Pelican
Underwriting

T: 0207 933 9368
enquiries@puml.co.uk
pelicanunderwriting.com

The Pelican Brief

Risk insights and intelligence

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2019 risk trends for Solicitors

This edition of the Pelican Brief focusses on risks for solicitors' firms, both current and emerging. We also look at developments in doubling ground rent claims, some recent court decisions on scope of duty and exposure to opponents' costs, and finally we provide a summary of parties' new obligations pursuant to the Disclosure Pilot in the Business and Property Courts.

Kennedys

There are three developing risks that we believe are highly likely to pose challenges to law firms over the coming year:

1. GDPR

The commencement of the General Data Protection Regulation on 25 May 2018 represented the largest overhaul of U.K. data protection laws in 20 years. Firms now face an ongoing challenge to ensure that their systems and processes are adequate to comply with GDPR's stringent requirements. The repercussions for a failure to comply are serious, with the ICO possessing a discretionary power to fine a firm up to 4% of its annual global turnover. With 46% of law firms reporting a loss or leakage of confidential information in 2018 (up 13% on 2017), the risk posed by GDPR moving forwards should not be overlooked.

Of particular concern to firms should be the increasing use of Data Subject Access Requests by both clients and third parties (such as beneficiaries). We have seen a rising number of SARs made by claimants' solicitors for the purpose of causing disruption/nuisance in litigation, or as part of an effort to obtain early disclosure. Firms should have procedures in place to enable them to identify and comply with requests within the one-month time limit. The recent £15,000 fine awarded against SCL Elections Ltd shows the serious consequences of failing to do so.

A good cyber insurance policy should help firms to manage a number of the risks and requirements created by GDPR.

2. Brexit

Brexit continues to pose a significant risk to law firms operating across all areas. Its potential impact on the economy and on the regulatory environment within which firms operate remains largely unknown. Firms should have contingency plans in place to ensure that they can adapt quickly to any challenges that they or their clients face. Such plans should be specific to the firm's areas of practice and should be capable of withstanding any eventuality. It is advisable to monitor the guidance notes being published by the Law Society on the potential consequences for each area.

3. Cyber Crime

Cyber attacks continue to present a growing concern to law firms of all sizes, irrespective of their area of practice. According to the Law Society, in 2018 60% of law firms reported an information security incident – an increase of almost 20% on the previous year. Confidential client data and significant sums held on client accounts make law firms an attractive target for cyber criminals. The consequences of an attack can be severe due to the serious financial and reputational damage that can be caused. A number of high-profile data leaks in 2018 and the commencement of GDPR have resulted in the average client becoming significantly more aware of their potential entitlement to compensation for a breach.

Cyber crime can take many forms and it is not just IT systems that are targeted. The number of social engineering attacks (where employees are tricked into divulging sensitive information) are on the rise. It is crucial that firms have robust procedures and up-to-date systems in place, and that staff are trained on how to spot and avoid potential frauds.

Doubling ground rent claims – an update

Recent press reports have continued to highlight problems being faced by some purchasers of leasehold interests, particularly those in new build residential properties, due to the inclusion of onerous "doubling" ground rent clauses in the leases.

We have seen a significant increase in claims against conveyancers for failing to provide adequate explanation of the impact of these clauses to their purchaser clients. The first issue which should be explained to clients is that the doubling ground rent provision means that over the lifetime of the lease, the owner of the property can end up paying more in ground rent than they paid for the actual property.

The second problem is that some of the UK's largest mortgage lenders have refused to grant mortgages to purchasers of leasehold properties that include such a clause where the ground rent exceeds 0.1% of the value of the property, making properties virtually unsellable.

Take, for example, a property worth £115,000 with starting ground rent of £250 per year but with a clause which provides for the ground rent to be doubled every 10 years. Initially the ground rent represents 0.22% of the value of the property. However, over the lease period, the owner of the property would pay £250 per year for the first 10 years, so £2,500, £500 per year for years 10 to 20 (£5,000), £1,000 per year for years 20-30 and so on. By years 50-60, the ground rent would be £10,000 per year, a whopping £100,000 over that 10-year period!

In December 2017, the Government announced that it would bring forward legislation to tackle what they view as

the exploitation of homeowners. In October 2018, the Government opened its consultation into those proposals, which closed on 26 November 2018 and a summary of the consultation responses was published in June 2019. The Government's key proposed changes on leasehold reform are:

- An enforceable ban on unjustified new leasehold builds for houses i.e. they have to be freehold (exceptions apply);
- A cap on future ground rents to peppercorn only;
- Measures to ensure service charges are fairer and more transparent;
- Measures to improve the way new leasehold properties are sold.

