas & Edwards*⁴, the court had to consider an architect's defective sound insulation design. The court recognised that, in the absence of an express term or express instructions, the architect was not under

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a duty specifically to review the design of the foundations, unless something occurred to make it necessary, or at least prudent, for a reasonably competent architect to do so. The judge said that the courts should be reluctant to conclude that claims which have otherwise become statute-barred could be resurrected on the basis that, at a time within the limitation period and less than six years before the issue of proceedings, the architect committed a fresh breach of duty.

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However, the court did recognise that:

“...a specific duty might arise if, before completion, the inadequacy of the foundations causes the building to show signs of distress; or if the architect reads an article which shows that the materials that he has specified for the foundations are not fit for their purpose; or if he learns from some other source that the design is dangerous.”

In such circumstances, the court said that the architect would be under a duty to review the design, and, if necessary, issue variation instructions to the contractor to remedy the problem.

In *Gold v Mincoff Science & Gold*⁵, the court had to consider a claim against a firm of solicitors. The court said that it should not be too easily persuaded by the claimant that he has a fresh cause of action against his solicitor on the basis that the solicitor failed to advise, at some point after his initial negligence, that he had been negligent. However, the court went on to conclude that:

“... if the subsequent instruction was also negligently implemented by the solicitor, and, this later negligence concealed the earlier negligence then, subject to normal questions such as causation and remoteness, if the earlier negligence only comes to light outside the limitation period, the loss of the right to sue in respect of it can properly be the subject of a claim based on the later negligence.”

Perhaps the last word from the judges can be left with His Honour Judge Richard Seymour QC, who put the matter most eloquently in *Tesco Stores Ltd v Costain Construction Ltd & others*⁶. An architect was sued for the negligent design of fire-stopping measures. The judge said that:

“In the ordinary conduct of human affairs a task which is considered to have been completed satisfactorily is put behind one as the next task is embraced. To expect someone in real life continuously to review what he or she is doing is to expect them to be paralysed into substantial inactivity by anxious traversing of old ground until eternity.”

As shown, arguments based on continuing duties will be difficult to establish. However, as a matter of risk management, what can be done to minimise the risk of such an argument being run?

One approach you might consider adopting (and one that tax accountants already use fairly routinely) is to insert a clause in your terms of engagement stating that the advice is provided on the basis of your understanding of your clients' requirements and the state of the law and practice as at the date the advice is being provided, and no obligation is assumed to update that advice thereafter without a specific request from the client (which may then in turn become the

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subject of a whole new retainer).

If, however, the time has already passed for such contractual measures, and if, having given your advice, you later discovered that your advice might have been wrong, you should (strictly speaking) draw this to the attention of the client and recommend that they seek independent advice. Failure to do so might well give rise to a fresh cause of action, leading to the clock starting to tick over again.

In any event, a failure to tell the client may well, if you are an accountant, be a breach of your duty to act with integrity and to avoid any action which discredits the profession (a “Fundamental Principle” enshrined in the ICAEW’s Code of Ethics).

Footnotes

1. [1979] 1 Ch. 394
2. [2002] Lloyd’s Rep PN 260
3. (18 February 1999)
4. (2001) BLR 74
5. [2001] Lloyd’s Rep PN 423
6. [2003] EWHC 1487 (TCC)

Case notes

Court refuses to give summary judgment on the basis of the illegality defence

In *Griffin v UHY Hacker Young & Partners*¹ the court dismissed an application for summary judgment on the basis of the *ex turpi causa* (or illegality) defence, and made a number of observations as to uncertainties in the law as it stands.

The claimant had been convicted of a strict liability offence under section 216 of the Insolvency Act 1986. He alleged that the defendants failed to advise him that his conduct might contravene section 216. The defendants applied for summary judgment on the basis that the illegality defence was a complete defence to all of the claimant’s claims.

