Insight 187

from Horwich Farrelly's Large & Complex Injury Group

WELCOME TO INSIGHT

Welcome to this week's edition of Insight in which we report on cases relating to:

- The Court of Appeal's view on how to value a 'lost years' claim
- Part 36 and what happens to costs when an offer is accepted on the 22nd day after it was made

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How to value a 'lost years' claim

Head (Deceased) v Culver Heating Co Ltd [2021] EWCA Civ 34

The Court of Appeal overturned the decision of the High Court that the deceased, a successful businessman, could not recover any loss of earnings because the profitability of his business would likely continue after his death and so any divided income from his shares in that business would survive his death. Mr Head was alive at trial but had died by the time the case came before the Court of Appeal. His widow was appointed to carry on the appeal. Liability was not in dispute.

The deceased was exposed to asbestos from 1974-79 and briefly in 1980-81 whilst working for the defendant company. He set up his own heating and ventilation company, Essex Mechanical Services Ltd ('EMSL'), of which he was the MD. The deceased was paid a salary and received divided income on his shares in ESML. Symptoms of mesothelioma started in 2017 and when it became clear that he was dying from the disease, he issued his claim for damages, including a claim for 'lost years' of a little under £4.5 million. Liability was not in dispute.

At first instance, the trial judge, Her Honour Judge Melissa Clarke, accepted the defendant's argument that there should be no award for the deceased's 'lost years' claim.

The defendant relied on *Adsett v West [1983]* QB 826 in which McCullough J distinguished between earned income arising from a claimant's capacity to work as recoverable in a 'lost years' claim, and income derived from capital surviving a claimant's death which is not recoverable in a 'lost years' claim. The judge asked whether it was relevant for the purposes of a 'lost years' calculation that the deceased's dividend income from his EMSL shares would survive his death and her reasoning is summarised as:

1. The principles of *Adsett v West* applied;
2. On the balance of probabilities, the profitability of EMSL was likely to continue after Mr Head's death, therefore the dividend income from the shares that he and his wife held in EMSL was likely to survive his death;
3. This dividend income was greater than the 'surplus' income he enjoyed;
4. Per *Adsett v West*, there was no loss in the 'lost years'.

She went on to concluded that *'the real distinction being drawn by McCullough J in Adsett v West is not between earned income and income from capital but from income which is lost on death and income which survives death'*.

Route to appeal: The judge refused permission to appeal, as did Simler LJ on a paper application for permission to the Court of Appeal. However, the claimant pursued matters and made an application under CPR 52.30, which codified the principle set out in *Taylor v Lawrence [2003]* QB 528. This route can only be used where there has been a final determination (in this case the appeal against the refusal of permission to appeal) where it is necessary to do so in order to avoid real injustice; the circumstances are exceptional and make it appropriate to reopen the appeal; and there is no alternative effective remedy. The order refusing permission was revoked. The question was referred for determination by the Court of Appeal. Bean LJ, giving the lead and unanimous judgment, deemed it necessary to reopen the determination of appeal in order to avoid 'real injustice', stating that:

'The overwhelming majority of Taylor v Lawrence applications are entirely unfounded but this one was a rare exception, perhaps the most striking one I have seen during six years' service in this court.'

The appeal: There were seven grounds:

(1) The first alleged that the decision was based on a misunderstanding of the expert accountancy evidence and a mistaken assumption that those experts had agreed that the profits of EMSL would continue undiminished after the claimant's death. Bean LJ found it unnecessary to resolve this ground in light of his judgment on the subsequent six grounds, which were:

(2) Contrary to *Pickett v British Rail Engineering Ltd* the judge failed to assess what the deceased had personally lost by the diminution of his life expectancy. The claim was wholly personal, but the judge held that the lost years claim could have been pleaded by reference to the company's loss of profit or the replacement cost of employing additional staff. This illustrated the underlying error of principle.

(3) The judge did not include dividend income or retained profits in her assessment of what had been lost. This was inconsistent with her findings that: (i) the deceased was *'the driving force of EMSL'* and would have continued to run the business but for the mesothelioma, (ii) that retained profits were a form of saving; (iii) that profits were distributed and extracted by the deceased on advice from his accountant and that he would have changed the split balance if the tax regime made it more efficient; and, (iv) that his *'real loss of earnings or earning capacity included 90% of EMSL's profits'* after deductions for directors' salaries and tax.

(4) The judge was wrong to treat the deceased's dividend income from EMSL as if it were the yield from a passive investment, such as a blue-chip stock with an annual dividend, rather than a means by which he distributed the fruits of his own labour in a tax efficient way.

(5) Accordingly, the judge did not include a substantial part of the deceased's income which, on her own findings, he would have derived from his efforts, and therefore failed properly to assess his loss of earning capacity. This was wrong in the light of *Pickett*.

(6) The judge erred in finding that there was no loss to the deceased because he could leave his shares in EMSL in his will. The 'lost years' claim should reflect the annihilation of his future earning capacity by the illness. He could not just transfer that value to someone else as it relied on his future efforts, which would be extinguished by his death. He had been deprived of something which would otherwise have a present value. It was wrong to find that there was no loss simply because EMSL might be managed by others and might continue to make a profit for someone else. He could gift his own future earning capacity in a will.

(7) The judge held, following *Ward v Newall's Insulation* that she must look at the reality of the situation, but then failed to do so in making her assessment of the loss. She accepted that the split between salary and dividend was for tax reasons but then assumed that the whole of the deceased's net profit, not taken by him as salary, would continue i.e. that only the salary element would be extinguished by his death. This was a distinction based solely on how the deceased had arranged profits for tax efficiency. This ignored the judge's own finding and was wrong in the light of *Ward*.

