LLOYD'S

360 LIVE DEBATE

IS BUSINESS FACING A LIABILITY CRISIS?

TUESDAY, 20 MAY 2008

The Rt Hon the Lord Falconer of Thoroton

Three pictures from recent times.

First the Perry triplets birthday party in 2005. They hired a bouncy castle. Sam Harris, a boy, was at the party. He went on to the bouncy castle. He got knocked in the head, by a much bigger boy. He sustained severe brain injuries.

Sam, through his mother, sued the triplets' parents for not supervising the bouncy castle carefully enough. Sam won. Damages have yet to be assessed. They are likely to be well over £1m. The Perry's were insured. They want this process, understandably, to be over. They don't want to appeal.

Second, the Bank of England, in concert with banking regulators all over the world, put the BCCI out of business as a bank because of the wide range of frauds and deceits practiced by that bank, which had become the 7th largest bank in the world. Nobody doubts the myriad frauds, and that the BCCI should have been put out of business.

After nine years of litigation and almost two years in court, a group of BCCI creditors dropped a $1b dollar claim against the BoE for malfeasance in their regulation.

And the third picture from modern times, the non-executive directors of Equitable Life. The company sued them, alleging that as non-executive directors, they should have spotted the potential risk to Equitable Life of having a variety of policies on which very high annuity rates would have to be paid. The litigation against the non-executive directors, as the litigation against the auditors, took years. It was never explained what they were supposed to have done about it had they become aware of the problem. Put aside the extra-ordinary inappropriateness of Equitable Life suing its non-executive directors.

The claim was dismissed, after the company abandoned its claim. But only after the litigation went on for three years, and £30m had been spent on costs of the claim against the auditors, and £10m in respect of the claim against the directors.

We live, now, in a world where there is a perception that for every injury there must be someone who will be liable to pay the losers. For every business risk which goes wrong there is someone to sue.

Whether the loss be the injuries suffered by a child, tragically, at a birthday party; whether it be a bank being run in a fraudulent way, whether it be a business venture which goes wrong because of unforeseen or unexpected liabilities there will be someone the world believes who is to blame, and, more significantly, someone who will pay.

That is the perception. In very many cases it is wrong. The courts are generally robust in their rejection of cases where although there has been an injury nevertheless no-one in truth is responsible for the loss. They do recognise there are cases where there are losses or injuries which are either the fault of the claimant, or, equally likely, the product of the risks which all of us take in our dealings – business and personal - with other people.

The number of personal injuries cases which have been made – including those which never got to court have, in recent years, have gone down.

But if you look at the longer picture, in 1973 there were 250,000 claims in 2001 it had gone up to 700,000.

But whatever the truth of that perception our society increasingly acts on the basis the perception is an accurate one.

That is demonstrated at two levels – the extent to which our society is now becoming damagingly risk-averse, and, secondly, the extent to which people will now look to pursue claims through proceedings which are then sometimes lost by the defendant, or, just as often, settled by the defendant because the costs of fighting are prohibitive, and the risks of losing are disastrous.

A task force set up to look at better regulation wrote a report a few years ago:

“media reports and claims management companies encourage people to "have a go" by creating a perception, quite inaccurately, that large sums of money are easily accessible. It

is this perception that causes the real problem: the fear of litigation impacts on behaviour and imposes burdens on organisations trying to handle claims. The judicial process is very good at sorting the wheat from the chaff, but all claims must still be assessed in the early stages. Redress for a genuine claimant is hampered by the spurious claims arising from the perception of a compensation culture. The compensation culture is a myth; but the cost of this belief is very real."

The reasons for the perception are many and various.

The quote refers to media reports, and claims management companies. The media reports successful claims like the bouncy castle. They also report the un-successful claims.

But, as often as not, they are horror stories like the BCCI or the Equitable Life, where the "winners" – the BoE, or the non-executive directors are perceived to have had the most horrendous time – rightly so. The costs and the cloud hanging over individuals and institutions are hard to deal with, and constitute to those individuals and institutions, a real threat.

They therefore represent hugely successful black mail weapons in the hands of claimants, particularly where some thing akin to a class action can be put together. Maybe it will not have much prospect of success, but the consequences if it does succeed will be such that to avoid the huge costs and emotional resources which have to be expended to win, better to settle as early as possible.

When I was at the commercial Bar – and I hasten to add, things I'm sure have changed – it was common for there to be three or four very large cases listed at the beginning of October. They would, mostly all settle either just before they started or after a few days. It was, generally, well worth making the claim. An argument was enough.

In addition to the press reporting, and the sense claims have a value way beyond their prospects of success, there are the activities of claims farmers – the people who are advertising for claims, and doing so by raising expectations.

In a recent article in The Times, a partner in a firm which conducts personal injury highlighted the problem :

“lets take[…] a driver suffering a minor whiplash via a rear shunt crash[…] chances are that within hours, if not days, the injured driver will be bombarded with offers of legal assistance. They may come from claims farmers on the prowl, from lawyers who have an arrangement with the crash pick up truck, from lawyers leaflets in the hospital, directly from doctors at the hospitals who have financial deals with lawyers, or from the driver’s motoring association. The going rate for passing a case on to a Law firm is between £250-500.”

