# CONTENTS

## Insurance and reinsurance

<table>
<thead>
<tr>
<th>Case</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>McManus Seddon Runhams (a firm) v European Risk Insurance Company</em></td>
<td>05</td>
</tr>
<tr>
<td>High Court confirms the validity of blanket notification.</td>
<td></td>
</tr>
<tr>
<td><em>Nulty and Others v Milton Keynes Borough Council</em></td>
<td>07</td>
</tr>
<tr>
<td>The burden of proof and competing theories on causation</td>
<td></td>
</tr>
<tr>
<td><em>International Energy Group Ltd v Zurich Insurance Plc UK</em></td>
<td>09</td>
</tr>
<tr>
<td>No apportionment of liability for mesothelioma claim</td>
<td></td>
</tr>
<tr>
<td><em>Aioi Nissay Dowa Insurance Co Ltd v Heraldglen Ltd and Another</em></td>
<td>11</td>
</tr>
<tr>
<td>Court upholds arbitrators’ decision that 9/11 World Trade Center attacks are two events</td>
<td></td>
</tr>
<tr>
<td><em>AstraZeneca Insurance Company Ltd v (1) XL Insurance (Bermuda) Ltd and (2) ACE Bermuda Insurance Ltd</em></td>
<td>13</td>
</tr>
<tr>
<td>First substantive case on the Bermuda Form comes before the Commercial Court</td>
<td></td>
</tr>
<tr>
<td><em>ACE European Group Ltd and Others v Chartis Insurance UK Ltd</em></td>
<td>17</td>
</tr>
<tr>
<td>Proximate cause: appeal on evidential grounds rejected</td>
<td></td>
</tr>
<tr>
<td><em>Beazley Underwriting Ltd and Others v Al Ahleia Insurance Co and Others</em></td>
<td>19</td>
</tr>
<tr>
<td>The interpretation of claims control clauses in reinsurance contracts</td>
<td></td>
</tr>
<tr>
<td><em>M J Gleeson Group Plc v Axa Corporate Solutions Assurance SA</em></td>
<td>22</td>
</tr>
<tr>
<td>The interpretation of the scope of indemnity cover in respect of defective workmanship of subcontractors.</td>
<td></td>
</tr>
<tr>
<td><em>Sea Glory Maritime Co and Another v Al Sagr National Insurance Co (The Nancy)</em></td>
<td>25</td>
</tr>
<tr>
<td>Marine insurer fails to establish non-disclosure, breach of warranty and illegality</td>
<td></td>
</tr>
<tr>
<td><em>Teal Assurance Co Ltd v W R Berkley Insurance (Europe) Ltd and Aspen Insurance UK Ltd</em></td>
<td>28</td>
</tr>
<tr>
<td>Supreme Court upholds general principle that liability policy coverage is triggered on ascertainment of the liability of the underlying insured.</td>
<td></td>
</tr>
<tr>
<td><em>Mitsui Sumitomo Insurance v Mayor’s Office for Policing and Crime</em></td>
<td>32</td>
</tr>
<tr>
<td>August 2011 riots: tumultuous behaviour and consequential losses under the Riot (Damages) Act 1886.</td>
<td></td>
</tr>
<tr>
<td><em>Genesis Housing Association Ltd v Liberty Syndicate Management Ltd</em></td>
<td>36</td>
</tr>
<tr>
<td>Court of Appeal confirms the legality of basis clauses</td>
<td></td>
</tr>
<tr>
<td><em>Equitas Ltd and Another v Walsham Bros &amp; Co Ltd</em></td>
<td>39</td>
</tr>
<tr>
<td>The continuing duty of a reinsurance broker to remit funds to its clients</td>
<td></td>
</tr>
<tr>
<td><em>Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd</em></td>
<td>41</td>
</tr>
<tr>
<td>Follow the settlements – the reinsurance proviso revisited</td>
<td></td>
</tr>
<tr>
<td><em>Rathbone Brothers Plc v Novae Corporate Underwriting</em></td>
<td>44</td>
</tr>
<tr>
<td>Commercial Court finds a consultant to have been covered by a company’s professional liability policy.</td>
<td></td>
</tr>
</tbody>
</table>
CONTENTS

Professional negligence
Berney v Saul (t/a Thomas Saul & Co)
Limitations periods – Court of Appeal considers principles for determining when a cause of action arises in tort .............................................................. 47
Frost v Wake Smith and Tofields Solicitors
Court of Appeal finds solicitor not negligent for failing to ensure legal enforceability of terms agreed at mediation ............................................... 49
Torre Asset Funding Ltd and Another v The Royal Bank of Scotland Plc
High Court clarifies the limited duties owed by agents in financing structures ........................................................................................................... 50

General interest
Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd
Court of Appeal construes exclusion clause narrowly to prevent party being left without remedy .......................................................... 53
Crawford Adjusters and Others v Sagicor General Insurance (Cayman) Ltd and Another
Privy Council finds tort of malicious prosecution available for civil claims .................................................................................................................. 55
Global Torch Ltd v Apex Global Management Ltd and Others
Hearings will usually take place in public, even where there may be damage to reputation .......................................................... 57
Watson v Sadiq
Court of Appeal dismisses appeal against Tomlin order on ground of judicial pressure to settle .............................................................. 58
Newbury v Sun Microsystems
High Court decision shows the need to be clear whether settlement offer subject to contract .............................................................. 60
Singh v Governing Body of Moorlands Primary School and Reading Borough Council
Court of Appeal finds undue pressure on witness to produce statement does not come within witness immunity rule .......................................................... 62
Jetivia SA and Another v Bilta (UK) Ltd (in Liquidation) and Others
Court of Appeal finds company in liquidation is not prevented from claiming against directors on the basis fraud is attributable to the company .................................................................................................................. 63
Andrew Mitchell MP v News Group Newspapers Ltd
Court of Appeal sends clear message on need for strict compliance in Mitchell decision .............................................................. 65
Durrant v Chief Constable of Avon & Somerset Constabulary
Court of Appeal applies Mitchell guidance and finds defendant cannot rely on witness evidence served late .................................................................................................................. 67
Regulatory
With-Profits Mutuals – FSA has ‘Road to Damascus’ experience ................. 69
Re Digital Satellite Warranty Cover Ltd
Supreme Court confirms extended warranties can be regulated
insurance products .......................................................... 75
PRA proposes clampdown on solvent schemes .................................... 77
Solvency II Trilogue discussions conclude – so what happens now? .......... 80

Personal injury/health and safety
Qualified one-way costs shifting (“QOCS”) for personal injury claims ........ 83

Alternative dispute resolution
Wright v Michael Wright (Supplies) Ltd
Court of Appeal suggests a rethink of the prohibition on
court-ordered compulsory mediation ....................................... 85
Willmott Dixon v Newlon
Adjudicator has jurisdiction despite concurrent referrals and late
service of referral notice ....................................................... 87
North Oxford Golf Club v A2 Dominion Homes Ltd
Post Jackson reforms – are mediation costs recoverable? .................... 89
PGF II SA v OMFS Co 1 Ltd
Failure to engage with ADR proposals: Court of Appeal extends
the Halsey principles ................................................................. 91
Jackson ADR Handbook Published .................................................. 94
Contributors .............................................................................. 96
We have again collected together various bulletins, briefings and notes produced over the last 12 months and which we hope will be a useful source of reference to our clients with an involvement or interest in relevant developments in the insurance and reinsurance market.

2013 has seen some familiar issues being litigated (such as blanket notifications and basis clauses) but there have also been some ‘new’ issues litigated and, in particular the first occasion that issues of construction of liability insurance written on the so-called ‘Bermuda Form’ have come before the Commercial Court. Unlike the previous few years, there have also been some notable reinsurance law decisions, including the first English law judgment on how World Trade Center losses should be aggregated, a perhaps controversial decision on the operation of a claims control clause and the latest in a series of cases on the proper interpretation of the Scor-type follow the settlements clause.

From a regulatory perspective, the most significant event for UK (re)insurers in 2013 has been implementation of reforms of the regulatory framework for financial services. In changes prompted by the financial crisis, the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”) replaced the Financial Services Authority from 1 April. Although it is still early days for the new regulators, firms are already seeing real changes in how they will be supervised. In Europe, lengthy negotiations over amendments to the Solvency II Directive (“Omnibus II discussions”) were finally resolved in November 2013. The Solvency II regime will, as a consequence, now take effect from 1 January 2016. Other European initiatives that are still to be completed include the proposed revision of the Insurance Mediation Directive (so-called “IMD2”).

Looking forward to 2014, the English and Scottish Law Commissions will produce a final report and draft Bill (currently summer 2014) covering the topics dealt with in its two earlier joint consultation papers: (1) Post Contract Duties and other Issues and (2) Business Insurance Law: pre-contract disclosure, misrepresentation and warranties. Any proposed reforms are likely to involve amendments to the Marine Insurance Act 1906 and the underlying common law. This will conclude the Law Commissions’ insurance contract law reform project.

We hope that you find the Annual Review of use. Should you need further hard copies (soft copies are available on the Herbert Smith Freehills website) then please contact any member of the insurance and reinsurance disputes team.

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HIGH COURT CONFIRMS THE VALIDITY OF BLANKET NOTIFICATION

In McManus Seddon Runhams (a firm) v European Risk Insurance Company, the High Court was called to rule on the contentious issue of the validity of a blanket notification of circumstances under a “claims made” policy, in this case covering solicitors’ professional indemnity. Adopting a broad approach to the validity of the notification, the Court rejected insurers’ challenges, but in the circumstances declined to grant the Claimants the declaratory relief they had sought.

BACKGROUND

The Claimant solicitors (“MSR”) were in practice in Bradford. In 2011, they took over the business of another Bradford firm, Runhams LLP. Runhams LLP had previously taken over the business of a third firm, Sekhon Firth, and MSR was the successor practice to both firms. MSR was insured under a professional indemnity insurance placed with the Defendant insurers. The policy was written on a claims made basis.

Between November 2011 and May 2012, MSR received notice of some 17 claims brought by former clients of Sekhon Firth, and 12 of the claims related to matters involving the same borrower. The claims were duly notified to and accepted by insurers.

Given the number of claims received, and the similarity between them, MSR engaged risk consultants, Corre Partnership (“Corre”), to undertake a file review to determine the extent of the possible issues. Corre’s report examined some 32 files, as well as the results of a wider review conducted by MSR fee earners. The report concluded that the Sekhon Firth files disclosed a consistent pattern of breaches of duty, particularly as against the former firm’s lender clients. The report suggested it was probable that further claims would be made in due course.

In September 2012 MSR wrote to insurers to provide what they described as “blanket notification of circumstances which may give rise to claims.” The notification reported the claims already received and referred to the conclusions of the Corre report and MSR’s own investigations into Sekhon Firth’s failings (which MSR considered to have been widespread). The notification letter concluded that:

“Every file conducted by Sekhon & Firth and Runhams LLP (in the period subsequent to the merger of those two practices), and in respect of which this firm is deemed by the Successor Practice Rules to be the successor practice contains or is more likely than not to contain examples of malpractice negligence and breach of contract and so each and every file of the predecessor firms Sekhon & Firth, Sekhon & Firth LLP and Runhams LLP should properly be notified to you as individually containing shortcomings on which claimants will rely for the purposes of bringing claims against this firm as successor practice.”

The file lists appended to the letter encompassed some 5,000 files, although MSR could not rule out that further files may be affected.

Insurers reviewed the notification and, whilst they accepted that a valid notification of circumstances had been made in relation to the particular matters reviewed by Corre (and imposed a reservation of rights), they rejected the notification in relation to the remaining files, noting that the matters specified did not:

“...amount to valid Circumstances as you have not [identified] the specific incident, occurrence, fact, matter, act or omission which would give rise to a Claim on each individual file. Simply stating that Sekhon & Firth worked on the files... does not constitute a valid notification, and as such, the notifications are firmly rejected in their entirety and without question.”

Following the investigations, MSR was unable to obtain cover for the 2012 year on commercial terms, and entered the Assigned Risks Pool (“ARP” - the insurer of ‘last resort’ for otherwise uninsurable solicitors). Accordingly, MSR sought declaratory relief, in the hope that it would enable them to convince a qualifying insurer to cover the firm, and allow it to leave the ARP. The terms of MSR’s proposed declaration were the subject of some drafting by counsel during trial, but the final form suggested that a valid notification had been given by reference to a particular time period and various particular species of negligence.

DECISION

The Court considered that insurers’ stance – that they could be liable only in respect of the files identified in Corre’s report – was “clearly wrong.” Referring to J Rothschild Assurance v Collyear and HLB Kidsons (a firm) v Lloyd’s Underwriters, the Judge held that whilst a notification of circumstances could be valid only insofar as it was based on a “substratum of external fact” over and above
HIGH COURT CONFIRMS THE VALIDITY OF BLANKET NOTIFICATION

During 2013, both the Claimant and the Defendant appealed the first instance decision of Rose J. The Defendant’s appeal related to a matter of costs. Of greater present interest is the Claimant’s appeal, which was brought in respect of the first instance Judge’s decision not to award any form of declaratory relief. The appeal was heard before a Court of Appeal composed of Arden, Black and Davis LJJ in December 2013.

There was no appeal from the first instance Judge’s decision that the blanket notification given by the Claimants was not invalid as a notification under the policy in respect of a claim arising out of the circumstances notified by that notification (as to which the Judge reached no conclusion).

The Court of Appeal, Davis LJ giving the leading judgment, declined to interfere with the first instance Judge’s exercise of her discretion not to grant any declaratory relief. The Court of Appeal noted that a detailed and rational explanation for that decision had been given in the first instance judgment, and that it was of particular concern that the nature of the declaratory relief sought had shifted during the course of trial both at first instance and on appeal, which suggested that the making of a declaration would not be appropriate.

Finally, the Court considered it highly speculative that the declaratory relief would be of any considerable benefit to the parties over and above the first instance judgment itself in any event.

ADDITIONAL REFERENCES

HLB Kidsons (a firm) v Lloyd’s Underwriters [2008] EWCA Civ 1206
McManus Seddon Runhams (a firm) v European Risk Insurance Company [2013] EWCA Civ 1545

the insured’s mere concerns, it need not refer to a specific defect in relation to the handling of a particular client or transaction which may give rise to a claim. Accordingly, insurers’ stance was misconceived, and at odds with the existing case law:

“provided circumstances exist which may give rise to a claim, and provided those circumstances are notified, then any future claim arising out of those circumstances must be paid out by the insurer at risk at the time of notification whether or not the particular transaction or possible claimant has been identified at the time of notification.”

As the Court noted, however, the circumstances of the case were “unusual, if not unprecedented”, in that a declaration was sought that would crystallise the scope of the circumstances notified, although no claims said to arise out of those circumstances had yet been made against MSR.

The Court accepted that MSR had prima facie a strong claim that given insurers’ rejection had been wrong, the interests of justice required a declaration. However, in practical terms, the effect of a declaration delimiting the notification in any particular way was “not at all clear.” Although insurers’ stated position was wrong, the Court considered that it would be unfair to close off any arguments that they may in future raise regarding whether any particular claim fell within the scope of the notification. The Judge considered that she was unable to set out exhaustively the circumstances covered by the notification, but that:

“To qualify any declaration by stating either that it is not an exhaustive list of the circumstances notified or that it is based on an assumption rather than a finding that the listed circumstances really existed… would denude the declaration of any real value to either party.”

Accordingly, the Judge declined to grant the declaratory relief sought, and simply restated the conclusion that the notification was valid and that insurers’ view was misplaced, in the hope that these findings would be of assistance to MSR in continuing practice.

COMMENT

This decision reinforces the principles arising out of previous cases governing blanket notifications of circumstances, and it is notable that the Court accepted as valid a notification which was, on its face, very broad in scope.

However, the case also emphasises the difficulties that may be encountered by insureds in demonstrating the necessary causal link between the circumstances covered a blanket notification, and any particular claim which later arises. Understandably in the circumstances of this case, the Court considered that it was unable to rule with any certainty on the limits of the circumstances notified. The careful drafting of any such notification will likely remain a challenging issue for insureds facing a ‘can of worms’ and an impending renewal.
THE BURDEN OF PROOF AND COMPETING THEORIES ON CAUSATION

The case of Nulty and Others v Milton Keynes Borough Council concerned an appeal to the Court of Appeal from the 3 November 2011 decision of Edwards-Stuart J in the Technology & Construction Court of the High Court. In upholding the first instance decision, the Court of Appeal reiterated the principle in cases where there are competing explanations for a particular loss that causation cannot be established only by a process of elimination such that the “least unlikely” cause of a loss is identified. A claimant must demonstrate that the particular version of events that they rely upon is more likely to have happened than not, in order for the civil burden of proof to be satisfied.

BACKGROUND
On 2 April 2005 a fire broke out at a recycling centre owned by Milton Keynes Borough Council (“the Council”). After the attendance of the fire brigade a second fire broke out causing extensive damage to the centre. The Council brought proceedings against Mr Nulty, a self-employed electrical engineer who had been responsible for carrying out works at the centre on the day of the fire. The Council alleged that Mr Nulty had caused the first fire by discarding a cigarette, and that the first fire had caused the second fire. Mr Nulty died before the claim came to trial and his professional liability insurers, National Insurance & Guarantee Corporation Ltd (“NIG”), conducted the proceedings. NIG contended that the first fire had been caused by the arcing of an electrical cable or by arson, and that the first fire had not caused the second fire. NIG also sought a declaration that they were not liable to indemnify Mr Nulty under his policy on the grounds of late notification of the claim.

FIRST INSTANCE DECISION
In a detailed and lengthy judgment, Edwards-Stuart J concluded that Mr Nulty’s discarded cigarette was the cause of the first fire which in turn caused the second fire. He dismissed the alternative causes advanced by NIG and their expert witnesses. Notably the Judge found that NIG were liable to indemnify Mr Nulty, but held that NIG’s liability should be reduced by 15% owing to the prejudice NIG had suffered by the late notification of the claim in breach of the relevant policy condition. This aspect of the High Court decision was not appealed.

The possibility that the first fire had been caused by an intruder, or by a cigarette discarded by someone other than Mr Nulty.

The Judge stated that none of the three suggested causes were, in their own right, “inherently likely” to have caused the fire. The Judge concluded that whilst the arcing of the cable was “very unlikely” to be the cause, the discarding of a cigarette by Mr Nulty was a feasible scenario: “I accept that it might be regarded as unlikely that an experienced electrical engineer, who had in the past been a part time fireman, would choose to smoke in a building to which he knew a no-smoking policy applied and then discard the cigarette end – albeit one that he thought he had stubbed out – into flammable waste lying on the floor. But if the only other possible causes of this fire are very much less likely, as I find they are, then in law the discarded cigarette becomes the probable cause of the first fire.”

COURT OF APPEAL DECISION
NIG appealed on two bases. Firstly that the Judge had erred in law, in that his approach to the question of causation was contrary to the principles set out by the House of Lords in Rhesa Shipping (The Popi M). Secondly, that the Judge had erred in fact on his findings concerning the competing causes for the first fire. NIG did not appeal the Judge’s findings on the cause of the second fire or NIG’s liability to indemnify Mr Nulty.

The Court of Appeal considered the leading House of Lords authority of Rhesa Shipping, which involved a ship, the Popi M, which sank in calm seas. The claimant ship owner contended that the cause of the loss was either a collision with a submarine or the negligence of the crew. The defendant insurer contended, on the basis of expert evidence, that the ship had been unseaworthy. As
The Court of Appeal declined to interfere with the Judge's findings of fact on the competing causes of the fire, emphasising that it is only where there is a serious ground for doubting the Judge's overall conclusion that an appellate court would re-examine factual conclusions.

**COMMENT**

This case is an interesting – albeit highly fact-specific – example of the approach to analysing competing causes of a loss. In complex cases heavily reliant upon expert evidence a claimant must be cautious not to assume that, just because their expert's view seems more plausible than that of their opponent, a court will necessarily accept that the claimant has proved their case. Equally, defendants facing the position that the claimant's explanation is the best of an unlikely selection should still give careful consideration to whether the claimant has discharged the burden of proof.

Parties are of course able to address in their contracts the situation where causation cannot be proven on the balance of probabilities. In an insurance context, **ACE European Group Ltd and Others v Chartis Insurance UK Ltd** (a case which is discussed later in the Insurance section of this Annual Review) discussed the application of '50/50' clauses in two policies of insurance which provided that in the event that it could not be demonstrated that damage was caused by a particular insured risk, the policies would each cover 50% of the adjusted claim.

Delivering the judgment of the Court of Appeal in **Nulty**, Toulson LJ stated that the balance of probabilities test requires "that the court must be satisfied on rational and objective grounds that the case for believing that the suggested means of causation occurred is stronger that the case for not so believing". He rejected as "intrinsically unsound" the approach submitted by the Council that when there exists a closed list of more than two possible causes, the court should allocate a probability factor to each individual cause and determine whether one has a probability factor greater than 50%.

Whilst the chance of a future event happening may be expressed in percentage terms the same is not true of past events. It cannot be said that there is a particular percentage chance that a particular event happened. The event either happened or it did not. In cases where causation is necessarily based on circumstantial evidence, the court must consider the whole picture, including the gaps in the evidence, whether factors which support an explanation are properly established and what factors detract from that explanation as well as what other explanations might fit the circumstances. Whilst eliminating all other possibilities might well lead to the conclusion that a particular explanation is more likely than not to be true, there is no rule of law that it must do so.

The Court of Appeal concluded that when Edwards-Stuart J's judgment was read as a whole it was implicit from his reasoning that he considered that the case that Mr Nulty was responsible for the fire was stronger than the case that he was not. However, the Judge's suggestion that it was a proposition of law that, if the only other possible causes of the fire were very much less likely than the discarded cigarette theory, then the discarded cigarette theory became, in law, the probable cause of the fire, was mistaken. The Court of Appeal made clear that there is no such rule of law.

**ADDITIONAL REFERENCES**

*Rhesa Shipping (The Popi M) ([1985] 1 WLR 948)
ACE European Group Ltd v Chartis Insurance UK Ltd ([2012] EWHC 1245 (QB))
NO APPORTIONMENT OF LIABILITY FOR MESOTHELIOMA CLAIM UNDER EMPLOYERS’ LIABILITY POLICY

In International Energy Group Ltd v Zurich Insurance Plc UK, the Court of Appeal found that an insurer under an employers’ liability (“EL”) policy was required to provide an employer with a full indemnity in respect of its liability to a mesothelioma victim. The insurer was not entitled to limit the indemnity by reference to its time on risk.

BACKGROUND
The Claimant was responsible for all of the liabilities of Guernsey Gas Light Co Ltd (collectively, the “Insured”). It sought an indemnity under EL policies issued by Midland Assurance Ltd, whose liabilities had been succeeded to by Zurich (the “Insurer”) covering a six year period from 31 December 1982 to 31 December 1988.

The Insured employed Mr Carré for 27 years from 13 November 1961 to 31 December 1988. Throughout the entire 27 year period of employment (which included the six year policy period) Mr Carré was negligently exposed to asbestos by the Insured. He subsequently contracted and died of mesothelioma.

Mr Carré’s claim was settled by the Insured who then sought to recover the settlement sum and its own costs from the Insurer. The Insured’s total outlay amounted to £274,431.60.

The issue in dispute was whether the Insured was entitled to an indemnity from the Insurer amounting to an indemnity from the Insurer amounting to the entirety of its outlay or whether it was only entitled to a proportion, corresponding to the proportion which the Insurer’s six year policy period bore to the full 27 year period of Mr Carré’s exposure to asbestos by the Insured.

The Insured’s liability to Mr Carré was governed by the law of Guernsey where the UK Compensation Act 2006 (the “Compensation Act”) did not apply. The Insurer argued that this was crucial, since the effect of the Compensation Act was to reverse the decision of the House of Lords in Barker v Corus UK Ltd, with the result that the position in Guernsey was governed by the decision in Barker.

FIRST INSTANCE DECISION
At first instance, Cooke J found that the Insured was entitled to a full indemnity in respect of its costs of defending Mr Carré’s claim, but that otherwise its right of indemnity was limited to a share of its outlay based on the proportion of the period of Mr Carré’s employment by the Insured for which the Insurer was on risk.

Cooke J founded his conclusions on his understanding of the rulings in Fairchild v Glenhaven Funeral Services Ltd and Barker. He considered that the effect of those decisions, in particular that of Barker, was that the House of Lords had created a new basis of liability in tort in mesothelioma cases, being the wrongful creation of a risk of suffering mesothelioma (rather than the causing of mesothelioma). On this basis, he held that the liability of the Insured in each policy year was the amount of risk which it created in that year. Accordingly, the total risk that the Insured created during the six year policy period for which the Insurer was on risk was to be calculated by comparison with the total period of Mr Carré’s employment.

The Insurer argued that its time on risk was crucial, since the effect of the Compensation Act was to reverse the decision of the House of Lords in Barker.

COURT OF APPEAL DECISION
The Court of Appeal was unanimous in allowing the Insured’s appeal against the refusal to grant a full indemnity and rejecting the Insurer’s cross-appeals, challenging Cooke J’s award of a full indemnity in respect of defence costs and his rejection of its alternative equity-based argument.

The Insured appealed against the rejection of its claim for a full indemnity and the Insurer cross-appealed, challenging Cooke J’s appeal against the refusal to grant a full indemnity and rejecting the Insurer’s cross-appeals.

Giving the leading judgment, Toulson LJ noted Cooke J’s reliance on Barker which Toulson LJ referred to as a “problematic decision” that “has not fared well” and highlighted the reasoning in the dissenting judgment of Lord Roger in Barker. Lord Roger maintained that, to analyse Fairchild as...
NO APPORTIONMENT OF LIABILITY FOR MESOTHELIOMA CLAIM UNDER EMPLOYERS’ LIABILITY POLICY

recognising a tort in which damage caused by the Defendant was not the mesothelioma, but the risk of developing mesothelioma, was not to reinterpret, but to rewrite the decision. He held that, properly analysed, Fairchild was a recognition that, in this particular type of case, because of the limitations of medical science, the usual “but for” test of causation should give way to a more generous test of causation, by which it was sufficient for the claimant to prove that the defendant had merely increased the risk of the victim contracting mesothelioma and that the victim had contracted the disease.

Toulson LJ noted that Lord Roger’s dissenting judgment in Barker has since been vindicated both by the Compensation Act 2006 (which is not applicable to Guernsey) and by a majority of the Supreme Court in the Trigger litigation.

The principal issue in the Trigger litigation was one of construction: identifying the event that had to occur within the policy period in order to render the insurer liable to indemnify the employer in respect of the latter’s liability to a mesothelioma victim. However, the question of causation also arose. The right of an indemnity afforded to the employer was in respect of liability for disease caused by that employer. Therefore, if the foundation of liability under Fairchild was not that the employer had caused the disease, but that the employer had incurred liability for exposing the victim to the risk of such disease, the employer would have to prove in addition that exposure during the policy period had, in fact, caused the disease to establish liability under the policy. The majority (with Lord Philips dissenting) interpreted the principle in Fairchild in a manner consistent with Lord Roger’s dissenting judgment in Barker. It was held that the rule imposed legal responsibility on the employer for the disease, for which purpose the law has accepted a weak or broad causal link to exposure which (in the words of Lord Mance who gave the leading judgment) “may but cannot be shown on the ordinary balance of probabilities to have played a role in the actual occurrence of the disease”.

The Court of Appeal held that the conclusion of the majority in the Trigger litigation on the interpretation of the Fairchild principle applied directly to the present case and, thus, that Cooke J was wrong to assess the Insurer’s liability on a time on risk basis.

The Court of Appeal rejected the Insurer’s alternative argument. The Insurer had argued that it was unfair that it should be required to provide the Insured with a full indemnity in circumstances where it had received premium for only six of the 27 years and, thus, that it should be entitled to a contribution from the solvent Insured in respect of the period during which the insured exposed Mr Carré to asbestos, but for which the Insurer was not on risk. The argument was presented on three bases. The first route was to recognise an equitable right of contribution from the employer; the second was to apply the law of unjust enrichment; and the third was for the Court to hold that natural justice provided it with an inherent equitable power to order the Insured to make a contribution to the Insurer equal to a rateable proportion of the total liability. The Court of Appeal was of the same opinion as Cooke J at first instance. Toulson LJ held that the relationship between Insurer and Insured was contractual. The premium reflected the risk that the Insurer was prepared to take and the price that he required for it. He noted that, whilst long tail insurers have suffered heavily in recent years because their liabilities have turned out to be far greater than expected when the policies were negotiated, the Court had no authority to adjust the consequences on the basis that they were thought to be unfair.

It was concluded that the combined effect of Fairchild and the Trigger litigation was that there was a sufficient link between Mr Carré’s exposure to asbestos during the six year policy period and his contraction of mesothelioma for the Insured to be legally liable for causing his disease and the insured had a contractual right of indemnity under the policy against that liability. The fact that, by the same reasoning, Mr Carré’s exposure to asbestos during the rest of his employment was also an effective cause was irrelevant to the Insured’s right to an indemnity. Toulson LJ indicated that the policy would require a special clause to limit the scope of the indemnity in such circumstances and that such a limitation would, on its face, be incompatible with the Employers’ Liability (Compulsory Insurance) Act 1969.

COMMENT

The Court of Appeal followed the Supreme Court’s interpretation in the Trigger litigation of the Fairchild principle and its application of the principle to the interpretation of insurance contracts. The effect is that an insurer can expect to cover an insured’s mesothelioma liability in full even though it was only on risk for a proportion of the overall period of exposure. At the same time, the task of the employer of obtaining a full indemnity will be easier.

Also worthy of note is the Insurer’s alternative argument that being required to provide the insured with a full indemnity was unfair and that the Insurer should be entitled to a contribution from the Insured. Whilst the argument was rejected both at first instance and by the Court of Appeal, the Court of Appeal acknowledged the increased burden for insurers, whose liabilities for long tail diseases have turned out to be far greater than expected. Following the decision of the Court of Appeal, the Supreme Court granted permission to appeal on 29 July 2013.

ADDITIONAL REFERENCES

Fairchild v Glenhaven Funeral Services Ltd [2003] 1 AC 32
Barker v Corus (UK) Plc (2006) 2 AC 572
Durham v BAI (Run Off) Ltd [2012] I WLR 867
Compensation Act 2006
Employers’ Liability (Compulsory Insurance) Act 1969
COURT UPHOLDS ARBITRATORS’ DECISION THAT 9/11 WORLD TRADE CENTER ATTACKS ARE TWO EVENTS

In Aioi Nissay Dowa Insurance Co Ltd v Heraldglen Ltd and Another, the Commercial Court upheld the decision of an arbitral tribunal that losses caused by the 9/11 attacks on the World Trade Center arose out of two events for the purposes of four excess of loss reinsurances. The reinsurances concerned permitted aggregation of insured losses which were caused by one or more occurrences or series of occurrences “arising out of one event”. The judgment thus sheds light on an issue of considerable interest to the insurance and reinsurance market.

BACKGROUND

The case involved four whole account catastrophe excess of loss reinsurances underwritten by Aioi in favour of the Defendant reinsureds. The reinsurances covered “all business underwritten by the Reinsured and classified by them as Aviation” including (on the AVN 48B standard wording) claims caused by acts carried out for political or terrorist purposes and hijacking. The cover responded in excess of limits ranging from US$200 million to US$500 million, and for a stated limit ranging from US$1 million to US$3 million “each and every loss”. The reinsurances were subject to LSW 351 which defined “each and every loss” to mean “each and every loss or accident or occurrence or series thereof arising out of one event”.

Following 9/11, a number of actions were brought in the US against the airlines in control of the four planes hijacked. The property and business interruption claims alone were the subject of a US$1.2 billion global settlement, allocated in different amounts between the various airlines. Each of the consequent claims on the ten inward reinsurances was settled on the basis that the attacks on the World Trade Center were two separate events. However, Aioi took the position that the outward reinsurances responded on a “one event” basis.

TRIBUNAL AWARD

The question of the basis on which the outward reinsurances responded was heard by a panel of three arbitrators. In an award dated 26 January 2012, the Tribunal concluded that the insured losses caused by the attacks on the World Trade Center arose out of two separate hijackings and therefore two events. The Tribunal’s reasoning was as follows:

1. With no dispute on the underlying factual circumstances of the losses, the Tribunal applied the well-known test of the four “unities” as to intention, cause, timing and location deriving from the Dawson’s Field Arbitration award and developed by Rix J (as he then was) in Kuwait Airways Corporation v Kuwait

2. On the intention of the human agents involved, the Tribunal recognised that the hijackings were the result of a co-ordinated plot orchestrated by Al Qaeda but noted that a plan cannot of itself constitute an occurrence or an event for the purposes of aggregation wordings referring to each and every loss, occurrence or event (as opposed to the implementation of that plan).

Next, the Tribunal concluded that there were two separate causes “because there were two successful hijackings of two separate aircraft, admittedly in execution of a dastardly plot to turn each into a guided missile each directed at one of the two signature Towers of a single property complex.” In relation to the unifying factor of time, the Tribunal considered that while there were similarities in the timing of the matters concerned, they were not such as to lead to the conclusion that there were one or two occurrences arising out of event. Rather, the Tribunal considered that the timings were indicative of two occurrences and two events (that is, the collapse of each of the towers and the use of violence on each of the aircraft). As for location, the Tribunal pointed out that while the towers were positioned in close proximity and were part of a single property complex, they were individual (albeit connected) buildings which did not stand or fall together.

Having examined the various potential unifying factors, the Tribunal thus declared itself “fully satisfied that the hijackings, consequent death and personal injury on board before contact with each tower, and then further death, injury and property damage consequent on the towers being separately struck constitute two separate occurrences which did not arise out of one event.” Further, an “independent objective observer” watching the hijackings unfold and then transported to the World Trade Center would have clearly had in mind two separate incidents. The Tribunal also noted that the position contended for by Aioi would give rise to curious
consequences so far as the further hijacked flights on 9/11 were concerned (there being four occurrences but three events for the purposes of the retrocessions).

**DECISION**

Aioi appealed against the award under section 69 of the Arbitration Act on the basis the Tribunal had made several errors of law in reaching its conclusion. The alleged errors of law, and the conclusions of Field J on each of them, were as follows:

1. Aioi contended that the Tribunal had wrongly focussed on the number of loss events arising out of the hijackings of all four flights on 9/11, the hijackings of the further aircraft which crashed into the Pentagon and in Pennsylvania being irrelevant to the matters in issue. Field J rejected this contention on the grounds it was clear from the award that the Tribunal was properly focussed on the World Trade Center hijackings and that the “sense check” undertaken in relation to the further hijackings did not vitiate the award.

2. It was also submitted that the incorrect approach had been adopted when assessing unity of cause. It was suggested that the Tribunal had inquired generally into the underlying cause of the losses whereas it should have considered the unity of cause in terms of operative peril (the approach adopted by Rix J in *Kuwait Airways Corporation*). Field J disagreed, holding that Rix J had only adopted the latter approach due to the manner in which the point had been argued in that case. In fact, the Tribunal’s approach was consistent with established authority.

3. Aioi argued that the Tribunal had failed to appreciate that, simply because hijacking and terrorism were both operative perils, it did not follow that there was more than one event. Aioi also submitted that the Tribunal had focussed too much on the hijacking peril. Neither argument was accepted – the first because it still begged the question whether the attack on the World Trade Center was one event or two and the second due to lack of evidence.

4. With reference to Rix J’s guidance that the unities should be assessed from the point of view of “an informed observer placed in the position of the insured”, Aioi submitted that the Tribunal erred in assessing the position from the standpoint of “the objective independent observer”. Citing various sections of the Award in support, Field J considered it was “tolerably plain” that the proper approach had been adopted (ie, that of Rix J).

5. It was further submitted that the word “event” in the aggregation clause should be given a broad meaning, not least because the retrocession protected a whole account distant from the original loss. Field J did not find anything in the award to suggest that the Tribunal had construed this provision too narrowly.

