Accountants' update

2016

Welcome to RPC's 2016 accountants' bulletin. The aim of the bulletin is to review a number of key developments from 2015, and to give an insight on some of the current "hot topics" in this area. Having been compiled by RPC's team who specialise in defending claims against accountants, we hope that there will be something of relevance and interest to accountancy firms, insurers and brokers. The first section includes a series of articles regarding topics that we are regularly asked about as a firm, the second section is a summary of some of the key cases from 2015.

Articles

Recent trends at the FRC

In this article Jeremy Barnes takes stock of recent trends at the FRC. more›

Extending the PRA's powers over auditors and actuaries

In this article Davina Given outlines the scope of the 2015 PRA consultation paper. more›

Accountants and cyber risk

In this article Phil Tansley gives an overview of key considerations in relation to the increasingly 'hot topic' of cyber risk. more›

Safeguarding against unlimited liability

In this article Robert Morris assesses the scope for firms to limit their liability to clients. more›

Case updates

Barclays Bank Plc v Grant Thornton UK LLP[1]

In this case the court dealt with the role of third party disclaimers (or Bannerman clauses) in audit reports. A Bannerman clause allows accountants to negate duties to third parties arising out of audit work. The effectiveness of such a clause was upheld in this case. more›

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In this case the Claimant was adjudged to have failed to act reasonably in mitigating its losses and, despite a finding of negligence against a tax advisor, was therefore unsuccessful in its claim. Whilst the case is a useful reminder of the principles relevant to an assessment of mitigation of loss, it is suggested that it is extremely fact specific. more›

Any comments or queries?

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1. [2015] EWHC 320 (Comm).
2. [2015] EWHC 912 (Comm).

Baker Tilly UK Audit LLP & Ors v Financial Reporting Council & Ors[3]

In this case the High Court considered a judicial review application in respect of an FRC investigation. It appears that the courts will be unwilling to extend much sympathy where firms seek to speed up FRC investigations by means of judicial review. more›

Altus Group Ltd v Baker Tilly Tax and Advisory Services LLP & Ors[4]

In this case the High Court considered how it should make loss of chance assessments in relation to tax mitigation schemes, in particular, whether the court should look to make a definitive assessment as to whether the relevant tax planning works as a matter of law. more›

3. [2015] EWHC 1398 (Admin).
4. [2015] EWHC 12 (Ch).

Recent trends at the FRC

In this article Jeremy Barnes takes stock of recent trends at the FRC.

Rise in FRC investigations

Somewhat surprisingly, in the immediate wake of the financial crisis in 2008, relatively few businesses went insolvent (largely as a result of historically low interest rates). As a result, there were perhaps not as many corporate scandals as one might expect following a period of economic decline. There was also a pause in the number of FRC investigations in 2010 and 2011, following concerns about the body's independence, complex structure and time-consuming procedures. This resulted in considerable reform of its structure and powers in 2012.

However, since the new-look FRC was established in 2013 there has been a series of high profile scandals. The near collapse of the Co-op Bank and the Tesco accounting scandal dominated the headlines. In light of destabilising events like these, there has been a greater impetus for the FRC to take a more active role.

In 2013, the FRC identified investigative monitoring and disciplinary procedures as one of its major projects and increased the number of formal investigations that it announced from three in 2012 to nine in 2013. Meanwhile, the overall cost of running investigations has increased. The 2013-14 budget provisioned for a cost of £5m for this work, with the equivalent figure having increased to £7m in the budget for 2015-16.

Rise in fines

There has also been a parallel increase in the size of fines imposed by the FRC. In February 2013 the FRC published new Sanctions Guidance for members of its Disciplinary and Appeal Tribunal to refer to when considering the imposition of sanctions.

Before the Guidance came into effect the highest fine issued by the FRC was £1.4m in relation to reporting to the FCA on compliance with client asset rules. After the Guidance, the FRC issued a new highest fine of £14m – although this was later reduced on appeal to £3m (see boxed text).

Despite the FRC's renewed vigour, its head count remains very small. Given this, some may question how it can realistically continue to achieve its regulatory objectives and expand its investigation work.

