CHANCERY BAR

"THERE ARE MORE QUESTIONS THAN ANSWERS": THE OPERATION OF S 14A OF THE LIMITATION ACT 1980 IN FINANCIAL MIS-SELLING CLAIMS

Financial products are often long term in nature. Where a recommendation is poor, it may be some time before the client realises that he had been badly advised. Indeed, with some products he may never realise this at all. For example, the total cost of borrowing money will normally be higher where the loan is on an interest-only as opposed to a repayment basis. But a borrower who meets all of the payments due may never appreciate that he could have borrowed more cheaply.

As with any professional advice, when a recommendation is made by an intermediary, the potential causes of action are likely to involve a breach of either or both of the contractual implied and tortious duties to exercise reasonable care and skill. There may also be a potential breach of statutory duty under what was formerly section 150 and is now section 138D of FSMA. Where the client is induced to enter into the transaction by something said by the product provider itself, there may be a cause of action in misrepresentation.

In so far as the claim is in contract or for sums recoverable by statute, the limitation period will expire six years after the breach.[1] In tort, even in relation to the primary limitation period (let alone any extended period under section 14A), the position is less straightforward. It is trite law that a cause of action in tort accrues when actual damage is suffered. But, in the case of financial products this poses problems, the occurrence of loss often being closely associated with the assumption of risk.

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[1] Limitation Act 1980, ss 5, 9

The notion of risk and return lies at the heart of any decision to invest. But the concept of risk is diffuse in nature. Numerous types of risk have been identified and recognised: interest rate risk, business risk, credit risk, taxability risk, call risk, inflationary or purchasing power risk, liquidity risk, market risk, reinvestment risk, social or political risk and currency or exchange rate risk.

The "Parable of the Talents" illustrates the difficulties surrounding another important concept associated with the identification and measurement of risk: the so-called risk-free interest rate. It has been observed that the concept of a risk-free rate means different things to different people. In *Nestle v National Westminster Bank Plc*, [2] a testator had left a portfolio of investments which was described by Dillon LJ as "reasonably well balanced"[3] for 1922. Equity holdings were predominately of "bank and insurance shares, which were particularly favoured at the time"[4]. It was alleged, albeit unsuccessfully, that loss had resulted from various failures to diverge from what may in the 1920's have been seen as a low risk (although admittedly not a risk-free) investment strategy.

Risk will not, though, lie at the heart of every decision. One product may simply be arithmetically cheaper than another. An example is the annuity market, this being the subject of a thematic review announced by the FSA in February 2013. Reference has already been made to the relative arithmetic expensiveness of interest-only borrowing, although, even here, risk is not wholly irrelevant. Concerns expressed by the FCA have been couched in terms of the risks to consumers when interest-only mortgages reach maturity and borrowers do not have the capital to repay the balance due.[5]

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[2] [1993] 1 W.L.R. 1260
[3] *ibid.* at 1265H
[4] *ibid.* at 1266A
[5] GC13/2 *"Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan"*

In many cases, by analogy with *Forster v Outred & Co*,[6] actual damage will be suffered (and a cause of action in tort will accrue) on the purchase of a product. If a client is badly advised in relation to an annuity, he is immediately locked into a product providing a lower income stream than would have been available elsewhere. But if a client is badly advised to purchase an overly risky investment, he may never suffer a loss at all in the everyday sense. The exploration company recommended may hit oil and its highly speculative shares may soar. How can the investor be said to have suffered a loss when he has, in fact, bettered what would have been the outcome of correct advice?

