Accountability

Insurance clause undermines liability cap

The recent decision handed down in *Trustees of Ampleforth Abbey Trust v Turner & Townsend Management Limited ([2012] EWHC 2137 (TCC))* will be of great interest to all those charged with the management of risk within professional services firms and their insurers. A clause in the project manager's terms of engagement which purported to limit the extent of their liability was held to be unenforceable in light of a further term that required them to hold professional indemnity insurance at a much higher level.

Background

In *Trustees of Ampleforth Abbey* the trustees alleged that Turner & Townsend had been negligent in their management of a construction project. As project managers, Turner & Townsend had failed to procure an executed contract from the building contractor and in doing so the Trust was unable to recover liquidated damages when the works failed to complete on time.

The court held that the project managers had been negligent in failing to try and ensure a contract was entered into. Turner & Townsend relied on the limit of liability clause contained in their terms of engagement. This clause provided as follows:-

"Liability for any negligent failure by Us to carry out Our duties under these Terms shall be limited to such liability as is covered by Our Professional Indemnity Insurance Policy terms... and in no event shall Our liability exceed the fees paid to Us or £1 million whichever is the less"

The same terms also included an obligation on the project managers to put in place professional indemnity insurance. The relevant clause provided that:-

"We shall take out a policy of Professional Indemnity Insurance with a limit of indemnity of £10 million for any one occurrence or series of occurrences arising out of any one event"

The amount of the claim as determined by the court was £226,667. The liability cap, if effective, would have capped liability to £111,321; the fees paid to Turner & Townsend by the Trust.

Turner & Townsend accepted their terms were "standard terms". This meant that s 3(2) of the Unfair Contract Terms Act 1977 applied, which requires an exclusion or limitation of liability to be reasonable (and if it is not, it will be unenforceable).

Turner & Townsend claimed the liability cap was reasonable and therefore enforceable because:

- The terms were clear, unambiguous and would have been understood by their client, if the client had taken the trouble to read them.
- There was no inequality of bargaining position.
• Ampleforth Trust had not received an inducement to accept the terms.
• Ampleforth Trust had the time, opportunity and freedom to turn to an alternative project manager.
• Generally commercial parties should be left to apportion risks as they see fit (referring to *Photo Productions* v *Securicor* [1980] *AC* 827).

**Decision**

The Judge decided the limit was unreasonable and therefore unenforceable. The 'central factor' relied on by the Judge was that Turner & Townsend had contracted to hold £10 million professional indemnity insurance, which far exceeded the limitation of liability cap. The Judge felt that the Ampleforth Trustees had in effect paid for access to £10 million of professional indemnity (PI) cover, and so it was unreasonable to deny access to that insurance:

"The effect of upholding the limitation clause would be that, although the parties had contracted for the insurance of the risks and (implicitly) for the Trust to pay for that insurance, far the greater part of that insurance would be rendered illusory."

**Comment**

This case highlights the perils of not dealing with insurance and liability caps/exclusion clauses in a consistent and connected way.

Accountants and suppliers of professional services should not contractually commit to hold professional indemnity insurance cover in excess of the liability cap. Clients will no doubt be encouraged to probe the supplier's insurance and use that to negotiate any limitation on liability clause. You therefore need to be on guard.

In our view it is, however, important to be wary of drawing too many conclusions from this case. The judgment runs to more than 200 paragraphs, of which just 11 deal with this point. It cannot therefore be said that this was the central issue in the case, nor was it dealt with in significant detail. Given the amount in play (£226,667 v £111,321), it is also unlikely this issue will be central to any appeal.

Furthermore, it should be noted that the parties involved had worked together previously on two earlier construction projects, when Turner & Townsend had also been engaged on their standard terms. Those standard terms were amended to include the limitation of liability clause and it was the amended terms upon which the project in question proceeded.

The Ampleforth Trustees were not informed of the changes to the standard terms and the Judge acknowledged there was 'force' in the argument raised by their Counsel that it was "wrong that, after building up a relationship of trust from two previous projects,... TT TPM [Turner & Townsend] should introduce this Draconian term which was wholly inconsistent with the requirement for substantial professional indemnity insurance without specific notice and any discussion".