6. Finally, Aioi asserted that the Tribunal had not paid sufficient regard to the intention behind the hijackings when considering the unities and should have gone on to consider whether the hijackings and subsequent crashes into the World Trade Center were a series of occurrences arising out of one event. Field J rejected this argument stating that the Tribunal had taken proper account of the underlying plot (which could not itself be an occurrence) when analysing how the plan was implemented.

The Judge therefore dismissed the appeal, holding that the Tribunal had adopted a proper approach and had been entitled to conclude that the insured losses caused by the attacks arose out of two events, not one.

**COMMENT**

This case represents the first occasion on which the question of how World Trade Center losses are to be aggregated has come before the English courts. The Tribunal’s conclusion that the reinsurances responded on a “two event” basis will thus be of considerable interest to the insurance and reinsurance market, even if the result on this wording may not come as much of a surprise.

**ADDITIONAL REFERENCES**

*Kuwait Airways Corp v Kuwait Insurance Co SAK (No 1)* [1996] 1 Lloyd’s Rep 664

Arbitration Act 1996
The decision of Flaux J in AstraZeneca Insurance Company Ltd v (1) XL Insurance (Bermuda) Ltd and (2) ACE Bermuda Insurance Ltd marked the first occasion that issues of construction of liability insurance written on the so-called “Bermuda Form” have come before the Commercial Court in England, albeit in the unusual situation of a wording governed by English law rather than the standard New York law. In short, the Court found (1) that properly construed, the policy in question required the insured to demonstrate that it was subject to an actual legal liability in order to establish entitlement to an indemnity, and (2) that the policy offered no free-standing indemnity for defence costs incurred by the insured.

BACKGROUND

The factual background to the dispute can be shortly stated. The Claimant was the captive insurer of the AstraZeneca pharmaceutical group. It provided liability cover to, amongst others, US and Canadian AstraZeneca group companies for the period 1 January 2001 to 31 December 2003 (the “Policy”). The Policy covered a layer of £133,333,333 excess of £365 million. No wording was issued for the Policy, but it was understood to have been written on the previous expiring wording: Bermuda Form XL004 as amended by a number of endorsements. Each of the Defendants reinsured the Claimant for a 50% share in respect of the insurance provided by the Policy (subject in the case of ACE to a per occurrence limit of US$100 million).

On 28 August 2003, a class action lawsuit was filed against AstraZeneca in Florida, alleging that its drug Seroquel (used in the treatment of schizophrenia and bipolar disorder) caused personal injury, was defective and that AstraZeneca had failed to provide adequate warnings in relation to its use. The “Complaint” in the class action was notified to AstraZeneca on or around 11 September 2003, and notice was given to the Claimant pursuant to the Policy by a letter dated 1 December 2003.

Following the initial Complaint, further proceedings were brought against AstraZeneca in the US. By 31 October 2012, it had paid out substantial sums in respect of the legal costs of defending the claims (defined as “Defense Costs”) and in settlements with the underlying plaintiffs, of which some £83.5 million was said to fall for cover under the Policy.

In what Flaux J described as a “striking feature” of the case, the Claimant did not assert that it would, on the balance of probabilities, have been liable for the claims it had settled. Rather, it contended that it was entitled to an indemnity under the Policy in respect of the settlement of arguable liabilities. The Defendants did not accept this contention, suggesting that cover under the Policy would lie only where the underlying insured was subject to an actual legal liability. The Defendants further contended that there was no cover for Defense Costs absent such liability.

Two preliminary issues therefore arose for determination:

1. whether the entitlement to indemnity under the Policy against sums paid out in settlement of claims was dependent on the insured being, on a balance of probabilities, liable for the claims it had settled. Rather, it contended that it was entitled to an indemnity under the Policy in respect of the settlement of arguable liabilities. The Defendants did not accept this contention, suggesting that cover under the Policy would lie only where the underlying insured was subject to an actual legal liability. The Defendants further contended that there was no cover for Defense Costs absent such liability.

DECISION

Governing law

The standard Bermuda Form policy provides for disputes to be resolved by London arbitration but on the basis that the governing law of the policy is New York law. In the present case, however, the Policy was amended by endorsement (Endorsement 14) as follows:
FIRST SUBSTANTIVE CASE ON THE BERMUDA FORM COMES BEFORE THE COMMERCIAL COURT

“This Policy, and any dispute, controversy or claim arising out of or relating to this Policy, shall be governed by and construed in accordance with the internal laws of England and Wales, except insofar as:

(1) such laws may prohibit payment in respect of or punitive damages hereunder;

(2) the law of another jurisdiction must apply pursuant to any directive of the Council of the European Community relating to non-life insurance;

(3) such laws are inconsistent with any provision of this Policy;

Provided, however, that the provisions, stipulations, exclusions and conditions of this Policy are to be construed in an evenhanded fashion as between the Insured and the Company; without limitation, where the language of this Policy is deemed to be ambiguous or otherwise unclear, the issue shall be resolved in the manner most consistent with the relevant provisions, stipulations, exclusions and conditions (without regard to authorship of the language, without any presumption or arbitrary interpretation or construction in favour of either the Insured or the Company or reference to the “reasonable expectations” of either thereof or to contra proferentem and without reference to parole or other extrinsic evidence).”

Accordingly, the Policy was governed by English law. Unusually, the parties agreed to waive the arbitration provisions in the Policy, and conferred jurisdiction on the Commercial Court.

As a preliminary point, the Claimants argued that the matrix of fact which should be admissible to inform the construction of the Policy included the origins of the Bermuda Form, and hence “the traditions and practices of the US [insurance] market.” They contended that under New York law (as would typically govern the Bermuda Form) the insured would not need to establish that it was actually liable in respect of the subject matter of the claim, provided that liability had been established by settlement or by determination at trial.

Flaux J firmly rejected those submissions. He found that to the extent the Claimant suggested “that the approach the English court should adopt to a contract of insurance expressly governed by English law should be influenced by how New York law would construe the contract because, if the parties had not amended the Policy) by Endorsement No 14, it would have been governed by New York law, that contention is wholly misconceived and... heretical as an approach to construction.” Rather, in agreeing Endorsement 14 the parties should be taken objectively to have intended that the Policy be governed by English law in place of New York law. Moreover, Flaux J found that the principle relied on by the Claimant was a substantive rule of law derived from insurers’ duty to defend under New York law. It had no impact on how a court (whether in England or New York) would approach the construction of the Policy. Thus, the Claimant could have derived no assistance from the principle in any event.

The Judge also rejected expert evidence directed at the commercial background to product liability litigation problems faced by entities in the USA as “precisely the sort of extrinsic evidence as to the “reasonable expectations” of the parties which is prohibited by the proviso [to Endorsement 14]” and in any event, irrelevant to the proper construction of the Policy. Similarly, considerations of commercial unfairness or unreasonableness in the Policy failing to respond to commercially sensible settlements were considered to be irrelevant to construction. Flaux J noted that cover for settlements regardless of liability is available to insureds should they consider it necessary (for example as provided by the QC clause typically included in professional indemnity policies written in England) but had not been included in the Policy.

First preliminary issue

The heart of the first preliminary issue was whether a liability policy will respond only to actual legal liability to a third party, or whether it is sufficient for the insured to be subject to an arguable liability, in relation to which it has paid out a settlement. Flaux J extensively reviewed the English authorities on the point, and concluded that:

“There is a consistent and well-established line of authority that, in the absence of clear contrary wording in the contract of liability insurance, under English law (i) the insured has to establish that it was under an actual legal liability, not just an alleged liability, to the third party before it is entitled to an indemnity under the contract and (ii) the ascertainment of loss by a judgment or settlement does not automatically establish such actual legal liability (although a judgment against the insured may be strong evidence of such liability). It is still open to the insurer to challenge that there was an actual legal liability, in which case it is for the insured to prove that there was.”

The Judge cited with approval the judgment of Christopher Clarke J in Omega Proteins v Aspen Insurance, which sets out the basis for the principle (in relation to liabilities ascertained by judgment, although the reasoning applies equally to settlements):

“If A successfully sues B to judgment the basis upon which he succeeds will be apparent from the judgment. It will not be open to C to say that A succeeded on another basis. To do so would be to rewrite history. But if A succeeds in suing B and B then claims against C, it is open to C to claim that in truth B was not liable to A (either at all or to the same extent), or that, if liable, it was not on the basis decided by the judge or not only on that basis. Unless B and C have by contract agreed something different, a judgment given in proceedings between A and B is neither binding on, nor enforceable by, C in subsequent proceedings between B and C.”

Having established the rule, Flaux J went on to consider whether the Policy, properly construed, contained the necessary “clear wording” indicating that the parties intended to depart from the usual position. The insuring clause of the Policy provided that the Claimant was to “indemnify the Insured for Ultimate Net Loss the Insured pays by reason of
liability: (a) imposed by law... for Damages on account of: (i) Personal Injury... encompassed by an Occurrence."

The Policy defined "Damages" as “all forms of compensatory damages, monetary damages and statutory damages... which the Insured shall be obligated to pay by reason of judgment or settlement for liability... and shall include Defense Costs.”

Flaux J considered that the critical point was that the Policy indemnity was provided for sums paid out by the insured by reason of liability imposed by law. This wording required a “clear causal link” between payment and an actual legal liability. Accordingly, the words used in the insuring clause strongly suggested that the parties intended the usual rule to apply, and the insured was required to demonstrate an actual legal liability.

The Claimants sought to invoke what they characterised as the broader scope of various definitions and other covers provided by the Policy to suggest that the insuring clause should be construed more broadly. Flaux J rejected those arguments (noting that in general terms, words used in policy definitions were inapt to amend the scope of the clear words of the insuring clause). In relation to the definition of “Damages”, he considered that the reference to the insured’s obligation to pay by reason of settlement was qualified by the words “for liability”. This, combined with the use of the words “obligated to pay” were an indication that even where the insured had settled a claim, such settlement had to have been made in respect of an actual liability.

The Claimant also highlighted that the definitions in the Policy provided that there would be an “Occurrence” where “actual or alleged” Personal Injury occurred during the policy period. Accordingly, they submitted, an Occurrence could encompass alleged as well as actual liability. However, Flaux J did not consider that the Claimant could derive any assistance from that construction, as an Occurrence was a necessary but not sufficient condition for indemnity. Further, he noted that:

“The insured who becomes aware from complaints or claims that a particular product is being alleged to cause injury to people needs to be in a position to give a Notice of Occurrence... at the time a decision has to be taken whether to serve such a Notice, inevitably the third party claims may only be at the stage of allegations.”

The Occurrence provisions simply allowed the insured to bring potential losses within the temporal scope of the Policy depending on when claims were alleged, rather than extending the terms of the indemnity.

Accordingly, on the first preliminary issue, Flaux J found that there was no wording which extended or displaced the usual coverage under a liability policy, and therefore the insured was entitled to indemnity only where it would have been under an actual liability for the third party claim.

Second preliminary issue

The second preliminary issue was whether the insured was able to recover Defense Costs under the Policy in the absence of a legal liability to the third party plaintiffs.

Flaux J noted as the starting point of his analysis that under English law, in non-marine insurance there is no entitlement to an indemnity against defence costs (even where defence of a claim reduces insurers’ exposure), unless the policy in question expressly provides such an indemnity. The initial question for the Court, therefore, was whether on proper construction, the Policy provided a freestanding indemnity for Defense Costs.

Flaux J noted that Defense Costs were included in the Policy as an adjunct to the definition of Damages. His view was that there was no basis to divide the part of the definition referring to Defense Costs so as to separate them entirely from Damages and so to construe the Policy as providing separate covers. Even if it were possible to sever the definition, both Damages and Defense Costs would only be recoverable under the insuring clause to the extent they were incurred by reason of liability imposed by law. Accordingly, he found that:

“The parties have expressed the intention that defence costs should only be recoverable in circumstances where what might be described as “traditional” damages are recoverable, not that there should be free-standing coverage for such defence costs. In relation to the first preliminary issue, I have decided that traditional damages are only recoverable where there is an actual legal liability. In those circumstances, it is difficult to see how Defense Costs, which are expressly made recoverable as part of Damages... can be recoverable even where no actual legal liability is established. That conclusion involves a subversion of language.”

Accordingly, Defense Costs could only be claimed by the insured where it was established that it was subject to an actual liability imposed by law, and were not otherwise recoverable.

COMMENT

As is well known to the London legal market, the Bermuda Form has been the source of a considerable volume of dispute work over recent years. Substantial sums are covered on complex wording, the clarity of the drafting of parts of which Flaux J did not hesitate to criticise. The insurance is traditionally governed by New York law with disputes to be resolved by arbitration with seat in London. This means that, in the absence of any ability to appeal a decision on a foreign law under the Arbitration Act, there is a dearth of public authority on the wording. The decision of Flaux J is likely to generate considerable interest for arbitrators, insurers and insureds alike. 

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FIRST SUBSTANTIVE CASE ON THE BERMUDA FORM COMES BEFORE THE COMMERCIAL COURT

The findings of Flaux J in relation to coverage for settlements as a matter of English law are unsurprising and follow a significant body of authorities. The findings in relation to Defense Costs are of greater interest, and we are aware of different views previously on the English law position. It will no doubt come as some surprise to the insured to discover it has no cover for the costs of mounting a successful defence.

More generally, the position under English law as to both underlying settlements and English judgments is clear. Neither are binding on an insurer/reinsurer absent express wording in the insurance/reinsurance (such as a “follow the settlements” clause) or other conduct binding the insurer/reinsurer (such as via the conduct of the defence). The position in relation to foreign judgments is however less clear. Potter LJ suggested obiter in Commercial Union v NRG Victory that foreign judgments would be binding on a reinsurer by virtue of an implied term in the reinsurance and provided certain criteria were satisfied (such as the reinsured taking proper defences). Aikens J suggested, again in obiter dicta, in Enterprise Oil v Strand that the same analysis applied in relation to contracts of insurance. On the other hand, it is difficult to see why the test of necessity for the implication of a term, and particularly one of such complexity, is satisfied. In obiter comments in AstraZeneca, Flaux J pointed to misgivings of Lord Mance in Wasa v Lexington on the implication of such a term, and felt the better view was that no term should be implied. The binding nature of foreign judgments is, of course, of far greater importance than an English judgment, which the English Court would very likely follow in any event. Flaux J’s comments strengthen the view that a court required actually to decide the point will refuse to imply a term.

ADDITIONAL REFERENCES

Christopher Clarke LJ (giving the only reasoned judgment) rejected this submission. He emphasised that “the Policy does not provide cover for Occurrences. The Occurrence is the shell within which the pearl of liability must be found; or to use the metaphor adopted by the judge, the Occurrence is the gateway to coverage.” On that basis, the Judge considered it unsurprising that the Policy provided that an Occurrence may arise out of actual or alleged liability, as this allowed the insured to give notice of an Occurrence before liability was established, as it must do in order to secure coverage. Accordingly, he held that both the language used in the Policy as a whole, and a substantial body of English authority indicated that the Policy responded only to an actual (as opposed to merely alleged) liabilities. The insured must establish both that it has suffered a loss and that that loss fell within the scope of the cover afforded.

The Claimant/Appellant relied also on a number of other terms of the Policy said to indicate that cover was provided for actual or alleged liabilities. In common with Flaux J at first instance, the Court of Appeal did not find these other provisions persuasive. Accordingly, despite expressly making clear that the Court was cognisant of the difficulties faced by the Claimant in respect of mass tort litigation in the United States, those considerations could not “change the nature of the Policy for which [the Claimant] bargained.”

In relation to the second issue, namely whether and if so in what circumstances the Policy provided coverage for Defense Costs, Christopher Clarke LJ made plain his view that the Policy was “badly drafted” and that on a “literal reading” (which he rejected) “Defense Costs can never be recovered” because they do not arise by reason of a liability imposed by law or an obligation arising out of a judgment or settlement. Holding that the parties had plainly intended that the costs should be recovered in some circumstances, he concluded that the only way consistent with the wording of the Policy to ensure that Defense Costs were recoverable in some circumstances was to treat them as parasitical on Damages (defined in summary as payments to underlying claimants for which the insured became liable) and hence recoverable only in the same circumstances as Damages, namely where the Claimant established that it was or would have been liable for the claim in question. Christopher Clarke LJ accepted that this outcome was surprising and, from the point of view of the Claimant, “profoundly unsatisfactory”. However, he viewed this as the unfortunate result of “having Defense Costs only catered for, and then more directly, by way of treating them as an addition to and an element of damages.”

The Court was plainly aware that the result was very unfavourable to the insured and that, taken together with all other terms of the Policy in question, the XL004 form (at least where governed by English law) should not “be treated as one whose terms are intended to be particularly favourable to the insured.” Whilst this no doubt appears from AstraZeneca’s perspective as something as an understatement, the Court of Appeal plainly considered that as a matter of the correct construction of the Policy, Flaux J had reached the right answer on both of the preliminary issues.
PROXIMATE CAUSE: APPEAL ON EVIDENTIAL GROUNDS REJECTED

We previously reported on the first instance decision in ACE European Group Ltd and Others v Chartis Insurance UK Ltd concerning issues of proximate cause and inherent vice (see our 2012 Annual Review). The Defendants, who lost at first instance, sought to overturn the decision on appeal arguing that the Judge, Popplewell J, was not entitled to find in favour of the Claimants based on the evidence before him. The Court of Appeal disagreed.

BACKGROUND

This case arose out of a dispute between two sets of insurers as to the cause of damage to blocks of steel tubing ("Economiser Blocks") which had been transported from Romania to Slough for incorporation into a waste facility which was being constructed for Lakeside Energy from Waste Limited ("Lakeside"). Some time after delivery, it was discovered that the Economiser Blocks were cracked.

Lakeside and its contractors were insured under two policies:

1. An Erection “All Risks” Public Liability and Delay in Start Up Insurance Policy (the “EAR Policy”) with the Claimant insurers (the “EAR Insurers”); and
2. A Marine Cargo Insurance Policy (the “Marine Policy”) with the Defendant insurers (the “Marine Insurers”).

Broadly, the Marine Policy covered loss of and damage to property in transit, while the EAR Policy covered loss and damage at the construction site. Both policies contained a 50/50 clause providing that, in the event it was not possible to ascertain whether the loss was caused during transit or after arrival at the site, each policy would cover 50% of the adjusted claim.

The EAR Insurers settled the claim with the insured and then, having received an assignment of rights from the policyholder, sought to recover from the Marine Insurers. The EAR Insurers argued that the damage occurred during transit due to the poor road conditions in Romania and missing packing between the steel tubes of the Economiser Blocks. The Marine Insurers argued that the damage occurred after delivery due to vibrations caused by wind at the construction site and the loss was therefore within the scope of the EAR Policy rather than the Marine Policy. The Marine Insurers also argued, in the alternative, that if the cracking occurred during transit, it was due to inherent vice which was excluded under the Marine Policy.

FIRST INSTANCE DECISION

Popplewell J explained that an insured must prove the proximate cause (the real efficient cause) of the loss on the balance of probabilities. Where presented with two rival explanations for the cause of damage, the Court could find that one or other of the explanations was the cause, or that there was sufficient doubt on both causes that the claim fails to meet the burden of proof. In the latter case, the 50/50 clause would apply.

Popplewell J concluded that the EAR Insurers had proved on the balance of probabilities that: (1) there was sufficient packing missing between the tubes to allow vibration to occur during transit; and (2) each block was transported over sufficiently rough road for a sufficient time to allow the necessary cycles of stress to cause the cracking. He therefore concluded that it was a “realistic and credible possibility” that the damage occurred in transit. He rejected Marine Insurers’ arguments that the damage was due to wind excitation and dismissed their alternative case on inherent vice (which was not possible where there was a fortuitous external cause of loss).

COURT OF APPEAL DECISION

Marine Insurers were granted leave to appeal by Stanley Burton LJ. Their three grounds of appeal (discussed below) focused on the sufficiency of the evidence upon which Popplewell J based his decision, rather than any points of law. The Court of Appeal found unanimously in favour of EAR Insurers.

Evidence on packing of Economiser Blocks

Marine Insurers submitted that there was insufficient evidence to enable Popplewell J to conclude that the packing of the Economiser Blocks was inadequate. In support of this argument, they pointed to photographic records which, in their view, showed that the packing was satisfactory.
PROXIMATE CAUSE: APPEAL ON EVIDENTIAL GROUNDS REJECTED

The Court of Appeal rejected this submission. Longmore LJ held that the photographic evidence was incomplete and that the Appellant’s submissions did not adequately take into account the expert evidence (accepted by Popplewell J) as to the ways in which inadequate packing could result in cracking. Importantly, Marine Insurers had also failed to prove which photograph was of which Economiser Block.

The Court noted that, although the photographs were in Marine Insurers’ possession and control for six months before trial, they were not in fact disclosed until two days before trial and the accompanying metadata were only provided five days into trial, after the experts had given evidence. In Longmore LJ’s view, “it is not right for such a case to be mounted in written closing submissions for the first time, let alone for it to be mounted even better after time for reflection, in this court”. Moses LJ went further, criticising the Marine Insurers for “the audacity, if not effrontery, with which [they] have advanced this appeal” and noting the metadata were disclosed “far too late for witnesses or the parties and still less the judge to assess their significance”. He said that Popplewell J should have been invited to rule that the photographs were inadmissible and concluded that, had Stanley Burnton LJ appreciated the circumstances in which the evidence had emerged, he would never have given permission to appeal.

Evidence on road surfaces and resonant response

Marine Insurers’ second and third grounds of appeal were that there was insufficient evidence to enable Popplewell J to conclude that: (i) the Romanian road surfaces were rough enough to set up a vibration of the frequency necessary to cause the fracturing; and (ii) the type of resonant response necessary to cause the damage could have occurred.

These arguments were also rejected by the Court of Appeal, which found that Popplewell J had been entitled to reach the conclusions he had, based on the evidence before him.

COMMENT

Popplewell J’s legal analysis on proximate cause and inherent defects was not in dispute. Instead, the focus of the appeal was on matters of evidence. The Court of Appeal’s judgment is, however, a useful reminder of the importance of complying with continuing disclosure obligations in litigation in a timely manner and the difficulties of relying on evidence adduced so late in the proceedings.

ADDITIONAL REFERENCES

ACE European Group Ltd and Others v Chartis Insurance UK Ltd [2012] EWHC 1245 (QB)
THE INTERPRETATION OF CLAIMS CONTROL CLAUSES IN REINSURANCE CONTRACTS

In Beazley Underwriting Ltd and Others v Al Ahleia Insurance Company and Others, the Commercial Court was asked to determine the scope and effect of a claims control clause in a proportional reinsurance contract. Eder J concluded that clauses of this type are to be construed strictly and that the clause in question only applied to settlements or admissions in respect of losses giving rise to a “matching” liability under the reinsurance contract. On the facts, the Judge concluded that the Defendant reinsureds had not acted in breach of their obligations by settling or admitting a relevant liability.

BACKGROUND

In around January 2005, the Defendants entered into an open cover construction all risks and third party liability insurance policy with the Kuwait Oil Company (“KOC”) and its contractors for a declaration period of 1 February 2005 to 1 February 2007 (“the Underlying Insurance”). The Underlying Insurance, which was subject to Kuwaiti law, contained a clause which excluded from cover the costs that “would have been incurred if replacement or rectification of the Insured Property had been put in place immediately prior to the said damage” (referred to as “the LEG2 exclusion”).

At around the same time, the Defendants entered into a reinsurance contract with the Claimants and AIG UK Limited (“AIG”) as reinsurers (“the Reinsurance Contract”) and written on a back-to-back basis. The contract itself was a Lloyd’s slip policy governed by English law, covering projects attaching during the same period as the Underlying Insurance. Between them, the Defendants retained 10.5% of the risk, ceding the balance to the Claimants and AIG. Aon acted as broker in relation to both the Underlying Insurance and the Reinsurance Contract.

The Reinsurance Contract contained the following provisions:

1. A claims control clause (“the CCC”) which, as amended by a subsequent reinsurance declaration, provided as follows:
   “Notwithstanding anything contained in the Reinsurance Agreement and/or the Original Policy Wording to the contrary, it is a condition precedent to any liability under this Reinsurance that:
   a) The Reinsured shall upon knowledge of any loss or losses which may give rise to a claim under this Policy, advise the Reinsurers thereof as soon as reasonably practicable;
   b) The Reinsured shall furnish the Reinsurers with all information available respecting such loss or losses and the Reinsurers shall have the right to appoint adjusters, assessors, surveyors or other experts and to control all negotiations, adjustments, and settlements in connection with such loss or losses;
   c) No settlement and/or compromise shall be made and no liability admitted without the prior approval of Reinsurers.

   In the event of a claim under the Original Policy Wording Reinsurers hereon agree that settlement shall take place at the same time as settlement or advance of funds under the said Original Policy Wording.”

2. A so-called “subscription agreement”, the accepted effect of which was that AIG and another of the reinsurers, Beazley Underwriting Limited (“Beazley”), were appointed joint slip leaders; and that the agreement of each of AIG, Beazley and two further reinsurers (together, “the Claims Agreement Parties”) would be deemed to amount to the agreement of all reinsurers for the purposes of controlling and agreeing claims. As a result of this agreement, it was also accepted that the prior approval of all of the Claims Agreement Parties was required to any settlement, and that AIG’s approval alone was insufficient.

In October 2005, KOC executed an agreement for the construction of a number of crude oil storage tanks. This project was declared to the Underlying Insurance and then notified and agreed under the Reinsurance Contract. In March 2007, one of the tanks was found to be defective and KOC sought an indemnity for the costs of repair.

On being notified, the Defendants’ reinsurers initially denied liability on the basis of the LEG2 exclusion. This was in contrast to the position taken by Al Ahleia Insurance Company (“AIC”) on behalf of the Defendants, who united with KOC in pressing its reinsurers to pay the claim. In about June 2009, Aon came under pressure from KOC and formed a plan to split off AIG from the other reinsurers. That approach resulted in an agreement between
THE INTERPRETATION OF CLAIMS CONTROL CLAUSES IN REINSURANCE CONTRACTS

KOC and AIG in October 2009 that AIG would pay its 20% share of an approximately US$19 million loss amount. This sum was considerably higher than the figure first notified to reinsurers. AIG’s co-reinsurers were not involved in the discussions leading up to the agreement.

Subsequently, on 2 December 2009, a conversation took place between representatives of AIC and KOC in which the implementation of KOC’s agreement with AIG was discussed. Shortly thereafter, AIC produced a memorandum which identified the “partial payment” to be made by AIC in light of the settlement with AIG and recorded (on 6 December 2009) that AIC had no objection to it. In the months which followed, further exchanges took place between all of the parties in which the implications of the agreement with AIG were explored, with the brokers encouraging the balance of the market to settle on the same basis as AIG. However, the Claimant reinsurers did not move from their position as regards the application of the LEG2 exclusion and maintained that AIC’s conduct was in breach of the CCC. Eventually, KOC brought proceedings against AIC in Kuwait for the payment of a sum equivalent to AIG’s proportion.

ISSUES

Against that background, the Claimant reinsurers brought proceedings against their reinsureds in England in order to establish their non-liability under the Reinsurance Contract. It being common ground that compliance with the CCC was a condition precedent to the Claimants’ liability under the Reinsurance Contract, this question was ordered to be heard as a preliminary issue. The Claimants’ case was that the Defendants had acted in breach of the CCC by:

1. Failing to allow Beazley or any of the Claimants to control the negotiations with KOC and instead in conducting those negotiations behind the backs of reinsurers other than AIG; and
2. Admitting liability for KOC’s claim, and settling/compromising it, without the prior approval of all of the Claims Agreement Parties.

DECISION

On the proper approach to the construction of the CCC, Eder J accepted the Defendants’ submission (citing Royal & Sun Alliance v Dornoch with approval) that the CCC was to be regarded as an exemption clause and therefore to be construed against the Claimants, being the parties seeking to rely on it. In doing so, the Judge rejected an argument by the Claimants that the CCC was not in the nature of an exemption clause in that it simply required that the reinsureds must engage with their reinsurers in order to recover under the Reinsurance Contract.

In relation to sub-paragraph (b) of the CCC, Eder J agreed with the Claimants that this provision obliged the Defendants to give their reinsurers a proper opportunity to control any negotiations as between insurers and insured (not insured and AIG as reinsurer). This obligation was said to have been breached by AIC in commencing negotiations with KOC on 2 December and in concluding a deal with KOC by 6 December without consulting the Claims Agreement Parties. However, in each case, the Judge held that there had been no breach of the CCC: first, because the discussions on 2 December 2009 could not be characterised as “negotiations” but as an update on KOC’s position and, second, because the subsequent memorandum was an internal document that simply confirmed the previous discussions.

Eder J’s findings made it unnecessary for him to decide the reinsured’s argument that any “negotiations” were in any event in relation to the AIG ‘slice’ of the loss, rather than the balance of the reinsurance market, such that the CCC was not breached. Eder J did however indicate that he thought the reinsurers would have a strong argument that the negotiations would be “in connection with” the loss as settling AIG’s claim would involve negotiations as to the correct figure to use for the 100% loss.

In relation to sub-paragraph (c), it was the Claimants’ primary case that AIC had acted in breach of this provision by agreeing a settlement on behalf of all of the Defendants of the entirety of KOC’s claim or by admitting liability in relation to the same. Alternatively, the Claimants argued that there had been a breach in any event as a result of the partial settlement or compromise of KOC’s claim, namely AIG’s share and/or the Defendants’ share, or an admission in relation to that liability. These arguments gave rise to the following points of construction:

1. Whether sub-paragraph (c) prohibited the reinsured from settling/compromising or admitting liability in respect of its own retained share, or in respect of that part of the claim covered just by another reinsurer’s share (as the Claimants contended on their alternative case). The Judge held it did not prohibit such settlements or admissions on the basis that the clause only applied to settlements/compromises or admissions in respect of losses which might give rise to a “matching” liability under the Reinsurance Contract. This was said to flow from the CCC as a whole and to be consistent with business common sense, in that absent clear words to the contrary a reinsured should be able to deal as it so wishes with losses which will not give rise to a claim against a particular reinsurer.

2. Whether in the context of sub-paragraph (c), the word “settlement” covered settlements agreed “without prejudice to liability”. Eder J held that the word “settlement” imported a legally binding agreement regardless of whether it was concluded on a without prejudice basis.
3. Whether for sub-paragraph (c) to be triggered, it was necessary for there to be a settlement or compromise and an admission of liability, or whether one or the other of these sufficed. Eder J preferred the latter construction.

4. What constituted an “admission of liability” in the context of this clause. Eder J concluded that an effective admission of liability must be communicated in clear and unequivocal terms. Accordingly, an offer to settle or agreement to pay a sum of money would not per se be sufficient unless it also incorporated an admission of liability.

On the facts, Eder J concluded that there had been no relevant settlement, compromise or admission of liability amounting to a breach of sub-paragraph (c), both in the period to 6 December 2009 and subsequently.

COMMENT

As is well known, breach of a condition precedent entitles an insurer (or reinsurer) to decline liability regardless of whether it has suffered any prejudice as a result of a breach. This result, frequently referred to in the authorities (including this) as “draconian”, does mean that judges are from time to time inclined to search for bases to avoid a finding of breach. This decision, with its surprising legal and factual findings, perhaps represents a good example of such approach. However, the result of this approach is that the outcome of such cases is not always predictable. Indeed, the Court of Appeal may form a different view (the reinsurers are understood to be seeking leave to appeal).

It is trite law that a reinsurer is not bound by a settlement as between the reinsured and insured (absent a “follow the settlements” clause). Accordingly, a reinsurer is only prejudiced by a settlement to the extent it produces a loss for which the reinsured then seeks an indemnity and (as in this case) to the extent the settlement sets “the negotiating bar” for subsequent discussions with the insured on the balance of the loss. The Judge’s construction of the CCC, in looking only at “matching” loss and claim, does not provide protection to the reinsurer in relation to the latter. Further, the Judge’s conclusion that the CCC operated as an exemption clause on the basis the settlement was prima facie binding must be open to serious doubt.

ADDITIONAL REFERENCES

Royal & Sun Alliance Plc v Dornoch Ltd [2005] Lloyd’s Rep IR 544
THE INTERPRETATION OF THE SCOPE OF INDEMNITY COVER IN RESPECT OF DEFECTIVE WORKMANSHIP OF SUBCONTRACTORS

In M J Gleeson Group Plc v Axa Corporate Solutions Assurance SA, the Court considered the terms of a public liability insurance policy when determining preliminary issues in a claim by a building contractor against its insurer, including the scope of the indemnity cover for defective workmanship of subcontractors. HHJ Raynor QC sitting as a judge of the High Court concluded that for the purposes of the indemnity in respect of defective workmanship of subcontractors, “Damage to Property” had to have occurred as an essential pre-condition of cover.

BACKGROUND

The dispute arose out of a development known as the “Lucidus Development” carried out by M J Gleeson Group Plc (“Gleeson”) under a contract made in October 2000 with F Rogers Developments Limited in relation to a site in Watford (“the Works”). Gleeson engaged two subcontractors in relation to the windows, roofing and cladding aspects of the Works, Airedale Glass and Glazing Limited and Boundary Roofing Services. The Works were completed on 17 May 2002 and a Certificate of Making Good Defects was issued in September 2006.

Axa Corporate Solutions Assurance SA (“Axa”) issued successive policies of insurance to Gleeson from 1999 until 2008 which included additional cover in respect of the defective workmanship of subcontractors under the “Public Liability” section of the policy. It was this additional cover that gave rise to the dispute.

On 25 May 2007 the funders of the Lucidus Development, the Strathclyde Pension Fund, wrote to Gleeson through Arlington Property Investors raising concerns in respect of the installation of the cladding and areas of the roof. On 10 July 2007 Gleeson forwarded a copy of the letter and the accompanying surveyor’s report to loss adjusters acting for Axa and indicated that it was “only asking you to note an interest in this matter as we are still carrying out investigation works into both the cause and the responsibility of the problems that are highlighted”. In September 2007 remedial works were proposed but Gleeson and the building owners were unable to reach an agreement in relation to the scope of the necessary remedial works, resulting in a substantial claim against Gleeson who in turn sought Axa’s confirmation that it would provide cover. Airedale Glass and Glazing Limited and Boundary Roofing Services were subsequently dissolved. Depending upon when the claim was first made, there were two policies which potentially applied for the periods 1 December 2006 to 30 June 2007 and 1 July 2007 to 30 June 2008, the terms of which were identical.

The Court was asked to consider five preliminary issues, the second and fourth of which were resolved between the parties and fell away:

1. Whether on proper construction of the policies, Axa was obliged to provide indemnity to Gleeson in respect of the claims regardless of whether “Damage to Property” had occurred; or on the basis that “Damage to Property” had to have occurred as an essential pre-condition of cover.

2. Was the claim first made by Gleeson during the period of insurance from 1 May 2006 to 30 June 2007 by, at the latest, the letter of 25 May 2007 (it is unclear from the judgment why the policy period was stated as commencing on 1 May 2006 when it is referred to elsewhere as commencing on 1 December 2006).

3. If the policy for the period 1 December 2006 to 30 June 2007 did contain a sub-limit, whether such sub-limit had been eroded and, if so, to what extent?

DECISION

Issue 1

The first issue involved the construction of the general insuring clause under Section 1 and Memorandum 23 (Subcontractors Workmanship) of the relevant policy for Public Liability. The general insuring clause under Section 1 provided:

In the Event of

a) Personal Injury to any person
b) Damage to Property
c) Obstruction, trespass or nuisance, denial or access, interference with any quasi easement or right of air light water or way of interference with any other amenity, disclosure or information of a personal, confidential or commercial nature.
Occurring within the Territorial Limits the Company will indemnify the Insured in respect of all sums which the Insured shall be legally liable to pay as compensation arising out of such Event. The liability of The Company for compensation shall not exceed the limit of Indemnity in respect of any one Event.”