This problem was considered by Dyson LJ in *Shore v Sedgwick Financial Services Ltd*[7] in a passage later cited by Lewison J in *Pegasus Management Holdings SCA v Ernst & Young*.[8] Dyson LJ said this:

> "In my judgment, an investor who wishes to place £100 in a secure risk-free investment and, in reliance on negligent advice, purchases shares does suffer financial detriment on the acquisition of the shares despite the fact that he pays the market price for the shares. It is no answer to this investor's complaint that he has been induced to buy a risky investment when he wanted a safe one to say that the risky investment was worth what he paid for it in the market. His complaint is that he did not want a risky investment. A claim for damages immediately upon the acquisition of the shares would succeed. The investor would at least be entitled to the difference between the cost of buying the Government bonds and the cost of buying and selling the shares."[9]

Strictly, this observation was *obiter*, *Shore* being concerned with a transfer of benefits under an occupational pension scheme. It does, though, accord with the proposition that, for this purpose, professional negligence cases are in some way different and distinct.

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[6] [1982] 1 WLR 86
[7] [2008] EWCA Civ 863; [2008] P.N.L.R. 37
[8] [2008] EWHC 2720 (Ch); [2009] P.N.L.R. 11
[9] [2008] EWCA Civ 863; [2008] P.N.L.R. 37 at [38]

Practical problems may also arise where the recommendation is to transfer assets to a discretionary manager. That advice may be unsuitable because, for example, the management service will be more expensive than a suitable packaged product. But if the advice to use a management service is not itself bad, at what point can any loss suffered by the client be said to have occurred? The fund manager may, for example, initially adopt an asset allocation which is in accordance with the client's requirements and only later switch to an overly risky strategy.

The significance of section 14A is that it provides for a special limitation period in the tort of negligence (and negligence only) for those who have suffered a loss but do not have the requisite knowledge relating to that loss. To establish when the special limitation period starts to run, it is necessary to determine the claimant's date of knowledge. As was explained in *Iron Trade Mutual Insurance Co Ltd v J K Buckenham Ltd*,[10] this is essentially a question of fact which will frequently have to be investigated at trial or by way of a preliminary issue.

Subsection 14A(5) says this:

> "For the purposes of this section, the starting date for reckoning the period of limitation … is the earliest date on which the plaintiff or any person in whom the cause of action was vested before him first had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action."

The expression "the knowledge required for bringing an action for damages in respect of the relevant damage" is defined in subsection (6). It means:

> "knowledge both—

[10] [1990] 1 All ER 808

> (a) of the material facts about the damage in respect of which damages are claimed; and
> (b) of the other facts relevant to the current action mentioned in subsection (8) below."

Subsection (7) provides that "the material facts about the damage" are:

> "such facts about the damage as would lead a reasonable person who had suffered such damage to consider it sufficiently serious to justify his instituting proceedings for damages against a defendant who did not dispute liability and was able to satisfy a judgment."

This subsection is sometimes misunderstood. Essentially, it seems to contemplate the situation where observable minor damage unexpectedly worsens to the extent that proceedings become justified.

The "other facts … mentioned in subsection (8)" are:

> (a) that the damage was attributable in whole or in part to the act or omission which is alleged to constitute negligence; and
> (b) the identity of the defendant; and
> (c) if it is alleged that the act or omission was that of a person other than the defendant, the identity of that person and the additional facts supporting the bringing of an action against the defendant."

Often, no issues will arise in relation to (b) and (c). (a), though, is potentially highly problematic. It introduces the elusive concept of attributability.

Subsection (9) provides that:

> "Knowledge that any acts or omissions did or did not, as a matter of law, involve negligence is irrelevant for the purposes of subsection (5) above."

In other words, a lay person's ignorance of the legal concept of negligence will not, of itself, prevent time from running.

Subsection (10) allows for constructive knowledge.

> "For the purposes of this section a person's knowledge includes knowledge which he might reasonably have been expected to acquire—
> (a) from facts observable or ascertainable by him; or
> (b) from facts ascertainable by him with the help of appropriate expert advice which it is reasonable for him to seek;
> but a person shall not be taken by virtue of this subsection to have knowledge of a fact ascertainable only with the help of expert advice so long as he has taken all reasonable steps to obtain (and, where appropriate, to act on) that advice."

