

## The scope of *Sephton*: limitation where you don't get what you ought.

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In *AXA Insurance Limited v Akther & Darby Solicitors & Ors*<sup>1</sup> Flaux J clarified the extent to which the House of Lords decision of *Law Society v Sephton*<sup>2</sup> changed the law in relation to when actual damage is suffered in tort. This is of considerable interest to professional liability practitioners, and it reduces some of the uncertainties caused by *Sephton*.<sup>3</sup> When actual damage is suffered is a question of fact specific to each case, but the Judge made it clear that where a solicitor owes a duty to bring about a transaction with particular characteristics or features, if upon completion the transaction is flawed because those characteristics or features are absent, then the client suffers actual damage on the date of the transaction. The fact that the flaw in the transaction means that inherent in it is a risk which in one sense is contingent, as it may or may not occur, does not mean that accrual of the cause of action is suspended until that contingency occurs.

### The nature of the claim and the relevance of limitation

*AXA Insurance Limited v Akther & Darby Solicitors & Ors* arose from a litigation funding scheme extremely similar to that which triggered The Accident Group litigation. Axa pursued the claim by virtue of rights assigned to it by the National Insurance and Guarantee Corporation ("NIG"). Under the litigation funding scheme, NIG provided ATE (After the Event) legal expenses insurance to members of the public who had various kinds of claim which they wished to litigate but could not fund from their own pocket. The scheme ran from October 2000 until August 2003. NIG issued about 40,000 ATE policies in respect of claims conducted by some 170 firms of panel solicitors. Its participation in the scheme proved financially disastrous.

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<sup>1</sup> [2009] EWHC 635 (Comm).

<sup>2</sup> [2006] 2 AC 543

<sup>3</sup> On which see H. Evans: "Contingent liability and 'damage'" [2006] 23 PN 2.

Axa brought the proceedings against 89 firms of panel solicitors, alleging that they acted in breach of duty to NIG in accepting and/or thereafter conducting some 26,000 claims. The proceedings were issued on 17 June 2008 and related to ATE policies which incepted from April 2001 onwards. Of those, 7,383 policies incepted more than six years before issue. The panel solicitors contended that any claim against them in respect of those policies was time barred both in contract (an issue which was not pursued), and, more importantly, in tort. Flaux J ordered the trial of a preliminary issue on limitation and that trial and his judgment were based on assumed facts.

### **The assumed facts**

NIG employed an agent, Composite Legal Expenses Limited ("CLE"), to act as coverholders in issuing ATE policies and to provide claims management functions. CLE in turn entered into agreements with panel solicitors governing the role they would have in the handling of claims under the scheme. Part of the role performed by the panel solicitors was the vetting of claims which members of the public wished to pursue and wished to be supported by ATE insurance. In order to be accepted under the scheme, claims had to have at least 51% prospects of success and be for a minimum amount of £1,000. Once a claim was accepted, CLE acting on behalf of NIG would issue an ATE policy of insurance to the person who was to bring the claim ("the Scheme Claimant"). In conjunction with the policy, a funder would grant a loan to the Scheme Claimant which would be the source for payment of the premium for the ATE policy. NIG also entered into agreements with the funders under which it agreed to indemnify the funder in respect of the loan in certain circumstances, for example where NIG avoided the ATE policy for misrepresentation.

AXA alleged that the panel solicitors owed two sorts of duties to NIG. The first was to vet and only take on Scheme Claims that had (i) greater than a 50% prospect of success and (ii) a likelihood of damages of £1,000 ("vetting duties"). The second was to conduct cases with reasonable care and skill thereafter. This duty was said to fall into two relevant categories. First a duty to notify NIG of Scheme Claims for withdrawal of indemnity where (i) the prospects of success fell below 50% and/or (ii) it became clear that damages would not

exceed £1,000. Second, a duty to conduct claims with due care and diligence (“conduct duties”).

Axa further alleged that by reason of panel solicitors’ breaches of these duties, NIG suffered loss and damage.

In relation to breach of the vetting duties, the loss and damage was the amount paid by NIG to the relevant funder to discharge the Scheme Claimant’s loan and/or other amounts paid pursuant to the ATE (eg. the successful party’s costs) when a Scheme Claim failed. In relation to breach of the conduct duties the loss was either the extra interest and/or disbursements incurred during the period where a Scheme Claim was wrongly continued, or the lost opportunity of securing a successful outcome at trial or settlement and so avoiding a call on the NIG Policy, where a Scheme Claim should have been brought to a successful conclusion.