Memorandum 23 (Subcontractors Workmanship) provided:

“This Section of the Policy extends to indemnify the insured in respect of legal liability arising from the defective workmanship of their subcontractors including the cost of making good defective workmanship provided that

1) a claim is first made against the Insured or notification given to the Company by the Insured of circumstances which might lead to a claim during the Period of Insurance.

2) this indemnity shall only come into effect after the expiry of any maintenance period by contract or when any contractors all risks insurance taken out by or on behalf of the contractor and/or subcontractor applicable to the carrying out of the work concerned has expired if earlier

3) this Memorandum shall not apply
   a) until all practical sources of recovery from sub-contractors or their insurers have been exhausted
   b) in respect of Damage to the property or defective workmanship for which an indemnity is provided for under a previous policy or Period of Insurance.”

Axa’s case was that Memorandum 23 did not displace Section 1 and cover was only provided under the former where the defective workmanship of the sub-contractors caused “Damage to Property” other than the part of the defective workmanship had to have occurred as an essential pre-condition of cover for the following reasons:

1. The distinction between the words used at the beginning of Memorandum 23 (“This Section of the Policy extends to indemnify”) and the words used in Section 1 (“The Company will indemnify”) was significant. The Judge held that the former expression makes clear that Memorandum 23 was not intended to be a self-standing form of cover but was to be governed by the general insuring clause under Section 1. Consideration of other Memoranda where the same expression was used reinforced his opinion.

2. Although the wording of Memorandum 23 could have been expressed more clearly, the Judge held that the intent of the provision was clear and the cover under Section 1 for Damage to Property arising from defective property was extended in two respects:
   (i) Where other property was damaged as a result of the defective workmanship, Gleeson would be indemnified against the cost of making good the defective workmanship (which would otherwise be excluded under the terms of the policy).
   (ii) Gleeson would be covered under Memorandum 23 (subject to its terms) where a claim was made or notification given during the Period of Insurance even though the Section 1 event occurred when there was no insurance in force.

3. It was implicit in the terms of Memorandum 23 that the legal liability must be for “Personal Injury”, “Damage to Property” or “Obstruction”, trespass, etc, by virtue of the fact that it was the Section 1 cover that was being extended.

4. The cover provided by Memorandum 23 could not be construed as extending in effect to a guarantee of the workmanship of subcontractors, irrespective of whether a Section 1 event had occurred. Such an extension would be highly unusual and require clear words and even possibly (as stated by Tuckey LJ in Tesco Stores v Constable) some other description of cover.

**Issue 3**

The issue here was whether the Arlington letter of 25 May 2007 with the accompanying report constituted “a claim... against the Insured” for the purposes of Memorandum 23 during the period of insurance ending on 30 June 2007. It was relevant that significant claims in respect of other projects had been paid by Axa to Gleeson during this policy period, thereby eroding the limit of cover available to meet this claim. Gleeson were therefore arguing that the claim fell under a subsequent period of insurance.

Gleeson argued that the letter of 25 May 2007 did not amount to a claim, relying on the statement of principle in the Canadian case.
THE INTERPRETATION OF THE SCOPE OF INDEMNITY COVER IN RESPECT OF DEFECTIVE WORKMANSHIP OF SUBCONTRACTORS

of Reid Crowther and Partners v Simcoe & Erie General Insurance Co, but at best a notification of circumstances that might lead to a claim. Gleeson pointed to the fact that the letter was not from the property owners but their agent and that there was distance between the author of the letter and the commissioner of the report. Gleeson suggested that the letter was merely a request for comments and proposals for rectification of apparent deficiencies and not a demand for rectification.

Axa’s case, relying on the dictum of Staughton LJ in Robert Irving and Burns v Stone, was that the letter, taken together with the report and its clear conclusions that there were defects of design and construction, amounted to a claim against Gleeson for the rectification of the apparent deficiencies in the original building design and construction.

HHJ Raynor QC agreed with Axa that the letter was more than a mere request for information but held that it did not constitute a claim within the meaning of the policy as it was not an assertion of a right to relief (as Steyn LJ defined a claim in Thorman v New Hampshire Insurance Co). He held that the letter of 25 May 2007 was the communication of circumstances which might lead to a claim.

Issue 5

There was also an issue as to whether an interest payment made under the policy in respect of another claim eroded the sub-limit for the period 1 December 2006 to 30 June 2007. The issue turned on whether the interest was paid on legal action costs (in which case such limit would not be eroded) or was an interest payment in respect of damages and/or consequential costs (in which case the sub-limit would be reduced). The witness evidence given to the Court made it clear that the latter proposition was correct and the Judge therefore held that if a claim was made in the policy period 1 December 2006 to 30 June 2007 (contrary to his ruling) the sub-limit would be reduced by that amount.

COMMENT

As the Judge observed, the extension of cover in respect of defective workmanship of subcontractors provided by Memorandum 23 to Section 1 of the Axa policy provided cover considerably more extensive than that provided by a conventional public liability policy. As a general rule public liability policies provide cover against liability to the public at large for claims for damages in tort; such policies do not therefore cover liability in contract for pure economic loss unless there is clear wording extending cover to the same.

The case serves as a useful reminder of the courts’ approach to the interpretation of insurance policies. In determining that on the proper construction of Memorandum 23 “Damage to Property” other than the part the subject of the defective workmanship had to have occurred was an essential pre-condition for cover, the Judge made it clear that the policy would be construed by reference to all that it contained including the general insuring clause Section 1.

ADDITIONAL REFERENCES

Reid Crowther and Partners v Simcoe & Erie General Insurance Co [1993] 99 DLR 741
Investors Compensation Scheme v West Bromwich Building Society [1998] 1 WLR 896
Tesco Stores v Constable [2008] EWCA Civ 362
Excelsior Group Productions Ltd v Yorkshire Television Ltd [2009] EWHC 1751 (Comm)
MARINE INSURER FAILS TO ESTABLISH NON-DISCLOSURE, BREACH OF WARRANTY AND ILLEGALITY

In Sea Glory Maritime Co and Another v Al Sagr National Insurance Co (The Nancy), the Commercial Court considered a US$4.45 million claim under a hull, machinery and war risks policy arising out of the constructive total loss of a vessel, The Nancy, due to fire. Blair J rejected the Defendant insurer’s arguments that it was entitled to decline cover due to non-disclosure, breach of warranty and illegality, whilst making some interesting observations on the utility of online databases in the presentation of a risk.

BACKGROUND

The Defendant, Al Sagr National Insurance Co ("Al Sagr") insured a fleet of vessels owned by the First Claimant, Sea Glory Maritime Co ("Sea Glory"). The fleet included a vessel called "The Nancy". The policy provided cover for hull, machinery and war risks and incepted on 2 December 2008. The insureds under the policy were Sea Glory and the Second Claimant, Swedish Management Co SA ("Swedish Management"), which was identified as the commercial and technical manager of the vessel.

A fire occurred on the vessel on 14-15 February 2009 while it was at the Russian port of Nakhodka near the Sea of Japan. As a result of the significant damage to the vessel, it was declared a constructive total loss. The Claimants sought an indemnity under the policy in the sum of US$4.46 million, after credit was given for proceeds of sale, return of premium and sue and labour expenses.

Al Sagr declined cover and the Claimants brought proceedings in the Commercial Court. Al Sagr disputed liability on five grounds: grounds 1-3 concerned alleged misrepresentations/non-disclosures, ground 4 concerned an alleged breach of the ISM Warranty in the Policy and ground 5 concerned alleged illegality under US law due to trading with Iran. Blair J rejected each of these arguments in turn.

DECISION

1. Misrepresentation of the management of the vessel

Al Sagr argued that, although the Claimants identified Swedish Management as the commercial and technical manager of the vessel, it failed to disclose that another company – Blue Fleet Management Company Ltd ("Blue Fleet") – was also materially involved in management. Blue Fleet had previously managed another vessel, Lady Belinda, which had been insured by Al Sagr. Al Sagr suspended cover for the Lady Belinda due to its poor condition and the vessel subsequently sank. Al Sagr argued that a prudent underwriter would have considered Blue Fleet’s involvement in the management of The Nancy as material to the risk and that it was induced to provide cover by the misrepresentation that Swedish Management was the manager. This was disputed by the Claimants.

Blair J found on the facts that, although Blue Fleet had some involvement in the day to day running of the vessel (in particular, in relation to Class), that involvement did not constitute management of The Nancy. He accepted the Claimants’ argument that Swedish Management had ultimate authority, control and decision-making powers and that the representation in the policy was therefore true. The expert evidence was that, if Swedish Management retained all decision making and all authority, Blue Fleet’s involvement would not be considered by a prudent underwriter to be material. There was therefore no material misrepresentation.

2. Non-disclosure of Port State Control detentions

Al Sagr’s second ground of defence was that the Claimants had failed to disclose that, prior to inception, the Nancy had been detained following Port State control ("PSC") inspections on four separate occasions. Three of the detentions related to failure to comply with fire safety requirements. Al Sagr also pointed to a post-inception detention in Iran in December 2008.

Blair J rejected Al Sagr’s argument.

On the facts, he held that the deficiencies identified by the PSC officers were in each case rectified whilst making some interesting observations on the utility of online databases in the presentation of a risk.
unseaworthiness. He accepted the Claimants’ expert evidence that a prudent underwriter would have been concerned with detentions in the recent past ie, 12 to 18 months before inception. He therefore rejected the suggestion that the four detentions prior to the policy inception were material and should have been disclosed.

With respect to a detention in October 2008 (just two months before inception), Blair J concluded, based on the Claimants’ expert evidence, that a prudent underwriter would only consider the fire safety deficiencies identified during that inspection to be material if they were not rectified. In this case, they had all been rectified.

In any event, the Judge found that, had the Claimants disclosed the detentions and underwriters discovered that all issues had been rectified, they would in any event have proceeded to renew cover on the same terms. The alleged non-disclosure did not, therefore induce the underwriter to offer cover on the terms that it did.

Finally, the Claimants had argued that, even if there was a material non-disclosure, Al Sagr was unable to rely on it to avoid cover because information about the detentions was available online and market practice was for insurers to access that information online. The information ought to have been known by the insurer in the ordinary course of his business and, hence, need not be disclosed by the insurer per section 18(3)(b) of the Marine Insurance Act 1906 (“MIA 1906”). Blair J concluded that, although a reasonable underwriter is presumed to know facts in his possession or which he had means of learning from available sources, in this case there was no presumption of knowledge merely because the detention information was available online. It was necessary to inquire whether there was a fair presentation of the risk in all the circumstances, including the availability of online information. In this case, Blair J found that the relevant databases to which the Defendant did have access provided inaccurate or incomplete information and did not therefore give rise to a presumption of knowledge.

3. Non-disclosure in relation to alleged conflict of interest on the part of the Second Claimant’s “Designated Person Ashore” for ISM purposes

Al Sagr argued that the Claimant’s Designated Person Ashore, Mr Medawar, had a conflict of interest which should have been disclosed. Al Sagr’s case changed during the course of trial but, in essence, it relied upon commercial associations between a company with which Mr Medawar was involved and the entity which conducted The Nancy’s ISM audits.

Blair J could find no conflict of interest capable of disclosure and therefore rejected Al Sagr’s third argument.

4. Breach of the ISM Warranty in the Policy

Al Sagr’s fourth ground of defence was that there had been a breach of the “ISM Warranty” in the Policy. The warranty in question merely stated: “Vessels ISM Compliant”. Al Sagr argued that the ISM Warranty was breached as at the date of the policy or, at the latest, at the date of the PSC detention in Iran in December 2008.

Blair J observed that the ISM Code, which was developed by the International Maritime Organisation and sets out safety requirements, was expressly stated to be in “broad terms so that it can have widespread interpretations” and apply to a broad range of vessels and shipping companies.

One of the key issues between the parties was the proper construction of the ISM Warranty. The Claimants argued that the ISM Warranty required only documentary compliance, which was achieved if a valid Ship Management Certificate for the vessel and a valid Document of Compliance for the vessel’s owner or manager had been issued in accordance with the ISM Code. Al Sagr, on the other hand, argued that the ISM Warranty required actual compliance with the ISM Code.

Blair J noted that there was no authority on the ISM Warranty wording. He also noted that it was common ground that any ambiguity was to be construed against the insurer. He held, based on the proper construction of the ISM Code and by analogy with authorities on the interpretation of class warranties (Transpetrol Maritime Services Ltd v SJB (Marine Energy) BV (“The Rowan”), the ISM Warranty only required documentary compliance. He opined that, given the severe consequences of breach of warranty (ie, automatic discharge of the insurer’s liability), the onus was on the insurer to stipulate the scope of the warranty more clearly in the policy. He did, however, hold that the ISM Warranty was a continuing warranty which applied throughout the policy period.

In any event, Blair J held that Al Sagr had not established on the evidence that there was any major non-conformity or failure to rectify a non-conformity with the ISM Code (and thus no breach in any event).

5. Illegality under US law due to trading with Iran

Finally, Al Sagr alleged that the insureds had issued freight invoices in respect of shipments from Iran to China which caused the New York correspondent bank nominated by the insureds to process payments in US Dollars. The insurer alleged that, in doing so, both the bank and the Claimants had acted in breach of US sanctions prohibiting certain dealings in connection with Iran. Al Sagr alleged that this amounted to a breach of section 41 MIA 1906 (the implied warranty that the insured venture is lawful).

Blair J noted that the Policy expressly envisaged that there would be voyages to Iran. Having considered the relevant US laws and the expert evidence on that legislation, Blair J concluded that (although the point was arguable both ways) the bank and the Claimants had committed civil (although not criminal) violations of US law.
Section 41 requires that the “adventure insured” must be lawful. Blair J found that the “adventure insured” in this case was the exposure of the ship to maritime perils, not the payment of freight. Further, Blair J (citing obiter comments in Royal Boskalis Westminster NV v Mountain) concluded that the implied warranty under section 41 requires that the adventure shall be lawful as a matter of English law, not foreign law.

Blair J also rejected Al Sagr’s argument that the claim was vitiated at common law due to illegality under foreign law. While a court may refuse to enforce a claim where the assured has to rely on his own unlawful conduct to succeed or where the assured would profit from his own crime, this was not such a case. The Claimants were not relying on the freight payments in order to claim an indemnity under the Policy, nor were they seeking to profit from the unlawful processing. The claim was entirely unconnected with the breach of US law. It might have been different if the adventure itself would have involved a breach of US law. The principle of ex turpi causa was inapplicable. Further, Blair J could find no public policy grounds for refusing to enforce the claim.

Finally, Blair J rejected Al Sagr’s argument that the illegality of the payments should have been disclosed, as it was information which the Claimants were deemed to know under section 18(1) of the MIA 1906. However, Blair J found that the illegality was not something the insureds should have known about. The insurer had at least as much opportunity to become aware of the US legislation.

COMMENT

This case is a useful reminder for insureds of the importance of ensuring that all material information is disclosed to underwriters and that they make a fair presentation of the risk. Whilst ultimately the insureds in this case succeeded, Blair J declined to make any hard and fast rules as to the extent to which insurers will be deemed to be aware of information available on online databases, particularly where the information in question is unreliable. The availability of information to any given underwriter will need to be scrutinised on a case by case basis, with the ultimate test being whether the insured made a fair presentation of the risk.

Blair J’s observations on the scope of the ISM Warranty will provide comfort to insureds. Insurers seeking to impose a wide-ranging continuous warranty should take care to do so in clear terms; any ambiguity may be construed against the insurer.

Finally, in this case the Judge was reluctant to find that there had been a breach of section 41 of the MIA 1906, notwithstanding the fact that the insured had arguably breached New York law. Doubtless the insured in this case was assisted by the fact that the policy expressly envisaged that there would be voyages to Iran.

ADDITIONAL REFERENCES

Transpetrol Maritime Services Ltd v SJB (Marine Energy) BV (“The Rowan”) [2012] 1 Lloyd’s Rep 564
Marine Insurance Act 1906
SUPREME COURT UPHOLDS GENERAL PRINCIPLE THAT LIABILITY POLICY COVERAGE IS TRIGGERED ON ASCERTAINMENT OF THE LIABILITY OF THE UNDERLYING INSURED

In Teal Assurance Co Ltd v W R Berkley Insurance (Europe) Ltd and Aspen Insurance UK Ltd, the Supreme Court upheld the decisions of the Court of Appeal and Commercial Court that a tower of liability insurance contracts was eroded when and in the order in which the insured’s liability giving rise to a claim under the insurance was ascertained by agreement, judgment or award. Accordingly the insured and its captive insurer could not vary the order in which insurance claims were paid under the tower so as to adjust the priority of claims and ensure that specific claims were paid by the ‘top and drop’ policy which sat above the tower. The decision reiterates that very clear wording will be needed if policy liability is to be triggered other than in the order in which the underlying claims are ascertained.

BACKGROUND

As outlined in our article on the Court of Appeal decision in our 2011 Annual Review, the Black and Veatch Group (‘BV’) is an engineering firm incorporated in Delaware. BV’s professional indemnity insurance programme for the 2007-2008 year was structured as a “tower” of insurance contracts which provided it with total cover for any one claim (and in an annual aggregate) of US$60 million in excess of the deductible and self-insured retention (“the PI tower”). The primary layer of US$5 million (“the primary policy”) was underwritten by Lexington Insurance Co Ltd (“Lexington”). Above this, there were three excess layers of cover totalling US$55 million underwritten by BV’s captive insurer, Teal Assurance Co Ltd (“Teal”). Teal also underwrote an additional “top and drop” layer which provided cover of up to £10 million in excess of the PI tower. This was reinsured by W R Berkley and Aspen (“the Reinsurers”). In contrast to the worldwide coverage provided by the PI tower, however, the top and drop policy excluded claims emanating from or brought in the USA and Canada.

The excess and top and drop policies incorporated the primary policy. This provided liability cover in respect of BV’s liability to third parties, and mitigation cover for costs and expenses incurred by BV in rectifying design defects. The primary policy provided in the Definitions section that:

“E. Deductible and/or Self-Insured Retention means the amount stated in Item 5. of the Declarations that the Insured will pay, as set forth in the Declarations, for Claim Expenses and Damages with respect to every Claim made during the Policy Period. This amount must be paid prior to the Company indemnifying the Insured under the terms and conditions of this Policy.”

The excess and top and drop policies also contained the following conditions, being standard excess layer wording reference LSW055:

“1. Liability to pay under this policy shall not attach unless and until the Insurers of the underlying policy(ies) shall have paid or admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses

3. If by reason of the payment of any claim or claims or legal costs and expenses by the insurers of the underlying policy(ies) during the period of this insurance, the amount of indemnity provided by such underlying policy(ies) is—

a) Partially reduced, then this policy shall apply in excess of the reduced amount of the underlying policy(ies) for the remainder of the period of insurance;

b) Totally exhausted, then this policy shall continue in force as underlying policy until expiry hereof.
5. All recoveries or payments recovered or received subsequent to a loss settlement under this Policy shall be applied as if recovered or received prior to such settlement and all necessary adjustments shall then be made between the Assured and the Underwriters provided always that nothing in this Policy shall be construed to mean that loss settlements under this Policy are not payable until the assured's ultimate net loss has been finally ascertained.

6. Except as otherwise provided herein this Policy is subject to the same terms, exclusions, conditions and definitions as the Policy of the Primary Insurers...” [sic]

The reinsurance contract in respect of the top and drop layer provided that “the reinsurer’s liability under this agreement shall follow that of the reinsured for losses under all terms, conditions and limits to the reinsured original policy or policies specified therein”.

BV notified a number of claims made against it in the USA, Canada and elsewhere, with a total value which was expected to exceed the cover available under the PI tower. The issue between Teal and the Reinsurers was the order in which these claims should be brought into account for the purposes of determining whether the primary and excess layers had been exhausted. This issue took on significance due to the differing geographical scope of cover provided by the PI tower (which applied worldwide) and the top and drop policy (which excluded US and Canadian claims). As a result of this discrepancy, if the US/Canadian claims were attributed to the excess layers, Teal (and thus its reinsurers) would become liable under the top and drop policy. If, however, the losses relating to the non-US/Canadian claims fell for coverage under the excess layers, the reinsurance would not respond, on the basis that the top and drop policy excluded US/Canadian claims.

**FIRST INSTANCE DECISION**

Andrew Smith J in the Commercial Court considered the order in which BV’s losses attached as a preliminary issue on construction of the reinsurance contract. Finding for Reinsurers, he took as a starting point the established approach that losses trigger coverage not when presented or paid, but in the order of date of loss for property insurance and in the order in which they are ascertained by judgment, arbitral award or settlement in the context of liability insurance (Post Office v Norwich Union Insurance Co Ltd applied). Construing LSWO55 Clause 1 of the excess and top and drop policies commercially, the Judge concluded that it operated as a pre-condition to the policies responding where there was a dispute on the underlying cover but did not affect the order in which the policy indemnity was eroded, as had been suggested by Teal.

**COURT OF APPEAL DECISION**

The Court of Appeal upheld the decision of Andrew Smith J and rejected Teal’s submissions as to the effect of Clause 1. The Court held that the key provision was Clause 3 of the top and drop policy, which provided that once the underlying policies had been exhausted, “this policy shall continue in force as Underlying policy”. It followed that upon the exhaustion of the PI tower, the top and drop policy was intended to drop down and become (or at least provide the same cover as) the primary policy.

Thus, once the first excess layer dropped down and effectively became the underlying policy, the insurer (Teal) was liable (as Lexington had been) once BV’s liability had been established by admission, judgment or award; and so on up the PI tower. The primary policy had no equivalent to the provisions of Clause 1, and so that provision was displaced by the terms of the underlying policy as each excess layer dropped down upon the exhaustion of the previous layer. The purpose of Clause 1 was to make clear (as a condition precedent to payment under the layer in question) that the obligation to pay under the excess layers was to be deferred until the resolution of any uncertainty as to the liability of the underlying insurer. The clause was not therefore apt to affect the order in which the policy indemnity was eroded. Furthermore, the construction for which Teal contended did not produce a commercially sensible result and would have permitted Teal to manipulate the lower excess layers to pay US/Canadian claims, leaving reinsurers to face non-US/Canadian claims – an outcome which was unlikely to have been the intention of the parties.

**SUPREME COURT DECISION**

Before the Supreme Court, Teal challenged the proposition that the ascertainment of a claim against the insured exhausted the insured’s cover to the extent of that claim. Teal accepted that under a liability policy the insurer’s liability typically arose at the time that loss within the scope of the policy was ascertained against the insured, but submitted that it was only when that claim was met by the insurer that policy cover was exhausted. On that basis, if a second claim was notified and ascertained against the insured, BV was free to claim and the insurer was free to make payment in respect of the latter first, in exercise of its contractual rights.

Teal also sought to rely upon LSWO55 Clauses 1 to 3 as providing that liability arose under each excess layer only once the underlying insurers “shall have paid or have admitted liability or have been held liable to pay, the full amount of their indemnity”. On this basis Teal submitted that its liability under the top and drop policy depended on the order in which the underlying insurers chose to settle insurance claims. Teal in its separate capacity as underlying excess layer insurer could therefore shape its own liability as top and drop insurer.
The Supreme Court did not accept Teal’s submissions and unanimously upheld the decision of the Court of Appeal. Lord Mance, giving the leading judgment, rejected Teal’s suggestion that policy cover was exhausted only when a claim was actually met by the insurer. He held that:

“Where an insurance had a limit, it made no sense to speak of the insured as having causes of action or recoverable claims which together would exceed that limit. The ascertainment by agreement, judgment or award of the insured’s liability gave rise to the claim under the insurance, which was exhausted to the extent of the claim at that time. The same applied to ascertained expenses incurred by BV, which were set against first the policy retention and deductible but thereafter against the insurance provided as and when the expenses were incurred. The policy thus met each ascertained loss when and in the order in which it occurred. The insured could of course forbear from notifying or could withdraw or abandon a claim, in which case the insurance would not be exhausted by that claim. That was not, however, what was envisaged by Teal who instead sought the continued pursuit of a claim, coupled with adjustment of its priority as against the programme of insurances.”

The terms of the relevant policies did not alter this position. Whilst the Definition in the Lexington primary policy required BV to have “paid” the amount of the deductible and self-insured retention prior to the insurer indemnifying BV, this simply underlined that the deductible and retention must be used up before Lexington prior to the insurer indemnifying BV, this simply underlined that the definition here as being used only as a measure of liability and understood here as being used only as a measure of liability or responsibility. The terms of the relevant policies did not alter this position. If the general approach was so intended to define when liability arose as affecting the claims in respect of which liability arose, Clause 1 was intended to make clear that the obligation to pay of each excess layer was deferred until the resolution of any uncertainty or dispute as to the liability of underlying insurers. It was not intended to alter the identity of the claims which fell to be met by that underlying insurance. Clause 1 merely provided that liability under the first excess layer only attached as and when Lexington paid or admitted or was held liable in respect of BV’s ascertained expenses or third party liability.

This position was confirmed by the terms of LSW055 Clause 3(b), which provided that on exhaustion of the Lexington policy, the first excess layer dropped down to continue in force as the Lexington primary policy ie, on the same terms as the Lexington policy. The Lexington policy had no equivalent of Clause 1 and liability under the first excess policy in its new role as the primary policy would therefore necessarily be determined by the timing of the ascertainment of BV’s third party liability and expenses. The same position would apply successively under each excess layer, including the top and drop, as each was exhausted in turn.

Looking to the commercial common sense of the policies (and citing the Supreme Court in Rainy Sky SA v Kookmin Bank) Lord Mance agreed that it was true that such a position might lead to some degree of control by the insured or primary insurer in the timing of the ascertainment of BV’s third party liability. This was less remarkable, however, than the degree of adjustment of the order of claims which Teal maintained it could achieve and which only arose because Teal was BV’s captive and party to BV’s insurance programme. This produced the unfamiliar phenomenon of an insurer seeking to maximise its own insurance liabilities. It could not readily be reconciled with the basic philosophy that insurance covers risks lying outside an insured’s own deliberate control. Lord Mance would not, therefore, have any difficulty agreeing with the Court of Appeal’s views on commerciality, but considered it unnecessary to do so as the terms and scheme of the relevant policies provided the answer without more.

COMMENT

As was the case in the Court of Appeal, there was no issue before the Supreme Court as to the general application of the rule that (in the case of liability cover) the liability of insurers typically arises as and when loss is ascertained as against the insured by judgment, arbitral award or settlement. Unlike before the Court of Appeal, however, Teal sought also to argue that as a general principle cover under such policy was only actually exhausted on payment by the insurer. There is no indication as to the basis for such submission, and the suggestion was given short shrift by Lord Mance. Teal’s better submissions concerned the question whether the general approach was varied by particular wording in the top and drop policy which provided that Teal only became liable as top and drop insurer once BV’s insurers on the layers below had admitted liability or been held liable to pay. If the general approach was so varied, it would have permitted Teal to order the claims so as to maximise its reinsurance recoveries. Whilst the comments of the Supreme Court were less obviously critical of Teal’s submissions on this issue than those of the Court of Appeal, it is notable that the Supreme Court did not (unlike the Court of Appeal) feel it necessary to consider the commercial sense of those arguments in

SUPREME COURT UPHOLDS GENERAL PRINCIPLE THAT LIABILITY POLICY COVERAGE IS TRIGGERED ON ASCERTAINMENT OF THE LIABILITY OF THE UNDERLYING INSURED
rebutting them. Rather, the analysis of the terms and scheme of the relevant policies was sufficient to answer the question. This reiterates in stronger terms the need for very clear wording to be used if the general rule on the attachment of losses is to be disappplied.

Lord Mance also noted that Teal’s application for permission had suggested that the case might raise the question of the formulation of insurers’ liability to indemnify, namely whether a claim under liability insurance is one for damages for the insurer’s failure to hold the insured harmless, or is a debt claim based upon the insurer’s undertaking to pay valid claims on the occurrence of particular events. The latter formulation would have the potential effect that insurers could become liable in damages for non- or late payment, contrary to the current position established by cases such as Sprung v Royal Insurance (UK) Ltd. In the event it was not considered as it would make no difference to the outcome of the appeal, but it is clear that this is an issue that the courts are eager to address should the opportunity arise. The English and Scottish Law Commissions are already reviewing the position (see their consultation paper Insurance Contract Law: Post Contract Duties and Other Issues) and the outcome of that process is eagerly awaited. It is difficult not to suspect that the Supreme Court granted leave to appeal originally in the mistaken expectation that this controversial issue could be looked at again at the highest level.

Finally, the Supreme Court (as with the Court of Appeal) made no comment on one aspect of Andrew Smith J’s underlying Commercial Court judgment of importance to reinsurance, namely his finding that reinsurance was properly analysed as an insurance of the underlying risk rather than a liability insurance of the reinsured. Despite that finding, Andrew Smith J held that a cause of action under the reinsurance would only be established once the reinsured’s own liability for the reinsured was ascertained by settlement, judgment or arbitral award. Such an approach is illogical, but does reflect the Commercial Court’s reluctance to create limitation difficulties on reinsurances.

### ADDITIONAL REFERENCES

- Post Office v Norwich Union Insurance Society Ltd [1967] 2 QB 363
- Charter Reinsurance Co Ltd v Fagin [1997] AC 313
- Sprung v Royal Insurance (UK) Ltd [1999] 1 Lloyd’s Rep IR 111
- Rainy Sky SA v Kookmin Bank [2011] UKSC 50
AUGUST 2011 RIOTS: TUMULTUOUS BEHAVIOUR AND CONSEQUENTIAL LOSSES UNDER THE RIOT (DAMAGES) ACT 1886

In Mitsui Sumitomo Insurance v Mayor’s Office for Policing and Crime, Flaux J in the Commercial Court determined two preliminary issues relating to coverage under the Riot (Damages) Act 1886 (the “RDA”) for property damage and consequential losses caused by the destruction by fire and looting of Sony’s Enfield warehouse during the nationwide riots of August 2011. The first preliminary issue concerned whether the claimed losses were caused by “persons riotously and tumultuously assembled” such as to trigger section 2(1) of the RDA. In concluding that the losses had been so caused, Flaux J readily found that elements of the statutory offence of riot were satisfied but considered at some length whether the rioters were also “tumultuously assembled together”—particularly in light of previous authority to the effect that a criminal enterprise such as a planned raid on a jeweller’s shop did not involve tumultuous behaviour. The second preliminary concerned whether there was cover for consequential losses under the RDA. In the face of a vacuum of authority on the point, Flaux J answered the issue resoundingly in the negative, thus clarifying for the first time that on its true construction the RDA does not extend cover to losses of this type.

BACKGROUND
On the evening of 8 August 2011, a Sony distribution warehouse in Enfield was broken into by a gang of 25 youths who had come across the fields from a nearby housing estate where they had congregated earlier. The youths looted some of the warehouse’s stock (but no more than they could carry without a getaway vehicle) and two of them threw petrol bombs into the stacking within the warehouse. The attack lasted a mere three minutes but the fire caused by the petrol bombs took hold and burned for some ten days, ultimately resulting in the total destruction of the building including plant, equipment and stock.

Following the fire, claims were made under the RDA to the Defendant as the compensation authority (being the statutory body responsible for oversight of the Metropolitan Police) in whose geographical area the warehouse was located.

Being aggrieved by the refusal of the Defendant to award the compensation sought, three separate High Court actions were commenced against the Defendant by respectively Sony DADC’s insurers for indemnified losses in respect of property damage, stock and business interruption losses of £49.5 million; the warehouse owner’s insurers for indemnified losses in respect of property damage and loss of rent of £9.35 million; and the owners of certain stock held at the warehouse for uninsured losses in respect of stock of £3.96 million. The preliminary issues in all three actions were tried together.

DECISION
Following a hearing in July 2013, Flaux J handed down judgment on 12 September 2013 in respect of the following two preliminary issues:

CASE REFERENCE AND JUDGMENT DATE
Mitsui Sumitomo Insurance v Mayor’s Office for Policing and Crime [2013] EWHC 2734 (Comm)
12 September 2013
1. Do the losses claimed by the Claimants (in so far as proved) arise out of the injury to or the destruction of a house, shop or building, or injury to, theft or the destruction of any property therein, by any persons riotously and tumultuously assembled together within the meaning of section 2(1) of the RDA at the warehouse on 8 August 2011?

2. Are consequential losses (including loss of profit and loss of rent) in principle recoverable pursuant to section 2(1) and/or 2(2) of the RDA and if so on what basis?

**The first preliminary issue: Riotous and tumultuous Assembly**

Section 2(1) of the RDA provides a right to compensation for persons who have sustained loss by riot as follows:

“Where a house, shop, or building in a police area has been injured or destroyed, or the property therein has been injured, stolen, or destroyed, by any persons riotously and tumultuously assembled together, such compensation as hereinafter mentioned shall be paid out of the police fund of the area to any person who has sustained loss by such injury, stealing, or destruction; but in fixing the amount of such compensation regard shall be had to the conduct of the said person, whether as respects the precautions taken by him or as respects his being a party or accessory to such riotous or tumultuous assembly, or as regards any provocation offered to the persons assembled or otherwise.”

Section 2(2) of the RDA provides insurers with an independent right to compensation to the extent that they have indemnified any person for losses within section 2(1).

The first preliminary issue specifically concerned whether the gang of youths who broke into, looted and set fire to the warehouse were “persons riotously and tumultuously assembled together” within the meaning of section 2(1).

The Public Order Act 1986 requires the word “riotously” to be construed in accordance with the statutory offence of riot under section 1 of that Act, which applies where “12 or more persons who are present together use or threaten unlawful violence for a common purpose and the conduct of them (taken together) is such as would cause a person of reasonable firmness present at the scene to fear for his personal safety...”. Flaux J found that there was no doubt that the elements of this statutory offence were satisfied in this case – and this had not seriously been disputed by the Defendant. More than 12 persons were present and, in Flaux J’s judgment, even if not all of them were smashing down the door or throwing petrol bombs, the others by their presence were still threatening unlawful violence which is defined under the legislation to include violence towards property. Objectively the conduct of the group was such as would have caused a person of reasonable fortitude present at the scene to fear for his personal safety; and indeed there was factual evidence of witnesses having feared for their personal safety. 

The arguments on the first preliminary issue were primarily directed to whether the group of youths had been gathered together tumultuously as well as riotously. Previous case law had established that the word “tumultuously” added an additional concept to “riotously”. Following a detailed examination of the authorities, Flaux J concluded that a tumult required that:

- The assembly must be of some size.
- While 25 people in the present case was sufficient, Flaux J declined to comment upon whether this aspect of the concept of a tumult would always be satisfied by 12 or more persons, as required to constitute a riot;
- The assembled persons must be acting in an agitated, excited and volatile manner, usually also making a noise.

In this regard, in both *JW Dwyer Ltd v Metropolitan Police District Receiver* and the unreported Court of Appeal decision of *DH Edmonds Ltd v East Sussex Police Authority*, the Court found that a raid by robbers on jewellers’ shops did not trigger the RDA. This was partly because the provision of compensation under the RDA is premised on the police being in breach of a strict but notional duty to prevent what has happened. It does not matter whether the police actually could or should have responded. As Flaux J put it: the real touchstone is that there must be some “public” element to the behaviour giving rise to a perceived or palpable threat of a riot to which the police could, notionally, have responded. That is to be contrasted with, for example, a planned raid executed not openly but furtively or with stealth; and

“The persons involved must engage in wanton damage to property or, put another way, display an animus toward the property rather than any damage being incidental to, for example, looting or theft.”