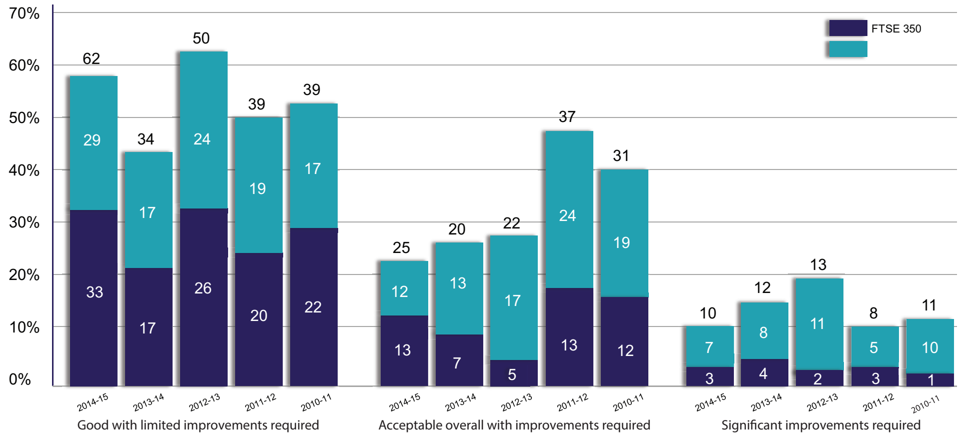
A look back at investigations launched in the past few years reveals the extent of the FRC's backlog in cases. The majority of investigations conducted since 2011 are yet to be resolved and those with a final outcome have taken on average over one and a half years to reach a conclusion (with investigations ranging from six moths to three years and ten months).

Audit quality

The purpose of the FRC's investigatory work is ultimately to increase audit quality. This begs the question – has the quality of audits increased as a result of the increase in FRC investigations? One helpful barometer is the FRC's audit quality review. This annual review looks at around 90-100 audits conducted at firms by auditors including the Big Four.

The results for the reviews conducted in 2010-2014 are shown below. It is difficult to say decisively that quality is improving.

Audit quality review results 2010-2014



Future trends

The FRC announced four investigations in 2015, a slight decrease on the six investigations announced in 2014. The trend had appeared to be an upward one pre-2015 with ever higher levies being imposed upon contributor companies and organisations. It will be interesting to see if 2015 is anomalous or indicative of a halt in pace for FRC investigation of individual firms with FRC activity instead focusing on reviews of the whole market.

One driver for the activity is political pressure as regulators and governments look to be visible in tackling corporate malpractice head-on. During 2015/2016, the implementation of the EU Audit Directive and Regulation and Competition Markets Authority recommendations requires the FRC to broaden the scope of its inspection work and responsibilities. The FRC says this will require it to expand some teams as its work widens to monitor audit quality.

On a national level, the PRA outlined that it wishes to take over aspects of the FRC's role in its recent consultation paper (see article below). This would involve coordination of enforcement action by the two regulators where they have a mutual interest (whether involving auditors or actuaries) and could see them both take action in respect to the same set of facts.

Forthcoming objectives

The FRC's Business Plan for 2015/2016 includes a focus upon achieving a consistently high standard of auditing, corporate reporting and enhancing the pace and effectiveness of its disciplinary function.

In light of this and the upward trends identified, firms should expect to remain under its scrutiny for the foreseeable future.

Record FRC fine slashed on appeal

- In September 2013, the FRC handed out their largest ever fine of £14m to Deloitte after conducting a six year-long investigation into the firm's work for companies involved in MG Rover's Phoenix arrangements and ultimate collapse. The FRC held that Deloitte had failed in its duty to avoid conflicts of interest by providing the businessmen leading the purchase of MG Rover from BMW with corporate finance advice whilst also acting as auditor for MG Rover. The FRC's focus on Deloitte's professional duty to "act in the public interest" was introduced the idea of accountancy firms being held to a far higher standard than previously thought to be the case. The widely accepted position prior to the FRC decision was that accountants' duties centred on acting with integrity and in their client's interests. Unsurprisingly, the far wider responsibility imposed by the FRC was of concern for firms of all sizes.
- Handed down in April 2015, the appeal tribunal decision significantly scaled back the FRC's sanctions on Deloitte, overruling eight out of 13 findings that the FRC had made. Of particular significance was the tribunal ruling that the "public interest" concept is "vague and unhelpful" and that the reason the FRC's fine was excessive was that the firm had not deliberately disregarded its duties. The welcome result for Deloitte was a reduction in the fine from £14m to £3m and a reversal of the three-year industry ban imposed on one of its partners.
- Although it has been confirmed that there is no general legal duty for firms to act in the public interest, firms may need to re-examine their compliance procedures in light of the increased consideration being given to whether such a duty should exist.

back to contents>

Extending the PRA's powers over auditors and actuaries

In this article Davina Given outlines the scope of the 2015 PRA consultation paper.

Auditors and actuaries are used to being overseen by the Financial Reporting Council (FRC). In a 2015 Consultation Paper, the PRA signalled that it intends to extend its disciplinary powers over the auditors and actuaries of all PRA authorised firms.

There are two significant changes proposed:

- in relation to the largest domestic banks and building societies that pose most risk to financial stability (ie those with total assets over £50bn), the PRA will require their external auditors to provide written reports to the PRA as part of the statutory audit cycle. These reports will be in addition to the existing communications between the PRA, auditors and audit committees. The PRA will review whether to extend these rules to insurers following the implementation of Solvency II
- the PRA plans to bring into force its powers to apply disciplinary measures to an auditor or actuary that has failed to comply with a duty imposed by rules of the PRA (including the proposed new requirement relating to the new written audit reports) or failed to comply with a duty under FSMA to communicate information to the PRA.