This wording seems sufficiently broad to mean that, where it is reasonable for a person not to take advice, he should not be fixed with the knowledge (for example, that he may have a potential claim) which he could have obtained by doing so.

As is observed in the *White Book*,[11] the "difficulties of the application of s.14A are well illustrated in the (leading) case" of *Haward v Fawcetts*.[12] When considering the consequences of advice relating to financial products, the devil in section 14A frequently lies in subsection (8)(a) and the concept of attributability. Even if *Haward* does contain something resembling a "bright-line" rule, it is easier to identify the potential problems associated with the concept of attributability than the practical solutions to those problems.

Haward concerned advice given by a firm of accountants in relation to the proposed acquisition of a controlling interest in a company. A forecast of the amount which

[11] *Civil Procedure* (2013), Vol 2, 8-43
[12] [2006] UKHL 9; [2006] 1 WLR 682

would have to be invested to bring the company to reasonable profitability proved mistaken.

The headnote to *Haward* contains two significant propositions of law: first "that "knowledge" for the purposes of section 14A … meant knowing with sufficient confidence to justify embarking upon the on the preliminaries to the issue of a writ". Secondly, it was held "that knowledge that the damage was "attributable" whole or in part to the acts or omissions of the defendant alleged to constitute negligence within section 14A(8)(a) meant knowledge in broad terms of the facts on which the claimant's complaint was based and of the defendant's acts or omissions and knowing that there was a real possibility that those acts or omissions had been a cause of the damage".

In formulating the first of these propositions, Lord Nicholls of Birkenhead referred to the "valuable guidance" given by Lord Donaldson of Lymington MR in *Halford v Brookes*.[13] The "preliminaries" may include:

> "submitting a claim to the proposed defendant, taking advice, and collecting evidence. "Suspicion, particularly if it is vague and unsupported, will indeed not be enough, but reasonable belief will normally suffice". In other words, the claimant must know enough for it to be reasonable to begin to investigate further."[14]

Subsection (10) (which was not relied upon in *Haward*) is sometimes referred to, not entirely accurately, as making the test of knowledge an objective one. Be that as it may, it seems reasonably clear that some personal characteristics of the claimant can and should be taken into account when assessing whether he had knowledge or behaved reasonably. In *Haward*, Lord Walker of Gestingthorpe drew a distinction between that case, which involved "a mature businessman's understanding of financial advice on the trading activities of a small company carrying on a fairly

[13] [1991] 1 WLR 428, 443
[14] [2006] UKHL 9; [2006] 1 WLR 682 at [9]

straightforward sort of business", and *HF Pension Trustees Ltd v Ellison*,[15] which concerned "laymen's understanding and appreciation of legal advice on a highly technical subject, that is, the exercise of fiduciary powers under occupational pension schemes".[16]

It is, though, the concept of attributability which seems to have caused particular difficulties in *Haward*. As Hoffman LJ had observed in *Hallam-Eames v Merrett Syndicates Ltd*[17], "the act or omission of which the plaintiff must have knowledge must be that which is causally relevant for the purposes of an allegation of negligence".[18] He continued:

> "It is this idea of causal relevance which various judges of this court have tried to express by saying the plaintiff must know the "essence of the act or omission to which the injury is attributable" … or "the essential thrust of the case" … or that "one should look at the way the plaintiff puts his case, distil what he is complaining about and ask whether he had in broad terms knowledge of the facts on which that complaint is based."