If this issue was assessed in more detail by a senior court, would the same decision have been made; that the limit on liability was unenforceable? Jumping from a contractual commitment to hold insurance, to making the liability cap unenforceable is quite a leap. Holding insurance is part of the service provider's risk management - why should its liability cap and insurance cover be the same? After all, even where insurance is on a per claim basis, a service provider will have a
justifiable interest in keeping its claims down in number and amount, in order to keep its insurance premiums down (and in turn ensuring its charges to its clients remain at a lower level).

Insurance is often subject to an aggregate cap and any claim made will therefore reduce the insurance available for other claims. Accordingly, it is not wise for a service provider to commit all of its insurance to one client, as that could leave the insurance exhausted for other claims. There is, therefore, a perfectly fair and reasonable justification for a service provider to have a liability cap which is less than its insurance cover.

In any event, the case is not saying that suppliers of professional services cannot cap liability at less than their professional indemnity insurance. If Turner & Townsend had made no express contractual commitment as to the amount of its PI cover, or indeed had the amount of PI cover required been substantially less, the case may have gone a different way. There is an ongoing debate about whether professional service providers that cap liability substantially below their PI cover are risking liability caps being unenforceable. This case does not change that debate.

**Court watch**

**Entire Agreement Clauses: can you exclude liability for pre-contractual misrepresentation?**

*AXA Sun Life Services PLC v Cambell Martin [2011] EWCA Civ 133*

Entire agreement clauses are commonly deployed in commercial contracts and more often than not form part of the standard boiler plate provisions. Such a clause aims to prevent the party relying upon it from being liable for statements or representations (including pre-contractual representations), except as expressly laid out in the contract.

*AXA Sun Life Services PLC v Cambell Martin* underscores the need for clear drafting of such clauses where the clause attempts to exclude liability for pre-contractual misrepresentation and highlights the risk of relying upon a standard form of wording.

The Court of Appeal held that the following wording was not sufficient to exclude liability for claims based on misrepresentation, but could prevent claims for breach of collateral warranty:

"This Agreement [...] constitutes the entire agreement [...] this Agreement shall supersede any prior promises, agreements, representation, undertakings or implications whether made orally or in writing between you and us relating to the subject matter of this Agreement [...]"

AXA had brought a claim against the defendant companies and insurance advisors for the recovery of sums that were due under a number of contracts. In their defence to the damages claim the defendants relied upon alleged misrepresentations, claiming that they had been induced to enter into the contracts by negligent misrepresentation and collateral warranties. Each contract contained an identical entire agreement clause and AXA sought to rely upon those clauses.

The Court of Appeal considered that the entire agreement clause, having been based on a boilerplate precedent, was not precise enough on the issue of misrepresentation. It held that, on its true construction, the language was not intended to exclude liability but rather it sought to ensure that prior representations did not become terms of the contract. If a party intends to exclude liability for pre-contractual misrepresentation, clear language to that effect is required.
The Court of Appeal also found that the entire agreement clause was itself reasonable under the Unfair Contract Terms Act 1977 (UCTA). While entire agreement clauses are not considered exclusion clauses, UCTA may be applicable where:

1. one party is dealing as consumer and the other on its standard terms of business; and
2. the pre-contractual representation or promise affects the performance that is reasonably expected of the consumer party to the contract.

However, UCTA was considered only in the context of the collateral warranty. Care should be taken when drafting a clause which is intended to comply with the reasonableness requirements of UCTA, while also excluding liability for pre-contractual misrepresentations.

Best endeavours

*Jet2 Com Limited v Blackpool Airport [2012] EWCA Civ 417*

The Court considered the meaning of "best endeavours" in a countersigned letter agreement which contained the following at clause 1:

"JET2.com and BAL will co-operate together and use their best endeavours to promote JET2.com's low costs services from BA and BAL will use all reasonable endeavours to provide a costs base that will facilitate JET2.com's low cost pricing."

Jet2, a low-cost airline, entered a 15-year contract with BAL, the owner and operator of Blackpool Airport, to operate flights there.

Clause 2 of the letter agreement dealt with operational matters, but said nothing about opening hours. For the first four years of the contract, BAL allowed Jet2.com to arrive and depart outside of its published opening hours and BAL ran at a loss. BAL then gave Jet2.com one week to change its schedules so as to conform with BAL's published opening hours.