Flaux J found that the group of youths who attacked, looted and set fire to the warehouse were “persons riotously and tumultuously assembled together” for the purposes of the RDA. Flaux J considered the evidence of the behaviour of the group from several witness reports and CCTV footage which revealed the incident to be a frenetic, agitated, chaotic process, with some youths almost dancing around outside whilst others were smashing their way into the building. Whilst Flaux J considered the raid to be planned and co-ordinated amongst the youths, he rejected the Defendant’s argument that it was an example of a planned criminal enterprise (akin to the burglaries in *Dwyer and Edmonds*) on the basis of the group’s lack of organisation. Had the raid been a systemic burglary, the group might have been expected to use more sophisticated tools for entry and stolen vehicles to remove more goods. As it was, the group’s behaviour was agitated and volatile when gathering on a playground before the incident, when moving towards the warehouse and when they were attacking the warehouse during the raid. The group made no attempt to hide what they were doing, moving quite
openly and being observed by several witnesses throughout the day. Flaux J concluded that there was a perceived and palpable threat which the police could, notionally, have responded to and prevented.

Although it was suggested by the Defendant that the petrol bombs were intended as a measure to destroy forensic evidence, Flaux J preferred the view that the use of petrol bombs objectively evidenced a wanton violence towards property being a hallmark of riotous and tumultuous behaviour.

**The second preliminary issue: consequential losses**

Several of the claims made against the Defendant included consequential losses such as loss of profit and loss of rent. The second preliminary issue concerned whether such losses are recoverable as part of the compensation payable under the RDA. The Claimants’ case was essentially that consequential losses are in principle recoverable because the liability on the Defendant under the RDA is akin to a strict liability in tort sounding in damages, such that, subject to any limitation in the wording of the RDA, the measure of compensation should reflect the measure of damages under the English law of tort for physical damage to property. In that regard, it was submitted that the law of tort extends to consequential losses and the RDA includes no words of limitation in respect of consequential losses. The primary position adopted by the Defendant was that, on a correct construction of the RDA (particularly when read in conjunction with the now repealed preamble), the compensation payable is limited to physical damage to buildings or other property and does not encompass consequential losses.

Flaux J had no hesitation in agreeing with the Defendant and concluded that the answer to the second preliminary issue was ultimately a short one: on the correct construction of the statute as a whole, the compensation payable is limited to physical damage to the relevant premises or property in it and does not extend to consequential losses such as loss of profit or loss of rent.

This answer was not provided by the wording of the operative compensation provision at section 2(1) of the RDA, which refers to “any person who has sustained loss by” the injury to property. Flaux J accepted that the word “by” is dealing with causation but says nothing about what loss is covered. However, the restriction to property damages was, he found, made absolutely clear by the (repealed) preamble, which referred to compensation “for” property damage. Moreover, section 7 of the RDA envisages claims being made by “persons who have sustained loss from” property damage “in relation both to the building and the property therein” – and these words could not encompass the wider meaning of loss for which the Claimants had contended.

While Flaux J considered the wording of the Act to be clear and unambiguous, such that it was not strictly necessary or appropriate to have regard to the Regulations made under it in construing the statute, those Regulations make it quite clear that the loss which is to be compensated is only physical loss and damage, including because Regulation 5 envisages only limited categories of claim and because of the relatively short period in which claims must first be brought.

Flaux J held that this analysis was not affected by the Claimants’ argument that the liability to pay compensation under the RDA is akin to a strict liability in tort sounding in damages. Although it was not necessary to determine the point, Flaux J considered obiter that the scheme of compensation under the RDA is analogous to a form of statutory insurance – with similarities to other statutory compensation schemes such as the Law Society Compensation Fund. Flaux J also suggested that, once the analogy with insurance is recognised, there was nothing in the slightest bit surprising or alarming in the exclusion of consequential losses because most insurance policies will not cover consequential loss without an express provision to that effect. Moreover, the RDA provides a self-contained regime of compensation under which the compensation authority is to award such compensation as appears to it just and, in particular, regard may be had to the conduct of the person who has suffered injury; that concept of taking into account failings by the injured person which reduce but may not extinguish the claim were alien to the law of tort at the time when the RDA was enacted prior to the later developments in the law of contributory negligence. As such, the RDA was never intended to reflect damages which would have been awarded in tort – and clear words would have been required (but were absent here) for the RDA to provide compensation by reference to damages in the law of tort as they are recoverable from time to time.

**COMMENT**

The case serves as a useful guide to what constitutes tumultuous action for the purposes of section 2(1) of the RDA. The main distinguishing factor setting Mitsui apart from cases such as Dwyer and Edmonds, in which small groups committed raids on jewellery shops, was the wanton nature of the damage to the property, which was more than incidental, and the agitated, excited and volatile manner of the perpetrators.

Importantly the case also brings a degree of much-needed clarification as to the issue of whether consequential losses fall for compensation under the provisions of the RDA. Previous cases had not addressed this as an issue of interpretation leaving rather a lacuna in the authorities. While Flaux J may well have reached the right conclusion on the proper construction of the RDA, such construction is not perhaps quite as black and white as his judgment suggests. The wording of the statute does not specifically exclude consequential losses; and the operative compensation provision at section 2(1) is not explicit as to the scope of loss covered. Ultimately, Flaux J was compelled to have regard to the now repealed preamble and section 7 (which is concerned with the identity of the proper claimant and not scope of loss) in determining the scope of covered loss.
Recent decisions on the RDA, both in Mitsui and in Yarl’s Wood Immigration Ltd v Bedfordshire Police Authority, have involved lengthy and technical legal debates about the underlying rationale for compensation under the Act, involving a trawl through the history of predecessor statutes and old case law. As far back as 2002 the Home Affairs Select Committee had called for the RDA to be repealed on the basis that it appeared arcane; and on 9 May 2013 the government announced that it had set up an independent review into the RDA which was expected to conclude by September 2013 although nothing has yet been published. The future for this long-standing piece of legislation therefore remains uncertain.

ADDITIONAL REFERENCES

JW Dwyer Ltd v Metropolitan Police District Receiver [1967] 2 QB 970
DH Edmonds Ltd v East Sussex Police Authority [15 July 1988] (Unreported)
Yarl’s Wood Immigration Ltd v Bedfordshire Police Authority [2010] Q.B. 698
Riot (Damages) Act 1886
Public Order Act 1986
In *Genesis Housing Association Ltd v Liberty Syndicate Management Ltd*, the Court of Appeal upheld the first instance decision of Akenhead J and confirmed the legality of basis clauses. A “basis clause” is a provision set out in the proposal form or in the insurance contract itself, to the effect that all or any of the answers to the questions in the proposal shall form the basis of the contract of insurance. By virtue of a basis clause the insured warrants the truth of the answers set out in the proposal. Should any of those answers – whether material to the risk or not – prove to be untrue, the insurer may repudiate the policy and treat itself as never having been on risk. As the builder who was to undertake the development was incorrectly stated in the proposal form, Genesis could not recover under the policy because it was in breach of warranty.

Whilst the English and Scottish Law Commissions, as part of their review of insurance contract law, propose to abolish the use of basis clauses for business insurance contracts, any changes to the law are likely to take several years.

**BACKGROUND**

Liberty Syndicate Management Limited (for and on behalf of Lloyd’s Syndicate 4472) (“insurers”) underwrote policies known as Premier Guarantees for Social Housing (the “Policy”), which were administered by MD Insurance Services Ltd (“MD”). The Policy provided cover for latent defects in social housing.

In 2007, Genesis Housing Association Limited (“Genesis”) acquired the leasehold to a large number of flats, as part of a renovation and redevelopment project in Bedford. Genesis contracted with Time and Tide (Bedford) Ltd (“TT Bedford”) to carry out the renovation of the leased properties. A term of the contract between Genesis and TT Bedford obliged TT Bedford to secure a building guarantee for the benefit of Genesis and the future owners of the properties.

The owners of TT Bedford, Graham and Perry Gamby, approached MD, seeking a policy. The policy was to include an endorsement providing an indemnity in the event of TT Bedford’s insolvency during the build period.

The proposal form was completed by an MD employee and signed by Graham Gamby for and on behalf of Genesis (as agent) and TT Bedford. Time and Tide Construction Ltd (“TT Construction”) was incorrectly named as the builder on the proposal form. The correct name of the builder being TT Bedford. The proposal form contained a declaration which included a basis clause and provided as follows:

“Declaration by the Insured

I/we declare that to the best of my/our knowledge and belief, the information I/we have given is correct and complete in every detail and I/we have not withheld any material fact.

I/we understand that the signing of this form does not bind us to effecting insurance under the Premier Guarantee for Social Housing scheme but agree that should a contract be completed for a New Development or Housing Unit that this proposal and the statements made therein shall form the basis of the contract between me/us and the Insurer.” [emphasis added]
COURT OF APPEAL CONFIRMS THE LEGALITY OF BASIS CLAUSES

In 2010, following severe delays on the build, TT Bedford was dissolved. Genesis sought to enforce the insololvency provision in the Policy without success, and consequently, proceedings were issued against insurers.

FIRST INSTANCE DECISION

We commented on the first instance decision of Akenhead J in our Annual Review 2012. In short, Akenhead J confirmed that basis clauses continue to be legal and will be enforced by the courts. While provisions contained in a policy could negate the effect of a basis clause contained in a proposal form, the wording included in the Policy was not sufficient to negate the effect of the basis clause.

Genesis appealed the decision to the Court of Appeal.

COURT OF APPEAL DECISION

The Court of Appeal unanimously dismissed the appeal. In reaching their decision, they considered three main issues which we consider in turn below.

1. Did the statements in the proposal form become contractual warranties?

Jackson LJ (who gave the leading judgment) reviewed the leading authorities on the effect of a basis clause:

“The principle which emerges from these authorities is that where a proposal form contains a “basis of contract” clause, (i) the proposal form has contractual effect even if the policy contains no reference to the proposal form; (ii) all statements in the proposal form constitute warranties on which the insurance contract is based”.

He held that the principle was not open to challenge in the Court of Appeal but could be displaced by express words in the insurance policy. However, the fact that the Policy set out a comprehensive list of all the documents said to comprise the Policy and omitted the proposal form was not sufficient to displace the principle here:

“If the parties intend to deprive of contractual effect a proposal form which purports to be the basis of their contract, they must do so by clear and unequivocal language. The policy in the present case contains no such express words”.

Thus the proposal form was of contractual effect and the statements in the proposal form became warranties forming the basis of the Policy.

2. Did Genesis warrant that TT Construction was to be the builder?

The name of the builder in the proposal form was stated as TT Construction. It was submitted by Genesis that the declaration in the proposal form qualified the statements made in the body of the proposal form; in the first sentence of the declaration the proposer declares not that those statements are true but that they are true to the best of his knowledge and belief.

As Akenhead J had found the error in the proposal form to be inadvertent, it was submitted that there was no breach of warranty. This argument was dismissed for a number of reasons. Factually, it had no basis as both Mr Galliers of Genesis and Mr Gamby knew that TT Construction would not be the builder and, therefore, the statement in the proposal form was contrary to what was known to be the case.

In addition, Jackson LJ said that the two sentences of the declaration were independent of each other and the first sentence did not qualify the basis clause in the second sentence: “The “basis of contract” clause cannot be read down, so as to mean that a misstatement has no effect if the proposer is unaware of the error”.

3. Did condition 7 restrict the insurers’ right to avoid for misstatement to circumstances where there was intent to defraud?

Condition 7 of the Policy provided:

“Misrepresentation

This Policy will be voidable in the event of misrepresentation, misdescription, error, omission or non-disclosure by the Policyholder with intention to defraud”.

It was contended by Genesis that the effect of condition 7 of the Policy was to limit insurers’ right of avoidance to cases where the policyholder intended to defraud. Jackson LJ dismissed this argument on the basis that it was not expressed to be a limiting provision and if the parties intended to achieve such an unusual result, they should (and would) have said so expressly:

“In my view condition 7 of the Policy can only be read as a provision conferring additional express rights on the insurers, regardless of whether or not those express rights serve any useful purpose. It cannot be read as cutting down the insurers’ general right to avoid for misrepresentation.”
COMMENT

Whilst the English and Scottish Law Commissions, as part of their review of insurance contract law, propose to abolish the use of basis clauses for business insurance contracts, any changes to the law are likely to take several years; their final report and draft bill are expected in 2014 but any reforms are unlikely to be enacted until 2015 to 2016.

In the meantime, buyers of insurance policies are well advised to liaise with their brokers and insurers to discuss removing any basis clauses at the earliest opportunity or ensuring that other provisions within the policy render the basis clause of no effect.

Airmic (the trade association representing more than 1,000 professional risk managers and insurance buyers), with assistance from Herbert Smith Freehills LLP, published a guide in 2013 to raise awareness of basis clauses and a sample endorsement to disapply them. A number of leading insurers have been supportive of the approach set out in the guide.

The guide and sample endorsement (which can be applied mid-term) can be found on Airmic’s website at http://www.airmic.com/research/guides/basis-clauses.

ADDITIONAL REFERENCES

Genesis Housing Association Ltd v Liberty Syndicate Management Ltd [2012] 2 C.L.C. 837
THE CONTINUING DUTY OF A REINSURANCE BROKER TO REMIT FUNDS TO ITS CLIENTS

In Equitas Ltd and Another v Walsham Bros & Co Ltd, the Court considered a series of preliminary issues as to the scope and nature of the duty which a reinsurance broker owes to remit funds to its clients, and the effect of the scope and nature of that duty on limitation. The Court also considered the recoverability of loss of investment income on the unremitted sum.

BACKGROUND

Equitas Limited (“Equitas”) is an entity which was created as part of the restructuring of Lloyd’s Insurance Market following the catastrophic losses suffered by Lloyd’s syndicates in the early 1990s (a process known as “Reconstruction and Renewal”), as a result of a series of long-tail liabilities and natural catastrophes. As part of Reconstruction and Renewal, a settlement agreement was entered into in September 1996 between, among others, Equitas, “Accepting Names” and various brokers (the “Settlement Agreement”). Under the Settlement Agreement, Equitas was to provide reinsurance of the syndicates’ liabilities in respect of their non-life business for the 1992 and all prior years of account, in return for which the syndicates assigned to Equitas their rights relating to those years.

Walsham Brothers & Company Limited (“Walsham”) was a significant reinsurance broker during the two decades prior to Reconstruction and Renewal, but was subsequently in decline and went into run-off in 2010. As a Lloyd’s broker at the time of Reconstruction and Renewal, Walsham was party to the Settlement Agreement.

Equitas brought a claim against Walsham, both as assignee of the syndicates’ rights and in its own name, for sums which should have been remitted to the syndicates, along with loss of investment income on the amounts due. Walsham had made a number of payments in respect of these sums (albeit with a substantial delay) (the “Settled Claims”), however, Equitas claimed that other payments remained outstanding (the “Outstanding Claims”).

It was Equitas’ case that it is entitled to recover those sums which have not been remitted to it by Walsham, and loss of investment income thereon, as a result of duties owed to Equitas in contract, tort and restitution (whether as assignee or in its own right). Walsham’s failure to do so was alleged by Equitas to constitute a continuing breach, such that the claims were not time barred.

Whilst accepting that it owed a duty to Equitas in contract and restitution (though not in tort), Walsham disputed Equitas’ claim that it had failed to make such payments and, to the extent that that it had, that the duty was absolute and one-off in nature.

Consequently Walsham maintained that Equitas was barred from bringing any claims by the Limitation Act 1980.

DECISION

Duty to Remit Funds

It was common ground between the parties that Walsham owed Equitas (as assignee) a duty to remit funds reasonably promptly in both contract and restitution. Males J found this duty to be an absolute duty and not merely one of due diligence. In addition to those duties, Males J stated that Walsham, as a provider of services, was under a statutory duty pursuant to the Supply of Goods and Services Act 1982 to supply those services with reasonable care and skill.

When considering whether there existed an additional duty in tort, Males J, citing Henderson v Merrett Syndicates Ltd, recalled that “the correct approach is to consider first the relationship between the parties in order to determine whether there is such an assumption of responsibility and then to consider whether liability in tort is excluded by the contract because it is inconsistent with it”. The Judge found that the evidence suggested that the syndicates had historically been heavily reliant on Walsham to administer the reinsurance contracts, including the prompt payment of any funds received for their account. It was not relevant whether a tortious duty of care was necessary in the circumstances, the question was merely whether it was inconsistent with, or excluded by, the contract in place between the parties. On the facts the Judge found that there was no inconsistency between the absolute contractual duty and the duty in tort to exercise reasonable care.

In addition, Males J held that, following the Settlement Agreement, Walsham owed to Equitas in its own right the same duties in contract, tort and restitution as it had previously owed to the syndicates; following Reconstruction and Renewal, Equitas’ role in the market was well known and Males J found that Walsham was acting, and understood itself to be acting, as broker to Equitas and Equitas had relied on it to do so.

Continuing duty

Having considered the authorities, Males J found that an obligation to remit funds will usually be a single duty (ie, one-off in

CASE REFERENCE AND JUDGMENT DATE

Equitas Ltd and Another v Walsham Bros & Co Ltd
[2013] EWHC 3264 (Comm)
28 October 2013
THE CONTINUING DUTY OF A REINSURANCE BROKER TO REMIT FUNDS TO ITS CLIENTS

nature, where the limitation clock starts to run from the date of first breach). However, the relationship between Walsham and the syndicates was such that Walsham was largely responsible for the administration of the reinsurance contracts (which the syndicates relied on) and, as such, could be categorised as a continuing relationship giving rise to continuing obligations. Therefore, Walsham committed a breach of its tortious duty to remit funds due each and every day it failed to do so. It followed that Equitas was entitled to bring a claim for all of the Outstanding Claims and loss of investment income on the Settled Claims paid within the last six years.

Calculation of Interest

Males J reviewed the leading case of Sempra Metals Ltd v Inland Revenue Commissioners in detail. Having considered the case, he found there to be a general rule that:

"...unless there is some positive reason to do otherwise, the law will proceed on the basis, at any rate in the commercial context, that a claimant kept out of its money has suffered loss as a result. That represents commercial reality and everyday experience. Specific evidence to that effect is not required...”

However, the rate at which the claimant can recover will depend on the circumstances. Ordinarily a claimant will be entitled to recover compound interest at the market rate, being LIBOR plus 1%. A solvent claimant who seeks to recover damages which exceed the market rate of borrowing is likely to be unsuccessful, as it could have mitigated its losses by borrowing at a commercial rate and making the same investment. There may, however, be situations in which there is a good reason why the claimant should not/could not have gone into the market to borrow money (eg, if it did not know that money was missing).

Applying the above, the Judge held that Equitas (in its role as assignee) was limited to recovering loss of investment income at the market rate on losses suffered by the syndicates because, although they were not aware the money was missing, the short term nature of their investment policies would mean that they were unable to invest their funds with the same degree of success as Equitas. However, as the Judge found that Walsham owed direct duties to Equitas following the implementation of the Settlement Agreement (September 1996), Equitas was entitled to recover for loss of investment income in its own name from September 1996 onwards, and could therefore make a claim for loss of investment income at a greater rate of return. There could be no question of remoteness in relation to such losses, as the greater returns that Equitas was able to achieve on its funds was one of the benefits of Reconstruction and Renewal advertised in the market; such a loss should, therefore, have been within Walsham’s reasonable contemplation.

Therefore, the Judge held that Equitas was entitled to recover the principal amount owed for all Outstanding Claims along with loss of investment income. However, Equitas would be barred from bring a claim for loss of investment income arising out of Settled Claims which were not paid by Walsham within the previous six year period, as these claims would be time barred.

COMMENT

The Judge’s findings regarding the continuing breach of duty to remit funds are likely to have considerable implications for future claims of this type. The nature of the relationship between Walsham and the syndicates was, historically, commonplace in the reinsurance market. The finding of a continuing duty to remit funds significantly reduces the scope for brokers to rely on a limitation defence in respect of any old client balance. On 17 November 2013, the Court of Appeal granted leave to appeal the decision.

ADDITIONAL REFERENCES

Henderson v Merrett Syndicates Ltd (No. 1) [1995] 2 AC 145
Sempra Metals Ltd v Inland Revenue Commissioners [2007] UKHL 34
Limitation Act 1980
Supply of Goods and Services Act 1982
Follow the Settlements – The Reinsurance Proviso Revisited

The case of Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd arose out of claims under a retrocession contract resulting from property damage and business interruption losses generated out of the Thai floods in 2011. Hamblen J considered five preliminary issues on the proper construction of that retrocession contract. The case is particularly notable for the Judge’s comments on the “follow the settlements” clause in the retrocession.

Background

Tesco was insured against property damage and business interruption losses under a “Master Policy” issued by ACE Europe. Tesco’s properties in Thailand were also insured under a local policy issued by ACE INA. The Master Policy responded on a Difference in Conditions (“DIC”)/Difference in Limits (“DIL”) basis.

In Autumn 2011, 165 of Tesco’s properties in Thailand were damaged as a result of flooding. Tesco claimed under the Master Policy and local policy for property damage and business interruption losses suffered. The claims were eventually settled on 20 February 2012 for £82.4 million, split £57.96 million to the local policy and £24.45 million to the Master Policy.

ACE was reinsured under a facultative retrocession (the “Reinsurance”) covering a 55% share of Tesco’s losses excess of the retention up to a limit of £100 million. The Claimant, Tokio Marine, had purchased retrocession cover (the “Retrocession”) with the Defendant, Novae Corporate Underwriting Ltd (“Novae”). Under the Retrocession, Novae agreed to reinsure Tokio Marine for 12.5% of Tesco’s losses in excess of £53 million each and every “Loss Occurrence” subject to a limit of £25 million each and every “Loss Occurrence”. The Retrocession included the following “Reinsurance Condition”:

“Following Original Policy Wording Reference Number: UKFRICT38309.10

The Contract is subject in all respects (excluding the rate and/or premium hereon and subject always to the Limits Reinsured hereon and except as otherwise provided herein) to the same terms, clauses and conditions as original and without prejudice to the generality of the foregoing. Reinsurers agree to follow all settlements (excluding without prejudice and ex-gratia payments) made by original Insurers arisings out of and in connection with the original insurance and to bear their proportion of any expenses incurred whether legal or otherwise in the investigations and defence of any claim hereunder in addition to limits hereunder.”

Novae resisted liability and Tokio Marine therefore commenced proceedings. Hamblen J was asked to consider five preliminary issues of construction, each of which is considered in turn below.

Decision

1. Does the Retrocession reinsure Tokio Marine for its liability to ACE INA in respect of the local policy as well as ACE Europe in respect of the Master Policy?

Novae argued that cover under the Retrocession was restricted to claims within the Master Policy; claims under the local policy fell outside its scope. In support of this argument, Novae referred to the reference to the “Original Policy Wording” in the Reinsurance Condition above.

Hamblen J disagreed. On a proper construction of the Retrocession, he considered that losses under both the local policy and Master Policy were covered. The reference to the “Original Policy Wording” was merely intended to incorporate the definitions from the Master Policy; it did not restrict cover. The “Perils” clause was widely drafted, covering exposure for “all risks of Direct Physical Loss, Destruction or Damage” and was not limited to losses covered by the Master Policy.

He found support for Tokio Marine’s broader interpretation in the factual background (in particular, the list of values at risk referred to in the Retrocession which did not distinguish between the local policy and Master Policy). He also considered that the broader interpretation reflected commercial and business sense. Novae’s construction would lead to a radical mismatch between the cover under the Reinsurance and cover under the Retrocession – there was no obvious reason why the parties should have intended this. Moreover, on Novae’s interpretation, it was difficult to conceive of a claim under the Master Policy which would not have also...
FOLLOW THE SETTLEMENTS - THE REINSURANCE PROVISO REVISITED

generated a significant loss to a local policy. If this is what the parties had intended, they would have spelt it out clearly.

2. Should “Loss Occurrence” be construed in the same manner as “Occurrence” in the Master Policy?

“Occurrence” was defined in the Master Policy and Reinsurance as “any one Occurrence or any series of Occurrences consequent upon or attributable to one source or original cause”. Tokio Marine argued that, because the Retrocession is expressly subject to “the same terms, clauses and conditions as original”, the phrase “Loss Occurrence” in the Retrocession should be given the same meaning.

Novae, by contrast, argued that by using a different phrase in the Retrocession, the parties intended “Loss Occurrence” to be construed differently, in accordance with the usual insurance definition of “occurrence” (ie, “something which happens at a particular time, at a particular place, in a particular way” per Countrwide Assured Group Plc v Marshall).

Hamblen J concluded that Novae’s interpretation would result in a major mismatch in cover. If this is what they intended, they would have spelt it out clearly. It made far more commercial sense for the parties to have intended a consistent approach to aggregation under the Retrocession and underlying policies. He therefore preferred Tokio Marine’s interpretation.

3. Did Novae agree to follow the settlements of ACE under the Master Policy and/or local policy, or Tokio Marine under the Reinsurance?

Tokio Marine noted that the Reinsurance Condition referred to “original Insurers” and “original insurance” and argued that this required Novae to follow the settlements of ACE under the direct insurance policies. Hamblen J agreed, finding that the words were clear and unambiguous. There were good commercial reasons for referring to the settlement between ACE and Tesco – this was the “coalface”; the level at which the substance of the claim will have been determined. It should be noted that absent this particular wording, the authorities indicate that it is the settlement of the immediate contract that should be considered.

4. Must Tokio Marine show that the claim falls within the terms of the Retrocession on the balance of probabilities, or is it sufficient to show that the claim arguably does so?

The “follow the settlements” clause in the Retrocession was an unqualified follow clause in similar terms to the clause considered in Insurance Company of Africa v Scor Reinsurance. In that case, Robert Goff LJ held that a settlement would be binding on reinsurers provided that:

“the claim so recognised by [the reinsured] falls within the risks covered by the policy of reinsurance as a matter of law [“the Proviso”], and provided also that in settling the claim the insurers have acted honestly and have taken all proper and business-like steps in making the settlement.”

Hamblen J referred to subsequent cases which discussed the operation of the Proviso where the inward and outward reinsurance contracts are back-to-back. In Hiscox v Outhwaite (No.3) Evans J had stated that the effect of the Proviso was that:

“The reinsurer may well be bound to follow the insurer’s settlement of a claim which arguably, as a matter of law, is within the scope of the original insurance, regardless of whether the Court might hold, if the issue was fully argued before it, that as a matter of law the claim would have failed.”

The first instance deputy Judge in Assicurazioni Generali SpA v CGU International Insurance plc (Gavin Kealey QC) had agreed with Evans J’s conclusions. However, in the Court of Appeal judgment Tuckey LJ (whilst agreeing with Evans J and the first instance Judge) appeared to go further, stating that the effect of the Proviso was that:

“The insurers do not have to show that the claim they have settled in fact fell within the risks covered by the reinsurance, but that the claim which they recognised did or arguably did”.

Based on Evans J’s dicta, Tokio Marine argued that it was only obliged to demonstrate that the underlying settlement “arguably” falls within the terms of the outward reinsurance contract. Novae, by contrast, contended that in using the word “arguably” Evans J was referring to the standard of proof for claims falling within the inward (re)insurance contract.

Hamblen J did not agree with Tuckey LJ’s analysis. It was difficult to see why a lesser standard of proof than the balance of probabilities should apply to the reinsurance. However, he considered that he was bound by Tuckey LJ’s decision and therefore found in favour of Tokio Marine.

5. Is Novae bound by a determination by ACE as to the construction of the aggregation provisions in the Master Policy?

In the underlying claim by Tesco under the local policy and Master Policy, there was an issue as to the proper construction of the aggregation provisions. Tokio Marine contended that Tesco’s claim was settled on the basis of a construction which was at the very least “arguable”. It therefore met the threshold under the “follow the settlements” clause for proving that the claim recognised by ACE falls within the coverage provided by the Retrocession. Novae could not re-open this issue of construction.
Novae disagreed. It sought to distinguish the Retrocession from the reinsurance contract in *Generali*, pointing out that the Retrocession was non-proportional, not back-to-back and a retrocession (rather than reinsurance) contract. The reinsurer would not entrust determination of its liabilities under the Retrocession to Tokio Marine or ACE.

Hamblen J found that the facts of this case were not sufficiently different from those of *Generali* to displace the interpretation of the same follow clause given in *Generali*.

**COMMENT**

It is well established that regardless of which type of follow clause is contained in a reinsurance, the loss as settled must still fall within the terms of the reinsurance. Thus, the sanctity of the reinsurance bargain is preserved.

For many years, a debate existed as to the position under a follow clause where the insurance and reinsurance were written on a back to back basis, with terms incorporated from the former into the latter. Could a reinsurer which was unable to challenge an arguable issue settled (in a business-like way) under the insurance, nevertheless decline liability based on the same issue under the incorporated term in the reinsurance? It would be odd if it could do so as it would remove the intended effect of the follow clause.

The answer to the above question was provided in the lengthy and helpful judgment of Gavin Kealey QC and in the much shorter judgment of Tuckey LJ in the Court of Appeal in *Generali*. It is not open to the reinsurer to re-open the disputed issue; rather, one looks at the position as settled under the underlying insurance for the purposes of the reinsurance.

The reference by Tuckey LJ in *Generali* to the reinsurer being “arguably” liable under the reinsurance has previously caused confusion, and often commentators have preferred to refer to the clearer first instance decision as a result. What Tuckey LJ appeared to be saying is that where the contracts are back-to-back incorporating the same terms, it is sufficient for the reinsured to demonstrate that a claim is arguably covered under the reinsurance, rather than having to prove that it is covered on a balance of probabilities basis. He was not suggesting that it is only necessary for a reinsured to demonstrate a claim was arguably covered under the reinsurance more generally under a follow clause.

It follows from the above that Hamblen J may have misconstrued Tuckey LJ’s views but even if not, we doubt that such views will be supported in due course by the Court of Appeal (Novae are applying for permission to appeal the decision at the time of publication).

**ADDITIONAL REFERENCES**

- *Hiscox v Outhwaite (No. 3)* [1991] 2 Lloyd’s Rep 524
- *Assicurazioni Generali SpA v CGU International Insurance Plc* [2003] EWHC 1073 (Comm)
- *Countrywide Assured Group Plc v Marshall* [2003] Lloyd’s Rep IR 195
COMMERCIAL COURT FINDS A CONSULTANT TO HAVE BEEN COVERED BY A COMPANY’S PROFESSIONAL LIABILITY POLICY

In Rathbone Brothers Plc v Novae Corporate Underwriting, the Commercial Court held that an individual engaged in a consultancy agreement with the policyholder of a professional liability insurance policy was covered by the policy notwithstanding that he was a consultant rather than an employee.

BACKGROUND

The Claimants, Rathbone Brothers plc (“Rathbone”) (a substantial international group whose trust business included the management of family trusts for wealthy clients) and Mr Egerton-Vernon (an individual who worked for a Rathbone group company, “RTCJ”) sought indemnity from the Defendant insurers under a professional liability policy issued to Rathbone. Mr Egerton-Vernon was an employee of RTCJ during the period 31 March 2000 to 30 June 2007. Thereafter he entered into a consultancy agreement with RTCJ with effect from 3 August 2007. During the time that Mr Egerton-Vernon worked for RTCJ he acted as personal trustee of one of the trusts established by the late Mr Jack Walker, the industrialist and chairman of Blackburn Rovers (the “Walker Settlement”). Mr Egerton-Vernon retired as personal trustee of the Walker Settlement on 21 July 2009.

Proceedings were brought in 2008 in Jersey against Mr Egerton-Vernon in his capacity as personal trustee of the Walker Settlement in respect of alleged breaches of his obligations as a trustee from the end of 1999 onwards. At the time of judgment the Jersey Court was considering whether to join Rathbone to the proceedings as vicariously liable for the actions of Mr Egerton-Vernon.

As a result the Claimants sought cover under their 2008-2009 Professional Liability Insurance (the “Policy”) for the defence costs incurred by them in the Jersey proceedings against any liability that may arise in the Jersey proceedings and Mr Egerton-Vernon in his capacity as personal trustee of the Walker Settlement. Mr Egerton-Vernon worked for RTCJ as a consultant from the end of 1999 onwards. At the time of judgment the Jersey Court was considering whether to join Rathbone to the proceedings as vicariously liable for the actions of Mr Egerton-Vernon. As a result the Claimants sought cover under their 2008-2009 Professional Liability Insurance (the “Policy”) for the defence costs incurred by them in the Jersey proceedings and Mr Egerton-Vernon in his capacity as personal trustee of the Walker Settlement. Mr Egerton-Vernon worked for RTCJ as a consultant from the end of 1999 onwards. At the time of judgment the Jersey Court was considering whether to join Rathbone to the proceedings as vicariously liable for the actions of Mr Egerton-Vernon.

The Defendants provided the excess (which are on-going) AIG, insurer to the primary layer of cover (of £5 million) accepted cover.

The Court required to consider three issues:

1. Whether Mr Egerton-Vernon was covered by the Policy for any liability arising from the period he was acting as a consultant for RTCJ;
2. If Mr Egerton-Vernon was covered by the Policy in relation to such period, whether he had to exhaust other remedies available to him before claiming under the Policy; and
3. Whether the Defendants had a right of subrogation against the policyholder, Rathbone.

DECISION

1. Coverage

The Policy provided that the insurer would indemnify any insured for any loss as a result of civil liability arising out of a claim first made during the policy period. The Court was therefore required to determine whether Mr Egerton-Vernon constituted an “insured” under the Policy. The Policy defined “insured” as “any insured company or any insured person”. An “insured person” was defined as “an actual person who was, is or, during the policy period becomes…[emphasis added]. The Policy went on to define “professional services” as “the financial services declared in the submission performed by or on behalf of an insured company pursuant to an agreement with a third party: (i) for compensation; or (ii) in conjunction with services for compensation”.

The issues for the Court to consider were:

1. Whether professional services were performed by Mr Egerton-Vernon on behalf of the insured company, RTCJ?
2. Whether professional services were performed pursuant to a relevant agreement?
3. Was Mr Egerton-Vernon in his capacity as a personal trustee working subject to the direct control and supervision of RTCJ?
4. Was Mr Egerton-Vernon a paid employee from 1 July 2007?

In relation to each of these issues, the Defendants accepted that Mr Egerton-Vernon was a paid employee from 2000 to 2007 but rejected the Claimants’ assertion that he was a paid employee after he entered into the consultancy agreement. The Defendants also denied that Mr Egerton-Vernon was providing professional services on behalf of RTCJ and under its direct control and supervision pursuant to an agreement with a third party.

Burton J held that:

1. Mr Egerton-Vernon was, when acting as a personal trustee, acting on behalf of RTCJ. RTCJ charged for his services as
such trustee, which it recognised in an Indemnity Agreement with Mr Egerton-Vernon were performed on its behalf. Mr Egerton-Vernon had never received any personal remuneration for his role as a personal trustee and when he entered into a consultancy agreement with RTCJ he accounted for any fees to RTCJ in return for receipt of set remuneration.

2. In interpreting “by or on behalf of an insured company pursuant to an agreement with a third party” it was sufficient that there was an agreement with the third party (in this case Mr Walker) and the insured person (rather than the insured company, as the Defendants argued) for compensation (payable to the insured person’s firm). The objective intention of the policy clause was only that the services should not be gratuitous.

3. Whilst performing his services as personal trustee on behalf of Rathbone from 2000 to 2008, Mr Egerton-Vernon was working under the direct control and supervision of RTCJ. He was subject to monitoring obligations both in his employment contract and his consultancy agreement and subject to Codes of Practice. Working under the direct control and supervision of RTCJ did not equate to an unlawful restriction upon the personal trustee’s independent discretion.

4. Mr Egerton-Vernon was a paid employee both before and after 2007 because his remuneration under the consultancy agreement was by reference to the hours spent and was not on a “sales or commission basis”.

2. Obligation to exhaust other remedies

Clause 5.14 of the Policy provided that “Insurance provided by this policy applies excess over insurance and indemnification available from any other source”.

