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INSURANCE AND REINSURANCE DISPUTES

2020 REVIEW

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Preface

Our Insurance Annual Review brings together the various articles that we have produced over the last 12 months. We hope that they will be a useful source of reference to our clients and contacts with an involvement or interest in developments in the UK insurance and reinsurance market.

2020 has been a year like no other and one which will live in the history books for many years to come, as well as in the memories of those of us who have lived through it. The disruption to people's lives and livelihoods has been significant. The role that insurance has to play in the economic losses suffered by many businesses as a result of the Covid-19 pandemic has received much attention. This gave rise to the most significant insurance case of the last decade in 2020 – the Covid-19 business interruption test case which was brought by the FCA against various insurers. The case considered whether certain common non-damage business interruption wordings provide cover for Covid-19 related business interruption losses. We represented the FCA. As befits the year of 2020, this was an unprecedented case on many fronts with an expedited timetable. In the space of just seven months proceedings were commenced and the case heard by both the High Court and "leapfrogged" to the Supreme Court, with the Supreme Court handing down its judgment on 15 January 2021. The case brings clarity to hundreds of thousands of business policyholders and the insurance market, as to how business interruption policies should respond to Covid-19 pandemic losses. There is a full analysis of the case inside this Annual Review.

Despite the unusual year in which we have found ourselves, the courts have still had to grapple with some very familiar issues in the context of insurance disputes which will be of interest to policyholders, brokers and insurers alike including aggregation, non-disclosure, reinstatement and jurisdiction. Our analysis of the relevant cases are included here.

Outside of the insurance sphere, there have been other significant decisions which will be of interest to those in the sector. Two cases on vicarious liability reached the Supreme Court (*WM Morrisons Supermarkets plc v Various Claimants and Barclays Bank plc v Various Claimants*) and we consider what these cases mean from an insurance perspective in our article inside this Annual Review. The Supreme Court decision in *Halliburton Company v Chubb Bermuda Insurance Ltd* will also be of interest to those involved in disputes in the insurance sector and beyond. The case concerned arbitrator conflicts in the context of an insurance dispute and is the most significant decision on English arbitration law in nearly a decade.

2020 also saw some significant changes proposed to two important procedural aspects of litigation – the preparation of witness statements and disclosure in the Business and Property Courts (one of the key forums for resolving insurance disputes). The changes proposed to witness statements aim to improve witness evidence by reducing the potential for a witness's recollections to be influenced or overwritten by the process of taking the statement itself, as well as refocusing witness evidence on the areas where it is actually needed. These changes are likely to come into force on 6 April 2021 and, it is hoped, will increase cost efficiency and reduce the burdens on witnesses. On disclosure, the Disclosure Pilot Scheme that has been operating in the Business and Property Courts since 1 January 2019 is now set to continue until the end of 2021. Both of these procedural changes are explored further in this Annual Review.

From a regulatory perspective, Brexit continued to be top of mind for many insurers and intermediaries as the end of the transition period approached on 31 December. Our work with clients across the sector continued throughout 2020 to assist them in preparing for the UK's exit from the EU, particularly given the lack of focus on financial services in the negotiations. Elsewhere in the regulatory sphere, the FCA published its final report on general insurance pricing practices and concluded that retail home and insurance markets are not delivering good outcomes for all consumers. The FCA published a proposed package of remedies and intends to publish a Policy Statement responding to feedback in Q2 2021.

We hope that you find this Annual Review of interest. To keep up to date on legal and regulatory developments affecting the sector please do visit our Insurance Blog where you can also subscribe for updates: https://hsfnotes.com/insurance.

Finally I would like to thank you for your continued support of our practice in what has been a challenging year for many.

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Court of Appeal confirms indemnity to be awarded on a reinstatement basis for damaged property which had not been reinstated

Endurance Corporate Capital Ltd v Sartex Quilts & Textiles Ltd [2020] EWCA Civ 308

5 March 2020

The Court of Appeal dismissed the insurer's appeal in *Endurance Corporate Capital Ltd v Sartex Quilts & Textiles Ltd.* Upholding the first instance decision of David Railton QC sitting as a deputy High Court judge in the Commercial Court, the Court of Appeal's decision confirmed that the reinstatement basis was the appropriate measure of indemnity for property severely damaged by fire which had not been reinstated.

The Court of Appeal held that it was not necessary for an insured to show that it had a genuine, fixed and settled intention to reinstate in order to recover for damaged property on a reinstatement basis of indemnity. The relevant questions were simply what was the insured's loss and what measure of indemnity fully and fairly indemnifies the insured for that loss?

Background

Sartex Quilts & Textiles Ltd (**Sartex**) occupied premises at Crossfield Works where it had manufactured bed linen and quilts. Sartex subsequently moved production to larger premises at Castle Mill in Rochdale and looked to convert its former premises at Crossfield Works for use as a manufacturing plant for 'shoddy hard pads' used in mattresses and insulation. Sartex took out a Property Loss or Damage Policy (the **Policy**) for the Crossfield Works site which provided cover for the buildings, plant and machinery, as well as business interruption cover. The insurer was Endurance Corporate Capital (**Endurance**).

On 25 May 2011, a fire at Crossfield Works severely damaged the buildings. The plant and machinery were a total loss. In November 2013 Endurance paid Sartex £2,141,527 based on their assessment of the market value of the buildings, plant and machinery. Following the fire, Sartex considered a number of options for the site and its business including: (i) reinstating the facility at Crossfield Works; (ii) re-siting the facility to Castle Mill; (iii) moving the manufacturing operation to Pakistan; and (iv) re-developing Crossfield Works as a banqueting/wedding venue. At the time of the trial, Sartex's prevailing intention was to reinstate the facility for manufacturing shoddy hard pads and it had taken steps to secure planning permission and listed building consent to do so. The terms of the Policy were in a standard form used by the underwriting agent and divided into sections. Section A covered material damage to property with the Insuring Clause providing:

> "Subject to the general conditions and exclusions of this Policy, and the conditions and exclusions contained in this Section, we, the Underwriters, agree to the extent and in the manner provided herein to indemnify the insured against **loss or destruction of or damage to Property** caused by or arising from the Perils shown as operative in the Schedule, occurring during the period of this Policy."
>
> (emphasis added)

Condition 7 of Section A, headed 'Reinstatement Basis', provided:

> "In the event of loss or damage to or destruction of Buildings, Machinery and Plant or All Other Contents, the basis upon which the amount payable hereunder is to be calculated will be the Reinstatement of the Property lost, destroyed or damaged."
>
> Special Conditions
>
> 1. Underwriters' liability for the repair or restoration of property damaged in part only, will not exceed the amount which would have been payable had such property been wholly destroyed.
> 2. No payment beyond the amount which would have been payable in the absence of this condition will be made:
> (a) unless Reinstatement commences and proceeds without unreasonable delay;
> (b) until the cost of Reinstatement has actually been incurred;
> (c) if the Property at the time of its loss, destruction or damage is insured by any other insurance effected by the Insured, or on its behalf, which is not upon the same basis of Reinstatement."

As Sartex had not incurred reinstatement costs, it was common ground that Special Condition 2(b) was not satisfied and Condition 7 of Section A of the Policy did not apply. The amount payable was therefore as provided for under the Insuring Clause on an indemnity basis.