Jet2 sued for breach of contract, having first obtained an interim injunction against BAL, which allowed Jet2 to continue operating its schedule. In its defence, BAL argued that its duties to use best or all reasonable endeavours did not require it to act against its own commercial interests. It was agreed that best and all reasonable endeavours, in the context of this case, meant the same thing. The question which arose was whether, in light of the language in clause 1, BAL was under an implied obligation to accept arrivals and departures of Jet2's aircraft outside of normal opening hours.

At first instance, the Commercial Court held that the best endeavours duty included an obligation to provide flexible opening hours. The performance of this duty did not allow scope for BAL to consider its own commercial interests. The Commercial Court did not, however, go as far as specifying the operating hours that BAL must provide for the remainder of the contract in satisfaction of that duty.

The Court of Appeal upheld the decision with the majority rejecting the argument that the best endeavours clause was too uncertain to be upheld. The nature of a low cost airline is such that it depends on early morning and late night operating schedules and the evidence before the Court supported the finding that the parties agreed and understood that.

Moreover, the parties had intended to enter into a binding agreement on the terms set out in the letter of agreement. It was held that BAL's losses did not justify its actions: the very fact that a party has agreed to use best endeavours pre-supposes that it may be put to some financial cost.
However, the extent to which a party can have regard to its own financial interests will depend upon the nature of the particular contract.

On the one hand, an endeavours clause could be too uncertain to enforce where a contract provided no objective criteria by which to judge whether a party's endeavours were adequate. However, this was not the case where the obligations gave rise to a clear binding obligation but the precise limits of the obligation were unclear.

Such a distinction was not made by the dissenting Judge. Here, the Judge found that where a contract is silent on a particular issue (i.e. the issue of keeping the airport open to Jet2.com's operating requirements), the default position must be that the issue was not covered, and the clause was too uncertain to be enforceable in that respect.

However, the decision serves to reinforce the principle that endeavours clauses will, when possible, be upheld. Nonetheless, the parties should be clear as to what the objective of such a clause is: if that is unclear, or if there is nothing against which to measure a party's attempt to achieve the objective, the clause may well be deemed too uncertain to enforce.

**Rectification**

Where both parties to a contract share a mistaken belief as to whether the contract accords with their prior commercial agreement, but for opposing reasons, which party will be bound?

*Daventry District Council v Daventry & District Housing Limited [2011] EWCA*

This case concerned a contract to transfer the claimant's housing stock to the defendant. The calculation of the price to be paid by the defendant was based on a number of factors, including the cost of making good a deficit in the claimant's housing department pension fund of some £2.4 million.

The parties agreed commercial terms for the transfer and an agreement in principle was reached whereby the defendant was to pay the pension deficit. The defendant's negotiator was aware of this but, as the agreement in principle was ambiguous, chose to interpret it as requiring the claimant to pay. Indeed, he let the defendant believe that the liability for the pension deficit would fall to the claimant. The contract ultimately provided for the claimant to pay the deficit.

The claimant claimed for rectification on the basis of mutual mistake, or in the alternative, unilateral mistake on the grounds that the commercial agreement had from the outset been that the defendant would pay.

The test for establishing mutual mistake is an objective one and the Court of Appeal found that the parties did share a mistaken belief that the transfer agreement accorded with the agreement they had reached in principle. The claimant was therefore entitled to rectification for the mutual mistake, despite the fact that the parties' reasons for sharing their mistaken belief were diametrically opposed:

- The claimant believed (correctly) that the commercial agreement was for the defendant to pay, and (incorrectly) that the executed agreement reflected this.

- Conversely, the defendant believed (incorrectly) that the commercial agreement was for the claimant to pay, and (correctly) that the executed agreement reflected this.

The Court of Appeal, by a majority, found that the words and actions of the defendant would lead a reasonable observer to conclude that it had agreed to pay the deficit. The contrary wording in the
agreement had to be interpreted in the context of the commercial terms of the original agreement and the commercial reality. Indeed, much emphasis was placed on the commercial negotiations and the reasoning behind the negotiations.

