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Don't get wasted!

Allan Reason & Ben Fairhead
highlight the dangers of acting without
requisite authority

IN BRIEF

- Solicitors should take care to ensure that they have authority from a client before acting in litigation.
- Failure to obtain that authority may leave solicitors open to an order for wasted costs.
- Alternatively, the court has a summary jurisdiction to award damages against solicitors who have commenced proceedings in breach of a warranty of authority.
- Recent developments show that the scope for recovering costs against solicitors in these circumstances remains as strong as ever.

The need to ensure that a corporate client provides proper authority to a firm of solicitors to act in proceedings is a point that can be easily overlooked, despite it being of crucial importance. A recent application for costs serves as a powerful illustration of what can happen when a firm acts without establishing the existence of that authority.

Recent scenario

The story starts in 2001 when a company (Company JV), until that point controlled exclusively by an individual (Mr K) at board and shareholder level, became a joint venture company. This followed the sale by one of the other companies controlled by Mr K (Company A) of its shareholding in Company JV to a separate company (Company B). Company B was a member of a different group of companies managed by a Mr D. Mr K and Mr D became the directors of Company JV, with Company A and Company B each holding 50% of the shares.

The principal customer of Company JV was Company B although, following a restructuring of the group of companies managed by Mr D, a further company (Company C) was created. It purchased the undertakings and assets of Company B, and Company B became non-trading,

Company C became the principal customer of Company JV and a 50% shareholder.

Following a breakdown in relations between Mr K and Mr D, proceedings were issued in May 2004 in the name of Company JV against Company C. However, this was purely on the instruction of Mr K. No steps were taken by Mr K to hold a board meeting or to obtain agreement of his co-director, Mr D, prior to

in the proceedings. He did so without a board meeting or the agreement of Mr D. Firm X was already acting at the time on behalf of Mr K and Company A in related proceedings against other members of the group of companies managed by Mr D.

Within a very short time of Firm X placing themselves on the court record, it was made clear to them in correspondence that there was a disagreement between the directors of Company JV about the issue of the proceedings and that, absent a decision of the board of Company JV, the proceedings and their instruction were not properly authorised. Despite this, and an additional warning that there would be no ratification of the proceedings at either board or shareholder level, Firm X purported to continue to act for Company JV.

Company C issued an application to strike out the proceedings by Company JV. The application, heard by Mr Justice Patten, was successful. Patten J held that the power to litigate was indeed conferred on the board of Company JV by virtue of the articles of association referring to the directors exercising "all the powers of the company".

“No meeting had ever been convened to authorise the commencement of proceedings”

the commencement of proceedings. Instead, Mr K instructed the company secretary of Company JV to commence the proceedings.

The claim related to unpaid invoices in respect of stock delivered to Company C by Company JV. However, Company C alleged in its defence, amongst other matters, that proceedings had been issued without the approval of the board of Company JV and that this was in breach of the articles of association of Company JV. Under the relevant articles of association, the power to commence proceedings was vested in the board.

A few months into proceedings, Mr K sought to instruct a firm of solicitors (Firm X) to act on behalf of Company JV

While the effect of the articles was that only one director was required for the purpose of rendering a meeting quored, no meeting had ever been convened to authorise the commencement of proceedings. Patten J held that the action by Company JV was not, therefore, authorised and should be struck out.

Given the basis upon which the claim by Company JV had been struck out, it was open to Company C to seek an order for costs against Firm X. Indeed, following submissions by Leading Counsel for Company C to that effect, Patten J made the conventional order for Firm X to show cause as to why they should not pay the resulting costs of the proceedings.

The pursuit of the costs application was delayed as a result of further litigation caused by Mr K making an ultimately unsuccessful attempt to ratify the proceedings at board and shareholder level. Had the proceedings by Company JV been ratified, that might well have removed substantially, if not entirely, any question of Firm X incurring liability for Company C's costs. However, once it had been finally established that there was no prospect of the proceedings being ratified, steps were taken to pursue an application for the entire costs of the proceedings. That application was compromised earlier this year with Company C receiving a payment from Firm X's insurers of a substantial proportion of the total costs it had incurred.

Basis for seeking costs

Although the application was ultimately resolved without the need for a hearing, submissions were made on behalf of Company C in respect of costs immediately after the proceedings by Company JV were struck out. Two alternative grounds were put forward upon which costs could be awarded against Firm X.