The issue in dispute was whether Sartex was in fact entitled to be indemnified on a reinstatement basis. The judge at first instance found in favour of Sartex and awarded damages based on the cost of reinstating the buildings and to replace the plant and machinery that was destroyed. He considered that the

relevant question of law was "what had the insured lost as a result of the insured peril?" In making this determination, he saw the primary focus as being on Sartex's intentions in relation to the property immediately before and at the time of the fire but he also thought it relevant to consider subsequent events, including the intentions of Sartex after the loss, in order to decide what measure of indemnity would fairly and fully compensate Sartex for its loss.

Endurance appealed on the basis that the sum awarded should have been limited to the (much lower) market value of the buildings, plant and machinery. Endurance argued that the judge was wrong in law to assess the indemnity payable under the Policy as the cost of reinstatement where the insured did not have a genuine, fixed and settled intention to reinstate the property.

Decision

The questions raised on appeal concerned the correct legal test for assessing the sum payable under a property damage policy when the policy does not contain a term which fixes the measure of loss. The main issue was whether, in order to recover the cost of reinstating damaged property under such a policy when this cost has not actually been incurred, the insured needs to show a genuine, fixed and settled intention to reinstate the property.

Leggatt LJ gave the leading judgment with which McCombe and Dingemans LLJ concurred.

The Court of Appeal considered that, as a matter of general principle, where an insurer has agreed to indemnify the insured against loss or damage caused by an insured peril, the nature of the insurer's promise is that the insured will not suffer the loss or damage. The general object of an award of damages is to put the claimant in the same position (so far as money can do) as if the breach had not occurred. There are two distinct ways to give effect to this principle: one is to award the cost of replacing or repairing the property; the other is to award the market value of the property in its condition immediately before the damage occurred (less any residual value). What measure is appropriate in the circumstances depends on the use to which the claimant was intending to put the property. Where the property is a building insured against damage or destruction which the owner was intending to use, or continue to use, as premises in which to live or from which to carry on business, the appropriate measure of damages will generally be the cost of repair, if the building is damaged, or the cost of reinstatement, if the building is destroyed. On the other hand, if at the time when the damage occurred the insured was intending to sell the building (and land on which it was built), the measure of loss is the amount by which the market value of the property has been reduced as a result of the damage.

In the present case, it was not in dispute that before the fire Sartex intended to use the buildings (and the plant and equipment) at the Crossfield Works site as a facility for manufacturing shoddy hard pads. Prima facie, therefore, the appropriate measure of the insured's loss was the cost of repairing the buildings and buying replacement plant and machinery.

Endurance argued, however, that in circumstances where the insured had not at the time of trial actually incurred the cost of reinstating the property at the Crossfield Works site and had not, in the period following the fire, demonstrated a genuine, fixed and settled intention to do so, this was not the appropriate measure of loss. Endurance relied on the Court of Appeal judgment in *Great Lakes Reinsurance (UK) SE v Western Trading Ltd* in which Clarke LJ said (at para 72) that:

> "I doubt whether a claimant who has no intention of using the insurance money to reinstate, and whose property has increased in value on account of the fire, is entitled to claim the cost of reinstatement as the measure of indemnity unless the policy so provides. The true measure of indemnity is 'a matter of fact and degree to be decided on the circumstances of each case' per Forbes J in Reynolds v Phoenix; and is materially affected by the insured's intentions in relation to the property."

Leggatt LJ reasoned that the statement of Clarke LJ relied upon by Endurance in the *Great Lakes* case was expressly limited to instances where the property damage had in fact increased the property value. Moreover, he considered that Christopher Clarke LJ's observations were in any case made obiter dicta as the insured's intention to reinstate was not an issue in dispute or on which the Court heard argument in the *Great Lakes* case.

In the absence of binding authority, therefore, it was necessary to consider the position in principle. The Court of Appeal considered that the relevance of intention only arises where, at the time when damages are assessed, the claimant has not taken any action to remedy or mitigate the effect of the defendant's breach of contract. In the present case, it was found as a fact that the insured was intending to use the Crossfield Works site as a facility for manufacturing shoddy hard pads. Thus to put Sartex in a position materially equivalent to the position it would have been in had the fire not occurred, it was necessary to award the cost of re-establishing such a facility. It was not suggested by Endurance that any of the other options considered by Sartex after the fire (such as re-siting the plant at Castle Mill or moving production to Pakistan) were options which Sartex ought reasonably to have adopted instead to mitigate its loss. As such, the question of whether Sartex actually intended to reinstate the buildings was of no relevance to the measure of indemnity.

Leggatt LJ also noted that in circumstances where Sartex was not intending to sell the property (and had no right to do so as it was only a licensee) the reduction in market value of the property could not be the proper basis of assessment.

Betterment

Endurance had an alternative ground of appeal, namely that the judge was wrong to decline to make a deduction from the cost of reinstatement for betterment.

At first instance the judge saw considerable force in the insured's argument that, where an insured is claiming the cost of the most reasonable and least expensive option, any benefit derived from getting something new for old is an unavoidable consequence of the loss and so to make a deduction for betterment is to deprive the insured of part of the indemnity to which he is entitled. However, he did not consider that it was open to him to depart from the well-established principle of betterment in the law of insurance. That said, he did not consider that he had a sufficient evidential basis to make a deduction for betterment.

Endurance submitted on appeal that the judge was wrong to regard the evidence as insufficient to make a deduction from the

cost of reinstatement to allow for betterment and that he should have made an assessment taking a broad brush approach by reference to the material available to him.

On the relevant principles in considering whether a deduction should be made for 'betterment', the Court of Appeal rejected the insurer's submission that a broader approach to betterment was justified in insurance cases than where damages are awarded for breach of contract. In particular, it is no more just where the defendant is an insurer than it is in any other breach of contract case to force the claimant to pay for a benefit which it did not choose to receive (as an incidental consequence of adopting a reasonable reinstatement scheme) and which does not save the claimant any money.

Moreover, in the present case, the insurer who had the burden of proving that damages should be reduced on the basis that the insured will save money as a result of reinstatement, had made no attempt to quantify the items of betterment for which an allowance should properly be made. In these circumstances, the Court of Appeal held that the judge was justified in declining to make any deduction for betterment.

Accordingly, Endurance's appeal failed on both counts.

Comment

This is the latest decision in a line of cases in which the English courts have grappled with the measure of indemnity in property damage cases where there is no term in the policy which fixes the measure of loss and no reinstatement has been carried out at the time when damages are assessed and thus no reinstatement costs incurred.

The Court of Appeal judgment which is based on general principles brings welcome clarification of the position confirming that an award based on the cost of replacing or repairing the damaged property can still be made even where reinstatement works have not been carried out. The relevant questions are simply what is the insured's loss and what measure of indemnity fully and fairly indemnifies the insured for that loss? Both the reinstatement basis of indemnity and the reduction in market value of the property may fairly compensate the insured depending on the insured's intention with regard to the property. However, where the property is a building which the insured was intending to use, or continue to use, as premises in which to live or from which to carry on business, the intention of the insured is only relevant where there is dispute about what action it would be reasonable for the insured to take to remedy or mitigate its loss. How the insured subsequently chooses to spend the damages and whether it actually attempts to reinstate the damaged property is irrelevant to the measure of indemnity.