### **The preliminary issues**

Flaux J ordered the trial of the preliminary issues to determine, in relation to both the alleged breaches of the vetting duties (“the vetting breaches”) and the conduct duties (“the conduct breaches”), when time started running under the Limitation Act 1980 for the purposes of any cause of action asserted by Axa. The arguments focused on when NIG suffered actual damage for the purposes of starting time for Axa’s claims in tort. The major issue concerned the alleged vetting breaches, which were financially far more significant.

### **The Vetting Breaches**

The panel solicitors, represented by Sue Carr QC, argued that NIG suffered actual damage upon the inception of the various ATE policies and that therefore all claims based upon policies incepted more than 6 years before Axa issued its claim were time-barred. It was submitted that *Sephton* had not changed the law, was to be approached with caution and given a narrow interpretation. They argued that if NIG was committed, as a consequence of a vetting breach, to an ATE policy with 50% prospects of success or less, then although NIG retained the net premium, it acquired in exchange a Scheme Claim which was less valuable

(in terms of the ability to generate recovery from the other side) than it should have been, meaning that actual damage was suffered immediately.

In contrast, Axa, represented by Charles Hollander QC, argued that one could not give *Sephton* a narrow interpretation, it had set out the principles relevant to the determination of when actual damages was suffered and that applying those principles to Axa's claim it could not be said that actual damage had been suffered until a Scheme Claim had actually failed. Until then, it was said, the liability of NIG was wholly contingent since even if failure of a Scheme Claim with less than 50% prospects of success was likely, there was still a chance that it might not. On this basis it was said that, pursuant to *Sephton*, this contingent liability was to be disregarded in assessing when actual damage had been suffered. Axa argued that the claim against the panel firms was indistinguishable from *Sephton* and the decision of the House of Lords in that case was the answer to the preliminary issue.

Axa submitted that one could discern from *Sephton* three categories of case in this area:

- (1) Where as a result of the defendant's negligence, the claimant has incurred a potential liability which may or may not accrue, that potential liability is a contingent liability, and is not to be considered as amounting to loss to the claimant unless and until the contingency occurs, however likely it is to occur (category 1 cases). It accepted that this analysis did not apply where there has also been some separate 'damage' to the claimant's assets upon entry into the transaction, which it submitted was the correct explanation of cases such as *Forster v Outred & Co* [1982] 1 WLR 86.
- (2) Where it was the defendant's duty to bring about a transaction having particular characteristics or features, and it was possible for the defendant to fulfil that duty, but due to his negligence, the claimant entered a different transaction lacking one or more of those features, actual damage may be suffered on inception of the transaction where the assets (tangible or intangible) obtained under the transaction may properly be viewed as 'damaged or defective goods'.

- (3) Where the position is that, but for the defendant's negligence, the claimant would not have entered into the particular transaction at all, the claimant will suffer loss only when the balance between the value of the liabilities acquired under the particular transaction and the value of any assets obtained thereunder becomes negative.

Axa argued that NIG fell within the first of these categories, because until a Scheme Claim failed NIG's liability under the ATE policy was purely contingent. Alternatively, the claim fell into the third of these categories, but that in comparing the value of the liabilities and assets obtained by NIG upon accepting a Scheme Claim and issuing an ATE policy one ought to ignore the liability side of the equation because the relevant liabilities in this case (the possibility of a scheme claim failing) were contingent.

Flaux J accepted that there was no remit for giving *Sephton* a narrow interpretation and that the House of Lords had clarified the law on limitation where as a result of a breach of duty a claimant was exposed to a "purely contingent liability standing alone"<sup>4</sup> that is a liability unconnected to a transaction to which he has been committed and which does not affect the value of any asset he owns. However, in all other material respects Flaux J rejected Axa's submissions and found for the panel solicitors.

In particular he held that:

- (1) While the analysis of cases into categories might be helpful in identifying a strand of authority that was most relevant, there were "Any number of cases [that emphasised] that whether or not actual damage has been suffered is, in each case, a fact specific question, an approach which by definition militates against analysis of the cases into...rigid categories...".<sup>5</sup> Moreover, even if one were to attempt categorisation of the sort proposed by Axa, a valid distinction could not be drawn between (i) cases where a claimant entered a flawed transaction and received damaged or defective rights and (ii) cases

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<sup>4</sup> See para 19 of the Judgment.