- First, as the primary ground, it was contended that costs could be awarded pursuant to the usual wasted costs regime in s 51 of the Supreme Court Act 1981 (SCA 1981) and CPR Pt 48.7.
- The alternative approach would have been for costs to have been awarded pursuant to the long-established principle in *Yonge v Toynbee* [1909] 1 KB 215.

Wasted costs regime

Provision is made in SCA 1981, s 51(6) for the court to order a legal representative to meet wasted costs, which are defined in s 51(7) as being costs incurred by a party "as a result of any improper, unreasonable or negligent act or omission" on the part of that representative or which the court considers, in the light of any such act or omission, it is "unreasonable" to expect that party to pay.

It was argued on behalf of Company C that Firm X's conduct could have been described as either unreasonable or negligent. As regards the term "negligent", it was held in *Ridehalgh v Horsefield* [1994] Ch 205, [1994] 3 All ER 848 the leading case on the meaning of s 51(7), that it "should be understood in an untechnical way to denote failure to act with the competence reasonably to be expected of ordinary members of the profession". According

to *Ridehalgh v Horsefield*, in pursuing an order under s 51, there must be a causal link between the unreasonable or negligent behaviour of the solicitor and the costs incurred by the applicant. That link is likely to be established if a firm continues to act without authority, notwithstanding warnings given in correspondence, with the result that a defendant incurs costs in defending proceedings that otherwise would not have been pursued.

Principle in *Yonge v Toynbee*

As an alternative to an order under s 51, the court has a summary jurisdiction to order damages against a solicitor who has commenced proceedings without the authority of his client. This is on the basis that the solicitor has breached his implied authority to act (or his warranty of authority). The action is for damages, usually amounting to the costs incurred in defending an unauthorised claim. This was the alternative ground relied upon by Company C. If a breach is established, liability is strict.

The principle is associated with *Yonge v Toynbee* in which Lord Justice Buckley held that a solicitor is liable on an implied contract that he had authority to act if he has, at the moment of acting, represented that he had such authority. This liability arises irrespective of whether the representation is made dishonestly. In the same case, Mr Justice Swinfen Eady held that it was essential to the proper conduct of legal business that a solicitor should be held to warrant the authority which he claims of representing his client. Otherwise, no one would be safe in assuming that an opponent's solicitor was properly authorised in what he said or did.

The issue arose last year in *Re Microsulis Ltd (in administration)* [2008] EWHC 1129 in which trustees, SMP Trustees Limited (SMP), contended that proceedings had been brought by Merriman White purporting to act on their behalf but without their authority. Mr Justice Toulmin held that there was overwhelming evidence that Merriman White did not contact the trustees of SMP directly in the course of the litigation to confirm from an authorised officer that SMP agreed with the instructions given by a separate individual, who was not a trustee. Merriman White were ordered to pay SMP's costs as well as those of most of the respondents.

Mr Justice Toulmin reached his decision on the basis of the authorities relating to solicitors' breaches of warranty of authority

but stated that he would still have found against Merriman White under the wasted costs regime on the basis that they had acted negligently as solicitors. Particular reliance was placed upon the clear breach by Merriman White of provisions of the *Guide to the Professional Conduct of Solicitors*.

Practical considerations

In practical terms, an order under SCA 1981, s 51 may not be an option unless a case is clear-cut. Notwithstanding evidence that proper authority has not been obtained, there may be extenuating circumstances that do not render the solicitor's behaviour unreasonable or negligent.

There are, however, also potential pitfalls to avoid if seeking an order using the principle in *Yonge v Toynbee*. For example, there is a risk that the court will decide that there are real issues of fact or law and that the court should not summarily determine the solicitor's liability for damages. Instead, it will leave the opposing party to start fresh proceedings by issuing a claim for breach of warranty of authority. Mr Justice Colman sounded this note of caution in *Skylight Maritime SA v Ascot Underwriting and others* [2005] EWHC 15 (Comm). In the same judgment, Colman J also held that a claim for breach of warranty of authority cannot be deployed to put the promisee in a better position than if the warranty had been true. If a supposed client is, therefore, insolvent, substantial damages for breach of a solicitor's warranty will not normally be recoverable because the promisee would not have been able to recover costs against the client even if the solicitor had had authority to act. There is, therefore, a potential advantage in obtaining an order under the wasted costs regime if the facts are sufficient to support such an application.

Whichever test is ultimately applied, the position remains clear that solicitors must take care to ensure that they have the requisite authority when acting for a company in litigation. If in doubt, it makes sense to check the position, especially if the other side put you on notice of a potential problem. Otherwise, as the recent scenario considered in this article demonstrates, it may result in more than just time being wasted.

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