Coming in the wake of a series of failures of UK financial institutions, these changes are intended both to improve the level of communication between the regulator and auditors, but also to incentivise them to improve the quality of audits of financial institutions, which has been criticised by the FRC. In this context, the PRA contends that the new disciplinary regime will be "proportionate and responsive".

However, the PRA then went on to note that a financial penalty can act as a direct punishment as well as an incentive to other members of the relevant professions to effect behavioural changes. Such language echoes the justifications given for the increasingly harsh penalties imposed by the FCA under the banner of "credible deterrence". This may suggest that the penalties imposed by the PRA for misconduct will be substantial. Further, the PRA has suggested that in some cases, the starting point for a financial penalty may be a percentage of the firm's total revenue or its revenue in respect of one or more areas of its business (or, for individuals, the pre tax profit of a sole trader or the relevant employment income). This is certainly an area for auditors and actuaries involved in financial institutions to keep a careful eye on in 2016.

back to contents>

Accountants and cyber risk

In this article Phil Tansley gives an overview of key considerations in relation to the increasingly "hot topic" of cyber risk.

Cyber risk is increasingly on the agenda for all businesses. However, the professions, and in particular accountants, have been singled out by bodies such as The Department for Business, Innovation & Skills (BIS) as a particularly vulnerable group. Why is that the case and what can be done to manage cyber risk from a legal perspective in 2016?

Exposures

"Cyber risk" is a collective term for business exposures arising from the loss or impairment of data. It can arise from the activities of third parties, such as hackers, insider fraud, or more mundane but equally serious problems such as technical failure or human error. The principle exposures are, briefly:

- business continuity issues/lost profits arising from disruption to business from the loss or corruption of data
- regulatory issues arising from the compromise of regulated data (principally personal, but also commercially or market sensitive data) including the cost of dealing with regulatory investigations and fines
- liability exposures to third parties (ie as a result of losing their confidential data or being unable to provide contracted services)
- the costs of notifying data subjects and providing remedial services, such as credit monitoring
- reputational damage.

In the context of cybercrime, accountants are currently in the spotlight as they (and other professional services) are said to be seen as the "soft underbelly" for cyber criminals. As traditional targets for cybercrime, such as financial institutions, tighten their security, criminals move their attention to service providers who may have access to the same sensitive data, and sometimes a "back door" to client systems, but may not necessarily have the same degree of sophistication when it comes to putting in place robust cyber security measures.

Typical issues depend on the size of the business involved. At the smaller end of the profession problems typically arise from straight forward issues such as lost laptops, keeping information in unencrypted format or simply failing to realise that they need to register as a data controller or processor for the purpose of the Data Protection Act. At the other end of the spectrum, large firms are targets due to the volume of commercially sensitive data to which they have access. Accordingly, whilst their security measures are generally more robust the consequences of a data loss or breach are more severe.

Factors to consider – pre-incident

From a legal perspective there are a number of steps which can be taken to reduce the risk of a breach, speed up the response, mitigate losses and ultimately justify the firm's conduct to regulators or clients in the event of a breach. These include:

- **data security policy review** – ensuring that data security policies are up to date and are robust. Typically this will include issues such as confirming what regulated data is held, where it is held (in particular, even in a relatively small business with overseas clients or outsourced IT systems, data may be subject to regulation in a number of different jurisdictions) and ensure procedures are in place to minimise the amount of regulated data and safeguard it adequately
- **breach response plan/readiness** – (in conjunction with technical experts) putting in place an effective breach response and recovery plan. This will include issues such as confirming the location of critical assets, establishing the team in the event of a breach and looking at contractual issues such as counterparty exposures and service supplier arrangements to avoid unwelcome surprises in the event of an incident (see below). For firms who do not have access to an integrated breach response service or appropriate cyber insurance, that will also include identifying the team that they will call on in the event of a breach to provide breach management, IT forensics, legal assistance, public relations support and other ancillary services, such as notification services or credit monitoring. For some firms additional readiness training or exercises will be appropriate
- **counterparty review** – as well as questions of access and assistance in the event of a breach, there is a more general question of ensuring the adequacy of agreements, often based on precedents drawn up in the pre-digital age, to deal with a cyber incident. Where one's own clients are concerned assessment needs to be made as to whether limits of liability are appropriate and whether the parties' roles and respective responsibilities are properly defined. Conversely, in the case of a firm's own service providers, it is necessary to ascertain whether contracts provide for adequate assistance and redress in the event of an incident.