The case stands as a reminder that, where one party knows that the other has made a mistake, this mistake should be drawn to the mistaken party's attention; regardless of how careless the mistaken party has been. The importance of always reading the final draft of a contract for points that may have changed cannot be over stated.

**Challenging an Expert Determination; will a decision be binding if the expert has departed from his / her instructions?**

*Ackerman v Ackerman [2011] EWHC 3428 (Ch) [first instance] & [2012] EWCA Civ 768 [Court of Appeal]*

Expert determination is an alternative method of dispute resolution; it is often used to determine discrete technical issues but it can also be used to determine a wide range of disputes. The expert's decision will be legally binding on the parties, where they have entered into a contract which provides for that to be the case.

It is possible to challenge the decision of an expert if he / she has materially departed from his / her instructions. In *Ackerman & Ackerman* the Chancery Court considered what would be regarded as a material departure from instructions.

This case concerned the demerger of a family group of companies in acrimonious circumstances. One of the parties, Mr Joseph Ackerman, had been advised by a senior tax QC (Mr Andrew Thornhill QC) for many years and all parties agreed that he should be appointed to deal with the demerger. Mr Thornhill's instructions provided for a 'Provisional Adjustment Report' to be prepared, followed by a 'Final Report' to be issued within a year.

Following submission of the 'Provisional Report' by Mr Thornhill, Mr Joseph Ackerman subsequently brought proceedings against him, and the other parties involved in the demerger. He sought to have the initial determination made by Mr Thornhill set aside for a number of reasons, including the fact that Mr Thornhill had not carried out the exercise he had been instructed to perform, as a result of which the report was not that for which the parties had contracted and so was not binding.

In *Veba Oil Supply & Trading GmbH v Petrotrade Inc* [2002] 1 All ER 703, the Court of Appeal had previously held that:

- A departure from instructions would be material unless it could "truly be characterised as trivial or de minimis in the sense of it being obvious that it could make no possible difference to either party".
- "...once a material departure from instructions is established, the court is not concerned with its effect on the result...the determination in those circumstances in simply not binding on the parties".
- The test for materiality is "whether the parties would reasonably have regarded the departure as sufficient to invalidate the determination".

However, in *Ackerman v Ackerman* the Judge at first instance considered this test to be contradictory since it is surely only possible to consider whether a departure from instructions is
"trivial" by considering the effect on the result. As such, the Judge drew a distinction between a departure from a substantive instruction and a departure from an instruction relating to procedure.

In this case, he held that there had been a departure by the expert from his instruction, but this had related to a procedural point and had not made a difference to the determination. It was therefore not a material departure from instructions and the determination remained binding.

The Court of Appeal gave permission to appeal on this specific issue on the basis that it is arguably irrelevant whether the result is the same or not. The question is whether the expert departed from the agreed contract to more than an "insignificant degree", since "the parties did not agree to be bound by a report made otherwise than in accordance with the agreed procedure".

The substantive appeal did not, however, take place as the matter subsequently settled. This issue is therefore still open for debate. It is questionable whether the distinction between procedural departure and substantive departure will survive, except perhaps in circumstances where the departure is so immaterial that it could not in fact be categorised as a departure at all.

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Industry update

ICAEW concerned over the Financial Reporting Council's proposed changes to its disciplinary processes

In our last edition of Accountability we reported on the Financial Reporting Council's (FRC's) consultation on changes to its disciplinary schemes. In its response, the ICAEW's principal comments relate to the proposed removal of the requirement that the FRC either obtains the consent of professional bodies or consults with them prior to taking certain steps under the Scheme.

In its consultation, the FRC had proposed that it be able to launch investigations, conduct preliminary enquiries and extend the scope of investigations under the schemes without consulting with registered supervisory bodies, as it is currently required to do.

ICAEW has voiced concerns that implementing this proposal would lead to a risk of the FRC deciding cases in isolation without reference to the professional bodies. It also points out that the FRC has not provided any evidence to support the assertion that such consultation delays the resolution of cases.

ICAEW says that it fully supports the FRC's desire to progress cases as quickly as possible, and has no wish to hamper the FRC in the speedy and effective operation of the Scheme. However, it remains concerned about the FRC's level of accountability should matters be determined without the supervising bodies being consulted.