Lord Brown of Eaton-under-Heywood observed that "the essence of the act or omission" could be

> "characterised in either of two ways: either as the act of recommending investment in the company (or omitting to caution against it …), or, with greater particularity, the act of recommending investment without first carrying out the investigations necessary to justify such positive advice".[19]

Lord Brown preferred the former, under which

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[15] [1999] Lloyd's Rep PN 489
[16] [2006] UKHL 9; [2006] 1 WLR 682 at [74]
[17] [1995] PNLR 672
[18] *ibid.* at [29-08]
[19] [2006] UKHL 9; [2006] 1 WLR 682 at [90]

> "the claimant knows nothing beyond the fact that his advisers led him into what turned out to be a bad investment; he does not know, as under the latter characterisation he would, that he has a justifiable complaint against his advisers. But he surely knows enough (constructive knowledge aside) to realise that there is a real possibility of his damage having been caused by some flaw or inadequacy in his advisers' investment advice, and enough therefore to start an investigation into that possibility".[20]

This passage, though, is not easy to reconcile with various passages in the other speeches. Lord Walker endorsed the body of Court of Appeal authority culminating in *Hallam-Eames* in which the claimants "were ignorant of the real significance of the bare facts which they did know".[21] He said:

> "It is no coincidence, I think, that both (*Ellison*) and (*Hallam-Eames*) were cases of pure economic loss occurring in areas (occupational pensions and reinsurance at Lloyd's) which call for specialised technical expertise. Areas of that sort are those in which it is most likely that a claimant may know the basic facts, but not know what, to an expert, they add up to."[22]

Lord Mance expressed the opinion that it was "wrong to suggest that all a claimant needs to know is that he has received professional advice but for which he would not have acted in a particular way which has given rise to loss".[23] He continued:

> "A claimant who has received apparently sound and reliable advice may see no reason to challenge it unless and until he discovers that it has not been preceded by or based on the investigation which he instructed or expected. A claimant who has suffered financial loss in a transaction entered into in reliance on such advice may not attribute such loss to the advice unless and until he either makes the like discovery about the inadequacy of the work

[20] i*bid.* at [90]
[21] i*bid.* at [63]
[22] i*bid.* at [64]
[23] i*bid.* at [118]

> done, or at least discovers some respect in which the transaction was from the outset unsound giving him (as Hoffmann LJ said) prima facie cause to complain. Such a scenario may well occur where there are other causes of loss which appear to him capable of explaining the whole loss."[24]

The final sentence of this passage is noteworthy. Just as the initial analysis of the risk characteristics of a particular investment may be a complex task, so it may far from easy *post facto* to attribute the performance of an investment to one characteristic, or potential cause of loss, rather than another. Such matters have been the subject of academic scrutiny for decades.

To give a heavily simplified example, between two dates ("A") and ("Z"), the market falls by 10 per cent but shares in X plc fall by 20 per cent. If an adviser was not negligent in recommending an investment of £100 in the stock market but negligent in recommending that an investment be made in X plc, it would seem to be only £10 of the total £20 loss (20 per cent) which could be said to be "attributable" within the meaning of section 14A(8)(a). In fact, the position may be significantly more complex than this, depending upon the nature of the advice and the level of risk which was justified. It might, for example, have been non-negligent to advise investment in an asset category slightly riskier than "the market" but negligent to advise investment in one substantially riskier.

There are two consequences which emerge from this. First, questions as to whether an adviser was justified in advising A rather than B, and as to the respective outcomes of the two courses of action, are firmly in the territory of expert evidence of opinion. Secondly, the unsophisticated retail client cannot necessarily realistically be expected to attribute and apportion causes to a loss which he may have suffered. To use the worked example given above, such a client cannot be expected to know from the mere fact that he has made a loss whether (i) the entire £20 loss was "attributable" to the market (and thus "one of those things") or (ii) whether some or

[24] i*bid.* at [118]

all of it (the £10) was (or might have been) "attributable" to the negligence (even in the non-technical sense) of the person making the recommendation.

Moreover, the unsophisticated customer may not appreciate that, whilst he appears to have a nominal profit, he may, in fact, have suffered an opportunity loss. Even a sophisticated client may not realise, until he has taken professional advice or made a subject access request, that his adviser had erroneously classified his tolerance of risk and then recommended investments which would have been suitable under that erroneous (but not under a correct) classification.