Factors to consider – post incident

Issues for consideration once an incident is underway include:

- **notification issues**: it is necessary to confirm what data is affected, what regulators might be involved (eg ICO, FCA, PCI or Stock Exchange) and whether notification is necessary or desirable. It will also be necessary to consider notification requirements in overseas jurisdictions. Finally, it will be necessary to consider whether any contractual obligation to notify a client or other third party who has provided data arises (under, for example, non-disclosure agreements)
- **access issues**: as mentioned above, legal input is sometimes required in obtaining access to data held by third parties such as data centres or other third parties, such as hosting providers. Other issues may arise in obtaining disclosure from service providers or employees who are thought to be implicated in a breach
- **liability claims**: breaches often give rise to liability claims. Although it is possible for data subjects to bring claims where they have suffered financial loss as a result of a breach (and

potentially for distress alone following the recent Google v Vidal Hall decision), claims from commercial counterparties for failure to perform contractual obligations are a much more common, and usually more serious, issue
- **the rest**: a multitude of other legal issues potentially arise – it may be necessary to obtain an injunction to prevent the misuse of confidential information, misappropriated funds may need to be traced and employment law issues may arise, if the issue arises from the activities of an insider, to name but a few.

back to contents>

Safeguarding against unlimited liability

In this article Robert Morris assesses the scope for firms to limit their liability to clients.

In an increasingly litigious society, the accountancy industry is well aware that the provision of accountancy services can give rise to a broad spectrum of potential claims. It is often necessary for accountants to rely on contractual terms that limit liability but developing such terms can be something of a legal minefield. Statutory restrictions prohibit clauses that limit liability too widely but do not provide definitive guidance as to what form of clause will be upheld or struck down by the courts.

Recent cases such as the much publicised *Mehjoo v Harben Barker* [2014] have reiterated the importance of a well drafted retainer letter, which is continually kept under review. Any confusion about an accountant's duties or instructions can lead to an accountant being held liable far outside the scope of initial instructions. A carefully constructed engagement letter should clearly set out these duties plus any limits on liability and is an extremely useful tool for striking the difficult balance between protecting against liability and falling foul of statutory restrictions.

Guidance

The ICAEW and ACCA recognise the risks of accountants being exposed to unlimited liability and have provided useful guidance (available via their respective websites) on limiting liability in a way that is unlikely to contravene statute.

The ICAEW makes a number of recommendations on limitation clauses in engagement letters. It particularly advises that the clause is clear and in writing, as well as discussed and negotiated with the client. It allows that accountants are entitled to be robust in negotiations over limiting liability but should avoid being unfair or unreasonable particularly where clients are in a lesser bargaining position. The emphasis is on the nature of the client, the work and the overall commercial risk. Practically, the ICAEW suggest specifying which tasks will and will not be undertaken, specifying client obligations (eg to ensure information provided is accurate) and setting out any limitations on the work such as limited time or lack of information with an explanation of the potential impact of those limitations.

The ACCA guidance is similar but also addresses the situation in which a client requires complicated advice in very short space of time. ACCA suggests specifying the impact of the short time frame, recommending that further time is devoted to the advice and warning against relying on the advice without further consideration unless there is a genuine emergency.

Restrictions

The Unfair Contract Terms Act 1977 (UCTA) provides that all clauses seeking to limit liability for negligence must meet the requirements of the reasonableness test. There is a parallel test for consumers in the Unfair Terms in Consumer Contracts Regulations 1999. The test requires the term to be fair and reasonable in all the circumstances that were (or should have been) in the contemplation of the parties at the time the contract was made. A range of factors are taken into account, including:

- the relative bargaining strength of each party
- whether the client was induced into entering the contract
- whether the client knew or ought to have known about the term
- the likely resources available to the person limiting liability to meet the liability if it arises
- how far it was open to the person limiting liability to obtain insurance cover.

Any clause failing to meet the test will be struck out entirely. This is the key cause of concern for accountants attempting to cap liability, as pitching an amount too low could lead to an accountant having no limit on their liability. It is essential for all such terms to be entirely separate so that removing the clause does not affect the other terms of the engagement (retainers might include standard wording that states that if one term is deemed ineffective, it will not affect any of the others). Providing a rationale for the value of caps (such as a sum linked to an accountant's insurance cover or to a multiple of the fees paid) is particularly helpful towards showing that a cap meets the reasonableness test.

Those accountants carrying out audit work will be subject to a different statutory regime under the Companies Act 2006. These rules require new terms every audit year along with shareholder approval for any limitation clauses and allow terms that fail the fair and reasonable test to be amended to an amount the Court considers reasonable.

The Consumer Rights Act, which came into force in October 2015, also applies a new regime for those clients who are acting mainly outside of their business or profession (for example, trustees of self-invested personal pensions) along with an additional rule prohibiting caps on liability that are lower than the fees paid.