Vos J decided that the defendants could not show that there was no real prospect of the claimant defeating the illegality defence. Vos J considered what level of culpability or negligence is required to be proved where the illegality defence is raised on the basis of an offence of strict liability:

- The existing authorities “do not speak with one voice” on what level of culpability is necessary for the illegality defence to succeed (and Vos J wondered if a “one size fits all” determination would be appropriate, given the range of strict liability offences).
- The use of the terms “gross”, “culpable” or “crass” negligence are unhelpful – the courts appeared to be searching for “some ill-defined element of culpability beyond negligence”.

Vos J felt that he should not decide these questions by summary judgment, and concluded that there must be a trial of the claim to fairly decide the outcome of the case.

FSA successfully appeals decision on foreign regulator’s request for assistance

The Court of Appeal held in *Amro International SA and Creon Management SA v FSA*² that the FSA is not required to satisfy itself of the correctness of what it is being asked to investigate by a foreign regulator or the basis upon which the investigation was asked for.

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The claimants were financing companies based in offshore jurisdictions. The SEC were investigating the activities of their New York investment adviser and had brought civil proceedings on the basis of an alleged short selling fraud. The SEC requested assistance from the FSA in obtaining documents from Goodman Jones Chartered Accountants, who held documents relating to the claimants. The FSA asked the SEC to clarify why the documents were relevant when the claimants were not parties to the action, and then compelled the production of those documents.

At first instance, Collins J held that where the request for assistance is based on the need to assist in a claim, the nature of the claim is of fundamental importance. He held that the FSA should have decided that the wide scope of discovery requested was not necessary or proportionate. We reported on the first instance decision in our December Update:

<http://www.rpc.co.uk/FileServer.aspx?oID=780&IID=0>

The Court of Appeal allowed the FSA's appeal. It held that it is of the greatest importance that national financial regulators co-operate, particularly where there are suspicions or allegations of financial fraud or other misconduct. The FSA is entitled to "accord full faith and credit" to a foreign regulator. The FSA is not required to satisfy itself of the correctness of what it is being asked to investigate and it was not incumbent on the FSA to examine the SEC's request critically.

The proper test to be applied by investigators when considering whether to exercise powers under section 171(2) FSMA was whether the production of documents sought is "relevant to the purposes of the investigation". This is a low hurdle.

Court rules that a liability cap excludes statutory interest

In *Markerstudy Insurance Company Limited v Endsleigh Insurance Services Limited*⁸ a limitation of liability cap in a contract did not apply to limit statutory interest awarded by a court for breach of contract.

The limitation clause stated that: "Endsleigh's total liability in contract... shall be limited to the aggregate amount of fees received". David Steel J held that contractual interest is clearly a "liability in contract" and would be within the cap on liability. Statutory interest is of a different character – it is a discrete statutory liability arising from the exercise of the court's discretion and was excluded from the cap.

Without prejudice material is inadmissible as an aid to construing a settlement agreement

The Court of Appeal has ruled that without prejudice "WP" material is inadmissible as an aid to construing a settlement agreement⁴.

The settlement agreement had been reached following WP discussions. At first instance, Andrew Smith J ruled the WP discussions were admissible, relying on an exception

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outlined in *Unilever v Proctor & Gamble Co*, namely that WP communications resulting in a compromise agreement are admissible when the issue is whether the agreement was concluded. We reported on this first instance decision in our October 2009 Update:

<http://www.rpc.co.uk/FileServer.aspx?oID=759&IID=0>

Reversing that decision, the Court of Appeal held that the WP material was inadmissible. The general rule against admission of WP exchanges was based on the policy that negotiating parties should not be discouraged by fear of subsequent litigation.

The policy behind the WP rule conflicts with the policy of having the best and most useful evidence available to the court, but that conflict cannot be resolved merely by saying the latter policy trumps the former. The question is whether the logic of the rule requires the exclusion of the evidence which it is sought to admit. In this case, the Court of Appeal decided that it was more important to preserve the WP principle than to allow it to be breached in order to permit the admission of background facts arguably relevant to construction.