Additional references

Sartex Quilts & Textiles Ltd v Endurance Corporate Capital Ltd [2019] EWHC 1103 (Comm)

Great Lakes Reinsurance (UK) SE v Western Trading Ltd [2016] EWCA Civ 1003

Another recycling plant fire, another non-disclosure case

Niramax Group Ltd v Zurich Insurance Plc [2020] EWHC 535 (Comm)

9 March 2020

In *Niramax Group Ltd v Zurich Insurance Plc*, the High Court held it was material to the assessment of a risk under an all risks contactors' mobile plant policy (the **Policy**) that the insured had failed to disclose the fact that risk requirements concerning a separate buildings policy remained outstanding and that special terms had been imposed.

But for the non-disclosure, the risk would have been referred to a more senior underwriter who would have demanded a higher premium on renewal of the Policy and would have refused an extension which had been granted for additional plant. Cockerill J held that the insurer was entitled to avoid the extension of the Policy in relation to the additional plant.

This is a decision under the "old law", prior to the Insurance Act 2015 coming into force, but the Court's careful scrutiny of materiality and inducement are instructive for any analysis of an alleged breach of the duty of fair presentation under a post-2015 Act policy. Further, difficulties faced by insureds in complying with policy terms or insurers' risk requirements under the current Covid-19 restrictions may themselves be material circumstances for disclosure under the duty of fair presentation.

Background

Niramax, a recycling company, purchased from Zurich, in December 2014, a suite of policies for the 2014/15 policy period designed to cover its mobile plant and machinery, which included the Policy.

Niramax separately purchased buildings insurance with Millennium Insurance for the 2014/15 policy period. Millenium's buildings insurance quote was subject to a survey, following which a report was prepared in February 2014. The report highlighted a number of risk requirements Niramax had to comply with, which Millenium stated were condition precedents to their liability, including the fitting of a fire suppression system at one of Niramax's sites by March 2014. This requirement was imprecise and although Niramax made some attempts to fit one, it failed to move it forward. As Millenium did not receive confirmation that the risk requirements had been complied with, in October 2014 it imposed special terms on the buildings insurance policy increasing the deductible per claim and requiring Niramax to self-insure for 35% of the balance of any loss.

In mid-2015, Niramax purchased a multi-million pound machine (the **Eggersmann plant**). Zurich declined to extend the Policy to the Eggersmann plant because the type of machinery was not suitable for insurance under the Policy which was designed for contractors' mobile plants. Rather, Zurich said the Eggersmann plant was a large fixed machine and instead suited to being insured under Niramax's property policy. Eventually, despite agreeing the risk was not appropriate, Zurich agreed to extend the Policy to insure the Eggersmann plant at least until expiry of the Policy, as a gesture of goodwill towards Niramax as a longstanding insured client.

In December 2015 a fire started and spread which caused damage to the Eggersmann plant and other plant items to a value of over £4.5 million.

Zurich initially declined cover based on a series of alleged non-disclosures some of which ultimately formed part of the defence at trial. The alleged non-disclosure which appears to have carried significant weight until shortly before trial, but which was ultimately not pursued, concerned the alleged failure to disclose a conviction for a serious offence of a shadow director, which was perceived as representing a serious moral hazard.

On being sued by Niramax, Zurich avoided the Policy. The key arguments maintained at trial by Zurich included that Niramax failed to disclose: (a) its own failure to comply with the Millennium risk requirements imposed in February 2014; and (b) the Millennium special terms imposed in October 2014 on the buildings policy. The non-disclosures were alleged both in respect of the Policy renewal in December 2014 and in mid-2015 on the addition of the Eggersmann plant. Zurich argued that had it been aware of these facts it would have referred the matter to a more senior underwriter, who would have declined cover or charged a much higher premium.

Decision

In a long and detailed judgment on the facts, the judge summarised the law briefly which "barely requires to be stated" given its familiarity. By section 18 of the Marine Insurance Act 1906 an assured must:

> "disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known to him."

A fact is material if it "would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk", which rests on the court's own appraisal. An insurer can only avoid the contract if (s)he was actually induced by the misrepresentation or non-disclosure to write the precise contract which was written. The burden of proof was on Zurich to make out the avoidance.

Cockerill J held that despite the lack of clarity around Millenium's requirements for the fire suppression system on the buildings insurance, Niramax had demonstrated a lackadaisical approach and did not comply with a number of other requirements that were clear. The lack of active engagement with Millenium's requirements was a material circumstance because it manifested a poor attitude to compliance with risk management imposed by insurers.

The Court then considered whether the non-disclosures induced Zurich to enter into the Policy and grant the extension, which but for the non-disclosures Zurich would not have done. The Court highlighted that it is important to keep in mind that an individual underwriter's evidence as to what he or she would have done had the material circumstance been disclosed is necessarily hypothetical. For that reason such evidence needs to be tested vigorously, especially where the relationship with the insured is long-standing (such that the underwriter might be reluctant to refuse cover to an established insured client).

In this case the Court scrutinised the underwriting process carefully and broke the question down to: (a) whether the risk would have been referred by a more junior underwriter to a more senior underwriter; and (b) whether that senior underwriter would have declined the risk in light of the information that should have been disclosed. In answering these questions, the Court considered in detail the character and experience of the underwriter witnesses, the processes they adopted as well as the nature of the non-disclosures. This was a searching exercise, particularly where the senior underwriter's evidence acknowledged the effect on his views of the moral hazard argument which was not ultimately pursued at trial.

Weighing up all these factors, on the first question, the Court held that the risk would have been referred to a more senior underwriter both at renewal stage and on addition of the Eggersmann plant. On the second question, it held that on the balance of probabilities the more senior underwriter would have offered renewal terms in December 2014 but would have refused the extension to cover the Eggersmann plant in mid-2015 on the basis that the plant was higher risk and inconsistent with underwriting policies established by that individual. The Court also held that the premium imposed would have been higher.

Niramax's claim succeeded in part in relation to the non-Eggersmann plant equipment but Zurich avoided the extension to the Policy validly such that the extra premium charged by the insurer for the extension to that plant was to be repaid. As a result the insured failed to recover for the majority of its loss.

Comment

This decision emphasises the need for full disclosure of all material circumstances surrounding a risk upon placement and highlights the perils for insureds who fail to comply with insurer requirements relative to one policy which shortcomings may need to be disclosed to insurers on other policies. Although the Policy was written under the law prior to the Insurance Act 2015, the Court's approach to scrutinising the conduct and decision-making of individual underwriters is instructive in terms of the analysis likely to apply where an insurer seeks to avoid a policy or rely on proportionate remedies under the Insurance Act 2015.

One of the key points for policyholders to take away, particularly during the current period of disruption due to Covid-19, is that it may be difficult to comply with some policy terms or requirements on existing coverages. Where this occurs it will be necessary to consider whether such difficulties, or other changes to their businesses, are themselves material circumstances to be disclosed at renewals or mid-term alterations and adjustments as part of discharging their duty of fair presentation.