Section 14A knowledge is *par excellence* a question of fact. That is not to say that in every case it will be a difficult issue of fact. In some cases, there will be clear contemporaneous evidence suggestive of contemporaneous knowledge of attributability. In other cases, the defendant may suspect that the claimant knew all along. "You knew perfectly well, didn't you?" is a wholly legitimate cross-examination question which may enable reliance on section 14A to be defeated at trial. "He must have realised, mustn't he?" prompts an enquiry into the level of appreciation and sophistication of the claimant. The discussion and reasoning set out above, though, suggest that courts should be cautious about attributing over-high levels of financial sophistication to retail clients (especially with the benefit of hindsight).

Where a product has performed badly, it will not be uncommon for a client to raise this with his adviser. Equally, it will not be uncommon for the adviser, first, to advise the customer to hold onto his investment and, secondly, to attribute any unrealised loss to some uncontrollable external factor: "It's the market" or "It's one of those things". Not surprisingly, it would be unusual for an adviser to attribute such a loss to his having given unsuitable investment advice in the first place. The effect of such assurances may be to dissuade the client from considering making a formal complaint (of which DISP 1.9 would require a record to be kept) or taking independent advice. In a suitable case, might an adviser be estopped from relying upon the proposition that the customer had the requisite knowledge at the time of the assurances? It seems unattractive to argue that the client knew "with sufficient confidence to justify embarking on the preliminaries to the issue of a writ" the exact obverse of the analysis actually proffered by the adviser.

Similarly, the application of subsection (10) may not be easy. A harsh approach has the potential to operate unfairly and oppressively towards retail clients. Taken to its logical conclusion, an approach which expected retail clients to be perennially alert to the possibility of negligence would require them to take advice each and every time they appear to have suffered a loss in order to ascertain whether that loss might be wholly or partially attributable to the negligence (in the non-technical sense) of whoever had advised them. It must also be borne in mind (i) that many of those most vulnerable to mis-selling will be those least familiar with the concept and (ii) that one should be cautious of the benefit of hindsight. There have been significant recent changes in consumer perceptions of the competence of financial institutions.

In *Mortgage Corporation v Lambert & Co*,[25] the Court of Appeal took a relatively lenient approach to subsection (10) in the case of a sophisticated client, a mortgage lender who had instructed the defendant valuers. As Chadwick LJ observed:

> "The real question, as it seems to me, is not whether a prudent lender would have been on enquiry, in November 1992 or June 1993, as to the validity of the original valuation; but whether (if on enquiry) it would have been reasonable for it to obtain a retrospective valuation of the property at that stage. … There was no evidence that …with some three years in hand before any relevant period of limitation would expire—a prudent lender would have taken the step of obtaining a retrospective valuation, the only purpose of which could be to provide a basis for a claim against the defendant valuers. It is not, at least to my mind, at all self-evident that a lender would not have acted reasonably in those circumstances if it had decided to wait until it had obtained the

[25] [2000] PNLR 820

> possession of the property which it was seeking before instructing valuers. It would need to instruct valuers, at that stage, to provide a current valuation of the property, in order to set a price at which the property would be offered for sale on the market. It might well have seemed sensible to wait until the valuers were instructed for that purpose (a current valuation) before asking them to provide a retrospective valuation as at April 30, 1990."[26]

In conclusion, one might pose (but necessarily leave unanswered) three particular questions. First, is *Shore* the final word on the problems arising when damage takes the form of the assumption of excess risk? Even if it is, might there not be cases where its practical application will prove problematic? Secondly, in circumstances where the legal concept of causation is so closely associated with the elusive financial concept of risk, where should the precise boundary lie between merely knowing that something has gone wrong and suspecting that an adviser may have done something wrong at the outset? And thirdly, what should be the legal effect of reassuring words which may be intended to placate but which might, in practice, have the effect of steering the client away from a potential remedy?

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[26] i*bid.* at 829