The Defendants argued that Clause 5.14 provided that Mr Egerton-Vernon could not access cover which the Court had found that he had under the policy without first exhausting one or more of the other routes available to him, specifically:

1. Indemnities provided to Mr Egerton-Vernon by Rathbone and RTCJ; and
2. Other insurance including a D&O policy.

With regard to indemnities, Burton J held that the wording “Insurance provided by this policy applies excess over insurance and indemnification available from any other source” (emphasis as in Burton J’s judgment) should be construed as referring to a source outside of the Policy such that the insurance provided by the Policy did not apply excess over indemnification from the policy-holder or other co-insured. The Judge felt that the existence of a possible indemnity should not rule out entirely (because of the existence of the excess) the cover for which the policyholder has paid and which the insured person is expecting and entitled to.

In relation to other insurance available, the Court was required to consider the wording of an available D&O policy. The D&O policy provided, under the clause titled “Management Liability”, specific cover for an “outside entity director” defined as “a natural person who... served... at the specific request or direction of, or with the approval of a company, as a director, officer, trustee, governor or equivalent of an outside entity”. The D&O policy also contained an exclusion “for damages or other relief for any actual or alleged wrongful act in performance of or failure to perform professional services or related back-office supporting services”. The Defendants asserted that there would be cover under the D&O policy for Mr Egerton-Vernon, arguing that the exclusion could not be intended to apply to an outside entity director since it would apply in every situation as the outside entity director would, if at all liable, be liable in relation to wrongful acts in performance of or failure to perform its own professional services.

The Defendants also contended that, even if there was no cover for damages or other relief in respect of any alleged wrongful acts for which Mr Egerton-Vernon may be found liable as an outside entity director, there would be cover for defence costs, which was not “damages or other relief”. Burton J disagreed with the Defendants’ arguments, holding that:

1. The definition of “Wrongful Acts” was limited to managerial tasks (rather than any other form of professional service) and the exclusion was therefore intended to be limited to such managerial tasks. The exclusion would not therefore apply in all circumstances where an outside entity director was held liable and the Defendants’ construction was incorrect.
2. It was not a proper construction of the D&O policy to decide that D&O insurers would be required to cover defence costs in relation to a claim which was bound (as the Judge had found) not to fall within the policy. He contrasted this decision with circumstances where there was a disputed claim, which in the end is found to fall without the policy, in which case the policy may cover such defence costs.

3. Subrogation

Burton J was required to decide:

1. whether the Defendants had a right of subrogation against Rathbone the policyholder and RTCJ, Mr Egerton-Vernon’s co-insured under the Policy, in respect of Mr Egerton-Vernon’s indemnity; and
2. whether the express provision that such subrogation is “before or after any payment under this policy” overrode the ordinary presumption that subrogation could only arise once payment had been made by the insurer claiming subrogation.

In relation to 1, Burton J established that there was a policy waiver of subrogation rights against RTCJ because RTCJ was a co-insured...
COMMERCIAL COURT FINDS A CONSULTANT TO HAVE BEEN COVERED BY A COMPANY’S PROFESSIONAL LIABILITY POLICY

that was insured in respect of the same loss as the insured making a claim (and the parties did not dispute the principle that if a co-insured against whom subrogation is sought is insured in respect of the same loss there is a policy waiver of subrogation rights as against that co-insured). Burton J held there was no such waiver in relation to Rathbone but he was asked to consider whether case law had established that the right of subrogation by an insurer on behalf of a co-insured against a policyholder who has paid the premium (like Rathbone in this case) should be excluded where the insurance was taken out for the benefit of the party against whom the subrogated claim is being brought. The Claimants sought to argue that this principle had been established by cases such as Mark Rowlands Ltd v Berin Inns Ltd. They argued that the benefit afforded to Rathbone under the Policy was that the indemnity provided to Mr Egerton-Vernon by Rathbone would be less likely to be called upon by virtue of the insurance.

Burton J rejected the Claimants’ arguments, holding that to establish such a principle would mean that, in effect, there could never be a subrogated claim brought against a policyholder who has paid the premium in respect of coverage of a loss for which the policyholder itself was not insured. He therefore concluded that insurers could exercise rights of subrogation against any such indemnity where such wording is included in the policy.

In relation to 2, Burton J rejected the Defendants’ argument that the wording “before or after any payment under this policy” conveyed a right to injunctive relief to protect a contingent right of subrogation such that an insured could be compelled, before he has been paid out, to issue proceedings. He felt that to establish such a right would require a whole range of new rules and considerations as to precisely when this right would arise. He was not prepared to reach such a conclusion.

COMMENT

It is unsurprising that the Court concluded that Mr Egerton-Vernon should be covered by the Policy during his time as a consultant for RTCJ given his close association with RTCJ as a consultant. The decision of Burton J was, however, closely linked to the facts of the case and the facts of any other case would have to be similarly closely analysed.

What is more significant is Burton J’s conclusion that the wording “Insurance provided by this policy applies excess over insurance and indemnification available from any other source” should be construed as referring to a source outside of the Policy such that the insurance provided by the Policy did not apply excess over indemnification from the policyholder or other co-insured. The judge felt that the existence of a possible indemnity should not rule out entirely the cover for which the policyholder has paid and which the insured person is expecting and entitled to. This clarifies the interaction of indemnities provided by co-insureds or policyholders to professionals covered by professional liability insurance and the professional liability insurance itself. Whereas previously co-insureds or policyholders may have found themselves having to indemnify an employee (but not necessarily being able to recover those sums themselves depending on the policy wording), now it is clear that the policy will respond before any such indemnity where such wording is included in the policy.

The final point to note from the judgment is that Burton J was not willing to extend the circumstances in which an insurers’ right of subrogation could be excluded or enforced. He was not willing to hold that the right of subrogation by an insurer on behalf of a co-insured against a policyholder who has paid the premium should be excluded where the insurance was taken out for the benefit of the party against whom the subrogated claim is being brought. It seems quite right that this could have far-reaching effects such that there could never be a subrogated claim brought against a policyholder who has paid the premium in respect of coverage of a loss for which the policyholder itself was not insured.

Burton J was also not willing to hold, despite arguably express wording in the Policy to this effect, that injunctive relief could be awarded in order to protect a contingent right of subrogation. Burton J did not object outright to the argument that in some circumstances it may be appropriate to grant injunctive relief in order to protect a contingent right, but he argued that this did not mean that the right existed “as an actuality”, and he remarked that “there would need to be a whole range of new rules” introduced if such a right was established. Whilst he therefore appeared to be unwilling to establish a right “in actuality” we may nevertheless see circumstances arise in which a court grants injunctive relief to an insurer in order to allow them to protect their contingent rights of subrogation.

ADDITIONAL REFERENCES

Mark Rowlands Ltd v Berni Inns Ltd [1986] QB 211
LIMITATIONS PERIODS – COURT OF APPEAL CONSIDERS PRINCIPLES FOR DETERMINING WHEN A CAUSE OF ACTION ARISES IN TORT

In Berney v Saul (t/a Thomas Saul & Co), the Court of Appeal considered the principles for determining the date on which a cause of action arises in a tort claim for professional negligence. It held that when a cause of action arises is a question of fact: namely, when did the claimant first suffer actual damage as a result of the professional negligence? In determining the date of actual damage, the court should ask: when is the claimant worse-off financially by reason of a breach of the duty of care than he would otherwise have been?

BACKGROUND

On 20 April 1999 the Appellant, Ms Berney, was involved in a road traffic accident (“RTA”) with a Mrs Liddell and suffered personal injury. Liability was conceded by Mrs Liddell’s insurers shortly after the incident and Ms Berney instructed the Respondent to act on her behalf.

The claim progressed slowly and on 12 April 2002 the Respondent issued a claim form on Ms Berney’s behalf. That Claim Form named the wrong defendant (it named Mr Liddell as opposed to Mrs Liddell) and did not attach Particulars of Claim. On 8 August 2002, the Claim Form was re-served naming the correct Defendant and stating that damages were limited to £50,000.

For a period of almost two years the parties corresponded in relation to medical records and evidence. At no point did the Respondent serve Particulars of Claim on Ms Berney’s behalf as per part 7 of the CPR despite being invited to do so by Mrs Liddell’s solicitors.

In March 2004, Ms Berney dismissed the Respondent and instructed new solicitors. On 2 June 2004 Ms Berney was advised by her new solicitors that an application to file Particulars of Claim out of time was unlikely to succeed, and that the RTA claim was vulnerable to being struck out

On 25 January 2005 Mrs Liddell’s solicitors wrote to Ms Berney’s newly-appointed solicitors asking whether certain medical records had been received and stating that, if they had not been, an application should be made to file Particulars of Claim out of time. Importantly, up until this point, Mrs Liddell’s solicitors had given assurances that no procedural points would be taken in relation to delay.

Faced with the risk of applying for and being refused an extension, and having the RTA claim struck out (and the following potential costs consequences), on 1 November 2005 Ms Berney accepted an offer of £25,000 in full and final settlement of the RTA claim.

On 20 January 2011, Ms Berney issued a negligence claim against the Respondent, alleging that she had settled the RTA claim at an undervalue due to the Respondent’s failure to serve Particulars of Claim.

FIRST INSTANCE DECISION

At first instance the Respondent applied for summary judgment on the basis that Ms Berney had no prospect of succeeding in her claim and that it was time-barred. The Respondent’s application was successful and on 22 September 2011 DJ Liston dismissed the claim on both grounds. An appeal of DJ Liston’s decision was heard by Simpkiss J on 24 July 2012. That appeal was also dismissed, but this time only on the basis that Ms Berney’s claim was statute-barred. On 8 November 2012 Sir Richard Buxton granted Ms Berney leave to appeal Simpkiss J’s decision to the Court of Appeal.

COURT OF APPEAL DECISION

The principal issue before the Court (Gloster, Moses and Rimer LJJ) was whether or not Ms Berney was out of time to bring her negligence claim against the Respondent. The Court held that she was not, although there was a difference of opinion as to when exactly the cause of action had accrued.

Judgment of Gloster LJ

In her judgment, Gloster LJ stated that the question to be answered was factual: namely, when did the Claimant first suffer actual damage as a result of the professional negligence?

In answering that factual question, and having considered the “arguably inconsistent” authorities, Gloster LJ applied the “simple and attractive” test set out by Lord Hoffmann in Nykredit Mortgage Bank plc v Edward Erdman Group Ltd and posed the question: when was Ms Berney financially worse-off as a result of the Respondent’s breach of his duty of care than she would otherwise have been?
Gloster LJ did not agree with the Respondent that Ms Berney’s chose in action (in this case her right to sue) had diminished in value at, for example, the point when an application for an extension of time became necessary. Gloster LJ held that she had therefore not suffered actual damage at that stage. Whilst, in Gloster LJ’s judgment, there may well be a time in the life of a chose in action when its value will diminish, she held that this had not occurred here. In Gloster LJ’s view, it was inconceivable that Ms Berney’s claim would have been struck out – Ms Berney had a cast-iron claim for damages and to strike it out would have denied her access to the Court. Nor did she see any reason why, if an extension of time had been sought, her claim would have been limited to any particular sum or to the evidential position based on the medical reports at that date.

Gloster LJ held that Ms Berney had become financially worse-off and as such suffered actual damage at the time she had entered into the settlement on 1 November 2005. The six year limitation period had therefore not expired.

**Judgment of Moses LJ**

Moses LJ (with whom Rimer LJ concurred) agreed it necessary to ask, as per Lord Hoffmann in Nykredit, when Ms Berney was financially worse-off than she would otherwise have been as a result of the Respondent’s breach of duty of care. However, Moses LJ expressed certain reservations with Gloster LJ’s reasoning, which he described as forthright.

Moses LJ did not agree with Gloster LJ that there was no risk that Ms Berney would have failed to obtain an extension of time for serving her Particulars of Claim. In his view, there was a real risk that, prior to the settlement, if Ms Berney’s solicitors had applied to the Court to extend the time for service, she would have been confined either to the sum of £50,000 (which she had originally claimed) or to such lesser sum based on the medical reports disclosed at that time. Moses LJ cited the case of Price v Price in which Brooke LJ attached importance to the damage caused by delay to the administration of justice.

As set out above, Mrs Liddell’s solicitors had given an assurance that no procedural point would be taken in relation to delay while steps were taken to obtain further medical evidence. That assurance was effectively withdrawn on 25 January 2005. After that time, in Moses LJ’s view, there was a real risk that Ms Berney’s claim would have been restricted. From 25 January 2005, due to the risk of a restriction being imposed, Ms Berney had suffered actual damage.

The different judicial interpretations in this case as to when actual damage was suffered and therefore when the cause of action arose made no difference to the outcome of the appeal: on both analyses Ms Berney’s claim was brought in time.

**COMMENT**

Determining the date a cause of action arises in tort in respect of financial loss caused by professional negligence is critically dependent on the circumstances in any particular case. This judgment adds weight to the test set out by Lord Hoffmann in Nykredit that a cause of action will not arise until, owing to negligence, the claimant becomes financially worse-off. Importantly, the Court of Appeal agreed that there may well be a time in the life of a chose in action when its value will diminish, notwithstanding that they disagreed as to when that diminution in value had occurred.

This case also serves to remind practitioners, insurers and individuals alike that the point at which a claim in tort accrues is, due to its fact sensitive nature, often far from obvious, such that even judges may not agree. Whilst the difference in opinion did not matter in this case, it might have had a serious outcome on different facts.

**ADDITIONAL REFERENCES**


Price v Price [2003] EWCA (Civ) 888
In a decision that will be of comfort to legal advisers representing clients at mediation, the Court of Appeal in Frost v Wake Smith and Tofields Solicitors upheld a finding that a solicitor was not negligent for failing to ensure the legal enforceability of handwritten terms signed by the parties at the conclusion of a mediation.

**DECISION**

Key to the Court’s ruling was its finding that the terms agreed at mediation were not sufficiently certain and complete to constitute a final agreement capable of being legally binding. Although the parties had made progress in their complex dispute over the division of business assets, there remained numerous issues that needed to be clarified, including proper identification of the assets, treatment of tax consequences and treatment of third parties’ interests in some assets. Much of this detail was not available to the solicitor at the time of the mediation and needed to be the subject of further investigation and agreement between the parties.

Importantly, the Court rejected a suggestion that the solicitor should have, prior to the mediation, undertaken all the factual and legal investigations necessary to enable a complete and final agreement to be reached and documented at mediation. The Court held that it was simply “unrealistic” to expect the solicitor to have spent the client’s time and money in immersing himself in the level of detail that would have been necessary, when it was impossible to know from the outset how the mediation would develop.

**COMMENT**

The decision is a welcome acknowledgment of the flexible and often iterative nature of the mediation process. As the Court noted, “it would be regrettable if any decision of this court were to cause practitioners to approach the process of mediation with anything other than the maximum flexibility”. The informality of the mediation process and its ability to result in pragmatic compromises could be undermined if parties were to regard the conclusion of an immediately binding agreement as a necessary requisite of a ‘successful’ mediation. The Court stressed this by observing that it “should be a cause for neither surprise nor dismay that the process of mediation did not in this case at the first session result in an immediately enforceable agreement.”

However, the judgment does suggest that the Court would have been more receptive of a complaint (if it had been properly pleaded and proved) that the solicitor had failed in his duty to warn the client as to the non-enforceability of the provisional agreement. Legal advisers should heed the Court of Appeal’s warning in this regard and ensure that their clients understand the nature of the mediation process and the fact that compromises reached may not be capable of enforcement through the courts without further agreement between the parties.
HIGH COURT CLARIFIES THE LIMITED DUTIES OWED BY AGENTS IN FINANCING STRUCTURES

In Torre Asset Funding Ltd and Another v The Royal Bank of Scotland Plc, the High Court provided important guidance on the precise role of an agent in complex financing arrangements. Given the prevalence of such roles across many different types of lending structure, the financial institutions who take on such roles will find particularly useful the Court’s clarification that the duties they are accepting are limited in nature.

BACKGROUND

Claims were brought against RBS in relation to a multi-tiered funding arrangement for a property company, Dunedin Property Industrial Fund (Holdings) Limited (“Dunedin”). Whilst complex, the funding structure can essentially be summarised as follows:

- Commercial mortgage backed security notes, referred to in the structure as the “Super Senior” lending, which were sold into the capital markets;
- “Senior” lending which was to be provided by RBS;
- Three levels of mezzanine lending, made up of:
  - “A” loans, to be sold into the market;
  - “B1” loans, also to be sold into the market; and
  - “B2” loans, which were held by RBS; and
- An equity participation, which was held between Dunedin and RBS.

Each tier of the loans was documented by a separate loan facility agreement, and the relationship between the lenders across the different tiers was governed by an inter-creditor deed. The claim was brought by Torre Asset Funding Limited (“Torre”) (and two funds which were managed by Torre) in relation to the funds’ participation in the B1 tier and the Claimants primarily relied upon duties said to be owed to them as a lender by RBS as “Agent” pursuant to the Junior Mezzanine Facility Agreement (the “JMFA”) and the inter-creditor deed.

In September 2008 Dunedin found itself in fatal financial difficulties, primarily as a result of the fall in value of the commercial property market and the impact such valuations had on its loan to value covenants. When it entered into administrative receivership and the security was realised at a level well below the amount outstanding, a number of the lenders including the Claimants did not recover their loans. In seeking to recover their loss from RBS, the Claimants advanced three heads of claim:

1. that RBS was made aware in July 2007 of circumstances relating to the financial position of Dunedin which amounted to an Event of Default under the facility agreements and that RBS, as Agent, was under a duty to inform the Claimants of those circumstances;
2. that RBS was provided in October 2008 with a business plan and cash flow statement by Dunedin, which it was under a duty to provide to the Claimants in its role as Agent; and
3. that in January 2008, one of the RBS team (acting as a lender) made negligent misrepresentations to the Claimants as to the reason for RBS asking for their consent to roll up interest in the B2 loan (held by RBS), which he said was to make extra cash available to Dunedin for capital expenditure purposes, but which in fact was a necessary step to avoid Dunedin failing, in the near term, to meet its interest obligations higher up the structure.

For each head of the claim, the Claimants asserted that, had RBS not breached its duties to them in this way, they would at each opportunity have sold their participation in the B1 loans into the market or would have sought a restructuring of the lending structure, and therefore avoided the loss they suffered.

DECISION

The limited nature of the Agent’s duties to the lenders

The crux of the case was the extent to which RBS as Agent owed duties to the lenders under each facility agreement, in particular the JMFA. The JMFA contained several provisions under which the Agent performed a number of administrative roles regarding the lending arrangements, and the duties were described expressly as “solely mechanical and administrative in nature”. Other clauses in the JMFA required the Agent to notify the other finance parties if it was aware of non-payment by the borrowers, and gave it a discretion to provide such information it believes it received as agent to the other finance parties, and act (absent majority lender instructions) in the manner it considers in the best interests of the lenders.

The Court determined that the discretion afforded to the Agent was subject to a standard which required it not to act in a manner...
which is arbitrary, capricious, perverse or irrational. On that basis, hypothesised Sales J, had the Agent been informed by the agent for another lending tier that an Event of Default had in fact occurred, it was highly likely that its discretion would be very narrow and that failure in those circumstances to inform the other lender would, absent exceptional circumstances, be irrational.

The first head of claim related to discussions in July 2007 between Dunedin and RBS (as Lender) concerning the rolling up of interest on the B2 loans, which it was found by the Judge amounted to an Event of Default under the facility agreements. However, it was plain from correspondence at the time that RBS (and Dunedin) did not treat it as such. In the absence of a communication to the Agent that there had been an Event of Default, Sales J found that the Agent was under no duty to make an evaluative judgment that there had been (and to inform the other lenders accordingly). On the contrary, absent an obvious Event of Default which requires no evaluative judgment (eg, failure to make a payment, which it was obliged to notify parties of), the Agent was entitled to assume that no Event of Default had occurred.

The existence of a wider duty under agency law, or an implied term that the Agent should pass to the lenders any information which it receives in its role as Agent, were rejected comprehensively by the Court as both unnecessary and inconsistent with the role of the Agent under the finance documents, pursuant to which it was not intended that the Agent should have a role in making substantive evaluative judgments about the operation of the financing arrangements; rather its role was intended to be limited to an administrative nature.

The second head of claim alleged that the Agent should have provided the Claimants with the business plan and cash flows which were provided to the RBS team in furtherance of discussions around the roll up of interest on the B2 loan. However, this claim also failed because of limits to the duties the Agent owed to pass on information to the other lenders. Whilst it was required to pass on Dunedin’s annual budgets for the purpose of approval by each of the lenders, the plans provided to RBS did not fall into this category of information. The agent was not under a duty to pass on other financial information, and there was no implied term which required the Agent to consider on its own initiative what financial information should be sought from Dunedin, because such duties were unnecessary and went well beyond the solely mechanistic and administrative nature of the duties it did owe under the JMFA.

The misrepresentation claim

The third head of claim related to the rationale provided by RBS as Lender to the Claimants in seeking their consent for the roll up of interest in the B2 lending tier. The Court found that, in providing an explanation to the Claimants with the intention of persuading them to provide that consent, RBS owed a duty of care to take reasonable steps to ensure that it was accurate because it assumed responsibility to do so. As a finding of fact, RBS breached this duty because what it told the Claimants about the use of that cash was not accurate.

However, this claim too failed because the scope of the duty that was assumed was to protect the Claimants from loss they may suffer as a result of giving consent to the proposed roll up of interest. It did not extend to a duty to protect the Claimants from the consequences of them using the information provided to reassess their participation in the B1 lending tier. As it happens, the roll up of interest did not take place because another of the lenders refused its consent. Accordingly, RBS’s breach of duty had no impact on the Claimants.

The neglect misrepresentation claim also failed as a matter of causation. Sales J referred to the distinction made by Lord Hoffman in SAAMCO between a duty to advise as to a course of action, where the negligent will be responsible for all foreseeable losses arising therefrom, on the one hand, and a duty to provide information on the other, where the negligent will be responsible for the foreseeable consequences of the information being wrong. The Agent’s duties were plainly the provision of information, rather than advice, and accordingly, losses which fell from investment decisions made, at least in part, from the information provided were outside the type of loss which could be recovered. To put it another way, the information was provided by RBS to allow the other lenders to manage the exercise of their rights under the facility agreements, not to provide them with the opportunity to consider whether to retain their exposure to the transaction on the basis of that information. Any attempt to do the latter was purely incidental to RBS’s representations.

COMMENT

Financial institutions commonly acting as agents in relation to the financing arrangements in which they participate will welcome the Court’s refusal to apply wide-ranging duties on the basis of implied terms or the introduction of wider concepts of agency into the relationship between the Agent and the other finance parties. Given the typical level of fee and the widely accepted mechanistic and administrative nature of the role, perhaps this is not surprising.

The decision emphasises, however, the typical approach of the English courts to identifying, with careful precision, the scope of duties owed by particular parties when carrying out their role in the capacity in which they are acting. RBS’s other roles on the transaction did not influence the Court’s findings as to the Agent’s duties.

The decision was of course based upon the specific finance documentation for this deal, although it was not atypical in its formulation of the Agent’s requirements. It did, however, provide the Agent with a degree of discretion in the way that it carried out
its role. Agents should remain aware that any such discretion afforded to them by the finance documentation will not be treated as absolute, and the standard of acting in a manner which is not arbitrary, capricious, perverse or irrational will apply to any exercise of that discretion.

Finally, the Court’s decision once more emphasises the correct approach under English law when considering the scope of duties of care, even when they are found to exist. The court will assess the precise purpose for which a representation is made so that, if found to have been negligently incorrect, the maker’s liability will extend only to the consequences of acting upon the inaccurate statement for the decision it was given to inform. It will not protect the recipient from any loss suffered from relying on it for any other decision it has taken.

ADDITIONAL REFERENCES
COURT OF APPEAL CONSTRUES EXCLUSION CLAUSE NARROWLY TO PREVENT PARTY BEING LEFT WITHOUT REMEDY

In Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd, the Court of Appeal held that an exclusion clause should not be construed as excluding liability for lost profits where this would have left the injured party without a remedy for non-performance.

BACKGROUND

Manchester Central Convention ("MCC"), the operator of the Manchester Central conference venue, contracted with Kudos Catering (UK) Limited ("Kudos") Kudos, a professional catering company, for Kudos to be the exclusive supplier of catering services at Manchester Central for five years. Some three years into the term of the contract, MCC gave notice that it was terminating the contract. In turn, Kudos wrote to MCC, stating that MCC’s purported termination was a repudiatory breach and accepting the termination.

Kudos subsequently brought a claim for, amongst other things, £1.3 million damages in lost profits that it would have earned during the remaining term of the contract. MCC denied liability, including by relying upon the exclusion clause. The proper construction of the exclusion clause was tried as a preliminary issue.

The exclusion clause provided as follows:

"[Kudos] hereby acknowledges and agrees that [MCC] shall have no liability whatsoever in contract, tort (including negligence) or otherwise for any loss of goodwill, business, revenue or profits, anticipated savings or wasted expenditure (whether reasonably foreseeable or not) or indirect or consequential loss suffered by [Kudos] or any third party in relation to this Agreement..."  

FIRST INSTANCE DECISION

At first instance, HHJ Seymour QC, sitting as Deputy Judge of the High Court, held that the exclusion clause clearly and unambiguously excluded MCC’s liability to Kudos for lost profits. Because, in his judgment, there was only one possible interpretation of the words used in the clause, there was no sensible question of construction for the Court to consider. The Court’s function was simply to apply the clause. The Judge rejected the submission that this would leave Kudos without a remedy for MCC’s premature termination; Kudos had not been bound to accept the repudiation by MCC and had "potentially other remedies available to seek to enforce the contract", such as specific performance.

COURT OF APPEAL DECISION

This decision was overturned in the Court of Appeal, which held that construing the exclusion clause in this way defied business common sense. Tomlinson LJ, giving the lead judgment, said it was not realistic to suppose that Kudos could have sought specific performance, in circumstances where performance of the contract would have required the full-hearted co-operation of MCC. This meant that a claim in damages was the only available remedy. A construction of the exclusion clause that effectively barred such a claim would leave Kudos without a remedy for MCC’s non-performance. The agreement would therefore be devoid of contractual content. It was inherently unlikely that this was intended by the parties.

The Court of Appeal found that the trial Judge had fallen into error in thinking that the ascertainment of the meaning of apparently clear words is not itself a process of contractual construction. The Judge had reached his conclusions without considering the words of the clause in their wider context. The Court of Appeal examined the context and found that, far from being a wide-ranging exclusion of liability, the clause was merely intended to qualify an indemnity given by MCC to Kudos. The provisions adjacent to the exclusion clause were concerned with indemnification and insurance with respect to losses, presupposing defective performance of the contract rather than a refusal to perform. Tomlinson LJ said that this is "not the place in which one would expect to find a wide-ranging exclusion clause of general application".

The exclusion, therefore, did not extend to losses suffered as a consequence of a refusal to perform or be bound by the agreement. Tomlinson LJ rejected MCC’s submission that such an approach represented an objectionable resort to the discredited doctrine of fundamental breach. He said it was a legitimate exercise in construing a contract consistently with business common sense and not in a manner which defeats its commercial object, as well as an attempt to give "effect to the presumption that parties do not lightly abandon a remedy for breach of contract afforded them by the general law." If the parties had intended to exclude all liability for financial loss in the event of a refusal to perform, they should have made this clear. Indeed, Tomlinson LJ said that he would expect it to be set out in a free-stating clause.

COMMENT

The Court of Appeal was clearly reluctant to construe the exclusion clause in a way that excluded MCC’s liability for non-performance completely. Such a construction would effectively have meant that MCC had an option to perform or
terminate for convenience. This would have been difficult to reconcile with the supposedly long term nature of the contract. The Court avoided such an unpalatable conclusion by invoking the principle, also seen in other recent cases, most notably Rainy Sky and others v Kookmin Bank, that contracts should be construed in a way that is consistent with business common sense.

The decision is also a reminder of the historically restrictive approach taken by the courts to exclusion and limitation clauses and of the residual role of guidelines and presumptions in the modern approach to contractual construction.

It also reinforces the long-standing rule that contractual provisions must be construed in the context of the contract as a whole. The Court of Appeal was critical of the Judge for construing the clause in isolation from surrounding provisions.

Of note in this context is a decision handed down by a different panel of the Court of Appeal on the same day as the Kudos judgment, namely Situ Ventures Ltd v Bonham-Carter. That case involved the construction not of an exclusion clause, but of a clause in a share purchase agreement dealing with the circumstances in which the vendors’ non-executive directorships could be terminated. It was common ground that the wording of the clause should be construed in the context of its purpose and the relevant surrounding circumstances. However, it was found that the actual wording of that particular clause was a more reliable guide to construction. Neither the overall context of the clause nor the commercial consequences of the differing constructions were such as to justify a departure from the natural meaning of the structuring of the clause and the words used by the draftsman.

While some may argue that the Court of Appeal’s construction in Kudos defied the language of the exclusion clause, it is perhaps simply a demonstration of the flexibility afforded by the modern approach to contractual construction. Nonetheless, the message for the draftsman wishing to exclude all liability for financial loss is clear. If the parties arrive at such an unlikely bargain, it must be expressed unambiguously.

Further, bearing in mind the Court of Appeal’s emphasis on construing a clause in the context of the contract as a whole, those drafting contracts should carefully consider not only the wording of the clause but the context in which it is placed. In general, it will be advisable to draft a wide-ranging exclusion clause as a free-standing provision. Tucking it into a sub-clause may not be sufficient, particularly where the adjacent sub-clauses are not concerned with the exclusion or limitation of liability.

The Court of Appeal’s decision, like that of the Supreme Court in Rainy Sky, is likely to offer encouragement to parties who wish to construe contract terms in a way that departs from their literal meaning but is more consistent with business common sense. Given the scope for debate as to what ‘business common sense’ requires in any given situation, it is reasonable to expect that there will be more cases in the future in which this issue is argued.

**ADDITIONAL REFERENCES**

Rainy Sky SA v Kookmin Bank [2011] UKSC 50
Kudos Catering (UK) Ltd v Manchester Central Convention [2012] EWHC 1192
Situ Ventures Ltd v Bonham-Carter (2013) EWCA Civ 47
PRIVY COUNCIL FINDS TORT OF MALICIOUS PROSECUTION AVAILABLE FOR CIVIL CLAIMS

The Privy Council held, by a majority, in Crawford Adjusters and Others v Sagicor General Insurance (Cayman) Ltd and Another that a claim for malicious prosecution may be brought in respect of civil as well as criminal proceedings.

BACKGROUND

The appeal was brought against an order of the Cayman Islands Court of Appeal in which that Court had dismissed Crawford Adjusters’ (“Crawford”) claim for damages against Sagicor General Insurance (Cayman) Ltd (“Sagicor”) for (inter alia) malicious prosecution. The Cayman Islands Court had held that all four elements of the tort had been established in that:

- Sagicor had brought proceedings against Crawford which had been determined in favour of Crawford.
- In those proceedings Sagicor had alleged fraud and conspiracy against Crawford without reasonable cause.
- The allegations had been made maliciously.
- As a result of the allegations, Crawford had suffered substantial financial loss and other damage.

However, the Court had found that it was precluded from holding Sagicor liable for malicious prosecution because the tort did not extend to civil proceedings (subject to limited exceptions) based on observations by the House of Lords in Gregory v Portsmouth City Council.

PRIVY COUNCIL DECISION

The majority of the Privy Council (Lords Wilson and Kerr and Lady Hale) held that the tort of malicious prosecution was available for civil proceedings. The majority was influenced by the fundamental principle that where there is a wrong there should be a remedy, unless there is a compelling justification to deny the remedy. Lords Sumption and Neuberger dissented, on the basis that it would represent an unjustified extension of an anomalous tort.

Lord Wilson noted that the holding in the Gregory case was that the tort of malicious prosecution did not extend to disciplinary proceedings. In that case, Lord Steyn had added as a postscript that, although there was a stronger case for an extension to civil legal proceedings than disciplinary proceedings, he was not persuaded that the extension to civil proceedings was necessary taking into account the protection afforded by other related torts. Lord Wilson said that these observations should not discourage the Board from concluding that the tort of malicious prosecution applied to the present case. Since no other tort could address the injustice of the present case (the Court having found that an action for abuse of process was not available on the facts) the rationale behind Lord Steyn’s hesitation lost all its force.

Lord Sumption disagreed. Although he recognised that the House’s comments in Gregory were obiter, and therefore not strictly binding, the point had been fully argued both in the Court of Appeal and in the House “and the answer given at both levels was as carefully considered as any ratio decidendi”.

The distinction between civil proceedings and criminal prosecutions was, in Lord Sumption’s view, neither arbitrary nor unsatisfactory. The tort of malicious prosecution was essentially bound up with the notion of abuse of a public function, namely the prosecution of criminal proceedings. He noted that the tort is an exception to two well-established principles of English law: namely the principle of absolute immunity for things done and said in the course of legal proceedings and the principle that malice does not make an otherwise lawful act tortious. These exceptional features were justifiable, he said, only because the tort was a form of misfeasance in public office. In Lord Sumption’s view, to apply the tort to civil proceedings would be to create a wholly new tort; the law had never been prepared to countenance such a tort in the past and should not do so now.

To counter Lord Sumption’s view that the tort of malicious prosecution had never previously applied to civil proceedings, Lord Wilson outlined the early development of the law in this area dating back to the 13th century. Lord Wilson’s view was that the tort had applied equally to criminal and civil proceedings until the Court of Appeal’s decision in Quartz Hill Consolidated Gold Mining Co v Eyre. In that case the Court had drawn a distinction between a petition to wind up a company, for which the tort of malicious prosecution was available, and an ordinary civil action, for which the Court thought no such action was necessary. This was on the basis that, at the time, allegations in civil proceedings were not made public until they were determined at trial, and therefore (unlike a winding up petition which must be advertised) would not involve damage to the defendant’s reputation. Lord Wilson said that today, in light of the public nature of allegations in civil proceedings, the basis of this distinction had crumbled away. Insofar as the tort was based on an abuse of the coercive powers of the state, that applied as much to civil as to criminal proceedings.

COMMENT

Previously it was thought that the tort of malicious prosecution did not extend to civil proceedings (subject to limited exceptions, including maliciously presenting a winding up petition). This
decision suggests, on the contrary, that a claim for malicious prosecution may lie where a claimant can establish that he has suffered damage as a result of a civil claim which was brought against him maliciously and without reasonable cause, and which was determined in his favour. The possibility of a claim for malicious defence of proceedings was left open.

Although Privy Council decisions are not binding on the English courts, they are of significant persuasive authority. In strong dissenting judgments, however, Lords Sumption and Neuberger highlighted concerns about the possibility of deterring parties from bringing claims, if they are potentially liable for malicious prosecution, and the risk of prolonging disputes by way of secondary litigation. These concerns are readily understandable, and may be shared by commercial parties engaged in disputes where feelings are apt to run high. As Lord Sumption put it:

“It is no answer to these concerns to say that the bar can be set so high that few will succeed. Malice is far more often alleged than proved. The vice of secondary litigation is in the attempt.”

**ADDITIONAL REFERENCES**

Quartz Hill Consolidated Gold Mining Co v Eyre [1883] 11 QBD 674
Gregory v Portsmouth City Council [2000] 1 AC 419
HEARINGS WILL USUALLY TAKE PLACE IN PUBLIC, EVEN WHERE THERE MAY BE DAMAGE TO REPUTATION

The Court of Appeal reaffirmed in *Global Torch Ltd v Apex Global Management Ltd and Others* that in most cases the open justice principle will prevail and that potential damage to reputation will not be sufficient to order that a hearing takes place behind closed doors.

BACKGROUND

The underlying litigation in the *Global Torch* case concerned two ‘unfair prejudice’ petitions presented by rival factions in relation to the same company. The first petition was presented by Global Torch against Apex and others. 10 days later Apex issued a petition against Global Torch and others including members of the Saudi Arabian royal family. Each petition made “allegations of egregious conduct on the part of the other” and denied the counter allegations. The Global Torch parties applied for an order that the proceedings be heard in private and that restrictions be placed on the media’s access to court documents.