This decision is currently subject to an appeal with the Court of Appeal hearing due to be heard in 2021.

UK Supreme Court confirms bank named as loss payee under assignment of insurance policy not bound by exclusive English jurisdiction clause under the Brussels Regulation Recast 1215/2012

Aspen Underwriting Ltd & Others v Credit Europe Bank NV [2020] UKSC 11

1 April 2020

The Supreme Court has held that the High Court of England and Wales does not have jurisdiction to hear claims of fraudulent misrepresentation and/or restitution made by Aspen Underwriting Ltd and certain other insurers (the **Insurers**) against Credit Europe NV (the **Bank**) in respect of sums they allege were wrongfully paid to the Bank as the assigned loss payee of an insurance policy following the loss of an insured vessel.

Background

In dismissing the Insurers' appeal and allowing the Bank's appeal, the Supreme Court held that the Bank, which was domiciled in the Netherlands and was not a party to the insurance policy in its capacity as assignee, was entitled to be sued in the courts of its own member state on the basis that the Insurers' claims against it were "matters relating to insurance" within the meaning of the Brussels Regulation Recast (Regulation (EU) 1215/2012) (the **Regulation**). The Supreme Court also clarified that the Bank was not required to prove it was an economically "weaker party" in order to obtain the benefit of the jurisdictional protections in the Regulation.

The Insurers insured the "Atlantik Confidence" (the **Vessel**) pursuant to a hull and machinery insurance policy (the **Policy**). The Policy had an exclusive jurisdiction clause in favour of the courts of England and Wales.

Under certain refinancing arrangements agreed with the Owners, the Bank took an assignment of the Policy and became the sole loss payee. The Vessel subsequently sank off the coast of Oman. The Owners and the Insurers, without the involvement of the Bank, settled the Owners' claim for indemnity under the Policy and Insurers agreed to pay US$22 million in respect of the loss. The Bank issued a letter to Insurers in its capacity as loss payee authorising Insurers to pay the settlement sum to the Bank via the Owners' insurance broker (the **Letter of Authority**).

Several years later, in separate proceedings, the Admiralty Court found that the Owners had deliberately sunk the Vessel. Upon learning of this development, Insurers commenced proceedings in the High Court of England and Wales seeking orders to recover the sums paid under the Policy to the Bank, either in restitution or as damages for fraudulent misrepresentation.

The Bank challenged the jurisdiction of the English High Court to hear the claims against it. In two first instance judgments, Teare J held that the Bank was not bound by the exclusive jurisdiction clause in the Policy but as the Bank was not the "weaker party" in its relations with the Insurers, it was not entitled to be sued in its own member state under section 3 of the Regulation. His Honour found that the English High Court did have jurisdiction to hear the misrepresentation claims under Article 7(2) of the Regulation, but not the restitution claims since these were not "matters relating to tort, delict or quasi-delict". The Court of Appeal agreed.

The Supreme Court was asked to determine four issues on appeal:

- Whether the High Court of England and Wales had jurisdiction to hear Insurers' claims against the Bank pursuant to the exclusive jurisdiction clause in the Policy?
- Whether the Insurers' claims were "matters relating to insurance" for the purpose of the protections in section 3 of the Regulation?
- If the answer to (2) was yes, whether the protections in section 3 of the Regulation apply only where the defendant is a "weaker party" in relation to the insurer?
- Whether the Insurers' claims of misrepresentation and/or restitution were matters relating to "tort, delict or quasi-delict" under Article 7(2) of the Regulation and thus ought to be heard in the High Court of England and Wales as the location where the harm allegedly occurred?

Lord Hodge (with whom Lady Hale, Lord Reed, Lord Kerr, Lord Lloyd-Jones, Lord Kitchin and Lord Sales unanimously agreed) delivered judgment. Consistent with recent authorities on the common law doctrine of forum non conveniens, it was for the Insurers to show they had a good arguable case that the High Court of England and Wales ought to hear their claims.

Decision

Issue 1 – Did the English High Court have jurisdiction over Insurers' claims against the Bank pursuant to the exclusive jurisdiction clause in the Policy?

The Insurers argued that the Bank, by issuing the Letter of Authority, had asserted a claim under the Policy for payment of the insured sums as assignee and loss payee and submitted to the exclusive English jurisdiction clause in the Policy. It was not disputed by the parties that the Bank would be bound by the clause if it had sued the Insurers but the question for the Supreme Court was whether the Bank's conduct in taking an assignment of the Policy and issuing the Letter of Authority was sufficient to attract the operation of the exclusive English jurisdiction clause in the Policy.

The Supreme Court dismissed the insurers' arguments. Under EU law, there must be actual consensus between the parties which is clearly and precisely demonstrated in order to displace the general proposition that a party must be sued in the member state in which it is domiciled (see *Coreck Maritime GmbH v Handelsveem BV*). The Supreme Court found that the Bank, as assignee and loss payee under the Policy, was not a party to the agreement with Insurers. Although EU law also recognises that a person who is not a party to a jurisdiction agreement may be taken to have consented to it if, under the applicable national law, it became a "successor" to the rights and obligations under the contract, that was not the case in this instance as the Bank was an equitable assignee of the Policy rather than a successor in title.

However, as an assignee, the Supreme Court observed that the Bank was unable to assert its rights in a way that was inconsistent with the terms of the Policy, including the English jurisdiction clause. That said, the Bank had not in fact asserted any rights at all under the Policy. The Letter of Authority merely facilitated the payment of the settlement sum as between the Owners and the Insurers and provided a mechanism by which the Bank as assignee and loss payee could receive payment via the Owners' insurance broker. Thus the Supreme Court held that the Bank not being a party to the Policy was not bound by the exclusive jurisdiction clause.

Issue 2 – Whether the Insurers' claims were "matters relating to insurance" under section 3 of the Regulation?

The Supreme Court then turned to the question of whether the Insurers' claims properly fell within Section 3 of the Regulation, which would operate to require the Insurers to bring proceedings against the Bank in the courts of the EU member state in which the Bank was domiciled, the Netherlands.

Section 3 of the Regulation is titled "Jurisdiction in matters relating to insurance" and sets out rules governing jurisdiction in matters relating to insurance under EU law. Article 14(1), so far as relevant, provides:

> "... an insurer may bring proceedings only in the courts of the member state in which the defendant is domiciled, irrespective of whether he is the policyholder, the insured or a beneficiary."
>
> (emphasis added)

The Insurers argued that their claims against the Bank were not matters "relating to insurance" as they were not claims for breach of an obligation relating specifically to the performance of the Policy as a contract of insurance. The Insurers argued that the heading of Section 3, "Matters relating to insurance" should be read narrowly as "matters relating to insurance contracts".

The Supreme Court held that the Insurers' claims against the Bank were "matters relating to insurance" within the meaning of Section 3 of the Regulation. The Supreme Court placed particular emphasis on the fact that the title of Section 3 was drafted more broadly than other sections of the Regulation, which referred to individual contracts rather than matters "relating to" insurance. The Supreme Court also noted that it was significant that Article 14(1) expressly referred to the rights of beneficiaries (such as the Bank as assignee) in addition to policyholders. The Supreme Court observed that even if, as Insurers had argued, Section 3 applied only to claims based on a breach of an individual insurance contract, that test would be satisfied in the present case in any event on the basis that the insurance fraud alleged by the Insurers would also involve a breach of the Policy. The Supreme Court concluded that the Insurers' claims against the Bank were matters relating to insurance within Section 3 of the Regulation.