Guidance on UCTA

Case law on limiting liability has demonstrated that much will depend on the specific set of circumstances and the relationship between the parties. In *Dennard v PricewaterhouseCoopers* [2010] a liability cap of £1m was permitted. Although the parties were not of equal bargaining power, the clients were still experienced business people who ought to have known about the cap and could have taken their business elsewhere. In *Ampleforth Abbey Trust v Turner & Townsend Project Management Limited* [2012], it was held that a cap of £110,000 (set at the amount of the fees paid) was unreasonable given that the required level of indemnity insurance for the project was £10m.

It appears that clauses limiting liability to a share of the loss proportionate to the work done are likely to be found reasonable, particularly where it is contemplated that there will be other parties carrying out related work for the client (*West v Ian Finlay & Associates* [2014]). This type of limit is a useful means of excluding the usual rule of joint and several liability that can require parties to meet a claimant's full loss even if another party is also at fault. By contrast, wholesale exclusions of a particular type of liability are less likely to be found to be reasonable, even where the type of liability may appear less relevant, such as liability for indirect loss (*IDS Building Distribution Ltd v Hillmead Joinery* [2015]).

These cases give a flavour of how the UCTA reasonableness test will apply. In most circumstances, evidence of clear communication with clients, sound commercial reasoning for limits and considering each client's level of commercial sophistication will provide accountants with the best chance of their limitation clause being upheld.

Conclusion

Though limitation clauses are a well-established part of most accountancy firms' standard terms, a blanket approach cannot necessarily be applied to limiting liability for all clients. It may not be commercially viable to apply highly tailored provisions to every set of instructions but accountants can provide a benchmark by, for instance, applying caps that provide multiples of the amount of fees paid. The focus on clients' commerciality and bargaining position allows accountants to apply wider restrictions on liability for those commercially advanced clients who are most likely to negotiate on such terms. Wherever the limit on liability is eventually set, it is crucial to ensure that clients are clearly informed of it. Finally, it is worth remembering that prevention is better than cure. It is possible to avoid certain claims altogether by clearly defining the scope of engagement at the outset, reviewing the scope regularly and ensuring that an accountant acts within the scope of its engagement throughout.

back to contents>

Case updates

Barclays Bank Plc v Grant Thornton UK LLP[1]

In this case the court dealt with the role of third party disclaimers (or Bannerman clauses) in audit reports. A Bannerman clause allows accountants to negate duties to third parties arising out of audit work. The effectiveness of such a clause was upheld in this case.

By way of background, Barclays relied on two non-statutory audits carried out by Grant Thornton for the Von Essen Hotels Group (VEH) in 2006 and 2007. Barclays was funding VEH under a £250m loan facility. Barclays alleged the auditors had been negligent in their failure to uncover fraudulent overstatements of VEH's financial position by two employees, causing the bank considerable losses when VEH became insolvent and was unable to repay the loan.

Each of the audit reports contained a disclaimer in standard wording produced by the ICAEW in respect of statutory audit reports (with some changes to reflect the fact these were non-statutory audits). The disclaimer stated that the reports were solely for the use of VEH's directors and that GT did not accept responsibility for anyone other than VEH and its directors using the audit reports. Barclays argued the clause had not been brought to its attention, and under the Unfair Contract Terms Act 1977 (UCTA), such a disclaimer was unreasonable, and therefore could not be relied upon.

Sitting in the High Court, Cooke J awarded Grant Thornton summary judgment. He upheld the validity of the disclaimer, and on this basis, deemed that Barclays had no realistic prospect of success. Summarising, Cooke J held the disclaimer was "clear on its face" and "could not have been misunderstood". The Court also made it clear that such a disclaimer is evidently applicable to a sophisticated commercial party such as Barclays.

This case is particularly noteworthy as it is the first instance of a Bannerman clause being scrutinised by the Courts. It will no doubt provide reassurance to auditors that its validity was upheld.

Given that the Court placed some reliance on the fact that the clause was "an industry standard clause used in statutory reports", it is hoped that the Court would also have upheld the validity and effectiveness of the clause in the context of a statutory audit.

back to contents>

Symrise AG & Others v Baker & McKenzie (a firm) & Baker & McKenzie LLP[2]

In this case the Claimant was adjudged to have failed to act reasonably in mitigating its losses and, despite a finding of negligence against a tax advisor, was therefore unsuccessful in its claim. Whilst the case is a useful reminder of the principles relevant to an assessment of mitigation of loss, it is suggested that it is extremely fact specific.

The Case

The Claimant was formed in 2003, following the merger of two large global companies specialising in the production of flavours and fragrances. The deal was highly leveraged, and as part of the post-merger integration a debt "pushdown" was implemented in several countries, including Mexico. The pushdown in Mexico was completed in 2004, with the Claimant's Mexican subsidiary becoming burdened with debt that equalled its pre-pushdown value.