Reduced auditing and reporting requirements for smaller businesses from 1 October 2012

The Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012 came into force on 1 October 2012 and will apply to accounting years ending on or after that date.
Announced by the Department of Business Innovation and Skills (BIS) in September, the Regulations reduce auditing and reporting requirements on SMEs by aligning mandatory audit thresholds with accounting thresholds.

Previously, companies with a turnover and balance sheet under a certain size were eligible for an audit exemption. Under the new Regulations, companies which meet two out of three criteria relating to balance sheet total, turnover and number of employees will now be able to make a commercial decision on whether or not to have a statutory audit. BIS claims this change will allow 36,000 more companies to opt out of statutory audit.

The Regulations will also exempt an estimated 83,000 subsidiary companies from audit, and a further 67,000 dormant subsidiaries from annual account filing - provided in each case the subsidiary's liabilities are guaranteed by their parent company.

The Regulations come at a time when there is huge downward pressure on audit fees. It is hoped that these changes will save companies millions of pounds in audit fees and encourage investment in Britain.

**FRC issues new UK Corporate Governance Code and Guidance on Audit Committees**

Following its consultation on revisions to the UK Corporate Governance Code and Guidance on Audit Committees, FRC has published a feedback statement summarising responses and its reasoned decisions on the Code and Guidance. New editions of both came into force on 1 October 2012.

Perhaps the most publicised addition made by the FRC is to state that FTSE 350 companies should retender their external audit contract at least once a decade. Unsurprisingly, this area of the FRC's consultation drew mixed responses from investors and auditors – the former supporting further measures such as caps on the length of audit appointments, with the latter suggesting alternative means of addressing the perceived lack of independence of long-standing auditors.

The FRC has sought to reach a compromise in its updated Code and has stressed that this retendering does not equate to mandatory rotation of auditors. Instead, what is desirable is the process of benchmarking to obtain the best quality and most effective audit; even if that is best secured by reappointing the incumbent auditor.

Other changes to the Code include the recommendation that the board's statement in its annual accounts should confirm that as a whole the annual report and accounts are fair, balanced and understandable. They should also provide the information necessary for shareholders to assess the company's performance, business model and strategy.

In the 'Guidance', internal audit committees are also now encouraged to report the process by which they have assessed the effectiveness of the external audit, rather than simply state whether they believe the audit has been effective.

If a company chooses not to comply with the tender requirements set out in the new code, it is important that a clear explanation is given so that its shareholders can decide if they are happy with the approach the company is taking.

**Update on European Commission audit reform**
The audit reform debate is also of course playing out on a wider scale in Europe. In September, the European Parliament's Committee on Legal Affairs published its draft report on the audit proposals tabled by the European Commission (EC) last November.

Mirroring the position reached by the FRC, the Committee (led by British MEP Sajjad Karim) has shelved the EC's radical proposals for mandatory rotation of auditors and creation of 'audit-only' firms. Instead, the revised draft Regulation produced by the Committee has suggested that public interest entities conduct a mandatory tender every 25 years, supported by interim 'independence threat assessments' of their statutory auditors and audit firms.

The draft Regulation has now progressed to the Economic and Monetary Affairs Committee, which is in turn expected to give its opinion this month before a final text is debated in the European Parliament. It was thought that the European timetable might be pushed back as a result of the delay in the UK Competition Commission publishing the preliminary findings of its investigation into the audit market (which is now due in January 2013). However, MEP Karim has confirmed they will press on with the European Commission's audit reforms.

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Stop press

The first in our proposed series of breakfast seminars aimed at those responsible for managing risk within accountancy firms and among networks and associations, took place on 16 October. The seminar, entitled 'Managing the Risk of International Referred Work' provided a retrospective look at the current claims environment faced by those firms who became embroiled in litigation arising from the acts and defaults of other firms in their Networks. It also provided plenty of guidance on how best to structure international work referrals in order to better manage the risks.

For a copy of the delegate pack or to discuss these issues further, please contact Jane Howard (jane_howard@wragge.com).

Wragge & Co's professional liability experts can advise accountants and other professionals on these and a range of other liability risk management issues. More information about their work in the sector is available online under the firm's professional liability expertise.

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