Issues 3 and 4 – Whether the protections in section 3 of the Regulation apply only where the defendant is a "weaker party" in relation to the insurer?

At first instance and in the Court of Appeal, it was held that the Bank could not take the benefit of Article 14 because it was not an economically "weaker party" in relation to Insurers. This finding was based on the lower courts' interpretation of recital (18) of the Regulation:

> "In relation to insurance... the weaker party should be protected by rules of jurisdiction more favourable to his interests than the general rules."
>
> (emphasis added)

The Supreme Court respectfully disagreed with the decisions at first instance and in the Court of Appeal and clarified that there is no such thing as a "weaker party" exception which removes a policyholder, insured or beneficiary, such as the Bank, from the protection of Article 14 and the right to be sued in the courts of their own member state. The Supreme Court gave six reasons for this conclusion:

- First, the insured and the beneficiary of an insurance policy are generally considered to be "weaker parties" in a commercial negotiation with an insurance company and are as a matter of course presented with a standard form contract (see *Gerling Konzern Speziale Kreditversicherungs–AG v Amministrazione del Tesoro dello Stato*);
- Second, while recital (18) may explain the policy behind Section 3 of the Regulation, it is the words of the relevant articles which have legal effect (see *Folien Fischer AG v Ritrama SpA*);
- Third, derogations from the jurisdictional rules in matters of insurance must be interpreted strictly and the existence of an unexpressed "weaker party" exception to the protection given to the policyholder, the insured and the beneficiary is inconsistent with this approach (see *Société financière et industrielle du Peloux v Axa Belgium*);

- Fourth, it is clear that the European Court of Justice (**CJEU**) does not engage in a case by case analysis to consider the relative strengths and weaknesses of the parties under Section 3 as to do so would give rise to legal uncertainty and unpredictability (see *Landeskrankenanstalten–Betriebsgesellschaft – KABEG v Mutuelles du Mans Assurances – MMA IARD SA*);
- Fifth, the CJEU looks to recital (18) not to decide whether a particular policyholder, insured or beneficiary is to be protected by section 3, but does so only in the context of reaching a decision as to whether those protections are to be extended to other persons who do not fall within the list of expressly protected persons (see *Universal General Insurance Co (UGIC) v Group Josi Reinsurance Co SA*); and
- Sixth, when the CJEU decides whether to extend the protections to persons not expressly mentioned in Section 3, it seeks to uphold the general rule in Article 4 that defendants should be sued in the courts of their own member state and only allows extensions to the protection of Section 3 where consistent with protecting the "weaker party."

The Supreme Court held that the Bank, as the assigned loss payee under the Policy, was the "beneficiary" of the Policy for the purpose of Article 14 and was entitled to be sued in the courts of its member state domicile (the Netherlands) pursuant to Section 3 of the Regulation. On this basis, the fourth issue as to whether Insurers' claims of misrepresentation and/or restitution were matters relating to "tort, delict or quasi–delict" under Article 7(2) of the Regulation and thus ought to be heard in the courts of England and Wales as the location where the harm occurred did not arise.

Comment

The Supreme Court's decision will be of interest to both policyholders (including insureds and beneficiaries, such as assignees/loss payees) and insurers alike in that it provides helpful clarification on the interpretation and application of the rules in Section 3 of the Brussels Regulation Recast on jurisdiction in matters relating to insurance. The decision makes clear that there is no economic "weaker party" exception which removes a policyholder, insured or beneficiary from the protection of Article 14; they are entitled to be sued by an insurer exclusively in the courts of their own member state, regardless of their economic strength. The decision also makes clear that "matters relating to insurance" is not to be read narrowly as "matters relating to insurance *contracts*"; the title of Section 3 is drafted more broadly and Section 3 is not therefore confined to claims for breach of an obligation relating specifically to the performance of an individual insurance contract.

In the case of beneficiaries under an insurance contract, the Supreme Court's decision also confirms that an exclusive jurisdiction clause does not usually bind a beneficiary who was not a party to it unless it commences proceedings to enforce its rights under the contract.

Additional references

Landeskrankenanstalten–Betriebsgesellschaft – KABEG v Mutuelles du Mans Assurances – MMA IARD SA (Case C–340/16) [2017] 7 WLUK 490

Folien Fischer AG v Ritrama SpA (Case C–133/11) [2013] QB 523

Société financière et industrielle du Peloux v Axa Belgium (Case C–112/03) [2006] QB 251

Universal General Insurance Co (UGIC) v Group Josi Reinsurance Co SA (Case C–412/98) [2001] QB 68

Coreck Maritime GmbH v Handelsveem BV (Case C–387/98) [2000] 11 WLUK 234

Gerling Konzern Speziale Kreditversicherungs–AG v Amministrazione del Tesoro dello Stato (Case 201/82) [1983] ECR 2503

The better part of valour – limits on insurers' absolute discretion

UK Acorn Finance Ltd v Markel (UK) Ltd [2020] EWHC 922 (Comm)

21 April 2020

The High Court has outlined the limits on insurers' discretion under an Unintentional Non-Disclosure clause. In *UK Acorn Finance Ltd v Markel (UK) Ltd* HHJ Pelling QC sitting as judge held that there was an implied requirement that the insurer could not exercise its discretion in a manner which was arbitrary, capricious or irrational, following the Supreme Court in *Braganza v BP Shipping Ltd.* In this instance the Court found that by failing to take into consideration matters which it ought to the insurer had irrationally reached the conclusion that the insured's misrepresentations were fraudulent and so was prevented from avoiding the policies by the Unintentional Non-Disclosure clause.

Background

The claim concerned professional liability policies taken out by Colin Lilley Surveying Ltd (**CLS**), a property valuation company, and underwritten by Markel (UK) Ltd (**Markel**) for 2013 and 2014 (the **Policies**). The Claimant, UK Acorn Finance Ltd (**Acorn**), a bridging finance lender mainly to agricultural businesses, obtained two judgments against CLS in respect of negligent overvaluations of 11 agricultural properties and sought to make a claim in respect of these judgments against Markel under Third Party (Rights Against Insurers) Act 1930.

Markel claimed that it was entitled to avoid the Policies as a result of misrepresentations (which took effect as warranties) and non-disclosures prior to renewal on these and earlier policies. The Policies were each subject to an Unintentional Non-Disclosure clause which it was agreed by the parties limited Markel's right to avoid the Policies.

Decision

The Policies

The Policies were broadly the same in each relevant year. Each Policy contained the following in the preamble:

> "Underwriters having received a Proposal which shall form the basis of and be incorporated in this contract and in consideration of the Premium having been paid to Underwriters, We agree to pay or indemnify to the extent and in the manner herein provided subject to the terms, limitations, exclusions and conditions of this Certificate."

The Polices' Insuring Clause was as follows:

> "We agree to indemnify You against Loss, arising from any Claim made against You during the Period of Insurance in respect of a Wrongful Act in or about the conduct of the Professional Services."