Unfortunately, Brexit means that there is currently no indication as to when these reforms will be implemented.

Commentary

The proposed changes will not apply retrospectively to leases that have already been issued. There are however various compensation schemes in place (Taylor Wimpey have launched such a scheme (albeit it is limited to those who bought directly from the developer)). The key message for conveyancers is, however, to ensure that you check the ground rent clause in the lease for a purchaser client and if there is a doubling element, clear advice should be given to your client as to the potential impact of the clause and, if so instructed, to negotiate an amended clause. With the Government having taken an interest in this matter there is pressure on house builders to include index linked ground rent clauses instead and in theory the doubling clauses should therefore cease to exist. They are however, currently, perfectly legal.

Disclosure Pilot – the end to standard disclosure?

Since the current disclosure process was first introduced by the Civil Procedure Rules over 18 years ago, the use of technology and volume of data produced by businesses has increased to the point where the current procedure is no longer fit for purpose. Searching for and reviewing disclosable documents is now, in many cases, the most expensive aspect of English litigation.

In response to these concerns, as part of the wider Court modernisation process, a mandatory pilot scheme for disclosure (Practice Direction 51U) has commenced in the Business and Property Courts (the "Pilot"), changing the way a party discloses documents in commercial disputes.

Application of the Pilot

The Pilot will run for two years from 1 January 2019 in the Business and Property Courts only. It will apply to all cases issued after this date and all those issued pre-January 2019 in which an order for disclosure has not yet been made.

Whilst this appears straightforward, since the Pilot's commencement there has been some uncertainty as to the Pilot's application where no order for disclosure has been made but statements of case have already been served.

Initial disclosure

The main change introduced by the Pilot is the front loading of the disclosure exercise. This will ensure the parties can clearly assess, at an early stage, the strength of the case. The hope is that such an approach will aid settlement and, if not, at least narrow the issues in dispute to reduce the costs in the long term.

Initial disclosure therefore requires parties, when serving a Statement of Case, to serve on the other: (i) the key documents on which it has relied (expressly or otherwise) in support of the claims or defences; and (ii) the documents that are necessary to enable the other parties to understand the claim or defence they have to meet. Unless otherwise ordered or agreed, the copies of the documents should be provided in electronic form.

It is possible, however, for 'initial disclosure' to be dispensed with where: (i) the parties have agreed; (ii) it is ordered by the Court; or (iii) there would be a significant volume of documents involved.

Extended disclosure

If a party wishes to seek disclosure over and above 'initial disclosure', or as an alternative to the initial disclosure, they can make a request for 'extended disclosure' to the Court. The Court, however, will only make such an order if it is persuaded that it is appropriate to do so in order to resolve one or more of the issues in dispute fairly (and there is a range of disclosure models (A-E) that the Court can order).

Duty to Preserve Documents

The Pilot places more onerous duties on parties and their legal representatives than previously. In particular, once litigation is contemplated, parties continue to have a duty to preserve documents, including documents which might otherwise be deleted or destroyed, and will now be required to send a written notification to all relevant employees setting out the steps they must follow to preserve documents. Written confirmation must also be given to the court confirming that reasonable steps have been taken to preserve relevant documents.

Commentary

There is no longer an automatic entitlement to search-based disclosure. The Pilot instead provides for limited 'initial disclosure', with one of the new 'extended disclosure' models only being provided where a party can persuade the Court that it is appropriate. Although the Pilot currently only affects claims in the Business and Property Courts, if successful, we can see it or perhaps aspects of it, having wider application in due course.

Case Law developments

Scope of duty: who and what are professionals responsible for?

It is long established law that professionals can owe a duty of care to non-client parties. However, following the Supreme Court's decision in Hughes-Holland v BPE Solicitors [2017], 2018 saw a number of decisions focussing on the assumption of responsibility test.

In the Scottish case of Steel v NRAM [2018] the purchaser's solicitor sent their client's lender an email containing numerous errors. Despite the solicitor not acting for the lender, the lender relied on the email and the incorrect information when it wrongly released all of its security over the property concerned, rather than partially as it intended. The lender could easily have verified the information in the solicitor's email by checking its own records but it did not do so.