Bean LJ accepted the position as set out in *Adsett* that the correct line to draw was between loss of earnings from work and loss of income from investments. Significantly, it was held, *Adsett* involved a claimant whose shareholdings and their respective dividend income had been gifted to him. Analogously, it was stated that had the deceased retired prior to the onset of mesothelioma symptoms, the loss of earnings claim would be nil. However, it was accepted by HHJ Clarke that the deceased was integral to the running of EMSL and that would have continued to be the case but for the mesothelioma.

The deceased was paid a very modest salary which was fixed for tax efficiency and, in light of the deceased being the driving force behind EMSL *'it made no sense at all […] to say that this was the full extent of his earnings from work.'* As a matter of logic, all of the deceased's income from EMSL represented the fruit of his labours and not a return on an investment. He went on to recognise two points - first, at the point at which the deceased would have stopped working full time, if he retained his shares in the company, his dividend income would be pro rata income on investments and not earnings from his work and second, upon the deceased stopping work altogether, any surviving dividend income would entirely constitute income on investments.

In short, Bean LJ agreed with the appellant's submission that the nature of a 'lost years' claim was to compensate the earning capacity which had been personally lost by a claimant:

'Mr Head was free to dispose of that income in whatever way he chose. By contrast, as Mr Steinberg rightly observed, he could not make a testamentary disposition of his own future earning capacity. It was not necessary for him to be able to plead and prove what the cost of a replacement would be to EMSL: that would be to mischaracterise the nature of a lost years claim, which requires assessment of the value of the earnings or earning capacity which the claimant personally has lost.'

The Court of Appeal therefore set aside the judge's assessment of the 'lost years' claim and remitted the case for an assessment of damages before the Senior Master.

When considering a 'lost years' claim, any quantification of income must look at the economic reality of a claimant's business structure. Distinguishing between salary and dividend income does not recognise that lines are drawn for the purposes of tax-efficiency. Separating the two is artificial.

Part 36: Wait one day and then put costs at large

Pallett v MGN Ltd [2021] EWHC 76 (Ch)

The claimant brought an action for infringement of privacy rights. In October 2020 she made a Part 36 offer to settle for £99,500 and ancillary relief. On the 22nd day after the offer was made the defendant accepted the claimant's officer, but with a proviso as to costs, which was that the court would be invited to deal with the extent to which it would have to pay costs.

The defendant argued that since the offer was accepted outside the "relevant period" (here, 21 days) it was entitled to invite the court to consider its liability for the costs of the action and was not bound to pay those costs, which it would have been if it had accepted within the 21 days, pursuant to CPR 36.13(5), and if it gets over that hurdle, the court should disallow the claimant's costs from 26th March 2019, essentially on the basis that the claimant did not engage properly in a settlement process.

The claimant argued that the Part 36 offer was accepted and the defendant was not entitled to introduce the qualification which it did, and if it was entitled to introduce that qualification, there was no justification for departing from the sort of costs order in her favour that would follow from acceptance of the Part 36 offer within the relevant period (21 days).

The questions that fell to be determined by Mr Justice Mann were:

(1) Was the defendant entitled to accept the part 36 offer in the manner which it did?

(2) If so, did its conduct amount to an acceptance?

(3) If so, did that acceptance have the effect in principle contended for by the defendant?

(4) If so, should the court exercise its discretion on costs in the manner proposed by the defendant?

In short, he answered yes to questions 1-3. The claimant used a contractual analysis to argue that the Part 36 offer had been accepted and that the defendant was not entitled to introduce qualifications into that acceptance by seeking to depart from the costs element of the offer. However, there could be no acceptance, and therefore no contract, on that analysis: one of the terms of the offer had been rejected and a different term proposed. In any event,

Part 36 was a self-contained regime, not a contractual regime. One had to follow the flow of the rules. The defendant was entitled to invoke r.36.13(4) and have the costs determined by the court. Although an offeror might not expect that the offeree could wait until the relevant period had passed, accept the offer and then seek to avoid the costs by asking the court to determine them, that was the effect of r.36.13(4),

For the defendant to succeed on question 4, it had to establish that the claimant had failed to engage in settlement negotiations, falling so far short of the standards which the courts expected of litigants in terms of willingness to negotiate that it could discharge the burden of showing that it would be unjust to apply the normal Part 36 consequences. The defendant had not discharged that burden.

The defendant had made various offers itself. The claimant's attitude of declining to negotiate until she was better informed had been entirely reasonable, bearing in mind the one-sided nature of the possession of information in such cases and the defendant's failure to comply with the early disclosure regime. By March 2019, early disclosure had been given, but by then the claimant had decided that she wished to get full disclosure in order to value her claim. The judge accepted that as sensible, not unreasonable.

Mr Justice Mann went on to say that the position might have been different if the defendant had made more attractive offers, but on 27 March it had actually reduced its offer. Disclosure had shown there was a case that the level of infringement of privacy had been greater than the defendant had conceded. It had enabled the claimant to put forward an offer to accept an increased sum.

Although it could be said that the claimant had not engaged in negotiation before October 2020, it could not be said that in the circumstances she should have been negotiating, or that the absence of negotiation was culpable so as to make it unjust to allow the normal consequences of the late acceptance of a Part 36 offer.

The claimant was awarded all costs of the proceedings.

This case turns on its own facts and there are two important points:

Claimants should not take this decision as a green light to decline to enter into negotiations before disclosure is complete. In many circumstances, it would be regarded as unreasonable.

Defendants often have no choice but to adopt this tactic if there is an issue on entitlement to costs. If they accept a Part 36 offer within the 21 day period they cannot then ask the court to exercise its discretion to make a different order on liability for costs. This is a good tactic, but only to be used where there is a valid argument that the usual order for costs should not apply.

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