The Policies contained an Unintentional Non-Disclosure clause in the following terms:

> "In the event of non-disclosure or misrepresentation of information to Us, We will waive Our rights to avoid this Insuring Clause provided that (i) You are able to establish to Our satisfaction that such non-disclosure or misrepresentation was innocent and free from any fraudulent conduct or intent to deceive…".

Misrepresentations and Non-Disclosure

The first issue to be decided by the Court was whether any misrepresentations or non-disclosures were in fact made by CLS to Markel when placing the Policies. To address this issue the Court considered the placement of the 2011 and 2012 policies taken out with Markel, as well as the 2013 Policy and 2014 Policy under which the present claim was made.

The key misrepresentations and non-disclosures on which Markel relied are as follows:

- For all four renewals CLS answered "Yes" to the following question in the pre-populated risk profile document on commercial valuations: "Can you confirm that all lending institutions for whom the Proposer carries out survey and valuation work are either UK clearing banks or building societies…?".
- On several occasions throughout the renewals Markel had asked CLS whether they had undertaken any 'sub-prime work' to which CLS repeatedly replied that they had not. Throughout these renewals Markel explained that they defined sub-prime as those who are not high street and clearing banks.
- That CLS did not disclose to underwriters a claim made against it in relation to a valuation it carried out for Waterman Capital prior to the 2014 renewal (the **Waterman Claim**).

It was accepted by the parties that these statements were incorrect in that CLS had undertaken valuation work for entities which were neither clearing banks nor building societies (including Acorn) and were therefore (by Markel's definition) sub-prime lenders. Over this process Markel repeatedly explained their concern about valuation work for sub-prime lenders due to the heightened risk from the lower borrower covenant strength and the increased appetite for higher loan to

value ratios, leading to increased levels of borrower default and claims against valuers such as CLS.

In presenting its case it was suggested by Acorn that:

- Because the risk profile document was provided by Markel with pre-populated answers filled out by the underwriter based on previous renewals this in some way made a difference to the duty of pre-contractual disclosure. This was rejected by the Court since the document expressly required CLS to "check this information for accuracy and let us know, within 14 days of inception/renewal, of any inaccuracies or changes required".
- CLS's understanding of 'sub-prime' was limited to residential non-principal lenders and that on this basis is was correct that Acorn (as a commercial lender) did not qualify as sub-prime. Again, this was rejected by the Court as for the purposes of pre-contractual disclosure CLS's understanding of the term was "irrelevant unless it could be shown that the defendant had been unclear as to what it meant by use of that phrase", whereas here the definition used by Markel was made clear in correspondence and CLS and its broker had not sought clarification.
- CLS had notified the Waterman Claim to Markel's claims team shortly before the 2014 renewal and that this fulfilled CLS's pre-contractual disclosure requirements. Here the Court approved Baker J's dicta in *Aldridge v Liberty Mutual Insurance Europe Ltd* that claims information that is not repeated or incorporated in a renewal application is not deemed to be known to an underwriter for the purposes of disclosure. As a matter of fact, the Court held that the underwriter at Markel was not aware of the Waterman Claim and therefore that it was not disclosed for the purposes of pre-contractual disclosure.

The Unintentional Non-Disclosure clause

As the Policies were placed under the Marine Insurance Act 1906, the parties agreed that the preamble to the Policies served as a basis of contract clause converting the above representations into warranties. Following a substantially similar clause in *Arab Bank Plc v Zurich Insurance Ltd*, the Court held that the effect of including a reference to the "right to avoid" in the Unintentional Non-Disclosure clause meant that a breach of warranty should be treated as having the same effect as a misrepresentation/non-disclosure but without the need to prove materiality or reliance.

Separately, the Court also dismissed an argument by Acorn that Markel had waived the right to rely on breach of warranty by virtue of Markel's letter to CLS avoiding the claim which referred only to avoidance for "deliberate and dishonest misrepresentations and non-disclosure" and not breach of warranty. The Court held there was no such waiver on the basis that Markel's letter referred to the preamble/basis of contract clause, that the effect of a breach of warranty and misrepresentations/non-disclosure were the same, and that breach of warranty automatically discharges the insurer from liability (ie without an election by the insurer). As for a waiver by estoppel the Court held that Acorn had not established any of the necessary requirements.

Contractual interpretation

Turning to the effect of the Unintentional Non-Disclosure clause, the dispute between the parties turned on the wording that Markel would not avoid the Policies where "You [ie CLS] are able to establish to Our [ie Markel's] satisfaction that such non-disclosure or misrepresentation was innocent and free from any fraudulent conduct or intent to deceive". As to this wording, Acorn contended that Markel could not avoid the Policies if it was determined as a matter of fact by the Court that the non-disclosures/misrepresentations relied on by Markel were free from any fraudulent conduct/intent to deceive. On the other hand, Markel asserted that it was open to avoid the Policies if its decision was open to a reasonable decision maker on the basis of the facts and matters such a decision maker was entitled to take into account in arriving at such a decision.

The Court favoured Markel's reading of the Unintentional Non-Disclosure clause:

- The clause was express ("to Our satisfaction") that Markel was the decision maker as to whether the non-disclosure/misrepresentation was free from any fraudulent conduct/intent to deceive. Citing the Supreme Court judgment in *Braganza*, the Court held that in light of such express wording "it is wrong as a matter of principle to conclude that the court (or, for that matter an arbitrator) can substitute its judgment for that of the defendant".
- However, given the conflict of interest inherent in conferring absolute contractual discretion on one party, "neither party can be treated sensibly as having intended to permit the defendant to make decisions that were arbitrary, capricious or irrational" and that a term should be implied into the Policies to that effect. Again following *Braganza*, in assessing irrationality the Court looked to the *Wednesbury* principles established for the judicial review of administrative decisions. These provide that the party exercising its discretion will have acted rationally where:
  - it does not take into account matters that it ought not to take into account and takes into account only matters that it ought to take into account; and
  - it does not come to a conclusion that no reasonable decision maker could ever have come to.

The Court did, however, reiterate the position of the Supreme Court in *Braganza* that there were limits on the degree to which the *Wednesbury* principles (applicable to public bodies) could be incorporated into a commercial contract. In addition, the Court agreed with the assessment of Markel's counsel that an insurer could not be expected to maintain "the same expert, professional and almost microscopic investigation of the problems both factual and legal, that is demanded of a suit in a Court of Law".

However, the Court rejected that the *Braganza* duty allowed the Court to take issue with the process by which decisions are arrived at as available at public law, in particular as these sit outside the *Wednesbury* principles and would ask too much of commercial decisions makers. In any event, as to Acorn's suggestion that Markel would have breached such a process requirement by virtue of not arranging a meeting with CLS prior to reaching the decision to avoid, the Court held that "the suggestion that there has to be a meeting in every case goes beyond what can reasonably be expected of an insurance company... an insurance company is fully entitled to approach the issues that arose by seeking an explanation in writing and in most cases at least to reach a decision taking account of the information supplied to it by or on behalf of the insured in response."