As this quote reveals litigation and claims are now assets to be traded. There are going rates for these claims.

And, as is apparent in the things I have said, that market reaches beyond the personal injuries market. The libel claims market has changed radically. Formerly, because legal aid was not available to libel claimants, the media had the whip hand. Now it is the other way round. The claimant can, usually, find a conditional fee agreement solicitor. The risks to the claimant are small, and to the media high.

But the market, as ever, has developed more than just conditional fee agreements to service this new landscape.

Third party funding of litigation has now become increasingly available.

Whereas the common law used to discourage as much as possible people unconnected with the claim from funding those claims - the law did not approve of people unconnected with the litigation maintaining that litigation - now however the courts are much more willing to see outsiders fund the costs of litigation.

They do so because it encourages access to justice. That principle is correct. And I do not object in principle to third party funding.

However, we need to ensure that the market in litigation which develops as a result is a market in cases which should be brought, not ones which would not previously have been

brought – because the claimant could not afford them, and because there was no merit in them – and which become a real threat to legitimate business activity and risk taking.

Hedge funds are now created which exist to invest in litigation.

Australia is the place where the market is now most developed.

On the 15th April 2008, by way of example, IMF (Australia) Ltd, a litigation funder announced the formation of a fifty-fifty Europe based joint venture with interests associated with class action specialists Maurice Blackburn. The announcement reads "the venture will provide litigation funding for group proceedings, known as class actions in Australia"

Or can I quote from another IMF announcement to the Australian stock exchange:

"listed litigation funder IMF (Australia) Ltd will fund shareholder class actions against four Australian fund managers that hit trouble after the global credit crisis emerged last year….during the six months, shares in the four finance companies slid dramatically as they struggled with heavy debt loads and complex structures"

A sign of things to come.

These funders' announcements echo the statements made by some of the shareholders of Northern Rock.

Those shareholders spoke threateningly of litigation if the government did not compensate them if they nationalised the company.

There are arrangements in the Nationalisation Act for value-ing the shares.

Northern Rock gambled and lost. They survived through a government loan of in excess of £56billion. Once Northern Rock lost access, through the freezing of the inter-bank credit arrangements in the summer of last year, to the funding of a significant proportion of their retail mortgages their business was entirely at risk. It was only saved by the government loan. Thereafter their future depended entirely on the attitude of the State.

For the shareholders, or some of them, to talk of litigation involved taking the compensation culture to its limits, and way beyond.

Because the business had failed. Investors take risks. Maybe to the shareholders it would have seemed a small risk. But it's the nature of business that if the risk does not occur you make money, and if it does you lose. There is not some third course called litigation.

The much greater resort to litigation, and the belief that someone will pay comes from a number of quite deep-seated changes in society.

First, we are much more individualistic. No longer do we look for salvation from collective action. We want to vindicate ourselves. It is reflected as much in the decline of the politician's standing – they are no longer perceived to represent individual's interests. That desire to vindicate ourselves creates an atmosphere of being able to take people on through the courts. If somebody did something wrong, an individual feels there must be a remedy.

Second, we trust people less. The large commercial body or the state organisation which denies liability is assumed to be acting only in its own interests. . Erin Brockovich made her name, quite legitimately from taking on a big corporation, and establishing that they were liable for damage done to individuals.

The heroisation of Erin Brockovich creates the picture of the campaigning lawyer who will cut through the lies and the unfairnesses, and provide vindication for the individual.

All based on the proposition you can't trust the big battalion.

The BCCI case involved allegations of bad faith against the Bank of England. Only if the claimants could establish the equivalent of bad faith on the part of the bank could they succeed. They were struck out by the lower courts because they could not get the allegation of bad faith off the ground, even at a preliminary stage. The House of Lords re-instated their claim, in part because they felt they should be reluctant to strike out a claim

against a public body like the BoE because that would reduce the accountability of a public body.

Third, funding for claims in which there may be substantial financial recovery has become much easier to find. True legal aid has been more limited. Because of pressures which have come, largely from the costs of funding criminal legal aid.

But for litigation which may produce financial rewards funding can now, generally, be found. And the higher the recovery, the more likely the action will be funded. Although the prospects may fall below 50%, nevertheless there is a place on the risk/reward ratio above which it is worth, whether as a solicitor's firm, or, more commonly now as a third party funder to take the risk of funding the litigation.

Of course, the larger the potential recovery, the more either a conditional fee agreement will be available - -the law firm will be prepared to take a bigger risk if the prospect of what will be recovered is high.

That sense that every wrong has a remedy is underlined by the advertising from claim companies, which creates the impression that, indeed, every injury does involve someone who will pay for it.

I have put together the compensation culture in the individual arena – particularly personal injuries, and the commercial arena, for example the signs that litigation will follow from the consequences from the credit crunch.

I do that because I believe they feed on each other and reflect changes in society. And because in both areas they are damaging to national life.