In 2005, the Mexican Tax Authorities (the MTA) challenged the tax planning pushdown arrangements. They regarded the interest payments made by the Claimant's Mexican subsidiary to its parent as in reality being dividends, and therefore not eligible for tax relief. MTA's challenge was partly referenced to a clause in the Intercompany Loan Agreement (ICLA) (establishing the debt pushdown arrangement) which the Defendant had advised on. The relevant clause (relating to recourse arrangements) was said to infringe Article 92 of the Mexican Income Tax Law.

The Claimant complained about the Mexican tax law advice given by the Defendant – specifically as to whether the drafting of the ICLA was appropriate, and the failure to advise that the relevant clause arguably engaged Article 92. Mr Justice Burton, sitting in the Commercial Court found that the Defendant had breached its duty to the Claimant in this regard. The Defendant's own expert witness accepted that a reasonable tax lawyer should have advised that there was a risk that the relevant clause of the ICLA would be challenged by reference to Article 92(1); it was also clear that the wording of the ICLA could easily have been altered so as to significantly reduce the risk of a challenge by the MTA.

On the question of causation, the Defendant sought to argue that the MTA would have pursued an investigation in any event, premised on another section of Mexican tax law (Article 31). It was stated in evidence that where the MTA finds aggressive tax structures it attacks them – and that too much debt was pushed down as part of the post-merger integration. However, the Commercial Court concluded that the purported infringement of Article 92 made it more likely that the MTA's investigation would continue, irrespective of whether infringement of Article 31 was also a live issue.

The key issue that remained for the Commercial Court to consider was whether the Claimant had adequately mitigated its losses. The Claimant's Mexican subsidiary paid various tax demands following the challenge to the pushdown arrangements but had then (on the advice of the Defendant) in January 2007 and October 2008 issued proceedings (referred to as nullity proceedings) in the Mexican courts, to challenge the MTA's determinations. However, having instructed another local firm specialising in tax matters in November 2008 (Tron), the Claimant decided in July 2009 to settle its tax liabilities with the MTA (without any real discount). As part of the settlement, however, the MTA was said to have offered a non-binding agreement in respect of treatment of future tax years.

The test to be applied as to the reasonableness of the settlement with the MTA was the one set out in *Siemens v Supershield* [2009]. There Ramsey J stated that the court needs to assess whether the settlement was "in all the circumstances within the range of settlements which reasonable people in the position of the settling party might have made. Such circumstances will generally include: (a) the strength of the claim; (b) whether the settlement was the result of legal advice; (c) the uncertainties and expense of litigation; (d) the benefits of settling the case rather than disputing it".

It should be noted that, during the course of the trial, the Claimant conceded that the Claimant's Mexican subsidiary would have succeeded with the nullity proceedings if they had proceeded with them. However, the Claimant sought to suggest that the deal with the Mexican authorities was reasonable, by reference to five factors: (i) the benefit of obtaining the unenforceable undertaking from the MTA about treatment of future tax returns; (ii) the Claimant had received advice from Tron that the nullity proceedings were not likely to succeed; (iii) the Claimant wanted to avoid protracted litigation; (iv) the Claimant's Mexican subsidiary saw benefit in "showing good faith" to the Mexican tax authorities; and (v) the Claimant's Mexican subsidiary needed to be brought out of a hole that it had been put into.

Judgment

In assessing the reasonableness of the settlement the Claimant entered into, the first question Mr Justice Burton posed was to compare what was obtained from the deal with the MTA, against the potential downside from carrying on with the nullity proceedings and losing them. He determined that had the Claimant proceeded with the nullity proceedings and lost (something that was deemed to be unlikely on the expert evidence in the case), they would have been "not much" worse off than in entering into the settlement with the MTA. They would have lost the chance of the non-binding agreement with the tax authorities (not to challenge further tax returns) being effective, paid an additional €625,222 in fines, and had to pay the additional legal costs of running the nullity proceedings (US$110,000). This potential downside rather paled into significance when compared to the very significant potential upside (of reclaiming many millions of Mexican dollars that it had paid out in tax). It was determined that "on any sensible analysis it was inevitably right to proceed, for very little more money by way of costs, for very little downside if they went ahead and lost".

In rejecting the five points submitted by the Claimant in support of the contention that their behaviour was reasonable, Mr Justice Burton concluded that: (i) the unenforceable undertaking was "of little worth"; (ii) the decision to settle with the MTA was taken before any advice was given by Tron, and in any event Tron only made reference to the nullity proceedings having limited prospects of success after significant "pressure" was applied by the Claimants (with one eye on – having by now consulted English lawyers on a potential claim against the Defendant – demonstrating reasonable efforts to mitigate loss); (iii) concluding the nullity proceedings would not have required protracted litigation (they were virtually concluded at the stage they were settled); (iv) in reality the Claimant's Mexican subsidiary had no interest in trying to show good faith to the MTA; and (v) if senior management of the Claimant wanted for their own Group reasons to conclude the litigation "all well and good, but not by dint of making an unreasonable decision, and not at the expense of [the Defendant]".