Application to the case

On the basis of the above implied term and following cross-examination of the claims handler responsible for avoiding the Policies, the Court found that Markel had not met the above standard of reasonableness in that it had both: (i) failed to take account of relevant facts/matters; and (ii) came to a conclusion that no reasonable decision maker could have come to. As such, Markel was prevented from avoiding the Policies by virtue of the Unintentional Non-Disclosure clause.

As to the first *Wednesbury* limb, the Could held that Markel had: (i) failed to bear in mind that it is inherently more probable that a misrepresentation has been made innocently or negligently rather than dishonestly; and (ii) failed to take into account that CLS's conduct was consistent with a belief that reference to sub-prime lenders only applied to residential lenders and not commercial ones. The issues which Markel had misinterpreted and/or overlooked included:

- CLS notifying Markel of the Waterman Claim shortly before the 2014 renewal. Here Markel failed to appreciate that, although not formally disclosing the Waterman Claim indicated "sloppiness", the notification was nevertheless a reflection of CLS's honesty.
- CLS seeking Markel's agreement prior to joining the panel of the Association of Short Term Lenders (which concerned residential lending) and choosing not to join it after Markel indicated that this would affect their insurance cover. Although this was further support of CLS's distinction between residential and commercial valuations, Markel had failed to take this into consideration.
- CLS not notifying claims timeously on the basis that they were not permitted to do so by reason of on-going police investigations. Here Markel confused whether or not CLS's belief was objectively justifiable with the question of whether this belief was subjectively held, only the latter of which went to the question of fraud.

As to the second *Wednesbury* limb, the Court concluded that no reasonable decision maker would have come to the conclusion to avoid the Policies by reason of fraudulent misrepresentation. As characterised by the Court these errors "permeate the whole of the decision making exercise, which on analysis consisted of little more than a reference to the falsity of the representations coupled with the fact that at the time they were made CLS was carrying out commercial valuation work for lenders other than clearing banks and building societies".

Comment

Via the application of the *Braganza* duty, this case serves as welcome clarification on the limits of insurer's discretion under an Unintentional Non-Disclosure clause and quite possibly more generally in insurance policies. No doubt the judge's comments that Markel placed the claims handler in "an invidious position" without training or guidance as to how to approach the assessment of fraud, will encourage insurers to take a more formal, targeted and overall cautious approach to asserting fraudulent breach under their policies. The Court did, however, affirm that insurers remain the decision maker where expressly afforded discretion by the terms of the policy and that a court will not interfere with the exercise of such discretion save in those instances where their decisions can be shown to be arbitrary, capricious and/or irrational. As such, when negotiating policy language insureds and brokers should seek to qualify the exercise of insurers' discretion, whether with an express requirement of reasonableness or, where appropriate, by expedited determination by a neutral third party.

While not a major feature of the judgment, the Court's conclusions on disclosure of the Waterman Claim is also instructive. While insureds and indeed brokers could be forgiven for thinking that notifications made to the insurer's claims team will serve to disclose the relevant issues to the underwriter, for policies governed by Marine Insurance Act 1906 this is reliant on the information actually reaching the underwriter prior to placement. The position is different for current policies placed under Insurance Act 2015 (section 5(2) of which expressly provides that an underwriter is deemed to know what ought reasonably to have been passed onto it by other employees of the insurer or what was readily available to the underwriter). Nevertheless, so as not to be held hostage to these provisions and especially in circumstances where a notification is made shortly before a renewal, in preparing renewal documents insureds and brokers should, as a matter of course, provide lists of notifications made in the prior year and recommend that the underwriter consult their claims team for further information on these and any other notifications made under the previous policies.

Additional references

Aldridge v Liberty Mutual Insurance Europe Ltd [2016] EWHC 3037 (Comm)

Braganza v BP Shipping Ltd [2015] UKSC 17

Arab Bank Plc v Zurich Insurance Ltd [1999] 1 Lloyd's Rep 262

Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223

English Commercial Court considers the application of the Recast Brussels Regulation when construing potentially conflicting jurisdiction provisions in insurance policies

Generali Italia SpA & Others v Pelagic Fisheries Corp & Another [2020] EWHC 1228 (Comm)

18 May 2020

In this case the Commercial Court held that it had exclusive jurisdiction to hear a disputed marine insurance claim (under Article 25 of the Recast Brussels Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ((EU) 1215/2012)) where the policies contained potentially conflicting jurisdiction clauses.

Background

The Kapitan Veselkov was a freezer trawler owned by Pelagic. The vessel sank in 2017, leading to Pelagic seeking payment of US$ 50 million from 23 insurers subscribing to its Hull and Machinery and Increased Value insurance programme (led by Generali).

The terms of the cover were recorded in cover notes provided to a number of the insurers, including Generali, which stated: "English Jurisdiction. Subject to English law and practice" (the **English Jurisdiction Clause**). However, the cover notes also referred to the Camogli Policy, a standard form of policy wording used in the Italian marine markets. The Camogli Policy contained an Italian jurisdiction clause which read: "Any dispute in connection with this contract is solely subject to Italian jurisdiction". The cover note issued to PICC, the 22nd Claimant insurer, was in the same terms but did not refer to the Camogli Policy. India International, the 3rd Claimant insurer's participation was set out in a placing slip which contained both English and Italian jurisdiction provisions. These insurers are referred to as the Treviso Insurers.

The remaining insurers (the non-Treviso Insurers) subscribing to Pelagic's insurance programme were issued with cover notes that made reference only to English law and jurisdiction and not to Italian law and jurisdiction or the Camogli Policy.

Between June and November 2018, Pelagic brought proceedings against the Treviso Insurers in Treviso, Italy, after they had purported to avoid the policies for non-disclosure and mis-representation. All 23 insurers (the Treviso and non-Treviso Insurers) thereafter commenced proceedings in England seeking declarations of non-liability against Pelagic. The Italian Court stayed the Italian proceedings to allow the English Court to determine jurisdiction. Pelagic had appealed the first instance decision of the Italian Court and applied in the English proceedings to challenge the English Court's jurisdiction.

Decision

A preliminary issue in the case was whether the English Court should proceed to determine whether there was an exclusive jurisdiction clause in favour of the English Courts or should it await a final ruling on jurisdiction in the Italian proceedings.

The trial judge, Foxton J, citing Cranston J in *Commerzbank AG v Liquimar Tankers Management Inc*, found that the effect of Article 31(2) (in Section 9 of the lis pendens provisions on related actions) of the Recast Brussels Regulation was to allow a second seised court to determine jurisdiction where "exclusive jurisdiction has been (arguably) conferred by agreement" to that court by virtue of an exclusive jurisdiction provision, irrespective of the position of the court first seised. The Treviso Insurers contended that there was a good arguable case that the English Jurisdiction Clause was an exclusive jurisdiction provision and on this basis the Commercial Court should determine the question of jurisdiction. Foxton J agreed. He also identified the fallacy of a set of circumstances in which the Italian Court had stayed its proceedings to allow the English Court to determine jurisdiction, if the English Court was then bound to stay its proceedings pending a decision on jurisdiction by the stayed Italian Court.