In the personal arena they lead to there being no bouncy castles at children's birthday parties.

And fewer school trips.

And fewer volunteers prepared to help with old people or vulnerable people.

And fewer places of interest to visit because their owners – local authorities or others – will not be willing to open them to the public if they run the disproportionate risk of being sued.

Each of those losses is sustainable on its own, but the combination of these things having an effect on the quality of all our lives.

And in the commercial field we risk the loss of people being unprepared to participate in corporate governance – the £30k paid to many non-executive directors looks a very low reward when the risk is so high.

And our regulators have to become defensive in what they do, and unwilling to allow, for example, the financial sector to grow and take the very risks on which our country's commercial success depends.

We have succeeded as a trading nation – look at the success over centuries of places like Lloyd's of London; and look at the growth of London as the most significant financial centre in the world – in large measure because we have got right the balance between proper regulation, and commercial freedom.

There is no doubt that people who deal in and with the UK have confidence that the law and the courts are un-corrupt and we are in many respect good in the regulation of our financial sector.

And that English law is sensible and attractive in its dealing with commercial issues – it brings certainty and clarity. Commercial people feel English law allows their bargains to be well reflected and enforced.

And we have been incredibly good as a nation in keeping the lawyers and the courts out, as much as possible, of areas where it is much better that the main focus be on the commercial players themselves.

The success of our takeover panel is one example of this. Another is the courts' effectiveness in ensuring that the courts will only rarely allow themselves to second guess the views of commercial arbitrators.

In both these areas we do so well when you compare us with our rivals – for example New York or Frankfurt.

There are a number of things we need to do, some of which have already been started.

First, as is already occurring, the regulation of claims farmers.

Not the funders, such as IMF, but those people who advertise on daytime TV to all those people who have suffered personal injuries who are misled into believing that their injury could produce a result.

The claims farmers who advertise in police stations or hospital waiting rooms with adverts which say things like:

"I've always wanted one of those and now I have had an accident I can have one."

The government's Compensation Act, passed last year set out to deal with the regulations and that is going well.

Second, we need to ensure that the courts continue to send out the message that those claims which do succeed in the courts are those which are sensible. My experience with the courts and the judges was they were just as committed as the commercial world, and the politicians to see the compensation culture given the clearest possible thumbs-down by the courts.

I have one major concern in this area. Whilst the courts remain sensible on the substance of the law the procedural and costs aspect of a case can be just as potent a threat as the fear of losing.

That you believe on good advice you will win at the end of the day may still not determine whether you settle. For all but the very richest, nine years in litigation drains the resources, and the ability of those involved to focus on the day-to-day.

It is vital the courts are willing to strike out the hopeless case. The consequences of not doing so can be just as damaging as bringing a winning case.

In both the Equitable Life case, and the Bank of England case the cases were struck out by first instance judges before being re-instated by higher courts. Both cases then failed, dramatically, after many months in court. But only after millions of pounds of costs had been wasted, and the English legal system had been damaged, in the eyes of commercial people.

Litigation which fails can be just as defining as litigation which succeeds.

When I was the minister responsible for promoting the Human Rights Act my efforts would repeatedly be set back by stories of the following type (and I quote):

“the Human Rights Act is becoming the first refuge of the scoundrel. It is snatched at by illegal immigrants wishing to avoid repatriation, and by prisoners who want to receive pornography in their cells (on grounds of "freedom of expression"). (Daniel Hannan in The Daily Telegraph on the 16th November 2006).”

The reference to pornography is a reference to Denis Nielsen’s attempt to get a declaration from the courts that his human rights entitled him to hard core porn in jail. The courts dismissed his application at the permission stage without calling on the other side to answer it. And yet the very application has become a defining aspect of the HRA.

The long hopeless commercial cases create a danger that the English courts get an unfair reputation for being insufficiently robust in dealing with long pressurising claim where commerce demands settlement even though that commercial pressure comes not from the strength of the claim, but from the cost and the inconvenience of fighting them.

The English courts have always had a reputation for robustness. This is an area where that reputation needs particularly to be apparent.

But the vanquishing of the damaging compensation culture depends as well on the insurance industry being willing to fight and defeat those hopeless claims which if settled encourage other hopeless claims to give it a go.

As the press releases coming out of Australia suggest the compensation culture club is gearing up for the credit crunch and the bad-times-coming litigation, where the losses quite a lot of people are suffering or are going to suffer were, in the eyes of the losers or their backers, not the fault of the business risk occurring but somebody else's fault – perhaps the regulator, perhaps the credit agencies, perhaps the advisors, perhaps the banks, perhaps the surveyors.

In some cases maybe it was.

But mostly it won't be. And the business community – insurers, courts and lawyers alike - have got to be able by the way we deal with these claims establish that we understand that so risk is viewed in its proper context.

We succeed as a trading nation because our commerce and our law understand what risks everyone take on themselves.

We must continue to do that. If we do our trading advantages continue. We must demonstrate that there isn't a compensation culture in this country.

There is a common sense culture which our commercial world understands.

Thank you.