The court at first instance, when deciding if there was a claim for negligent misstatement against the solicitor, held that it was neither reasonable nor foreseeable for the lender to rely on the solicitor's email, without carrying out their own independent verification. The lender appealed to the Court of Appeal which held that there had in fact been an assumption of responsibility on the part of the solicitor. The solicitor then appealed to the Supreme Court and it unanimously restored the original decision - they held that any prudent lender would have checked the accuracy of the information provided and it was reasonable for the solicitor to have expected the lender to do so.

In Manchester Building Society v Grant Thornton LLP [2018], an accountant had advised a building society to enter into hedge accounting of its long-term interest rate swaps in order to protect itself against interest fluctuations for its lifetime mortgage products. The building society subsequently discovered that hedge accounting was prohibited under International Accounting Standards. All of the swaps had to be closed and a claim for £48m ensued, £33m of which related to the cost of breaking the swaps. The judge held that but for the negligent accounting advice, the costs incurred in breaking the swaps would have been avoided. However, these costs were not recoverable as damages as the accountants had not assumed responsibility for them, rather they were only retained to advise on the treatment of the building society's business activities in their accounts.

Notwithstanding these decisions, it is important to bear in mind, when providing information to third parties who are not your client, that they may rely on the information you provide. Accordingly, appropriate caveats should be used in relevant communications.

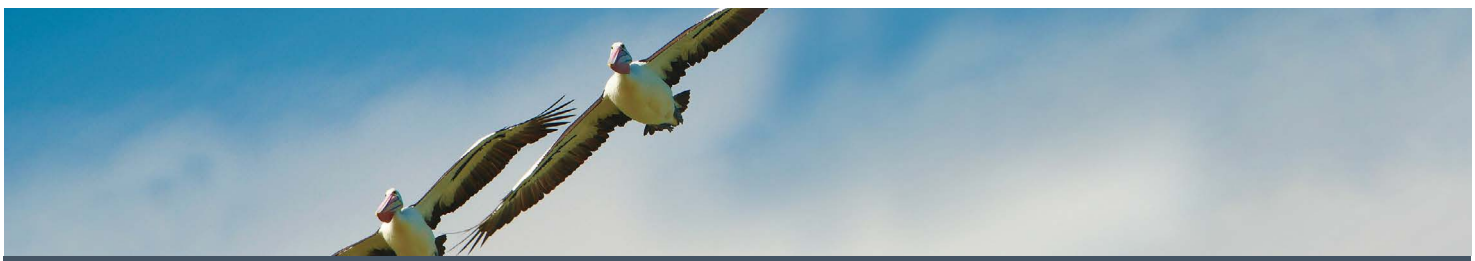
Exposure to opponents' costs

Prior to decisions in the cases of Travelers Insurance Company Ltd v XYZ [2018] and Various Claimants v Giambrone & Law (A Firm) & Others, AIG (Europe) Limited [2019], a liability insurer (or other third party funder) would only be held liable to pay a claimant's costs pursuant to section 51 of the Senior Courts Act 1981, if the claimant could show that the insurer had controlled the litigation for its own interest. The test was that an insurer needed to be a "real party" to the litigation, rather than someone who simply paid the legal fees, i.e. there had to be predominant control.

In Travelers, the Court of Appeal introduced the principle of "reciprocity" in holding that a party who stands to benefit from proceedings (in the case of a liability insurer, by avoiding liability for a claim), should bear the burden of paying the successful party's costs if the defence of the claim is unsuccessful. The High Court re-affirmed this approach in Giambrone.

As the law currently stands it is difficult to see how a liability insurer can protect itself against exposure to an additional costs liability over and above the limits of indemnity in its policy. Whilst this superficially could be seen as a positive for Insureds who may otherwise face direct exposure to a costs liability which is uninsured, the practical effect in the future of the law is not changed may be an increase in the cost of liability insurance cover across all lines of business as insurers attempt to protect themselves against the extra-contractual potential exposure.

The Supreme Court has recently heard the Travelers appeal and judgment is expected shortly which we hope will bring clarity and some comfort to Insurers. Giambrone is pending in the Court of Appeal for hearing in early 2020.



Pelican Underwriting Forum House, 15-18 Lime Street, London, EC3M 7AN. pelicanunderwriting.com
Jay Bowey Director T: 0207 933 9368 M: 07973 348 741 jay.bowey@puml.co.uk