Under CPR 39.2 the general rule is that a hearing is to be in public but a hearing or any part of it may be in private in certain circumstances including if: “(a) publicity would defeat the object of the hearing, or ... (g) the court considers this to be necessary, in the interests of justice”. The argument in this case centred mainly around sub-paragraph (g).

As for the applicable legal principles, the paramountcy of open justice was emphasised by the House of Lords in *Scott v Scott*, and since then the common law has remained resolute apart from certain statutory exceptions. That is not the whole story however as there are three rights under the European Convention on Human Rights (“ECHR”) which are potentially engaged and require reconciliation with the open justice principle and with each other: the Article 6 right to a fair trial, the Article 8 right to respect for private and family life and the Article 10 right to freedom of expression. A judge therefore needs to consider whether there is a sufficient public interest in maintaining the open justice principle to justify curtailment of the competing right, in this case reputational rights under Article 8.

DECISION

Maurice Kay LJ, giving the judgment of the Court of Appeal, held that the Judge had asked himself the right question and came to the correct conclusion, namely that the open justice principle prevailed. He observed that in most cases falling outside the area of recognised exceptional circumstances this will be the outcome and this is so as much at the interim stage in proceedings as at trial. He also observed that as with many civil and most criminal cases, grave allegations had been made and that a person on the receiving end of such allegations is at significant risk of reputational damage. However if the allegations were false, vindication would be obtained through the judicial process and that affords adequate protection in most cases.

COMMENT

Where a case involves allegations of commercial misconduct but there is no proven abuse of process, risk of disclosure of confidential information which will affect the value of the disputed rights, or risk that publicity will defeat the object of the hearing, an order that a hearing takes place in private will be very difficult to obtain.

CASE REFERENCE AND JUDGMENT DATE

*Global Torch Ltd v Apex Global Management Ltd and Others* [2013] EWCA Civ 819

10 July 2013

**ADDITIONAL REFERENCES**

Scott v Scott [1913] AC 417
European Convention on Human Rights 1998
Civil Procedure Rules 1998
COURT OF APPEAL DISMISSES APPEAL AGAINST TOMLIN ORDER ON GROUND OF JUDICIAL PRESSURE TO SETTLE

In *Watson v Sadiq*, the Court of Appeal considered the grounds on which a Tomlin order, a form of consent order commonly used to record agreed terms of settlement, could be set aside.

**BACKGROUND**

A Tomlin order is a consent order staying proceedings on agreed terms, which are commonly set out in a schedule to the order but may also be set out in a separate agreement referred to in the order, and granting the parties permission to apply to the court for the purpose of enforcing those terms. Tomlin orders are intended to allow the settlement terms to remain confidential, while enabling the terms to be enforced without having to commence a new action for breach of the agreement.

The order in this case had been made at the end of four days which had been set aside for the trial of the action. The Claimant contended that the order should be set aside on the basis of duress/absence of true consent and on the basis that he did not receive a fair trial, contrary to common law and/or Article 6 of the European Convention on Human Rights ("ECHR").

He complained that the Judge had repeatedly adjourned to allow the parties to engage in settlement discussions, so that a conclusion of the trial within the allotted period would have been impossible, and had entered into the detail of those discussions in a manner that was likely to result in him being unable to continue to hear the case if settlement was not achieved. Accordingly, the Claimant said he had been backed into a position where the only true avenue was settlement.

**DECISION**

The Court of Appeal dismissed the appeal. The terms of the schedule to an order in Tomlin form amounted to a contract between the parties. The schedule to a Tomlin order was not an order of the court and could only be set aside on the grounds on which any ordinary contract could be set aside.

Insofar as the Claimant’s case was based on allegations of duress or undue influence, these would need to be tried out either in a new action or by reference to the court below to try any relevant issue. It was impossible for the Court of Appeal, on the papers and without examination of witnesses, to interfere with the contract on these grounds.

The only question was therefore whether the proceedings infringed common law principles of procedural fairness and/or Article 6 rights.

The Court commented that it is well within a judge’s function to indicate the view that an action ought sensibly to be compromised, to enquire as to whether avenues for settlement have been fully explored, and to afford the parties time out of court to explore possibilities of compromise. The judge should try to ensure that this does not interfere with his or her ability to deal with the case and decide it expeditiously if compromise is not possible. However, if the parties are aware that available trial time is slipping away during their negotiations, making a conclusion of a contested trial impossible if settlement negotiations break down, then that is a risk that they run.

The Court concluded that what happened in this case did not infringe either common law principles or Article 6, saying that the Judge’s handling of a badly prepared case and intractable settlement negotiations were clearly carried out in good faith and with the best intentions, even if his allowing time to slip by as he did may have amounted to poor trial management. Although some of his interventions may have surpassed desirable levels of judicial encouragement of sensible compromise, that was not the same as offending principles of fairness or Article 6.

In any event, the Claimant had affirmed the agreement by insisting on its performance by the Defendant in subsequent correspondence. He therefore waived any deficiency in the proceedings about which he sought to complain on appeal.

**COMMENT**

The Claimant contended that he had been driven into agreeing the consent order by improper interventions and pressures to settle the case exerted on him by the Judge trying the case. The Court of Appeal concluded that, although the Judge’s interventions may have “surpassed the desirable levels of judicial encouragement of sensible compromise”, they did not infringe common law principles of procedural fairness or the right to a fair trial under Article 6 of the ECHR. In any event, the Claimant had affirmed the agreement by seeking to enforce its terms.

McCombe LJ, who gave the lead judgment, commented:

“*I would not wish to say that a Tomlin Order could never be set aside for breach of the principles invoked by [the Claimant] in this case, but I am quite satisfied that there was no relevant breach of those principles here, and certainly none sufficient to undermine [the Claimant’s] consent to the agreement.*”

The decision also reinforces the confidentiality of the terms agreed by way of a Tomlin order. The Court commented that the schedule to a Tomlin order is not an order of the court and that the Civil
Procedure Rules have no application to it. This would suggest that the schedule should not be available to non-parties even where it is on the court file, a point which has been the subject of some uncertainty. Given that the point is not directly addressed in the Court’s decision, however, the safe course must still be to ensure, if possible, that the document setting out the agreed terms is not kept on the court file.

**ADDITIONAL REFERENCES**

European Convention on Human Rights
Civil Procedure Rules 1998
HIGH COURT DECISION SHOWS THE NEED TO BE CLEAR WHETHER SETTLEMENT OFFER SUBJECT TO CONTRACT

In Newbury v Sun Microsystems, the Court found that the Defendant’s letter constituted an offer that was capable of acceptance and had been accepted by the Claimant. This illustrates the importance of making clear that a settlement offer is intended to be subject to contract where this is the case.

BACKGROUND

On 3 June 2013, nine days before trial of the action was scheduled to begin, the Defendant’s solicitors wrote to the Claimant’s solicitors stating that the Defendant had agreed to make a further offer of settlement. The letter stated: “Our client is willing to settle the entire proceedings by paying the Claimant within 14 days of accepting this offer, the sum of £601,464.98 (the “Settlement Sum”) … such settlement to be recorded in a suitably worded agreement.” The offer was stated to be open for acceptance until 5pm that day, after which it would be automatically withdrawn. The parties agreed to extend the deadline to 5.30 pm.

At 5.21 pm, the Claimant e-mailed a letter to the Defendant’s solicitors marked “without prejudice save as to costs”. The letter stated “the Claimant accepts the terms of your client’s offer” and said that a draft agreement would be forwarded to the Defendant’s solicitors for approval. The parties then failed to agree on the terms of the draft agreement.

A dispute arose as to whether the 3 June exchange of correspondence itself constituted a binding settlement agreement. The Claimant said it did; although the agreement was to be recorded in a suitably worded agreement, that was not a condition of the agreement coming into effect. The Defendant contended there was no concluded agreement; its letter of 3 June indicated that a draft agreement would be forwarded to the Defendant’s solicitors for approval. The parties then failed to agree on the terms of the draft agreement.

DECISION

The Judge (Lewis J) held that, viewed objectively, a binding agreement had been concluded. That agreement would be recorded in a suitably worded agreement, ie, one which reflected the terms of the agreement, but execution of that agreement was not a condition of creation of a binding agreement. The Judge reached this conclusion for a number of reasons:

1. The Defendant’s letter of 3 June was expressed in terms of constituting an offer of settlement and set out the terms of that offer.

2. The offer was stated to be available for acceptance by a specified time and, if accepted by that time, payment would be made within 14 days of acceptance. Both those factors were a clear indication that the letter was intended to be a binding offer capable of acceptance.

3. The letter referred to “such settlement” being recorded in a suitably worded agreement. The reference to “such” settlement was a reference back to the terms set out, not to terms still to be negotiated and agreed.

That conclusion was reinforced by the reference to the terms being “recorded” in a suitably worded agreement, ie, as a record of what had already been agreed.

4. The letter was not expressed to be “subject to contract”. Had those words been used, it would have been clear that the terms were not yet binding or agreed until a formal contract was agreed. The fact that those words were not used was a relevant factor.

That conclusion was reinforced by, but not dependent on, the factual background against which the letters were exchanged, namely an attempt to reach a final compromise and therefore avoid the potentially expensive trial that was due to begin shortly.

The Judge rejected the Defendant’s contention that the conduct of the parties following the 3 June exchange of correspondence was admissible and relevant in determining whether that exchange gave rise to a binding contract. Where a contract was said to be contained in a document or documents, the Judge found, it was not legitimate to have regard to the parties’ subsequent conduct for the purpose of considering whether those documents gave rise to a binding agreement.

Such conduct might be relevant in limited circumstances, for example if it is alleged that there was a variation or new agreement, or that the contract was a sham, or if there are claims of estoppel. But such conduct was not relevant in determining whether, properly construed, the documents gave rise to a binding contract. In any event, on the facts, the Judge considered that the subsequent correspondence did not support the Defendant’s contention that the parties had not reached agreement.

COMMENT

There was little dispute as to the applicable principles. In determining whether a contract has been concluded, the Court must look at the correspondence as a whole and apply an objective test. Where it is understood that a formal document recording the terms will need to be executed, the question of whether the parties intend to be bound immediately, or only when
the formal document is executed, depends on an objective appraisal of their words and conduct.

On the one disputed point of principle, the Court found that where, as here, a contract is said to be contained in a document or documents, the court cannot have regard to the parties’ subsequent conduct for the purpose of considering whether those documents gave rise to a binding contract.

Ultimately each case will turn on its own facts, but here it was significant that the offer specified a period for which it was available for acceptance, and a period in which payment would be made if accepted. The Judge said these factors clearly indicated an intention to put forward a binding offer. It was also relevant that the letter was not expressed to be "subject to contract"; the presence of those words would have been a clear indication that the terms were not intended to be binding, and their absence was a relevant factor indicating the contrary.
COURT OF APPEAL FINDS UNDUE PRESSURE ON WITNESS TO PRODUCE STATEMENT DOES NOT COME WITHIN WITNESS IMMUNITY RULE

Witness evidence and witness statements have long been given immunity from civil proceedings. The rationale is twofold: firstly so that witnesses in future cases will not be deterred from giving evidence for fear of being sued for what they say in court; and secondly to prevent satellite litigation. The immunity cannot be outflanked by alleging for example a conspiracy to give false evidence. However, in Singh v Governing Body of Moorlands Primary School and Reading Borough Council, the Court of Appeal made clear that if the cause of action is not the allegedly false statement itself, there is no need to extend the immunity and the principle that a wrong should not be without a remedy prevails.

BACKGROUND
The Moorlands case concerned whether Ms Singh, who was claiming constructive discriminatory dismissal and constructive unfair dismissal from her position as head teacher at a primary school, could amend her claim to allege that undue pressure had been placed on a witness to produce a witness statement containing allegedly false or otherwise inaccurate evidence for the purpose of the proceedings. This claim was made in support of the allegation that the Defendants had breached the implied duty of trust and confidence between an employer and employee.

The Council objected to the amendment on the grounds that it was bound to fail because of judicial proceedings (witness) immunity. No alternative application to strike out on the facts or for lack of particularisation was made so judicial proceedings immunity was the only issue to be decided on the appeal.

COURT OF APPEAL DECISION
The decision of the Court was given by Lewison LJ. After reviewing the authorities he summarised the position as follows:

- The core immunity relates to the giving of evidence and also comprises statements of case and other documents placed before the court.
- That immunity is extended only to that which is necessary in order to prevent the core immunity from being outflanked.
- Where the gist of the action is not the allegedly false statement itself but is based on things that would not form part of the evidence in a judicial enquiry there is no necessity to extend the immunity.

- In such cases the principle that a wrong should not be without a remedy prevails.
- Procedural safeguards such as strike out and summary judgment counter the floodgates argument.

On the facts he considered the complaint to be not about the content of the statement (although any discrepancies between the statement and what the witness had previously said might help prove the allegation of undue influence) but to be about the means by which it was procured. As he observed, the complaint of breach of contract would be just as valid if pressure was applied to a witness but resisted.

COMMENT
The decision continues the trend in recent years of restricting immunity: advocates and experts no longer enjoy immunity for negligence (Hall v Simons, Jones v Kaney); malicious prosecution may be available for civil as well as criminal proceedings (Crawford Adjusters v Sagicor General Insurance (Cayman) Ltd and another, a case covered in the General Interest section of this Annual Review); the handling and preparation of exhibits for a criminal trial may not be protected by immunity (Smart v The Forensic Science Service Ltd).

CASE REFERENCE AND JUDGMENT DATE
Singh v Governing Body of Moorlands Primary School and Reading Borough Council [2013] EWCA Civ 909.
25 July 2013

ADDITIONAL REFERENCES
Hall v Simons [2002] 1 AC 615
Jones v Kaney [2011] 2 WLR 823
Crawford Adjusters v Sagicor General Insurance (Cayman) Ltd [2013] UKPC 17
Smart v The Forensic Science Service Ltd [2013] EWCA Civ 783
COURT OF APPEAL FINDS COMPANY IN LIQUIDATION IS NOT PREVENTED FROM CLAIMING AGAINST DIRECTORS ON THE BASIS FRAUD IS ATTRIBUTABLE TO THE COMPANY

In Jetivia SA and Another v Bilta (UK) Ltd (in liquidation) and Others, the Court of Appeal unanimously upheld an order refusing to strike out a claim by a ‘one-man’ company in liquidation, which had been the vehicle for a VAT fraud, against its former directors and overseas suppliers alleged to have been involved in the fraud. The Court held that the claim was not precluded by the public policy principle that a party cannot bring a claim which relies on its own illegal act (known as the ex turpi causa principle).

BACKGROUND

Bilta (UK) Limited (“Bilta”) and its liquidators brought proceedings to recover £38 million in unpaid VAT from two former directors, Bilta’s sole shareholder and various third parties including the appellants, Jetivia SA (“Jetivia”) and its sole director, Mr Brunschweiler.

Bilta traded in the purchase and sale of carbon credits on the Danish Emissions Trading Registry. It bought carbon credits from traders carrying on business outside the UK, including Jetivia, a company incorporated in Switzerland, which was zero-rated for the purposes of VAT. The carbon credits were then sold on back-to-back to VAT registered UK persons. These were taxable supplies at the standard rate in the UK and, as a result, Bilta owed HMRC £38 million in VAT on the transactions. However Bilta was unable to pay the VAT as it made no profit on the transactions. It never received or retained the proceeds of sale of the carbon credits. Instead, on the instructions of Bilta’s directors the price payable on the sale of carbon credits in the UK was paid directly to Bilta’s third party suppliers, including Jetivia. Bilta was wound up and liquidators were appointed.

Bilta brought claims for conspiracy and dishonest assistance, alleging that the Defendants had conspired to injure and defraud Bilta by depriving it of money to which it was contractually entitled and thereby preventing it from being able to meet its VAT liabilities. The liquidators brought separate claims for fraudulent trading under section 213 of the Insolvency Act 1986.

Two Defendants, Jetivia and Mr Brunschweiler, sought summary judgment on the basis that the ex turpi causa principle precluded Bilta’s claims. They argued that as Bilta was a one-person company, following Stone & Rolls, the fraud could be attributed to Bilta and therefore Bilta was not able to rely on that fraud to found its claim. They also submitted that the liquidators’ section 213 claim had to fail because that section only applied to persons within the jurisdiction and had no extraterritorial effect.

The Chancellor of the High Court dismissed the application and allowed the claims to proceed. Jetivia and Mr Brunschweiler appealed to the Court of Appeal, relying on two key arguments (both of which were relied upon by the auditors in Stone & Rolls):

1. Unless Bilta could properly be regarded as the victim of the fraud, the fraud should be properly attributable to it. The true victim on the facts was HMRC who suffered loss from a fraud in which Bilta was a key participant. As such Bilta was a villain, not a victim, and could not rely on its own fraud to found a cause of action against its co-conspirators.
2. Alternatively, the ‘sole actor exception’ applied. As Bilta was a one-person company, there were no innocent participants in the company who could be said to be prejudiced by its inability to recover compensation for the consequences of the directors’ fraud.

They also appealed on the territorial scope of section 213.

DECISION

The Court of Appeal dismissed the appeal and allowed the claim to proceed. Patten LJ gave the leading decision, with which the Master of the Rolls and Rime LJ agreed. The Court of Appeal broadly agreed with the Chancellor’s reasoning in finding that neither the principle of ex turpi causa nor the decision in Stone & Rolls precluded Bilta’s claim.

In relation to the first argument, the Court applied the fundamental rule accepted in Belmont Finance Corp Ltd v Williams Furniture Ltd (and also in Stone & Rolls) that the law would not attribute the fraud or other unlawful conduct of the director to the company when it is itself the intended victim of that conduct. As Patten LJ pointed out “the fact that the fraudulent director is the directing mind and will of the company has never been regarded as an answer to a claim by the company against the directors for a breach of duty committed against the company”.

In relation to the second argument, the Court also rejected the claim that section 213 was restricted to claims only where the claimant was within the jurisdiction. It held that the case was one where a foreign claimant had been involved in fraud and therefore the law of the forum should be applied to the claimant as well as the defendant.

CASE REFERENCE AND JUDGMENT DATE

Jetivia SA and Another v Bilta (UK) Ltd (in liquidation) and Others [2013] EWCA Civ 968
31 July 2013
On the facts as pleaded, Bilta was the “intended and only victim” and could rely on the Belmont principle to bring the claim. The court noted the Appellants’ argument that the Belmont principle did not apply because this was in reality a conspiracy to defraud HMRC but said that was a point to be decided at trial. For the purposes of an application for summary judgment, the claim had to be considered as pleaded.

On the second argument, Patten LJ said that the “sole actor exception” was not “an established feature of English law for all purposes”. In the context of a claim by a company against its fraudulent directors, “the rule [had] no place in English law and would directly contradict the protection given to creditors under s. 172 and 239 of the Companies Act 2006”. He distinguished Stone & Rolls on the basis that there was a significant difference between the liability of an auditor for failing to notify the company about what was taking place and a conspiracy against the company by its directors and others to deprive it of its assets. Stone & Rolls was “readily distinguishable” and “should be confined … to the claim and the facts in that case”.

The Court of Appeal also upheld the Chancellor’s finding that section 213 had extraterritorial effect. In Re Paramount Airways Ltd, the Court of Appeal held that section 238 of the Insolvency Act 1986 (transactions at an undervalue) applied to “any person”, whether within the jurisdiction or not. There was no reason to distinguish between section 213 and section 238 in terms of whether Parliament intended them to have extra-territorial effect.

**COMMENT**

This decision is of interest for its consideration of the ex turpi causa principle in the context of an insolvent company’s claims against directors and others that have committed a fraud against it. It is helpful in confirming that the principle will not prevent a company bringing such claims where the company was a victim of the fraud, regardless of whether it is a one-person company or whether all directors were involved in the fraud.

When considering this decision it also important to bear in mind the crucial role played by office-holders in this jurisdiction in attempting to recover money from former directors on behalf of a company’s creditors. The UK’s approach to direct creditor redress against those responsible for fraud is much more limited than in other jurisdictions. In the United States, for instance, creditors themselves have the right to take recovery action against directors who have committed misconduct. By contrast, in the UK creditors of insolvent companies are heavily reliant on the ability of insolvency practitioners to pursue civil remedies against former directors (either in their own name or in the name of an insolvent company) to seek appropriate redress.

This issue has been highlighted by the Department for Business, Innovation & Skills (“BIS”) in a new discussion paper, *Transparency & Trust: A Discussion Paper*. BIS identified a “need to find ways to increase trust in our regime by ensuring that if directors (and those advising them) act fraudulently or recklessly they personally run the risk of being required to compensate those suffering loss as a result; and to ensure that directors are aware of this”. The Court of Appeal’s limited application of the ex turpi causa defence in the present case increases the prospect of culpable directors being pursued and will be welcomed in this context.
In Andrew Mitchell MP v News Group Newspapers Ltd, the Court of Appeal dismissed an appeal against tough sanctions imposed for a failure to file a costs budget in time.

BACKGROUND

The high profile defamation action brought by Andrew Mitchell MP related to The Sun newspaper’s reporting of the so-called “plebgate” affair. The case proceeded under the pilot costs management scheme which applied to defamation cases before 1 April 2013, rather than the broader costs budgeting regime implemented as part of the Jackson reforms.

Both the pilot scheme and the new rules require parties to file and exchange costs budgets not less than seven days before the relevant hearing (normally the first case management conference). The new rules also provide (at CPR 3.14): “Unless the court otherwise orders, any party which fails to file a budget despite being required to do so will be treated as having filed a budget comprising only the applicable court fees.” There is no equivalent provision under the pilot scheme rules.

There are two other relevant amendments to the CPR which apply from 1 April 2013, both of which emphasise the increased focus on compliance as a result of the Jackson reforms:

- An amendment to CPR 3.9 which replaces the previous list of nine factors the court had to consider on an application for relief from sanctions with a statement that the court must consider: “all the circumstances of the case, so as to enable it to deal justly with the application, including the need – (a) for litigation to be conducted efficiently and at proportionate cost; and (b) to enforce compliance with rules, practice directions and orders”; and
- An amendment to the “overriding objective” at CPR 1.1 to add a new sub-paragraph (f) which makes it clear that dealing with cases justly includes “enforcing compliance with rules, practice directions and orders”.

In this case the Defendant filed a costs budget but, in breach of the pilot scheme rules, the Claimant failed to do so until the day before the case management conference. In determining the appropriate sanction for the failure, the Master looked to the new rules that apply from 1 April. She ordered that the Claimant’s budget be limited to court fees, effectively applying the new CPR 3.14 by analogy. The Master considered but refused the Claimant’s application for relief from the sanction she had imposed.

DECISION

The Court of Appeal (Lord Dyson MR, Richards and Elias LJJ) dismissed the Claimant’s appeal and gave guidance as to how the new approach should be applied in practice.

Lord Dyson, who gave the judgment of the Court, said that the new CPR 3.9 reflects a deliberate shift of emphasis. The two considerations which were singled out for specific mention in the rule (ie, the need for litigation to be conducted efficiently and at proportionate cost and the need to enforce compliance) should be regarded as of paramount importance and be given great weight. Although the court still has to consider “all the circumstances of the case”, those other circumstances should be given less weight than the two considerations which are specifically mentioned.

The Court specifically endorsed comments made by the Master of the Rolls in his 18th implementation lecture on the Jackson reforms, delivered on 22 March 2013, in which he highlighted a shift away from an exclusive focus on doing justice in the individual case:

“...the tougher, more robust approach to rule-compliance and relief from sanctions is intended to ensure that justice can be done in the majority of cases. This requires an acknowledgement that the achievement of justice means something different now. Parties can no longer expect indulgence if they fail to comply with their procedural obligations. Those obligations not only serve the purpose of ensuring that they conduct the litigation proportionately, and that the court enables them to do so, but more importantly they serve the wider public interest of ensuring that other litigants can obtain justice efficiently and proportionately, and that the court enables them to do so.”

In giving guidance on how this new approach should be applied in practice, the Court said:

- If the non-compliance can properly be regarded as trivial or insignificant, the court will usually grant relief provided that an application is made promptly. Examples include where there has been a failure of form rather than substance, or where a party has narrowly missed a deadline imposed by an order but has otherwise complied fully.
- If the non-compliance cannot be characterised as trivial, then the burden is on the defaulting party to persuade the court to grant relief. If there is a good reason for the default, the court will be likely to grant relief. Examples may include where a party or his solicitor “suffered from a debilitating illness or was involved in an accident”; or where later developments show that the original
The upshot is that courts are likely to take a firm line on those who breach rules or court orders. As the Master of the Rolls put it in the judgment: “well-intentioned incompetence, for which there is no good reason, should not usually attract relief from a sanction unless the default is trivial.”

Key points that come out of the decision include:

- Where non-compliance is “trivial” or “insignificant” and an application for relief from sanctions is made promptly, the court will usually grant relief. Otherwise the defaulting party must persuade the court that there was good reason for the default.
- Overlooking a deadline is unlikely to be a good reason.
- The courts will look more favourably on applications for an extension of time made before time has expired than applications for relief from sanction made after the event.
- An application for relief from a sanction presupposes that the sanction was properly imposed in the first place. If a party wishes to contend otherwise, the proper route is an appeal or, exceptionally, an application to vary or revoke the order.

In considering the application for relief in the present case, the Court of Appeal started by re-iterating that it would not lightly interfere with a case management decision. As stated in Mannion v Ginty:

“... it is vital for the Court of Appeal to uphold robust fair case management decisions made by first instance judges.”

Here, the Court said, there was no proper basis for interfering with the Master’s decision. She did not misdirect herself in any material respect or reach a conclusion that was not open to her. Although the Court acknowledged that it was a robust decision, it said the Master was right to focus on the essential elements of the post-Jackson regime, adding:

“The defaults by the claimant’s solicitors were not minor or trivial and there was no good excuse for them. They resulted in an abortive costs budgeting hearing and an adjournment which had serious consequences for other litigants. Although it seems harsh in the individual case of Mr Mitchell’s claim, if we were to overturn the decision to refuse relief, it is inevitable that the attempt to achieve a change in culture would receive a major setback.”

COMMENT

In its decision, the Court of Appeal has confirmed that the Jackson reforms mean a real change to the Court’s approach toward compliance with rules and court orders, not only in relation to the costs budgeting regime but in the conduct of litigation more generally, and has given guidance on how the new approach should be applied. A number of first instance decisions since the reforms were implemented on 1 April had highlighted a tension between the increased focus on compliance and the desire to do justice in the individual case. The Court of Appeal’s decision comes down firmly on the side of compliance.

The Court described as “misguided” the Claimant’s attempt to rely on factors to show that the Master should not have ordered the sanction in the first place. An application for relief from a sanction presupposes that the sanction has in principle been properly imposed. If a party wishes to contend that it was not appropriate to make the order, that should be by way of appeal or, exceptionally, by asking the court which imposed the order to vary or revoke it under CPR 3.1(7).

In its decision, the Court of Appeal has confirmed that the Jackson reforms mean a real change to the Court’s approach toward compliance with rules and court orders, not only in relation to the costs budgeting regime but in the conduct of litigation more generally, and has given guidance on how the new approach should be applied. A number of first instance decisions since the reforms were implemented on 1 April had highlighted a tension between the increased focus on compliance and the desire to do justice in the individual case. The Court of Appeal’s decision comes down firmly on the side of compliance.

ADDITIONAL REFERENCES

Mannion v Ginty [2012] EWCA Civ 1667
Mitchell v News Group Newspapers Ltd [2013] EWHC 2355 (QB)
Civil Procedure Rules 1998
COURT OF APPEAL APPLIES MITCHELL GUIDANCE AND FINDS DEFENDANT CANNOT RELY ON WITNESS EVIDENCE SERVED LATE

In its decision in Durrant v Chief Constable of Avon & Somerset Constabulary, the Court of Appeal overturned a decision to grant relief from sanctions, holding that the Defendant cannot rely on witness evidence served late.

BACKGROUND

The Court of Appeal has held that a Defendant Chief Constable’s late service of witness statements meant that it could not rely on any witness evidence in defending the Claimant’s allegations (which included false imprisonment, assault, malicious prosecution and race discrimination).

In doing so the Court of Appeal overturned the High Court’s decision to grant relief from sanctions and took an early opportunity to apply its own guidance in Andrew Mitchell MP v News Group Newspapers Ltd. In the Court’s judgment, the first instance Judge did not approach the application with the focus or degree of toughness called for by the guidance in Mitchell. In particular, he did not appreciate that the two considerations specifically mentioned in the new CPR 3.9 (the need for litigation to be conducted efficiently and at proportionate cost, and the need to enforce compliance with rules, practice directions and court orders) are the most important considerations and should be given greater weight than other factors. Nor did he appreciate how much less tolerant an approach towards non-compliance is required by the new rule.

Significantly, in giving the judgment of the Court, Richards LJ (who was also on the panel in the Mitchell appeal) stated: “If the message sent out by Mitchell is not to be undermined, it is vital that decisions under CPR 3.9 which fail to follow the robust approach laid down in that case should not be allowed to stand. Failure to follow that approach constitutes an error of principle entitling an appeal court to interfere with the discretionary decision of the first instance judge.”

As well as reinforcing the Court’s tough approach to whether there is “good reason” for non-compliance, the decision underlines the need to apply for relief from sanctions promptly, even where a breach may be described as “trivial”. Here the Court refused to permit the defendant to rely on two witness statements where the deadline was missed by just one day, as well as others for which the delay was more serious, in part due to the Defendant’s failure to apply promptly for relief. The decision also illustrates how narrow the court’s focus will be on an application for relief from sanctions; the starting point will be that the order imposing the deadline and sanction were appropriate when made, in the absence of any appeal or application to vary or revoke that order.

DECISION

The Court of Appeal allowed the Claimant’s appeal and held that the application for relief should be refused. The result is that the Defendant will not be permitted to rely on any witness evidence at trial.

Since there was no appeal against the order imposing the deadline and sanction for breach, or an application to vary or revoke that order, the Court had to proceed on the basis that it was a proportionate sanction which complied with the overriding objective (and in any event, on the facts, the Court said the sanction was correctly imposed). The Judge did not have that point sufficiently in mind. Further, although the Judge purported to proceed on the basis the new CPR 3.9 required a “much stronger and less tolerant” approach, he did not approach the exercise with the focus or degree of toughness called for by the guidance in Mitchell. He did not appreciate that the two considerations specifically mentioned in the new rule are the most important considerations and should be given greater weight than other factors. Nor did he appreciate how much less tolerant an approach towards non-compliance is required by the new rule. He therefore granted relief in circumstances which could not justify it on any proper application of CPR 3.9.

Regarding the six witness statements served in May/June, the non-compliance was on any view serious, rather than merely trivial, and the Defendant’s explanations did not get near to providing a good reason for non-compliance. The excuses that the solicitor gave for failing to meet the original deadline (other professional commitments, holiday season, bad weather, operational commitments of the witnesses) were such that the decision to extend time could be considered “generous”. The Court of Appeal said:

“But in granting the extension, the judge had made clear by the terms of his order that this was the defendant’s final opportunity. The failure to meet the final deadline was not the result of any unforeseeable event. It was due to incompetence, as Judge Birtles found, and was simply inexcusable.”
The Court of Appeal said that the considerations on which Birtles J placed particular weight, ie, the potential effect on the careers and reputations of the police and the public interest in scrutinising their actions in the light of all the evidence, should have only a limited role to play in the context of an application for relief from sanction. Such considerations may be relevant at the earlier stage of considering the appropriate deadline and sanction for a failure to meet it. However, once the court has determined both the deadline and the sanction applicable for failure to comply, such considerations could not properly carry much weight in determining whether to grant relief for non-compliance.

In relation to the two witness statements posted on 12 March 2013, the Court of Appeal accepted that the non-compliance, taken by itself, might be characterised as trivial since the deadline was narrowly missed. It was more significant, however, when seen against the background of the failure to comply with the earlier order and the fact that a sanction for non-compliance had been specified. Further, even in relation to trivial non-compliance, the judgment in Mitchell states that “the court will usually grant relief provided that an application is made promptly”. Here the application was not made promptly. Nothing was done about the non-compliance for over two months, and the delay was all the more inexcusable since the Claimant had protested loudly that the statements were late and so there was no question of the Defendant being lulled into a false sense of security. The application for relief was therefore refused even in relation to the evidence of those two witnesses.

The Court of Appeal however refused to strike out the Defence or enter summary judgment on the Claimant’s claim. The claim depended in part on her own credibility, which the Defendant was entitled to challenge at trial, including on the basis of documentary material. The Claimant would still need to prove her case.

**COMMENT**

The decision reinforces the key messages from the Mitchell case, sending a clear signal that there has been a dramatic shift in the courts’ approach to dealing with procedural deadlines.

**ADDITIONAL REFERENCES**

Andrew Mitchell MP v News Group Newspapers Ltd (2013) EWCA 1537
Civil Procedure Rules 1998
WITH-PROFITS MUTUALS – FSA HAS ‘ROAD TO DAMASCUS’ EXPERIENCE

Mutual insurers facing an uncertain future as consumer demand for with-profits products fades will undoubtedly have welcomed proposals published by the FSA in December 2012. At the time, the FSA was responsible for aspects of supervision covered by CP12/38, which have now been taken over by the FCA.

The FSA’s consultation “Mutuality and with-profits funds: a way forward” (“CP12/38”) represented a radical change from its previous approach. Seemingly, it had been persuaded by arguments made on behalf of mutual insurers over several years. Whilst there remained some points to be made in consultation responses, it was encouraging that the FSA had listened to industry and sought to achieve an outcome that offers many mutual insurers a future and that, in turn, should promote diversity in retail financial services.

We are still waiting for FCA feedback to CP12/38, which has now been put back to March 2014.

**CP12/38 highlights**

- A supervisory approach that enables mutual insurers with a viable business plan to transition from with-profits to non-profit products was both long overdue and extremely welcome.
- The proposed method of effecting a separation of interests in a mutual insurer’s common fund would give the FCA the flexibility it needs to consider firms’ proposals on a case by case basis without the formality and expense that would necessarily go with the use of existing statutory procedures (where available).
- Formal recognition of an agreed split of the common fund between a with-profits fund and a members’ mutual fund should also give mutuals comfort that they will not face regulatory challenge for continuing to write non-profit business once their new with-profits business becomes immaterial.
- Proposed changes to the FCA (at the time, the FSA) Handbook require some adjustment.

**1. HOW DOES THE NEW APPROACH COMPARE TO OTHER OPTIONS?**

Mutuals will wish to understand the relative benefits of CP12/38 proposals (discussed below) over other options for repositioning their business to reflect the decline in with-profits. Reliance Mutual has successfully restructured its business through use of a court-approved scheme of arrangement. Another option is a transfer of business under a Part 7 scheme to a replacement mutual, part of which scheme could include the restructuring of the common fund. Whilst the CP12/38 proposed approach does not necessarily score more highly than other methods in terms of desired outcomes, it is likely to be considerably less cumbersome and expensive. It may also present considerable advantages in terms of there being no need for the uncertainty associated with policyholder votes and/or a court hearing.

**2. SUMMARY OF THE FSA’S PROPOSALS**

Insurers have had to consider in recent years how to adapt their business in the light of reducing consumer demand for traditional with-profits products. The position for mutual firms has been particularly acute as the FSA’s approach before December 2012 left them facing complete closure once their with-profits business goes into run-off.

Discussions between the FSA and mutual insurers (known as “Project Chrysalis”) have finally culminated in proposals, which seem to resolve the position in a way that meets regulatory concerns about protecting the interests of with-profits policyholders whilst offering the mutual industry a future.