<sup>5</sup> See para 21.

where, but for the defendant's breach, the claimant would not have entered the transaction at all. Referring to *Nykredit v Edward Erdman* [1997] 1 WLR 1627, he pointed out that in many cases where a claimant would not have entered a transaction but for his solicitor's breach, on an analysis of the facts it could be seen that loss was nonetheless suffered on the date of the transaction: "*Neither of the House of Lords decisions [in Nykredit nor SAAMCO [1997] AC 191] is authority for the proposition that merely because, had the correct advice been given or the negligent professional defendant performed his duty, the claimant cannot as a matter of law have suffered actual damage when the flawed transaction was entered.*"<sup>6</sup>

- (2) There was nothing in *Sephton*, when properly analysed, that led to the conclusion that the date upon which NIG suffered actual damage as a consequence of vetting breaches was suspended until a Scheme Claim had actually failed. *Sephton* was applicable to cases where a claimant was exposed to a purely contingent liability standing alone, but this was not such a case.
- (3) If one had to categorise Axa's case, it would fall into the second of the categories they proposed in the sense that the duty the panel solicitors were alleged to have been under in tort was a duty to bring about a transaction with particular characteristics or features, i.e. to take reasonable care to vet claims so as to ensure that CLE accepted and ATE policies were issued in respect of only those claims whose prospects were more than 51%.
- (4) Axa's claim fell within the line of decisions of the Court of Appeal running from *Forster v Outred & Co* [1982] 1 WLR 86 to *Shore v Sedgwick Financial Services* [2008] PNLR 37 the effect of which, as Lewison J most recently summarised it in *Pegasus Management Holdings v Ernst & Young* [2009] PNLR 11 at paragraph 74 is as follows: "*it is firmly established at the level of the Court of Appeal that, in a professional negligence case, the client suffers*

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<sup>6</sup> Para 37.

*damage if he does not get what he ought to have got*". The fact that the flaw in the transaction means that inherent in it is a risk which in one sense is contingent, because it may or may not occur, does not mean that the accrual of the cause of action is suspended until that contingency occurs (if it does). When the professional's duty is to procure that a transaction had a particular characteristic or feature, and in consequence of his breach of duty it does not, the cause of action accrues on entering the transaction. In this case NIG was committed to a series of flawed transactions in the form of policies where the prospects of success were less than 51%. Therefore, NIG was exposed to a greater degree of risk than what it was entitled to expect if the panel solicitors had complied with their duty. Accordingly, NIG suffered actual damage when committed to the flawed policy and thus exposed to the greater risk.

Of particular interest is the reasoning behind Flaux J's rejection of Axa's argument that because accepting Scheme Claims only exposed NIG to a contingent liability, actual damage was not suffered on entering the transaction. In making this submission, Axa relied upon Lord Hoffmann's approval of the following passage from *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 529, 532 and 532, which he said provided the answer to the appeal in *Sephton*:

*"[Forster v Outred is explicable] by reference to the immediate effect of the execution of the mortgage on the value of the plaintiff's equity of redemption... It has been contended that the principle underlying the English decisions extends to the point that a plaintiff sustains loss on entry into an agreement notwithstanding that the loss to which the plaintiff is subjected by the agreement is a loss upon a contingency. For our part, we doubt that the decisions travel so far. Rather, it seems to us, the decisions in cases which involve contingent loss were decisions which turned on the plaintiff sustaining measurable loss at an earlier time, quite apart from the contingent loss which threatened at a later date... If... the English decisions properly understood support the proposition that where, as a result of the defendant's negligent misrepresentation, the plaintiff enters into a contract which exposes him or*

*her to a contingent loss or liability, the plaintiff first suffers loss or damage on entry into the contract, we do not agree with them. In our opinion, in such a case, the plaintiff sustains no actual damage until the contingency is fulfilled and the loss becomes actual; until that happens the loss is prospective and may never be incurred."*

Axa argued that this passage supported their case that, as the consequence of the panel solicitors' negligence was to expose NIG to a contingent liability, actual damage was not suffered until the relevant contingency was actualised because the relevant claim had failed. Flaux J rejected this interpretation of the passage and emphasised that the point made in *Wardley* could not be taken too far, and did not represent the answer to the limitation position in relation to Axa's claim or cases like it. He pointed out that when Lord Hoffmann approved this passage of *Wardley* in *Sephton* he was not purporting to deal with 'flawed transaction' cases, which he addressed elsewhere in his speech, and in relation to which he expressly approved both *Bell v Peter Browne & Co*<sup>7</sup> and *Knapp v Ecclesiastical Insurance*.<sup>8</sup> These cases clearly establish that where a defendant's duty was to procure that a transaction had a particular feature, actual damage may well be incurred when the transaction was entered because the claimant had not got what he should have got, even if further damage may be incurred because the flaw in the transaction is still contingent. Flaux J pointed out that Lord Hoffmann himself highlighted the distinction between purely contingent liability cases, such as *Sephton*, and 'flawed transaction' cases in paragraphs 30 and 31 of his speech in *Sephton*:

*"30 In my opinion, therefore, the question must be decided on principle. A contingent liability is not as such damage until the contingency occurs. The existence of a contingent liability may depress the value of other property, as in Forster v Outred & Co [1982] 1 WLR 86 , or it may mean that a party to a bilateral transaction has received less than he should have done, or is worse off than if he had not entered into*

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<sup>7</sup> [1990] 2 QB 495.