Round-up

FRC Appearance before the Treasury Select Committee

The Financial Reporting Council's chief executive, Stephen Haddrill, appeared before the Treasury Select Committee in February, where he was questioned on a number of topics likely to dominate the FRC's agenda in the coming year.

Questions put to him included ones on the Big Four's overt desire to increase fee revenue from non-audit services; lack of transparency over the proportion of audit to non-audit fees for blue chip companies; and concerns over lack of competition in the market.

Haddrill made clear that the FRC would be keeping a close eye on the ratio of audit to non-audit fees, but noted that the growth of non-audit fee revenue was not, of itself, indicative of failings in the regulatory system. He suggested, for example, that the growth of non-audit fees would relate only to firms' non-audit clients. No doubt the FRC will be monitoring this topic particularly closely over the coming year.

Enron Appeal

In the US, Jeffrey Skilling, former Chief Executive of Enron, currently serving a 24 year prison sentence for conspiracy and fraud, has commenced his appeal against his conviction. Skilling maintains that the statute under which he was convicted, the honest services law, is so vague as to be unconstitutional. The law makes it a crime for public officials or other individuals to deprive others of the *'intangible right to honest services'*.

Skilling's lawyers argue that prosecutors are using the law to criminalise a business failure. Adam Hoffinger, of Washington law firm Morrison & Foerster, is reported to have said that the law was *'the most brazen and obvious attempt to criminalise behaviour that may be bad, but that would not otherwise be considered criminal'*. A decision is expected next month. Should Skilling's appeal be

Footnotes

1. [2010] EWHC 146 (Ch)
2. [2010] EWCA Civ 123
3. [2010] EWCH 281 (Comm)
4. *Oceanbulk Shipping & Trading SA v TMT Asia Limited* [2010] EWCA Civ 79,

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Round-up continued...

successful, it would pave the way for others convicted under the law, including Lord Black, former owner of the Daily Telegraph, to mount appeals.

iSoft

Ian Storey, former Financial Controller of iSoft Group plc, has been excluded as a member of the ICAEW for a minimum period of eight years and ordered to pay £20k costs to the AADB following a disciplinary hearing.

Mr Storey accepted that between November 2003 and November 2005 he had repeatedly provided false and misleading information to iSoft's former auditors in relation to a purported iSoft contract. The FSA has brought criminal proceedings against four former directors of iSoft. The AADB has declined to publish the report of the Disciplinary Tribunal relating to Mr Storey, on the basis that its disclosure is not in the public interest given the criminal proceedings. The AADB has said, however, that this situation will be kept under review.

Budget 2010

The Government pledged to clamp down on the avoidance and evasion of tax in this year's Budget. The moves will include a clampdown on double taxation relief moves, income tax advantages gained by securities transactions, stamp duty avoidance, and the strengthening of disclosure rules for tax planning schemes. The Government has said that such moves would yield some £1.5bn in additional tax. Tax advisers have expressed concern that the measures will adversely impact smaller, more vulnerable businesses.

The Future of UK GAAP

The Accounting Standards Board (ASB) has published the 150+ high quality responses to its policy proposal 'The Future of UK GAAP' on its website. The proposal was issued in August 2009 and sets out recommendations for the future reporting requirements for UK and Irish entities, focusing on moving UK GAAP towards an international framework. The ASB plans to host an event, or events, for discussion and comment on the responses later this year, prior to producing an outline of the Board's recommendations. The ASB has stated that it will work closely with the Department for Business Innovation & Skills on this matter.

Firm News

Note that the date of our next Breakfast Briefing has changed! It will now take place on **Tuesday 22 June**. Jane Howard and other members of our Professional Risks team will be looking at fraud and the duty to detect it in the context of audit services. To register your interest please email us at seminars@rpc.co.uk.

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