CP12/38 was published on 19 December 2012. It suggested a change of approach of Damascene proportions within the FSA (now the FCA), leaving some mutuals at least with the real prospect of staying in business once their with-profits business dries up completely. In summary, it provided for the following:

- **Purpose** – CP12/38 presented a change in the approach of the regulator to how rules and guidance on with-profits business in Chapter 20 of the Conduct of Business sourcebook (“COBS 20”) apply to mutual insurers.

- **High-level aim** – A proprietary insurer is not faced with closure if its with-profits fund goes into run-off; non-profit business can be supported from outside the closed fund. The FSA’s proposals aimed to put mutual insurers in the same position, while ensuring that the various interests in the common fund were recognised.

- **Proposal** – Where a mutual insurer has a single common fund, the FSA finally accepted that its equivalent of shareholder capital is mixed in with all the other interests in that fund. CP12/38 proposed that a mutual should be able to separate those interests in a way that recognises the particularities of that mutual.
WITH-PROFITS MUTUALS – FSA HAS ‘ROAD TO DAMASCUS’ EXPERIENCE

It would achieve this by amending the “Treating With-Profits Policyholders Fairly” rules and guidance in COBS 20 to recognise explicitly the ability of with-profits mutuals with a single common fund to carry out an exercise to separate out interests in that fund into a mutual members’ fund and a with-profits fund. Once a separation has been agreed, COBS 20 protections should only apply to the with-profits element of the common fund; the mutual members’ fund would be free of many of the constraints that otherwise apply to the entirety of the fund.

- **Process** - The process for achieving separate recognition of with-profits interests and a mutual members’ fund would be through formal modification/waiver by the FCA of the definition of “with-profits fund” that is used for the purposes of COBS 20.
- **Timing** - The consultation closed on 19 March 2013. Feedback was expected before the end of 2013 but has recently been postponed to March 2014.

### Impact for mutual insurers

The CP12/38 new approach should afford mutuals a real opportunity to restructure their common fund but, crucially, without the need to carry out a formal restructurings (eg. through a scheme of arrangement, the route adopted in early 2012 by Reliance Mutual). As such, taking the new approach should be considerably less cumbersome, lengthy and expensive than other options, while enabling mutuals to carry on writing non-profit business into the future. It will be necessary, however, to find a split of the common fund that satisfies the FCA that with-profits policyholders’ entitlement to be treated fairly is being met in full and we would expect negotiations with the FCA to take some time. It is impossible to know at this stage how difficult these negotiations will be but a mutual should be well-prepared to address the FCA’s likely concerns before entering into discussions.

### 3. WHY DID THE FSA CHANGE ITS MIND?

We can only speculate as to why CP12/38 represents such a turnaround from the FSA’s previous statements on Project Chrysalis. It did, however, appear to have taken the following factors into account for the first time.

- All mutuals are different and the same approach cannot, therefore, be applied in all cases to determine the interests of policyholders and members and how those interests should be respected. In contrast to its starting point on Project Chrysalis, the FSA acknowledged that a “one size fits all” approach could be unfair to other stakeholders such as non-profit policyholders and policyholder members who are not also with-profits policyholders.
- The FSA’s rules did not give sufficient recognition to mutuals that “give genuine meaning” to membership of a mutual, quite apart from their obligations to with-profits policyholders. This was, again, a significant shift from the FSA’s approach to earlier Project Chrysalis discussions.
  - The strict application of COBS 20 to mutuals experiencing declining volumes of new with-profits business may mean that they face closure, irrespective of whether a move into non-profit business could be achieved in a way that is both fair to policyholders and in the interests of members.
  - This places mutuals at a relative disadvantage to proprietary firms, which are not forced to consider closure if the with-profits fund goes into run-off because new non-profit business can be supported from elsewhere within the firm.
  - The FSA had previously taken the position that mutuals could solve the problem they faced by obtaining with-profits policyholder consent to continue writing non-profit business. In CP12/38, it recognised that with-profits policyholders are unlikely to give such consent if doing so takes away their opportunity for a windfall benefit arising from closure of the with-profits fund.
  - With-profits mutuals that have a viable business plan should be able to continue to provide financial products after the run-off of their with-profits business.

At a more fundamental level, the FSA noted that the key benefit of its proposal was that “it helps maintain diversity in the provision of retail financial services”. This was acknowledgement, perhaps, of a broader political backdrop to this issue, including a commitment in the Coalition Agreement to “foster diversity” and “promote mutuals” (in the context of banking reform but the same principles could be expected to apply here).

The FSA recognised that:

“[t]he challenge for those encouraging diversity in financial services provision is not only to support mutuality as a model for corporate ownership, but to ensure that it has a value that is appreciated by members and other policyholders.”

The FCA’s newly introduced operational objective to promote effective competition in the interests of consumers in the market for financial services (where doing so is compatible with its other objectives) also seems likely to have played a part in the FSA’s thinking.

### 4. THE CP12/38 APPROACH

In CP12/38, the FSA’s aim was to place mutuals in the same position as proprietary firms when it comes to remaining in business once new with-profits business has declined to unsustainable levels. Specifically (see paragraph 2.2), policyholders in a mutual should be “no worse off in terms of policy benefits” than equivalent policyholders in a proprietary (we
assumed that “policy benefits” here is not intended to cover distributions of excess surplus that are properly characterised as “windfall” payments.

In achieving this aim, the CP12/38 proposal:

- seeks to ensure that with-profits policyholders can be treated fairly, while allowing due weight to be given to the potential unfairness to other policyholders of closing down the mutual’s non-profit business simply because its with-profits business is no longer sustainable;
- does not have an effect on the existing position on policyholders’ interests in proprietary with-profits funds; and
- encourages mutual firms to provide new means of sharing in profitable future experience with their members.

5. THE PROPOSALS IN DETAIL

The FSA proposed to reflect its new approach through changes to COBS 20 guidance. The changes would allow mutuals to present proposals on a case-by-case basis, identifying that part of the common fund that relates specifically to the with-profits policyholders, as distinct from that part of the fund that might be described as “mutual capital” or the “mutual members’ fund”.

The FSA described the key elements of its proposal as follows:

- COBS 20 should explicitly recognise the ability of with-profits mutuals with a single common fund to undertake an exercise to separate out interests in that fund into a mutual members’ fund and a with-profits fund. Where existing rights or interests in the common fund are unclear and undetermined, the effect of such an exercise would be to determine the extent to which COBS 20 should apply to the common fund and not to achieve a reattribution.

- Firms may formalise such a separation through available legal processes (eg, a scheme of arrangement or Part 7 FSMA transfer scheme). However, where such options are not available or viable in the circumstances of a particular firm, firms will still be able to put forward proposals for effecting a separation which gives a fair outcome for all relevant categories of policyholders, taking all relevant circumstances into account. Each proposal will be assessed on its merits.

- Any separation agreed to by the FSA (now the FCA) would be given effect through a formal modification of relevant COBS 20 rules under new section 138A FSMA (inserted with effect from 1 April 2013 by the Financial Services Act 2012), subject to meeting relevant statutory tests (see separate box). The effect of the modification would be to change the definition of the “with-profits fund” for the purposes of COBS 20, to narrow its focus to the with-profits element of the common fund only.

<table>
<thead>
<tr>
<th>Statutory conditions for modification of rules</th>
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<tr>
<td>The FCA cannot waive or modify its rules under section 138A FSMA unless it is satisfied that:</td>
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<tr>
<td>- compliance:</td>
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<tr>
<td>- would be unduly burdensome; or</td>
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<td>- would not achieve the purpose for which the rules were made; and</td>
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<tr>
<td>- the waiver/ modification would not adversely affect the advancement of its operational objectives.</td>
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- Where a modification is granted, COBS 20 rules will still apply to the with-profits fund as identified but will not apply to the mutual members’ fund. Fair treatment of policyholders may still affect the mutual members’ fund in other ways eg, when considering the role of any mutual members’ funds as support for the with-profits fund.

- Consistent with this new approach, certain elements of existing COBS 20 rules and guidance, which might otherwise be seen as prescribing a particular process or standard of evidence, will be removed or amended.

Issues raised by these proposals are considered separately below.

6. PROCESS FOR RECOGNISING A MEMBERS’ MUTUAL FUND

As stated above, the FSA proposals envisaged a right for mutuals to apply for a modification under section 138A FSMA to change the definition of a with-profits fund for that firm as it relates to the relevant rules in COBS 20.

The FSA’s commentary (at paragraph 2.16) indicated that the process would not be regarded as a reattribution for regulatory purposes and the firm is not, therefore, required to comply with COBS 20 rules applying to reattributions. This comment appears to be inconsistent with proposed new Handbook text, which suggests that the firm must persuade the FCA that the division of the common fund is not a reattribution. We hope that the FCA will confirm in guidance that undertaking an exercise of the type proposed in CP12/38 will not constitute a reattribution even if it would perhaps otherwise be so. This same exemption should probably be granted to any mutual firm which chooses to use an available alternative legal mechanism (such as a scheme of arrangement) to restructure its common fund.
WITH-PROFITS MUTUALS – FSA HAS ‘ROAD TO DAMASCUS’ EXPERIENCE

Even though (on this basis) the process would not be regarded as a reallocation for the purposes of its rules, the FSA expected an application under section 138A to be supported by a report by an independent expert, the identity of whom and terms of reference for which would be agreed with the FCA (consulting with the PRA, as necessary) in advance. Where appropriate, there should also be effective pre-consultation with with-profits policyholders and other members.

The key relevant factor in determining where the split between the with-profits element of the common fund and the mutual members’ fund should lie will be the individual features of the mutual concerned. The FSA expected seven high-level principles to apply to consideration of applications (see box).

High-level principles applying to applications
1. The firm has a convincing and robust business case
2. The firm can demonstrate that its proposals are compatible with its obligations to treat policyholders fairly
3. An independent assessment of the proposals and how they affect policyholders is carried out
4. With-profits policyholders under the firm’s proposals will be no worse off than equivalent with-profits policyholders in a proprietary with-profits fund
5. The firm has a strategy to ensure that with-profits policyholders and the wider membership of the mutual are appropriately engaged and informed
6. Safety and soundness issues are identified and addressed appropriately
7. The rule variation applied for meets the appropriate statutory tests

Firms will need to consider how they might meet each of these high-level principles well in advance of any application to the FCA or even discussions leading up to an application. This exercise may be difficult, though, given the lack of clarity surrounding the meaning of the high-level principles. There is, for example, no guidance on what constitutes “a convincing and robust business case”.

The FCA might also usefully confirm that its comparison of the meaning of the high-level principles well in advance of any application to the FCA or even discussions leading up to an application. This exercise may be difficult, though, given the lack of clarity surrounding the meaning of the high-level principles. There is, for example, no guidance on what constitutes “a convincing and robust business case”.

7. FUTURE DISTRIBUTIONS FROM BUSINESS FUNDED BY THE MUTUAL MEMBERS’ FUND

The FSA also commented on future distributions from business that is funded by the mutual members’ fund as opposed to the with-profits element. It noted that mutuals are already developing member dividends and premium reductions as part of the means of sharing the positive experience of the with-profits fund with members. This sharing, it stated, needs to take place without recreating the issues caused by the current decline in with-profits business although it is not entirely clear what is meant by this comment. Finally, the FSA noted that, where new business is funded by the mutual members’ fund, with-profits policyholders who are also members will benefit in their capacity as members along with other non-profit members. Further developments in this area would be encouraged.

8. SOME SPECIFIC ISSUES RAISED BY THE FSA’S PROPOSALS

Circumstances in which new process should be available are unclear

The FSA suggested that firms should be able to put forward proposals for achieving a separation of the common fund where other legal processes are “not available or viable in the circumstances”. Whilst the concept of an alternative mechanism not being “available” is fairly clear (eg, a scheme of arrangement is not a mechanism available to a friendly society), it is not clear what the word “viable” is intended to mean here. For example, is it sufficient that alternative mechanisms are more expensive and uncertain or is more required? It would be helpful if the FCA clarified, consistent with the proposed new Handbook text, that the proposed new mechanism should be available as an alternative in all cases and not just where other, more cumbersome, statutory processes are not available. Otherwise, there is a risk that much of the benefit of what is proposed in CP12/38 will be lost.

No mention of legal rights

CP12/38 continued the FSA’s previous practice of analysing Project Chrysalis issues solely on the basis of “fairness”. The FSA suggested that the process of agreeing a split in the common fund with firms will not be dependent on any particular legal view of the respective rights and interests of with-profits policyholders and members. We are not entirely sure what this means. It may reflect FSA recognition that much of the disagreement to date has been driven by different legal views and
that it seeks, in its new proposals, to adopt a pragmatic policy to achieve its new high-level aim (of ensuring that mutuals are not faced with complete closure if their with-profits business runs off) without needing to resolve legal differences. However, analysis of the law has played a crucial part in the Project Chrysalis debate and we would question a firm’s ability to formulate a proposal without first understanding policyholder and membership rights and interests.

Firms that seek to agree a split with the FCA without having regard to legal rights and interests must leave themselves exposed to challenge as to the legitimacy of what has been agreed.

**Rule modification has limited scope**

The CP12/38 proposal is that firms should apply for a rule modification to change the definition of a “with-profits fund” for that firm “as it relates to the relevant rules in COBS 20”. The effect of such a modification would be that only the with-profits element of the common fund would remain subject to COBS 20 requirements; the mutual members’ fund would be regarded as outside the with-profits fund for COBS 20 purposes.

It is less clear whether other aspects of the FCA/PRA Handbook that attach to the with-profits fund (as defined in the Glossary to the Handbook) should apply to the members’ mutual fund once a separation for COBS 20 purposes has been agreed (see, for example, The Prudential sourcebook for Insurers (“INSPRU”) 1.1.27). Although the FSA stated that the members’ mutual fund would be regarded “for regulatory purposes” as separate from the with-profits element of the common fund, it did not specifically address whether this means that modification of the definition of the “with-profits fund” is intended to apply across the Handbook. It also did not address how, if this is the intention, the FCA will work with the PRA to ensure that the right outcome is achieved for firms in relation to both prudential and conduct aspects of the regime. Depending on the nature of rights that are granted to policyholders in their capacity as members, and absent a separate waiver/modification on this point, the members’ mutual fund may also qualify in its own right as a separate “with-profits fund” as defined in the Glossary. Consequences of this would include a requirement for firms to establish Principles and Practices of Financial Management (“PPFM”) separately for the members’ mutual fund, in addition to any required in respect of the original with-profits business. We think more thought needs to be given to the regulatory status of the mutual members’ fund and to how that status needs to be reflected in its new approach.

Firms also need to note that the members’ mutual fund will remain part of the long term fund. It follows that Handbook provisions applying to the long term fund (eg, INSPRU 1.5 restrictions on the use of long term fund assets) must continue to be met in full unless the application of those requirements has been modified to reflect the agreed split in the common fund.

Finally, other legal and regulatory consequences may follow from the modification of COBS 20. For example, PPFM are likely to require amendment and procedures for making such changes and their communication to policyholders need to be followed carefully. Depending on the content of each firm’s principles (as opposed to its practices), formal modification by the FCA of rules restricting the ability to amend principles in the PPFM may also be required.

**Rule modification will be time-limited**

The FSA expected any modification that it issues to be time-limited. However, it also recognised that the insurer would need enough time to complete the run-off of its with-profits business without renewal of the modification. Given the length of time it is likely to take for the business to be run off in full, we wonder why the FSA was not willing to accept the practical reality that each modification will need to be permanent.

**Mismatch between high-level principles and draft Handbook text**

High-level principle 5 (see above) requires a firm to ensure that its “with-profits policyholders and the wider membership” are engaged and informed about the proposal to split the common fund. There is a mismatch between this statement and the text of the proposed guidance in COBS 20.2.1(2A)(iv), which refers to engagement with the mutual’s “with-profits policyholders and other policyholders”. Clearly, a mutual’s membership does not necessarily align completely with its policyholders and this should, therefore, be corrected by replacing the words “other policyholders” in COBS 20.2.1(2A)(iv) to read “other members”. The same point applies to proposed COBS 20.2.1(2A)(vii).

**Implications of Solvency II for proposed new approach**

The FSA had previously published proposed amendments to COBS 20 to give effect to the Solvency II Directive (see CP12/13). Those changes were not reflected in the Handbook text proposed in CP12/38, which will, therefore, need to be looked at again for Solvency II purposes. This is likely to include looking at abolition of the distinction between the long term fund and the shareholder fund and the implications of new rules concerning ring-fenced funds.

Some of the restrictions that currently attach to the long term fund will, under current Solvency II proposals, transfer into COBS 20. For example, the Interim Prudential sourcebook for Insurers (“IPRU(INS)” 3.3, which relates to the distribution of established surplus between shareholders and policyholders, will attach to distributions from the “with-profits fund” post-Solvency II (see proposed COBS 20.2.19A). The transfer of provisions from
WITH-PROFITS MUTUALS – FSA HAS ‘ROAD TO DAMASCUS’ EXPERIENCE

prudential sourcebooks into COBS 20 may (absent further modification of the CP12/13 proposals to reflect the CP12/38 proposals) have the unintended consequence of changing the effect of a pre-Solvency II modification of the definition of “with-profits fund” that is grandfathered across to the new regime without adjustment.

Finally, the FCA may need to consider how its approach under CP12/38 is consistent with Solvency II proposals to amend COBS 20 to state that firms may only manage their with-profits funds taking into account support arrangements that have been formally approved by a court.

9. CONCLUSION

CP12/38 will, we believe, have been welcomed by mutuals that have been involved in discussions on Project Chrysalis and that had been frustrated by the FSA’s persistent failure to recognise the threat posed to their future by its earlier approach. The FSA’s change of heart offered mutuals a real prospect of remaining in business once their with-profits business is no longer sustainable. CP12/38 comments and proposed amendments do raise some specific questions but not to the extent that should preclude support from being given to CP12/38 as a whole.

ADDITIONAL REFERENCES

Financial Services and Markets Act 2000
Financial Services Act 2012
FSMA (Regulated Activities) Order 2001
The Conduct of Business sourcebook
Interim Prudential sourcebook for Insurers
Prudential sourcebook for Insurers
SUPREME COURT CONFIRMS EXTENDED WARRANTIES CAN BE REGULATED INSURANCE PRODUCTS

In Re Digital Satellite Warranty Cover Ltd, the Supreme Court confirmed that extended warranties on consumer goods can be “contracts of insurance”, bringing them within the regulatory framework established by the Financial Services and Markets Act 2000 (“FSMA”).

BACKGROUND

Digital Satellite Warranty Cover Limited (“DSWC”) and Mr Bernard Freeman and Mr Michael Sullivan, who traded in partnership as Satellite Services (“SS”), entered into agreements to repair and replace customers’ satellite television equipment in the event of breakdown, malfunction or certain types of damage caused by external forces (the “Warranties”). Obligations of DSWC and SS (the “providers”) under the Warranties were fulfilled by repairing or replacing the equipment (ie, by the provision of benefits in kind); the providers were not required to pay money in respect of repair or replacement costs incurred by the customer.

FIRST INSTANCE DECISION AND COURT OF APPEAL DECISION

At the High Court in January 2011, Warren J made winding-up orders on the hearing of public interest petitions brought by the FSA under section 367 FSMA against the providers and another related entity. Warren J held that the Warranties were “contracts of general insurance” for the purposes of FSMA. Selling the warranties and providing repair and replacement services were, therefore, regulated activities, for which the providers did not have the requisite FSA authorisation.

The Court of Appeal upheld Warren J’s decision.

SUPREME COURT DECISION

The Supreme Court also upheld Warren J’s decision.

To be regulated under FSMA, the Warranties needed to be both:

- a “contract of insurance” (not defined in FSMA) under common law; and
- a “contract of general insurance” within the definition set out in Article 3(1) of the FSMA (Regulated Activities) Order 2001 (“RAO”).

The assumption that the Warranties qualified as contracts of insurance at common law was not challenged by the providers. Instead, it was argued that the Warranties did not fall within Article 3(1) of the RAO on two grounds – that:

- EU law requires the RAO to be construed as applying only to contracts of insurance that provide for pecuniary benefits (ie, paying money to the customer, rather than repairing or replacing the equipment); and
- the business carried on by the providers did not actually fall within any of the classes of general insurance specified by the RAO.

DEGREE OF HARMONISATION UNDER EU LAW

UK legislation providing for the authorisation and regulation of insurance companies gives effect to a number of EU directives. The First Non-Life Directive1 (“1NLD”) is most relevant to this case; the eighteen classes of general business set out in the RAO essentially correspond to the eighteen classes that are specified in 1NLD. The argument run by the providers was that classes 1-17 in 1NLD2 do not extend beyond contracts of insurance that provide pecuniary benefits and that, in transposing the requirements of the directive, Member States were not entitled to regulate other types of non-life business (including contracts that only provide for benefits in kind).

The question for the Court was, therefore, whether the UK was able to regulate more extensive classes of general insurance (in the RAO) beyond those set out in the Annex to 1NLD.

Lord Sumption (delivering the judgment of the Supreme Court) noted that, whilst he was willing to proceed on the basis that classes 1-17 in 1NLD do not extend beyond contracts of insurance that provide pecuniary benefits and that, in transposing the requirements of the directive, Member States were not entitled to regulate other types of non-life business (including contracts that only provide for benefits in kind), he had doubts whether that analysis was correct. Deciding the point was a matter for the European Court of Justice, however, and not for the national courts of a Member State.

Even assuming that this narrow interpretation of 1NLD was correct, Lord Sumption was in no doubt that the Non-Life Insurance Directives (including 1NLD) were minimum harmonisation measures that did not exclude the right of national governments to extend regulation to a wider class of benefits in kind insurance. 1NLD was never intended to impose a comprehensive scheme of authorisation and the 18 classes of business that were listed were not intended to limit Member States’ ability to regulate other categories of business.

FOOTNOTES

1. 73/239/EEC
2. Class 18 is excepted from this argument as it clearly extends to contracts providing benefits in kind.
It may be interesting to consider whether the same analysis will apply once the Solvency II Directive comes into force. Solvency II is certainly intended to be a maximum harmonisation measure in the sense that firms covered by the directive should be subject to the same system of supervision irrespective of where they are located in the EU. It does not necessarily follow, though, that Member States cannot also choose to regulate firms that fall outside the scope of the Solvency II Directive; indeed, the PRA and the FCA, who have now replaced the FSA as regulator of financial services firms in the UK, clearly propose to continue regulating a number of smaller insurers that do not qualify as Solvency II firms under relevant directive thresholds.

The Supreme Court’s decision also poses the question of whether extended warranty contracts can be sold on an unregulated basis in other European jurisdictions which do not regulate beyond the classes of insurance prescribed by EU law in national legislation.

**CLASSES OF INSURANCE UNDER FSMA**

Article 3(1) defines a contract of general insurance as “any contract falling within Part I of Schedule 1” to the RAO. The providers argued that the Warranties did not fall within any of the classes of insurance set out in Part I of Schedule 1, so were not contracts of insurance of a type that are regulated under the FSMA regime.

**Class 16 (Miscellaneous financial loss)**

The main class of business under consideration was class 16 (miscellaneous financial loss):

“Contracts of insurance against any of the following risks, namely –

(a) ... 

(b) risks of loss to the persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within paragraph 18);

(c) risks which do not fall within sub-paragraph (a) or (b) and which are not of a kind such that contracts of insurance against them fall within any other provision of this Schedule.”

The Supreme Court agreed with both Warren J at first instance and the Court of Appeal that the Warranties fell within class 16(b) – risk of loss attributable to the insured incurring unforeseen expense. It agreed with Warren J’s analysis that there is no material distinction between a contract which only provides for repair and replacement and one which also provides an indemnity for costs actually incurred by the insured. Both cover the same risk – the possibility of the equipment breaking down or malfunctioning – and a contract that brings about the result which the insured would otherwise have to pay to achieve (ie, having equipment that works) can properly be categorised as a contract which protects him from financial loss.

**COMMENT**

The judgment:

- does not shed any light on what is or is not a “contract of insurance” under common law;
- does not decide whether general insurance business classes 1 to 17 in 1NLD extend to contracts that only provide for benefits in kind; but
- does confirm that extended warranty plans providing for the repair or replacement of goods or equipment in the event of breakdown or malfunction can be regulated insurance contracts for the purposes of FSMA (on the basis that, without the repair or replacement, the consumer would suffer financial loss); and therefore
- may have implications for those providing or selling extended warranty plans for various consumer goods and appliances on an unregulated basis.

The FSA published a press release commenting that:

“The Supreme Court’s decision will be of interest to other firms that offer warranties, helping them to understand when they should speak to us about getting authorised.”

Unregulated providers and sellers of extended warranties should consider whether they need to be authorised, either directly or indirectly under the appointed representatives regime. FCA guidance on when extended warranties should be regarded as insurance for the purposes of FSMA can be found in Chapter 6 of the FCA’s Perimeter Guidance manual.

**ADDITIONAL REFERENCES**

- Financial Services and Markets Act 2000
- FSMA (Regulated Activities Order) 2001
- The First Non-Life Directive (72/239/EEC)
- Solvency II Directive (20/138/EC)
- Perimeter Guidance (FCA Handbook)
PRA PROPOSES CLAMPDOWN ON SOLVENT SCHEMES

The PRA put down a clear marker that policyholder interests must come first when insurers are looking for ways to return capital to shareholders. It is particularly concerned that schemes of arrangement used by solvent insurers to achieve an early exit from the market can expose policyholders to a forced commutation of their cover and to settlement of their claims at less than full value. Shareholders, on the other hand, benefit from having earlier access to their capital than if the business had been run off in the usual way.

The PRA’s conclusion that this type of scheme is “unlikely” to be compatible with its policyholder protection objective (from CP6/13, issued on 9 September 2013) has generated a considerable amount of unease. Its approach is representative, perhaps, of the shift of both the PRA and the FCA towards greater protection of consumers. However, the PRA needs to recognise that it may also deter proposals that would be supported by the vast majority of a properly defined solvent creditor class.

1. KEY MESSAGES
- Opinions on the use by solvent insurers of schemes of arrangement to exit insurance markets tend to be polarised.
- For some, this type of scheme unjustifiably favours shareholders in giving them early access to their capital, while exposing policyholders to a loss of cover and/or under-valuation of their policies.
- For others, the Companies Act 2006 (“CA 2006”) establishes a mechanism that insurers may legitimately use to cut short the run-off process and which safeguards policyholder interests through voting requirements and the involvement of the court.
- The PRA’s approach is likely to mean that fewer schemes get to court.
- There is an argument, therefore, that its proposals represent an unwarranted intrusion into a statutory process that Parliament has provided for varying creditors’ contractual rights. That process depends on approval by the necessary majority of each affected class of creditors and the court’s assessment of the merits of a proposal, not the decision of another body that has no formal powers under the CA 2006.
- A consequence of the PRA’s new approach may turn out to be the increased use of Part 7 transfers as a way for firms to exit insurance markets, but this process will inevitably depend on finding a willing transferee.

The PRA’s consultation on capital extractions by general insurers in run-off (see CP7/13, also issued on 9 September 2013) is less controversial than CP6/13. Both consultations closed on 26 October 2013.

This article considers the PRA’s comments on schemes of arrangement and their implications for insurers.

2. PRA CONSULTATIONS

On 9 September 2013, the PRA published draft supervisory statements describing its approach to:
- CA 2006 schemes of arrangement proposed by PRA-authorised insurers (“CP6/13”); and
- Proposals for capital extractions by general insurers in run-off (“CP7/13”).

CP7/13 does little more than elaborate on the principle that general insurers in run-off must maintain an adequate level of capital at all times. The PRA’s comments about solvent schemes of arrangement are, however, of greater interest. The supervisory statement being consulted on is intended to replace guidance issued by the FSA in July 2007, which was removed from the FSA website before Legal Cutover on 1 April 2013.

3. USE OF CREDITORS’ SCHEMES BY GENERAL INSURERS

A scheme of arrangement is a compromise or arrangement between a company and its members or creditors (or any one or more classes of them) under Part 26, CA 2006. It must be approved by a majority in number representing 75% by value of all members/creditors of each class and sanctioned by the court.

Creditors’ schemes, involving an insurance company and its policyholders, are increasingly used by general insurers wishing to bring an early end to their business in a way that releases capital
PRA PROPOSES CLAMPDOWN ON SOLVENT SCHEMES

that would otherwise be tied up while the company is in run-off. This type of scheme – sometimes known as a “cut off” or “estimation” scheme – has its origin in schemes traditionally used by insolvent insurance companies in provisional liquidation as an alternative to liquidation, under which dividends are paid as claims become agreed in the ongoing insolvent run-off of the insurer. Schemes proposed by solvent insurance companies take a different approach in that they seek to “cut off” future liabilities under policies in return for a once and for all payment.

This type of scheme can be controversial. Policyholders may be forced to accept early termination of their cover (which may be irreplaceable) and settlement of claims at less than full value, irrespective of whether they formed part of the required majority of policyholders that voted in favour of the scheme. Concerns of this nature have resulted in two high-profile court challenges to solvent schemes in Re British Aviation Insurance Company Ltd and Re Sovereign Marine & General Insurance Co Ltd. Other schemes have been abandoned following concerted policyholder objections to their implementation. Objecting policyholders have also relied on the threat of objection to negotiate favourable cash commutations that have allowed those schemes to proceed unchallenged.

4. CP6/13 – PRA APPROACH TO SCHEMES OF ARRANGEMENT BY GENERAL INSURERS

The PRA’s starting point in assessing solvent schemes

Although the formal scheme process is established by the CA 2006, not FSMA, the PRA’s draft supervisory statement focuses on its statutory objectives under FSMA. Specifically, the PRA will look to ensure that, where insurers wish to exit the market, they take proper account of policyholders’ need for an acceptable degree of continuity of cover.

Applying this general principle, the PRA’s proposed starting point is that a scheme put forward by an insurer that still satisfies its regulatory capital requirements and expects to be able to meet claims as they fall due is “unlikely” to be compatible with the PRA’s policyholder protection objective. The reasoning is that use of a scheme in these circumstances could undermine the traditional shareholder/creditor hierarchy in allowing shareholders effectively to extract capital from the company while subjecting policyholders to a binding compromise in respect of claims.

Underpinning the PRA’s starting point is the assumption that policyholders are always best served by preservation of their cover. The legislation regarding creditors’ schemes has been part of English company law for well over a hundred years in establishing and maintaining a statutory process for varying creditors’ contractual rights, Parliament has recognised that there are circumstances in which policyholders might expect their contracts to change (the position is similar in the context of Part 7 transfers of insurance business) subject to the safeguards that are built into the CA 2006. Although it is applicable to all types of company, not just insurers, the existence of such a statutory process casts doubt on the PRA’s assumption about continuity of cover. This must in turn leave the validity of its starting point on schemes open to question.

Rebutting the PRA’s presumption

Overturning the PRA’s starting point will depend on whether it can be persuaded that:

• there are compelling reasons to take a different approach in order to secure an appropriate degree of policyholder protection; or

• alternative safeguards will ensure an acceptable level of continuity of cover for dissenting policyholders.

Unfortunately, the draft statement does not define when a reason would be regarded as sufficiently “compelling” for these purposes.

We are not aware of any finalised scheme to date in which “alternative safeguards” have been offered by a general insurer to dissenting policyholders although the PRA’s draft statement is likely to encourage work in this area to continue. The idea is that policyholders not wishing to commute their policy under the terms of the scheme could opt to take out replacement cover with an alternative insurer (this would need to be done by novation). This would give the scheme company the finality that it seeks, while providing policyholders with continuity of cover. The difficulty may be to find an insurer that is suitably highly rated to satisfy the PRA and that is willing to take on the relevant long tail liabilities.

Application of supervisory statement to life companies

The title of CP6/13 reads “Schemes of arrangement by general insurance firms”. The heading to the draft supervisory statement also restricts its application to “general insurance firms”. The text of the draft statement does not, however, limit its scope to general insurers and there may well be some life schemes where the unfairness of being bound by a majority approval and court sanction arises in the same way. In such cases, it may well be possible to offer an “opt-out” mechanism to a policyholder who does not wish to be bound by the scheme, as has happened in one case to date.

The PRA should clarify its position in relation to schemes proposed by life insurers, in particular, given recent changes to rules on reattributions in the life sector (which now prohibit the use of schemes of arrangement as they do not provide the necessary “opt-out”).
There is a danger, in our view, in assuming that solvent schemes will be objectionable rather than approaching each scheme on its merits. The latter approach requires the regulator to reach an informed (and reasoned) decision about a scheme based on a proper understanding of its implications for policyholders. The risk with the former approach is that it becomes very difficult or impossible to rebut the PRA’s presumption that solvent schemes are “unlikely” to be compatible with protecting policyholders, leaving insurers reluctant to propose schemes that would have been approved in the past.

In practice, insurers may seek to address PRA concerns by allowing dissenting policyholders to maintain their cover instead of being forced to accept its termination under the terms of the scheme. Whether they can achieve this (without retaining the liability themselves) will, however, be dependent on finding an insurer that is willing to take over the liabilities and that is regarded as suitable by the PRA. Alternatively, we may see an increase in Part 7 transfers of insurance business by insurers seeking to avoid run off.

Use of this option will, of course, also depend on the availability of a willing transferee to take on the insurance liabilities.

5. LIKELY PRACTICAL IMPACT OF THE PRA’S APPROACH

Although the court is ultimately responsible for deciding whether a scheme of arrangement should go ahead, experience indicates that it is likely to adopt the PRA’s views absent strong arguments why it should not. In practice, this probably means that fewer solvent schemes will actually reach the court as insurers come to appreciate their difficulty in overcoming PRA objections to a proposal.

However, the PRA derives its statutory authority from FSMA, not the CA 2006, and it has no formal part to play in schemes of arrangement. Parliament has instead entrusted the court to decide whether a scheme of arrangement should go ahead and the court can be expected to exercise its powers with particular care when a proposal involves the variation of contractual rights. This will include looking at whether a solvent scheme is a reasonable one for policyholders to have approved. The PRA’s involvement in schemes in the way it proposes arguably undermines the role that has been entrusted to the courts and it should perhaps revisit whether its approach can be justified.

The PRA’s approach is also likely to deprive policyholders of the ability to negotiate themselves a better deal with insurers on the basis of withdrawing their objection to a scheme. There is little to be gained by the insurer in trying to agree an outcome with policyholders if the PRA is in any case going to challenge the scheme in court.

6. SOME FURTHER CONSIDERATIONS

The FSA’s July 2007 guidance indicated that it was unlikely to object to a scheme that fell within the range of possible reasonable actions the firm might take, depending on what was fair in the circumstances. The approach proposed by the PRA in CP13/6 represents a significant change from the FSA’s position, not least because it is, seemingly, founded on the assumption that solvent schemes are not in the best interests of policyholders.

There is a danger, in our view, in assuming that solvent schemes will be objectionable rather than approaching each scheme on its merits. The latter approach requires the regulator to reach an informed (and reasoned) decision about a scheme based on a proper understanding of its implications for policyholders. The risk with the former approach is that it becomes very difficult or impossible to rebut the PRA’s presumption that solvent schemes are “unlikely” to be compatible with protecting policyholders, leaving insurers reluctant to propose schemes that would have been approved in the past.

In practice, insurers may seek to address PRA concerns by allowing dissenting policyholders to maintain their cover instead of being forced to accept its termination under the terms of the scheme. Whether they can achieve this (without retaining the liability themselves) will, however, be dependent on finding an insurer that is willing to take over the liabilities and that is regarded as suitable by the PRA. Alternatively, we may see an increase in Part 7 transfers of insurance business by insurers seeking to avoid run off. Use of this option will, of course, also depend on the availability of a willing transferee to take on the insurance liabilities.

**PRA role on schemes of arrangement**

- Only the court has power to sanction schemes of arrangement under the CA 2006.
- Nonetheless, the PRA expects to receive details of any schemes contemplated by insurers before a court application is made.
- The PRA will assess the risks posed by the scheme to its statutory objectives of safety and soundness and policyholder protection.
- It expects to inform the court in all cases whether it has any objection to a scheme.