<sup>8</sup> [1998] PNLR 172.

*the transaction (according to which is the appropriate measure of damages in the circumstances). But, standing alone as in this case, the contingency is not damage.*

*31 The majority of the Court of Appeal appear to have decided the case on the basis that the Law Society did not enter into any transaction giving rise to the contingent liability. It did nothing and the contingent liability was created by the misappropriations and the previous existence of the compensation fund and the rules which governed its administration. No doubt in most cases in which a party incurs a contingent liability as a result of entering into a transaction, that liability will result in damage for the reasons already discussed in relation to bilateral transactions. But I would prefer to put my decision on the simple basis that the possibility of an obligation to pay money in the future is not in itself damage.”  
(emphasis added)*

As well as analysing *Sephton* Flaux J considered the case of *Companhia de Seguros Imperio v CE Health*<sup>9</sup>, which had not been cited in *Sephton* and was relied on by the panel solicitors as the leading case on when damage in tort is suffered by a commercial insurer. While agreeing with Axa that *Imperio* needed to be approached with caution, because limitation in tort was not in fact a live issue in that case, Flaux J considered that the following reasoning of Langley J at pages 586-7 was persuasive, not contrary to *Sephton*, and consistent with the Court of Appeal’s decisions in *Forster v Outred*, *Moore v Ferrier* and *Bell v Peter Browne*:

*“The questions whether and when damage is suffered are questions of fact .... But the receipt of something less valuable or the transfer of something of value without an agreed protection is itself damage. There must be actual damage within the measure of damage applicable to the wrong in question for the cause of action to accrue but an increase in a plaintiff's obligations plainly may constitute such actual damage. Nor is it relevant that the damage may later become more serious or capable of more precise quantification...Insurance is the business of undertaking risk for reward. An insurer who is committed to a greater risk than agreed for no reward has thereby suffered a real loss.”*

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<sup>9</sup> [1999] Lloyd’s Rep IR 571.

Finally, Flaux J reviewed the cases on limitation in this area since *Sephton* and considered these strongly supported the conclusion that in the case of the vetting breaches, actual damage was suffered by NIG when each ATE policy inception.<sup>10</sup>

### **Conduct Breaches**

As to the conduct breaches, Flaux J held that the alleged failures in notifying NIG when the prospects of Scheme Claims fell below 50%, or its value fell below £1,000, could be analysed in the same way as the vetting breaches and that actual damage was suffered at the point where there was a failure to notify: “...which is when NIG was exposed to a greater degree of risk than intended, even though it was not until a later stage when the relevant claim actually ‘failed’ that NIG would pay out more on the claim than it had received net premium.”<sup>11</sup> The Judge further held that, in relation to the alleged failures to carry on cases with proper care thus losing NIG the opportunity of securing a successful outcome at trial or by favourable settlement, actual damage was suffered when as a consequence of a breach there was a material diminution in the prospects of a Scheme Claim’s success.

### **Conclusion**

*Axa* is of interest because it illustrates and explains the limits of *Sephton* and the continued relevance of authorities prior to *Sephton*. It is a clear demonstration that merely because a claimant’s loss consists of a contingent liability that he would not have been exposed to had he been properly advised, this does not mean that actual damage can only be suffered when the contingency occurs. Rather, it is necessary to consider what was the scope of a professional’s duty of care. If the professional was obliged to take reasonable steps to ensure that a transaction was free from a certain flaw, then his client will suffer loss if he enters into a transaction that possesses that defect. The fact that the flaw in question is a risk that may or may not occur, does not mean that accrual of the cause of action is suspended until that contingency occurs. Flaux J’s reminder that each case must be

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<sup>10</sup> *Poole v HM Treasury* [2007] Lloyd’s Rep IR 114; *Watkins v Jones Maidment Wilson* [2008] PNLR 23; *Spencer v Secretary of State for Work and Pensions* [2009] 2 WLR 593; *Shore v Sedgwick Financial Services* [2008] PBLR 37; *Pegasus Management Holdings v Ernst & Young* [2009] PNLR 11

<sup>11</sup> At paragraph 97.

approached on its own facts is pertinent, but his judgment will undoubtedly assist practitioners on how to apply the law to those facts.