In concluding, Mr Justice Burton stated "it is very often in cases of mitigation that a victim of a tort or breach of contract can say that it was put into a difficult position by the tortfeasor or contract breaker, and thus, often in the agony of the moment, had to get out as best it could ... But such is not this case". He went on to say that "it would also not be reasonable for a victim, particularly one not in the agony of the moment, to be swayed by the expectation of recovery against the tortfeasor into taking a step influenced by that fact alone".

Wider application

On the face of it, whilst a good reminder of principles the courts will apply when assessing the reasonableness of effort to mitigate loss, this case is perhaps unlikely to have a great deal of wider application. This is on the basis that, in the current climate in the UK, regarding tax efficient arrangements (with HMRC in a particularly bullish mood), there are unlikely to be many instances where all expert evidence will point to a challenge to HMRC's rejection of a claim for tax relief being successful. As a general rule, claimants will be able rely on the oft repeated informal mantra of "there's no need to litigate to mitigate". However, claimants should be reminded not to see a negligence claim against former advisers as their first port of call – but carefully consider all potential avenues for mitigating loss before embarking on litigation.

back to contents>

Baker Tilly UK Audit LLP & Ors v Financial Reporting Council & Ors[3]

In this case the High Court considered a judicial review application in respect of an FRC investigation. It appears that the courts will be unwilling to extend much sympathy where firms seek to speed up FRC investigations by means of judicial review.

In this case the High Court rejected an attempt by Baker Tilly (and two of its audit partners) to judicially review an FRC decision to deliver a Formal Complaint relating to Baker Tilly's audit work in respect of Tanfield Group Plc and two of its subsidiaries.

Tanfield Group was significantly affected by exposure to the US residential construction market following the economic downturn in 2008. The FRC considered whether impairment provisions made in 2008 should have been put in place one year earlier.

Baker Tilly had first been notified of an investigation into its conduct in September 2009, yet a Formal Complaint was not served on them until 3 June 2014 – so it is therefore easy to sympathise with its frustration at the delay. It faced the unenviable decision of defending disciplinary proceedings which it considered to be ill-founded (and possibly not recovering costs even if the defence was successful) – or seeking judicial review of the regulator's decision to raise a Formal Complaint (with the associated difficult test premised on illegality or irrationality).

The process of raising a Formal Complaint is a precursor to a hearing by the independent Disciplinary Tribunal of the FRC. The Formal Complaint raised in June 2014 included allegations that in signing off Tanfield Group's financial statements: (i) insufficient evidence was obtained to support the conclusions that no material errors existed; and (ii) there was a failure to adequately review and discuss audit evidence.

Baker Tilly sought to judicially review the Formal Complaint on the grounds that:

- guidance on the delivery of Formal Complaints issued by the FRC in July 2013 was unlawful, in that it supports a legally erroneous approach to "misconduct" and contains a misdirection as to what is capable of being "serious misconduct"
- the decision to deliver the Formal Complaint was flawed by a "fundamentally erroneous approach" to the legal meaning of "misconduct" within the FRC's disciplinary scheme relating to accountants
- the public interest test which had to be satisfied before a Formal Complaint could be delivered was flawed by errors of law, in particular because of the long delay before it was raised.

Mr Justice Singh, in handing down judgment on 19 May 2015, rejected all three grounds of complaint.

The Court determined that there had been no demonstration that the Guidance was "inherently and necessarily unlawful" and that this aspect of the challenge was premised on ignoring the context of certain paragraphs of the Guidance (trying to infer that issues concerning the public interest test were relevant to the evidential test).

The judgment went on to state that:

"Having regard to all relevant matters, including the Guidance, the Executive Counsel came to the view that the alleged misconduct was "serious". The Claimants disagree with that view. However, I am unable to regard it as being irrational or otherwise unlawful ... public interest considerations are par excellence matters for the evaluation by the relevant decision makers".

Finally, the Court concluded that it was wrong as a matter of principle that the judicial review had been instigated in the first place. Five factors were set out in support of this conclusion:

- such cases should be determined by the Disciplinary Tribunal, which is the expert in the field (and if necessary and appropriate its decisions can be appealed)
- it is undesirable in principle that the public interest should be impeded by delaying proceedings before the Tribunal in such cases
- the Tribunal would have the opportunity to consider evidence in full and hear live evidence – something the Court in judicial review proceedings was not equipped to do
- if there was an abuse of process, the Tribunal has jurisdiction to stay proceedings
- although the Claimants sought to argue that there was no alternative remedy other than judicial review proceedings, because costs were not available to the successful Defendant who was subject to Disciplinary Tribunal proceedings, it was noted that the Tribunal does in fact have the power to order costs (even though costs will not necessarily follow the event).