**ADDITIONAL REFERENCES**

- Re British Aviation Insurance Company Ltd [2006] B.C.C. 14
- Re Sovereign Marine & General Insurance Co Ltd [2006] B.C.C. 774
- Financial Services and Markets Act 2000
- Companies Act 2006
- PRA CP 13/6
SOLVENCY II TRILOGUE DISCUSSIONS CONCLUDE – SO WHAT HAPPENS NOW?

On 14 November 2013, it was announced that trilogue discussions on the Omnibus II Directive ("Omnibus II") had finished in agreement. The announcement put to rest uncertainty about the future of the Solvency II Directive and set in train a timetable bringing the new regime into force from the beginning of 2016. Of more immediate concern, a Supervisory Statement issued by the PRA ("SS4/13") describes its approach to guidelines published by the European Insurance and Occupational Pensions Authority ("EIOPA") that address Member State preparations for Solvency II (the “Guidelines”).

1. ISSUES FOR FIRMS

- Detailed requirements of the Solvency II regime, including delegated acts and technical standards, are only likely to be agreed some time in 2015. This is very late given the 1 January 2016 start date for Solvency II put in place by the second “Quick Fix” Directive.
- Because the Guidelines are addressed to Member State regulatory authorities, they are not binding on firms.
- The PRA has not made new rules reflecting the requirements of the Guidelines. Nonetheless, it expects firms to comply with them to the extent specified in the Supervisory Statement (ie, in guidance).
- The PRA argues that it has not sought to set substantially new expectations of firms and, in any case, that the Guidelines in many respects reflect work that firms should be doing to prepare for Solvency II. Where PRA expectations do extend beyond current requirements, we question its use of guidance instead of rules.

The Guidelines have applied since the beginning of 2014.

2. SOLVENCY II TIMETABLE

The Commission’s 14 November announcement means that insurers and reinsurers will need to revive their Solvency II preparations where they have been put on hold while Omnibus II negotiations continued to stall. Our understanding is that the Solvency II timetable will be as set out below. Notably, the Omnibus II Directive will not be published until spring 2014 and much of the detail of the new regime will not be finalised until 2015. This leaves firms with very little time to make sure that their preparations are complete by the beginning of 2016 (although clearly transitional provisions may mitigate that deadline in certain areas).
The PRA’s use of Supervisory Statements (guidance) was explained in its April 2013 document “The PRA’s Approach to Insurance Supervision”. In summary:

- The PRA does not plan to issue significant amounts of detailed guidance to clarify its policy, whether in the form of general guidance issued publicly or advice given to individual insurers.
- Where the PRA judges that general guidance material is required, this will be issued in a consistent format as Supervisory Statements.
- Such material will be focused on the PRA’s expectations, aimed at facilitating insurers’ judgement in determining whether they meet these expectations, and will not be overly detailed.
- Insurers are expected to engage directly with policy material, including rules, EU material and Supervisory Statements, to determine whether they meet the PRA’s expectations.

Crucially, the PRA expects firms to “implement” the Guidelines, notwithstanding that they have not been reflected in PRA rules. However, aspects of the Guidelines go beyond the current regulatory regime. Where this is the case, it must be questionable whether guidance establishing the PRA’s expectations for firms is consistent with its obligations under the Financial Services and Markets Act 2000 (“FSMA”). FSMA establishes a framework for regulation of insurers that is based on rules, not guidance, and as such requires rules to be made if firms are to be made subject to hard new regulatory requirements (eg, reporting obligations under the Guidelines).

This issue is not addressed by the PRA, which simply argues that many of the Guidelines represent good practice in conformity with existing rules and should not present an additional burden for firms. It also argues that, in determining its strategic approach to the Guidelines, it has:

- Focused on the outcomes the Guidelines are intended to achieve;
- focused on their preparatory nature, the fact that progress is intended to be incremental and that firms’ preparations can reflect that;
- sought to achieve the outcomes intended by the Guidelines in a way which is consistent with existing provisions in the PRA Handbook, current expectations of firms and the PRA’s supervisory approach;
- not sought to draft new rules or set substantially new expectations of firms; and
- been proportionate in the application of the Guidelines to minimise the risk of periods of dual running.
SOLVENCY II TRILOGUE DISCUSSIONS CONCLUDE – SO WHAT HAPPENS NOW?

All of this is helpful for firms who may be concerned about how (or whether) the PRA will seek to enforce compliance with the Guidelines. The Supervisory Statement makes no comment about their enforcement although the PRA does state that it intends to review firms’ preparations in a proportionate and risk-based manner.

Interestingly, in addressing aspects of the Guidelines that deal with reporting, the PRA states that it considers its approach to be compatible with the PRA’s general powers to receive information under section 165 FSMA. The drafting of section 165 FSMA suggests that it applies where the regulators wish to ask for information from firms on an individual basis, not through the issue of general guidance. As such, we do not understand the PRA’s mention of section 165 but it perhaps reflects a concern that expectations set out in the Supervisory Statement in relation to reporting do go beyond guidance and require some additional statutory authority.

5. COMMENT

Now that Omnibus II is agreed, firms can plan with much greater certainty for a Solvency II start date of 1 January 2016. To this extent, the PRA understandably expects firms to address issues covered by the Guidelines, which may actually act as a useful reference for firms who are planning for the next two years. Nonetheless, it would be an unfortunate precedent if the PRA sought to sidestep its rule-making obligations and to introduce hard regulatory obligations through guidance.

ADDITIONAL REFERENCES

Financial Services and Markets Act 2000
EIOPA Regulation
The Conduct of Business sourcebook
QUALIFIED ONE-WAY COSTS SHIFTING ("QOCS") FOR PERSONAL INJURY CLAIMS

QOCS was introduced for personal injury claims from 1 April 2013. This means that defendants will generally be ordered to pay the costs of successful claimants but, subject to certain exceptions, will not recover their own costs if they successfully defend the claim.

QOCS does not apply to proceedings where the claimant has the benefit of a Conditional Fee Arrangement ("CFA") or After The Event ("ATE") insurance policy which was entered into before 1 April 2013 so that the success fee/premium continues to be recoverable.

DOES QOCS APPLY OUTSIDE PERSONAL INJURY ACTIONS?
Initially at least, QOCS applies only to personal injury claims, including clinical negligence claims. There has however been some speculation that it is likely to be expanded to other types of claim.

Ramsey J (the Judge in charge of the Technology and Construction Court) was reported in autumn 2012 as saying that QOCS was likely to be extended to other parts of the civil justice system, but if so extended was likely to be means tested. We will have to wait and see.

WHY HAS THIS CHANGE BEEN INTRODUCED?
The introduction of QOCS implements a recommendation of Jackson LJ which was aimed at counter-balancing the impact on personal injury claimants of the decision to abolish recoverability of CFA success fees and, in particular, ATE insurance premiums.

From 1 April 2013 parties can still enter into CFAs and take out ATE insurance to fund their litigation, but have to bear the additional costs of doing so, with an obvious impact on the level of damages claimants will receive (though in personal injury cases the success fee is subject to a cap of 25% of damages, excluding future pecuniary loss).

The introduction of QOCS is one of a number of measures intended to counter-balance this impact. In particular, the intention behind QOCS is to make ATE insurance unnecessary for personal injury actions, since the claimant will not be liable for the defendant’s costs if the claim fails. It is not clear how effective this will be in practice, however, since:

- The fact that the claimant can lose the QOCS protection where the defendant has made a Part 36 offer to settle. In other words, the Part 36 offer regime “trumps” QOCS, so that a claimant who refuses a defendant’s Part 36 offer but fails to do better at trial is at risk for the defendant’s costs from the end of the relevant offer period. However, the claimant’s liability for the defendant’s costs in these circumstances is capped at the level of damages and interest recovered by the claimant. In light of these provisions, it is important for defendants to make a well-judged Part 36 offer at an early stage.

The rules also do not preclude a successful claimant being deprived of all or part of his or her costs, or ordered to pay the defendant’s costs, in other circumstances, such as where the claimant has failed on an interim application or on some issues at trial. Again, however, the claimant’s liability for any costs orders is capped at the level of damages and interest recovered.

IS QOCS MEANS TESTED?
No. It applies to all personal injury claims, regardless of the claimant’s wealth or otherwise.
QUALIFIED ONE-WAY COSTS SHIFTING ("QOCS") FOR PERSONAL INJURY CLAIMS

COMMENT
Where commercial parties defend personal injury claims, they will have to pay the claimant’s costs if the claim is successful but will not be able to recover their costs if they successfully defend the claim (subject to the exceptions referred to above).

For repeat defendants, however, their overall costs in claims that they defend are not likely to increase as a result of the move to QOCS. The inability of defendants to recover costs in claims that fail is likely to be outweighed by the fact that defendants will no longer be liable to pay the success fee and ATE premium in claims that succeed against them.

The crucial point for defendants to personal injury claims is to consider making a well-judged Part 36 offer at an early stage of the case, in order to retain some costs protection.

The move to QOCS may also lead to a rise in the number of personal injury claims being brought, since claimants will not face a costs risk if the case fails (subject to the exceptions referred to above).

ADDITIONAL REFERENCES
Civil Procedure Rules 1998
COURT OF APPEAL SUGGESTS A RETHINK OF THE PROHIBITION ON COURT-ORDERED COMPULSORY MEDIATION

In a withering attack on what he terms “the emasculation of legal aid” and the inevitable increase in unrepresented litigants in the English courts, Ward LJ in the Court of Appeal suggested that it may be time to review the rule in Halsey v Milton Keynes General NHS Trust prohibiting a court from ordering unwilling parties to refer their dispute to mediation. In Wright v Michael Wright (Supplies) Ltd, the Court of Appeal addressed the power of the courts to order a stay for mediation to be attempted other than at the allocation stage under CPR 26.4(2)(b).

BACKGROUND

The case concerned a dispute between two unrepresented litigants, formerly successful business partners, who had fallen out and were pursuing litigation with a vengeance. Despite being, in Ward LJ’s words, “intelligent and not unsuccessful businessmen”, the parties steadfastly refused to mediate despite the continued encouragement of the trial judge, which resulted in a disproportionately expensive trial and appeal process. The appeal itself concerned an alleged procedural error by the trial judge in not acceding to a request by one party to adduce oral evidence, an error which Ward LJ considered may well have arisen, in part at least, as a result of the “chaos which litigants in person inevitably – and wholly understandably – manage to create” in such cases.

MEDIATION

The rule against court-ordered mediation was set out by Dyson LJ and Ward LJ himself in Halsey in the following terms:

“It seems to us that to oblige truly unwilling parties to refer their disputes to mediation would be to impose an unacceptable obstruction on their right of access to the court.”

Delivering his judgment in Wright, Ward LJ noted that in Halsey he had been persuaded by the argument that to order parties to mediate would fall foul of the right to a fair trial enshrined in Article 6 of the European Convention on Human Rights. In Wright, Ward LJ suggested that he may have been wrong to decide this point as he did in Halsey and rhetorically questioned whether forcing the parties to go through an additional step before gaining access to Court would in fact be an “unacceptable obstruction”. Whilst he declined to answer this question, since the point was not before the Court in Wright, he suggested that a “bold judge” may wish to accede to an invitation to rule on this question, in order that the Court of Appeal may revisit this aspect of Halsey in the light of developments in mediation practice over the last decade. Ward LJ also suggests in Wright that CPR 26.4(2)(b) (which allows a court at the allocation stage to stay proceedings of its own initiative in order for the parties to attempt ADR), might permit the court at any time to direct a stay for mediation to be attempted with the warning of adverse cost consequences for unreasonably refusing to attempt ADR.

COMMENT

The recent reduction in legal aid funding may on its face have saved expenditure in one area, but this has, in Ward LJ’s view, simply increased the costs and expense of court proceedings, both at the trial and appellate stages. Aside from the “inevitable chaos” of a case involving unrepresented litigants (Ward LJ referred to the requirement on judges to “micro-manage” such cases and praised Judge Anthony Thornton QC in this case for his “manful, patient, polite, careful and conscientious” efforts in this regard) he considers that Wright also highlights the impossibility of shifting litigants off the trial track and onto the parallel track of mediation, a situation which he describes as “depressing”. This is particularly so since he considered mediation to be a proper alternative to be “tried and exhausted” before finally resorting to trial, especially in cases such as this where mediation is an obvious way to move forward before parties “cripple themselves with debt”.

Ward LJ’s comments, whilst persuasive, are obiter and it therefore remains to be seen whether a suitable case and a “bold judge” emerge to tackle this issue head on, as he hopes. If this aspect of Halsey is overruled, it will be interesting to see how this will affect both the take up of mediation and its success rate. It seems likely that legislation (either adapting CPR 26.4(2)(b) or a new provision entirely) would be desirable to put matters on a clear setting. In any event, forcing a party to mediate is one thing, forcing them to settle is a different matter entirely and is fraught with theoretical and practical difficulties even in cases which are overwhelmingly
Court of Appeal suggests a rethink of the prohibition on court-ordered compulsory mediation

It is well established that the success of mediation often rests in large part on the parties’ willingness to engage in the process, and as Ward LJ himself acknowledged, “you may be able to drag the horse (a mule offers a better metaphor) to water, but you cannot force the wretched animal to drink if it stubbornly resists.” The increase in court-annexed mediation pilots in England and Wales (for example in relation to small claims and certain appeals) should be monitored closely and their success analysed in this regard.

Additional references

Halsey v Milton Keynes General NHS Trust [2004] EWCA Civ 576
Civil Procedure Rules 1998
ADJUDICATOR HAS JURISDICTION DESPITE CONCURRENT REFERRALS AND LATE SERVICE OF REFERRAL NOTICE

In Willmott Dixon v Newlon, the High Court ruled that an Adjudicator had jurisdiction to make two decisions despite the fact that the responding party (Newlon) did not receive the referrals when they were served on the adjudicator. The court also rejected Newlon’s argument that the adjudicator could not be referred two disputes concurrently pursuant to section 108(1) of the Construction Act 1996.

BACKGROUND

The case concerned a PPC2000 contract and the Construction Industry Council (“CIC”) adjudication procedure, which is rare.

Having served two notices of intention to refer to adjudication on 9 October 2012, Willmott Dixon (“Willmott”) sent two letters addressing the two issues to the Adjudicator enclosing the referral notice with a bundle of copy documents (the “October Referral Notice”). These were said to be sent to Newlon’s solicitors at the same time. The Adjudicator confirmed receipt of the referral three days later. Newlon submitted a response referring to a referral notice in a previous (July 2012) adjudication but not those material to the present adjudication. Willmott queried this and served a reply enclosing a further copy of the referral in the October adjudication to which Newlon served a rejoinder raising no new substantial points. The Adjudicator originally said that he had not received the October Referral Notice but subsequently confirmed in writing and in his decision that he had received it but had not noticed these at the time as they had become unattached from the main file. Subsequently he made two decisions in Willmott’s favour which Willmott sought to enforce.

DECISION

Newlon submitted that the Adjudicator had no jurisdiction to reach his decision as the referral notice had not been served within seven days of the giving of the notice of intention to refer. This was a breach of the requirements of Section 108(2)(3) of the Construction Act and Rule 14 of the applicable CIC Rules. Both require the dispute to be referred to the Adjudicator within seven days of the notice of intention to refer.

The Court rejected this argument. The reality of the situation was that the Adjudicator did receive the October Referral Notice at the correct time, as he made plain in his later letter. This point was incorporated within his decision and this was a finding or statement of fact within his jurisdiction which was not open to challenge on the application for enforcement. Even if he had not received the referral documents at the required time, the covering letter and the enclosed bundle sufficiently set out a statement of Willmott’s case in relation to each adjudication, to which Newlon responded in detail. In the Court’s view, Newlon should have raised the issue at the time of its response and by not doing so, was in breach of contract itself.

Ramsey J went on to observe that even if it were correct that Newlon had not received the referral notice at the proper time, this was not sufficient to displace the Adjudicator’s jurisdiction. At most, this might go to the question of whether or not the procedure complied with natural justice. In doing so, the Court adopted a wide meaning for “statement of case” (the CIC adjudication procedure did not prescribe the form this should take). In construing this, the Court included the points raised in Willmott’s detailed cover letter.

The Court also refused the Defendant’s submission that two adjudications could not be referred to one adjudicator. The authorities on this point, particularly the case of Witney v Beam Construction, made it clear that two disputes cannot be referred in one adjudication but there is nothing wrong with two disputes being referred to the same adjudicator in two adjudications.

The award was therefore ordered to be enforced.
ADJUDICATOR HAS JURISDICTION DESPITE CONCURRENT REFERRALS AND LATE SERVICE OF REFERRAL NOTICE

COMMENT

Although the combination of the contract and rules applicable in this case is unusual, it does indicate, as in many previous cases, that technical arguments on enforcement are unlikely to be given much credence. The judgment suggests a certain degree of latitude in the service requirements. It is unclear why Newlon did not raise the issue on receipt, and instead chose to refer to an earlier referral notice yet respond to the substantive claims raised in Willmot’s cover letter. This seemed to influence Ramsey J’s findings. Ramsey J found that this was out with the spirit of the CIC adjudication procedure, which required the parties to work together to solve problems and resolve disputes. The decision may appear surprising but it is against this backdrop, and the fact that technical breaches should not be taken to avoid adjudicators’ decisions, that it must be interpreted.

ADDITIONAL REFERENCES

Witney v Beam Construction [2011] EWHC 2332 (TCC)
Construction Act 1996
CIC Rules
POST JACKSON REFORMS – ARE MEDIATION COSTS RECOVERABLE?

In North Oxford Golf Club v A2 Dominion Homes Ltd, the court considered whether mediation costs are recoverable. Under Jackson LJ’s costs reforms, the multi-track costs budget (Precedent H) requests details of the costs of ADR/settlement discussions. This has prompted the question whether Precedent H creates a presumption that the costs of a failed or aborted mediation form part of standard recoverable costs.

BACKGROUND
Reasonable and proportionate costs incurred in seeking settlement or engaging in negotiation are recoverable in the usual way (Civil Procedure Rules PD 47 para 5.12(8)), and the court has jurisdiction to make an order in relation to the costs of a failed mediation (Chantrey Vellacott v The Convergence Group Pte & Others). In addition, costs (including pre-action costs) may be “costs of and incidental to the proceedings” under section 51 of the Senior Courts Act (however, costs incurred in a pre-action mediation which took place over two years before proceedings were issued did not fall within section 51 (Lobster Group v Heidleberg Graphic Equipment Ltd and Close Asset Finance Ltd)).

Despite the above rules providing for the recovery of mediation costs, these are usually explicitly split between the parties in the mediation agreement, and the courts will not look behind such agreements and make a different order. If the agreement is silent, there may be scope to argue that such costs are recoverable. If the parties agree that mediation costs should be costs in the case (or the court orders this), they will be recoverable. The parties’ intention will be paramount.

North Oxford Golf Club was heard on 9 April 2013. Pursuant to the mediation agreement, the mediator’s fees were to be borne equally between the parties, and the Claimant’s solicitors had written to the Defendant’s solicitors suggesting that the parties agree to share equally “the costs of the main room and any costs attributed to the mediator”. On detailed assessment, the Claimant argued that the costs of the mediation were part of the inter-parties costs, whilst the Defendant argued that the mediation was entirely separate. The Costs Master ruled that, on the facts, there was a distinction between the participation costs (the mediator’s costs, hire of room etc) and the costs of preparation and presentation of the mediation borne by the parties and their lawyers. The Costs Master disallowed the former and allowed the latter.

DECISION
In a written judgment handed down on 24 April 2013, the Judge hearing an application for appeal in the case said that in his view the Costs Master had probably been right but the authorities did not provide a clear answer on this.

COMMENT
It is clearly advisable for parties to give thought to mediation costs upfront and to state in writing whether they should be split, or treated as “costs in the case”. Most mediators will push in their standard terms for the mediator’s fees to be borne equally and paid before the mediation. However, this does not preclude the parties from stipulating that these and other costs should ultimately be treated as costs in the case (or at least as reserved costs so that the judge can be addressed later on the options open to him/her).

ADR institutions are increasingly providing for the recoverability of costs in their standard agreement/terms (see CEDR’s model mediation agreement 13th edition (clause 9)). Indeed, there is no reason why the parties have to agree to share the costs of the mediation and a party who believes they are likely to succeed in the underlying litigation should certainly think twice before doing so.

Parties should ensure that the costs provisions in an applicable ADR clause, mediation agreement, or settlement agreement do not conflict (or make clear which takes precedence if they do). It was held in Nat West Bank v Feeney that the costs provisions of a settlement agreement should be explicit and make clear that they supersede the terms of the mediation agreement.

Ultimately, whilst Precedent H supports the argument that failed mediation costs are recoverable, nothing will overrule the parties’ intention, which should be made clear in writing.

CASE REFERENCE AND JUDGMENT DATE
North Oxford Golf Club v A2 Dominion Homes Ltd
(2013) EWHC 852 (QB)
24 April 2013
Finally, and from a practical point of view, it will be difficult for a costs judge to rule whether mediation costs should be recoverable or not, given that without prejudice privilege attaches to mediation. Unless the parties are willing to lift the without prejudice veil over the mediation, the judge will not be able to look at the circumstances surrounding the mediation to determine whether it is just to include mediation costs.

ADDITIONAL REFERENCES

Chantrey Vellacott v The Convergence Group Plc & Others [2007] EWHC 1774
Nat West Bank v Feeney [2006] EWHC 90066 (Costs), affirmed on appeal, [No 9 of 2007] (unreported)
Lobster Group v Heidelberg Graphic Equipment Ltd and Close Asset Finance Ltd [2008] EWHC 413
Senior Courts Act 1981
Civil Procedure Rules 1998
CEDR Model Mediation Agreement, 13th edition
Those guidelines have been applied in numerous subsequent decisions. However, most have involved situations where a party has expressly rejected a proposal to mediate and provided at least some form of reasoning for that position. As the Court of Appeal in the present case noted, there has been scant authority addressing the situation where a party simply declines to respond to an invitation to mediate.

FIRST INSTANCE DECISION

In High Court proceedings involving a commercial tenancy dispute, the Claimant had made what the Court of Appeal subsequently described as "a serious and carefully formulated written invitation" to mediate, which was met with complete silence by the Defendant. A repeat of the offer over three months later similarly elicited no substantive response. Following a last-minute settlement of the claim (save as to costs), by the Claimant accepting a Part 36 offer made some nine months earlier, the trial judge was called upon to rule on costs, including the implications of the Defendant’s conduct in relation to the ADR proposal.

The Judge decided that
(i) the Defendant’s silence amounted to a refusal to mediate and
(ii) applying the Halsey guidelines, that refusal had been unreasonable. The costs sanction imposed was to deprive the Defendant of the costs benefit to which it would otherwise have been entitled under Part 36 (that is, the whole of its costs for the period the Claimant had delayed in accepting the offer).
FAILURE TO ENGAGE WITH ADR PROPOSALS: COURT OF APPEAL EXTENDS THE HALSEY PRINCIPLES

Both parties appealed (the Claimant maintaining that the costs sanction did not go far enough and should have extended to compelling the Defendant to also pay the Claimant’s costs for the same period).

COURT OF APPEAL DECISION

In the leading judgment, with which the other members of the Court agreed, Briggs LJ took the opportunity to undertake a review of the progress of mediation as a dispute resolution mechanism in civil disputes in the UK in the nearly 10 years since the Halsey decision, including reviewing statistics demonstrating its effectiveness (noting the Court of Appeal’s own pilot scheme has a 50% current success rate). He also highlighted the intense focus in Jackson LJ’s Review of Civil Litigation Costs upon achieving proportionality between the cost of litigation and the value of that which is at stake – and his clear endorsement of ADR as a process which is still insufficiently understood and under-used; and the publication earlier this year of the Jackson ADR Handbook.

Briggs LJ noted that the Handbook sets out advice to parties who receive an invitation to mediate but believe they have reasonable grounds for refusing to participate at that stage. He summarised that advice as calling for “constructive engagement” in ADR – including not ignoring the proposal, giving full reasons for declining to participate, seeking to resolve any obstacles such as shortages of information and not closing off ADR of any kind and for all time.

Having reviewed the current state of practice and policy as to the use of mediation, Briggs LJ proceeded to articulate what he described as “a modest extension” to the Halsey principles and guidelines, as follows:

“... the time has now come for this court to firmly endorse the advice given in ... the ADR Handbook, that silence in the face of an invitation to participate in ADR is, as a general rule, of itself unreasonable, regardless of whether an outright refusal, or a refusal to engage in the type of ADR requested, or to do so at the time requested, might have been justified by the identification of reasonable grounds.”

This was expressed as a general (rather than invariable) rule, as the Court acknowledged the possibility of exceptional cases, such as where the failure to respond to a proposal was due to administrative error or “rare cases where ADR is so obviously inappropriate that to characterise silence as unreasonable would be pure formalism” (no examples of the latter were given).

However, the Court stressed that the onus would lie squarely on the recipient of the invitation to make such explanation good.

This principle was sufficient to justify a conclusion that the Defendant’s conduct in this case warranted a costs sanction, without the need for a detailed point-by-point analysis of the Halsey guidelines as to reasonableness. (The Court did, however, confirm that it agreed with the trial judge’s findings that the silence constituted a refusal and that the refusal was unreasonable).

As to the type of costs sanction that was appropriate, the Court accepted that a finding of unreasonable conduct regarding ADR (in whatever form) produced no automatic results in terms of penalty. The proper response may range between disallowing the whole, or only a modest part of, the otherwise successful party’s costs. (The Court rejected the Claimant’s submission that the sanction should have extended to the Defendant paying the Claimant’s costs. Although noting that the court must in principle have such power, it considered that a sanction ‘that draconian’ should be reserved for only the most serious and flagrant cases – such as where a party had ignored the Court’s encouragement to consider ADR.)

On the present facts, Briggs LJ regarded the trial judge’s disallowance of the whole of the Defendant’s costs during the period as “a little more vigorous than I would have preferred” – given his view that it was primarily the Claimant’s late acceptance of the Part 36 offer that was responsible for costs continuing to accrue. However, the ruling was within the permissible scope of the trial judge’s discretion and was upheld.

COMMENT

The result in this case – that a party who ignored an invitation to mediate had a substantial costs sanction imposed upon it – is not in itself a surprising outcome. Given the courts’ clear disapproval and sanctioning of parties who decline mediation proposals on grounds that are ultimately judged to be unreasonable, most observers might have assumed that it went without saying that completely ignoring such proposals would risk attracting at least the same level of disapproval. To that extent, the decision should not have any dramatic practical impact on how properly advised litigants respond to invitations to mediate.

However, the interesting development is that the Court did not reach that result by having to characterise the Defendant’s silence as a refusal to mediate and then applying the Halsey guidelines to assess whether that refusal was unreasonable. Rather, the Court was prepared to take the step of characterising refusal to discuss mediation as prima facie unreasonable in itself, regardless of whether there may have been reasonable grounds (under the Halsey guidelines) for the party to have declined the proposal. That effectively also reverses the onus of proof as between the parties. That is, in the case of a successful party expressly refusing to mediate, the onus will remain on the unsuccessful party to show that that refusal was unreasonable. However, where a successful party simply refuses even to engage in discussion about mediation, the onus is now on that party to persuade the court that its silence was in the particular circumstances not unreasonable.
While there is unlikely to be a large volume of cases in which that distinction will be relevant, it is significant that the Court of Appeal has taken the step of clearly singling out for particular disapproval refusal to engage in discussion of mediation (as distinct from refusal actually to mediate). This can be clearly seen as a further step in a progressive shift toward courts expecting parties not only to respond appropriately to judicial encouragement of ADR but to take a more constructive role themselves in exploring the potential for its use. As Briggs LJ noted, there is an increasing recognition that the potential for waste of judicial resources is not limited to courts having to try cases that could have been settled earlier by ADR – it is also a waste of resources for judges to have to “manage the parties towards ADR by robust encouragement”, where they could and should have engaged with each other in this regard without the need for the court’s active intervention.

In particular, Briggs LJ’s judgment clearly encourages parties pro-actively to identify and seek to resolve or reduce any obstacles to ADR that may exist in a particular case, such as by addressing any deficiencies in information. He notes that, in the context of case management in respect of trial preparation, it is well established that parties are expected to discuss any problems and differences in position and to seek to narrow their differences before submitting those that are irreconcilable to the court. Given that case management now clearly includes consideration of ADR and not just trial preparation, Briggs LJ could “see no reason why the same should not apply to ADR”.

One other interesting aspect of the judgment is that Briggs LJ’s supporting reasoning reinforces a theme we have observed increasingly featuring in judicial discussion of mediation and other forms of ADR. That is the growing recognition that the value of an ADR process should not be viewed solely in terms of whether or not it ends in a resolution of the dispute. The recent Court of Appeal judgment in Frost v Wake Smith and Tofields Solicitors (a case covered in the Professional Negligence section of this Annual Review) is an example of the courts recognising the valuable role mediation can play as one element of a progressive resolution process even if it does not immediately result in a full and final settlement. Further, even where the dispute is not ultimately resolved, there is a growing recognition of the potential for ADR to delineate and narrow the ambit of issues in dispute that need to be put before the court. Both these potential benefits were cited by Briggs LJ as supporting the courts’ insistence that parties constructively discuss mediation at the relevant time when the possibilities can be fully explored, rather than simply disregard it as an option and articulate their objections only later when resisting a costs sanction.

In the Court’s own words, “this case sends out an important message to civil litigants” that, even where they believe that a particular mediation proposal is not appropriate at a particular time, they are expected to engage constructively in discussions and not simply close their minds to ADR of any kind and for all time. Parties who ignore that clear message will do so at their peril.

**ADDITIONAL REFERENCES**

Halsey v Milton Keynes General NHS Trust [2004] EWCA Civ 576
Frost v Wake Smith and Tofields Solicitors [2013] EWCA Civ 1960
Jackson ADR Handbook
The publication in April 2013 by OUP of the Jackson ADR Handbook (“the Handbook”) forms part of the suite of measures introduced in 2013 to reform civil litigation in England and Wales. The Handbook is intended to inform litigants, lawyers and judges about the benefits of ADR in the hope that it will become more readily deployed in the context of civil litigation.

**BACKGROUND**

Jackson LJ’s Review of Civil Litigation Costs in January 2010 strongly supported the increased use of ADR and concluded that “ADR (particularly mediation) has a vital role to play in reducing the costs of civil disputes, by fomenting the early settlement of cases. ADR is however under-used.” (6.3, executive summary).

Jackson LJ endorsed a “serious campaign” to ensure that lawyers, judges and the public were alerted to the benefits of ADR in resolving disputes, and recommended that an authoritative handbook be prepared to provide practical and concise guidance on all aspects of ADR, and in particular the use of ADR in relation to civil claims in England and Wales.

The Handbook is authored by Susan Blake, Julie Browne and Stuart Sime of City University London assisted by an editorial advisory board co-chaired by Lord Clarke of Stone-cum-Ebony and Lord Neuberger of Abbotsbury. The Handbook has been endorsed by Jackson LJ, the Judicial College, the Civil Justice Council and the Civil Mediation Council, and every judge who hears civil cases will receive a copy as an aide. The Handbook will also be used in Judicial College and Continuing Professional Development training sessions.

**CONTENT OF THE HANDBOOK**

The Handbook covers the full gamut of ADR processes, from negotiation through to arbitration, and contains in depth guidance on mediation practice and procedure, as well as dedicated chapters on other ADR processes such as early neutral evaluation, conciliation, ombudsmen, expert determination and adjudication. Additional materials on mediation providers and specimen documents are available on a supporting website.

**WILL ADR USE INCREASE IN LIGHT OF THE JACKSON REFORMS?**

**The pre-April 2013 position**

ADR has long been part of the framework for civil litigation in England and Wales. The Woolf reforms heralded the Civil Procedure Rules 1998, which impose on the English courts an obligation to encourage disputing parties to use ADR and a requirement on litigating parties to demonstrate that they have at least considered ADR at various stages of the dispute. A body of case law evolved over time establishing that the courts could punish successful parties to litigation if it was shown that they unreasonably refused to attempt ADR (Halsey v Milton Keynes and subsequent case law). In tandem with this, the Pre-Action Protocols, Court guides and case management powers (for example to grant a stay for the parties to attempt ADR, or make an “ADR order” in the context of the Commercial Court) developed so as to strongly encourage litigating parties to attempt ADR. These always fell short of rules compelling parties to undertake ADR.

Other developments in recent years have also sought to support ADR as an adjunct to litigation:

- The establishment of court mediation pilot schemes and the development of the Civil Mediation Online Directory
- A wide number of respected bodies now support ADR and the Civil Mediation Council created in 2003, provides training and practice standards
- The government’s strong support for ADR, including its Dispute Resolution Commitment of 2011, strengthening an Alternative Dispute Resolution Pledge made in 2001. This requires all government departments to attempt alternatives such as mediation and arbitration whenever possible before taking a dispute to court.

**Jackson LJ’s recommendations**

Following a detailed review of ADR usage and after canvassing the views of a wide range of stakeholders, Jackson LJ concluded that, despite the developments above, ADR was not sufficiently used or understood and this was hampering its more widespread use. “Its potential benefits are not as widely known as they should be” he wrote in chapter 36 of the January 2010 Report. However, Jackson LJ has emphasised that, despite its many benefits, parties should never be compelled to mediate – “cultural change as opposed to rule change” was called for. As such, there have been no rule changes requiring parties to attempt ADR either before or during litigation as a result of the Jackson reforms.
The 2013 Reforms

As well as the Handbook, a number of Jackson LJ’s other recommendations, implemented as a package from 1 April 2013, may also increase the use of ADR. These include the development of judicial case management to include costs management, and the introduction of costs budgets. Both should focus the parties on costs and ensure that ADR options are adequately explored. The revised “proportionality” test for costs should also help to ensure that the cost benefits of ADR are better assessed.

COMMENT

We strongly endorse the publication of the Handbook. ADR processes are flexible and developing, however, and the Handbook constitutes an evolving work in the promotion of ADR rather than blueprint that limits the definition and changing nature of ADR processes.

We agree with Jackson LJ’s view that the use of ADR in the context of civil litigation should remain voluntary. ADR can only take place where both parties agree to it, and since much of the impetus for success comes from the positive message created by both parties agreeing to commit time and senior resource to the process, there is a significant risk that a mandatory ADR stage in litigation would become no more than a tick the box exercise. Moreover, in the commercial context, parties are well able to determine whether mediation should take place and at what stage. Therefore, it is right in our view that parties to litigation are not obliged to engage in ADR in England and Wales. A combination of a party’s obligations under the CPR, as well as the costs risk of refusing to undertake ADR, means that litigation lawyers must advise their client as to the ADR options available and the risks of failing to attempt it in some form.

Now more than ever, the judiciary plays an essential role in promoting mediation/other forms of ADR in appropriate cases, both within and even more importantly outside the commercial context, where litigants have less experience of ADR and may need guidance. Whilst judicial activism should be welcomed, we also believe that corporate clients have the ability to exercise greater control over outcomes and costs by pro-active use of ADR processes at the earliest appropriate opportunity (including through the incorporation of ADR clauses in contracts and the use of Early Case Assessment (“ECA”) procedures). Herbert Smith Freehills has extensive experience of working with in-house counsel to review their approach to effective dispute management and avoidance.

ADDITIONAL REFERENCES

Halsey v Milton Keynes General NHS Trust [2004] EWCA Civ 576

Jackson ADR Handbook

Review of Civil Litigation Costs

Civil Procedure Rules 1998
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If you would like any more information about Herbert Smith Freehills LLP’s insurance and reinsurance disputes group, including our previous publications, please visit our website at www.herbertsmithfreehills.com

If you are interested in seminars or workshops on any areas of insurance and reinsurance then please contact any member of the insurance and reinsurance disputes group.

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