Comment
This case demonstrates the difficulty that can be encountered in attempting to short cut (or even just speed up) disciplinary proceedings. Whilst the process of a regulatory investigation can be extremely frustrating, the courts are unlikely to look favourably on a challenge outside the parameters of the relevant disciplinary scheme.

back to contents>

Altus Group Ltd v Baker Tilly Ltd[4]

In this case the High Court considered how it should make loss of chance assessments in relation to tax mitigation schemes, in particular, whether the court should look to make a definitive assessment as to whether the relevant tax planning works as a matter of law.

Background
The accountancy firm Baker Tilly was engaged by Altus for the purposes of preparing its corporation tax returns from 2007 to 2010. Altus claimed Baker Tilly failed to advise them of the tax implications of section 1263 of the Corporation Tax Act 2009 (CTA 09). The legislation came into force on 1 April 2009 – however, Baker Tilly did not inform Altus of the change in the law until October 2011.

A month after being informed of the statutory change Altus employed Ernst & Young as a tax adviser. EY proposed a company restructuring in order to mitigate its tax liability under the new legislation. However, the attempt to restructure was eventually abandoned after four months.

Altus' claim centred on the contention that had Baker Tilly advised them regarding s.1263, it would have had sufficient time to restructure and mitigate any new tax liabilities.

Baker Tilly admitted it had breached its duty with regard to advising Altus of the introduction and implications of s.1263 CTA 09. However, the firm argued that even if they had provided advice, Altus would not have implemented the restructure, and therefore Altus had not suffered a loss. They also argued that HMRC would have investigated the new structure proposed and determined that it did not work.

The Decision
Judge Keyser QC (sitting in the High Court) held that Baker Tilly was in breach of its duty towards Altus, particularly considering it held itself out as being "a top-end very large firm of

specialist advisers." Consequently, the Court deemed it was reasonable to judge them by those standards, rather than the standards of an "ordinary" firm of accountants.

The Court also concluded that, contrary to Baker Tilly's defence, had the accounting firm given the relevant advice, Altus would have undertaken the company restructuring.

Loss of a Chance

Judge Keyser QC then considered the consequences of the breach, and decided any loss should be determined on the basis of loss of a chance.

The claim consisted of a breach of duty in the form of an omission, but the benefit to Altus had the breach not occurred was dependent on the actions of a third party (ie HMRC, who could have challenged the legitimacy of the proposed tax planning). The Court therefore applied the relevant case law, *Allied Maples Group Ltd v Simmons & Simmons*[5].

Allied Maples contains a two stage test which any Claimant must successfully overcome in order for a loss of chance to be proven. The two stages are:

- the Claimant must prove on the balance of probabilities what it would have done had the breach not occurred
- should the Claimant overcome stage 1, damages will be assessed on the basis of the value of the chance that the third party would have acted in such a way as to confer the benefit.

Leading Counsel for Baker Tilly accepted that the first question involved the Claimant showing on the balance of probabilities that it would have implemented a restructure. In relation to the second question, he submitted that an assessment needed to be made as to whether that restructure would have had the desired effect as a matter of law. That is, if tax planning was held to be ineffective as a matter of law, no damages should be recoverable even if there was a significant chance of the restructure succeeding in practical terms (ie of HMRC not challenging it). The Court rejected this approach and decided that it needed to make:

"a practical assessment of the chances that [the restructure] would in fact have resulted in a tax saving for the claimant. Only if a particular issue of fact or law is so clear that there was no substantial prospect of it being resolved other than in a particular way should the court depart from the "loss of a chance" approach".

The Court was confident that had Altus instructed E&Y in 2009 it would have implemented the restructure. However it was not confident that the Claimant would have in fact instructed E&Y at all in 2009, even with knowledge of the new legislation. Instead, Judge Keyser QC believed that Altus would have instructed PwC, its preferred tax adviser of the time. He was confident that on the balance of probabilities PwC would not have recommended the type of restructure proposed by E&Y, and therefore the claim failed at stage 1 of the Allied Maples test.

Nevertheless, the Court went on to discuss hypothetically stage 2 of the test – how damages would have been assessed had the claim been successful. It concluded if there had been a restructure there was a 7.2% chance that the tax benefits of Altus' original filing position would have been set aside.

5. [1995] 1 WLR 1602

Conclusions

Despite being a first instance decision, this case provides useful guidance on how the Courts will apply loss of a chance cases to accountancy matters (particularly those involving tax mitigation). It is noteworthy that the Court decided to take a relatively broad brush approach to loss of a chance, and rejected the suggestion that it needed to make a definitive ruling on whether a certain form of tax planning worked as a matter of law. Clearly this is likely to be of significance in relation to claims against accountants and financial professionals in cases involving alleged negligent promotion or advice in respect of tax efficient products.

back to contents>

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