By contrast, Pelagic did not argue that there was an exclusive Italian jurisdiction clause in the policies but that, prima facie, both the English and Italian Courts had non-exclusive jurisdiction and since the Italian court was first seised, under the lis pendens provisions of the Recast Brussels Regulation, the Italian Court ought to determine the question of jurisdiction. Foxton J noted that the position would have been more complex had Pelagic contended that the Italian courts had **exclusive** jurisdiction, meaning that had the dispute involved two competing exclusive jurisdiction clauses then there may have been an arguable case that the Italian Court should determine the question of jurisdiction.

The second and principal issue was whether, on their proper construction, there was a good argument that the policies of the Treviso Insurers were subject to an exclusive English jurisdiction clause for the purpose of Article 25 (in Section 7 of the prorogation of jurisdiction provisions) of the Recast Brussels

Regulation, thereby preventing incorporation into the policies of the Italian jurisdiction clause in the Camogli Policy (as the insurers submitted). Alternatively, the Commercial Court was asked whether the English Jurisdiction Clause and the Camogli Policy could and should be read together so that both the English and Italian Courts would have jurisdiction (as Pelagic submitted).

On one view, Foxton J recognised that where a contract contains a specifically negotiated term, then that term ought to prevail over a set of pre-existing standard terms that have otherwise been written in (following *Indian Oil Corporation v Vanol Inc*). However, he also placed weight on case law that suggested, where possible, a court should seek to read and apply negotiated and standard (incorporated) terms together (citing *Bayoil SA v Seawind Tankers Corp*).

In this instance, Foxton J concluded (applying English law, which he determined was the applicable law of the policies as well as the lex fori) that for the purposes of Article 25 of the Recast Brussels Regulation, the insurers had the better of the argument and that the English Jurisdiction Clause amounted to an 'exclusive jurisdiction agreement' that was intended to operate as a stand-alone condition rather than as a condition whose contractual effect depended upon it being read together with the Camogli Policy. The following factors cumulatively led to this finding:

- Weight was placed on the English Jurisdiction Clause being a bespoke provision set out in terms on the face of the cover notes. In contrast, the jurisdiction wording in the Camogli Policy was a printed term in a standard set of terms and it was not specifically referred to in the contractual documentation.
- Similarly, the way in which the contractual wording referred to the respective provisions suggested that the English Jurisdiction Clause was intended to have a higher contractual status as compared to the Camogli Policy. In particular, the English Jurisdiction Clause was described by Foxton J as:

  > "...using what is clearly promissory language as a "condition", and it appears together with those provisions which determine the extent of the insurance cover provided. By contrast, the Camogli Policy is referred to as the "form", suggesting it is (in effect) a documentary vessel into which the conditions are to fit..."

- Foxton J also cited the fact that the contractual documentation was structured in a manner that in effect meant that the parties would have expected to set out the key contractual provisions in the cover notes without there being the need to refer back to printed terms incorporated by reference to the Camogli Policy in order to ascertain the meaning and effect of the cover note terms.
- Foxton J highlighted that the result of reading the English Jurisdiction Clause together with the Camogli Policy would be to effect a fundamental change to the meaning and impact which the English Jurisdiction Clause would have commanded on its own. Ordinarily, the English Jurisdiction Clause would confer exclusive jurisdiction on the English courts thereby providing a single and certain jurisdiction to bring claims. This was so not only because the choice of English law in conjunction with the reference to English jurisdiction was a powerful factor in favour of construing the choice of English jurisdiction as exclusive but also because there was another set of insurers (the non- Treviso Insurers) subscribing to Pelagic's insurance programme and whose cover notes made sole reference to exclusive English jurisdiction.

  Against this background, Foxton J concluded that giving the Camogli Policy's jurisdiction wording meaning in conjunction with the English Jurisdiction Clause would have, in effect, resulted in different insurers commencing proceedings in different jurisdictions in respect of the same casualty (even where some of these insurers agreed to follow Generali's claim lead). This would produce an inherently uncommercial outcome of splintering the resolution of coverage disputes, meaning that it was all the more likely that the parties intended the English Jurisdiction Clause to apply to the exclusion of inconsistent provisions in the printed form Camogli Policy.
- The English Jurisdiction Clause was inconsistent with the jurisdiction provisions in the Camogli Policy.

Insofar as the India International placing slip was concerned, Foxton J held that references to Italian jurisdiction were simply errors in drafting.

Comment

The decision of the English Commercial Court, which appears based on sound reasoning, is an important reminder to policyholders and insurers alike to consider carefully any actual or potentially conflicting jurisdiction provisions in their policy documentation, in particular where bespoke cover notes and slips are combined with standard wordings.

More particularly, the judgment provides useful clarity on how the court will determine what is an 'exclusive jurisdiction agreement' in an insurance policy for the purposes of Article 25 of the Recast Brussels Regulation. In this regard, the relevant factors that feed into the determination appear similar to the general principles of policy construction, which is to say that Foxton J appeared keen to avoid a clearly commercially undesirable outcome in having related proceedings in parallel across different jurisdictions in respect of the same casualty.

Additional references

Commerzbank AG v Liquimar Tankers Management Inc [2017] 1 WLR 3497

Bayoil SA v Seawind Tankers Corp [2001] 1 Lloyd's Rep 533

Indian Oil Corporation v Vanol Inc [1992] 2 Lloyd's Rep 563

Scottish Appeal Court revisits first Insurance Act 2015 decision on whether an insurer had waived its right to disclosure

Young v Royal and Sun Alliance Insurance Plc [2020] CSIH 25

19 May 2020

The Scottish Inner House has dismissed the insured's appeal in *Young v Royal and Sun Alliance Insurance Plc*. Upholding the Outer House decision of Lady Wolffe, the Inner House held that the insurer could not be considered to have impliedly waived the insured's duty of fair representation of risk under the Insurance Act 2015. In finding there had been no waiver, the Inner House held that no reasonable person would consider the insurer had restricted its right to receive all material information, and it was therefore entitled to avoid the policy.

Background

Mr Young and a company controlled by him were co-insureds under a policy that insured commercial premises (the **Policy**). Fire extensively damaged the premises and Mr Young claimed £7.2 million under the Policy in respect of the damage caused.

The insurer declined the claim on the basis that the insured had breached its duty under section 3(1) of the Insurance Act 2015 to make a fair presentation of the risk. The insurer argued that Mr Young had not disclosed the fact that he had been the director of four companies which had been dissolved after an insolvent liquidation or had been placed into insolvent liquidation within the 5-year period immediately preceding the policy inception (the **undisclosed information**). In response, the insured argued that the insurer had waived disclosure of the undisclosed information.

The insured had provided the insurer with a market presentation in advance of inception, created using software used by the broker. It included a question that sought to elicit information around the insured's potential moral hazard:

> "Select any of the following that apply to any proposer, director, or partner of the Trade or Business or its Subsidiary Companies if they have ever, either personally or in any business capacity:"

The software used to create the presentation provided for seven possible responses including one option which was in the following terms: "been declared bankrupt or insolvent or been the subject of bankruptcy proceedings or insolvency proceedings". The response chosen from the list of drop-down options was "None".

Following the submission of the market presentation, the insurer sent a reply email to the broker attaching the terms of cover and setting out the following list of assumptions:

"Insured has never:

- Been declared bankrupt or insolvent
- Had a liquidator appointed
- Been the subject of a County Court judgment [...]".

At first instance, the Outer House rejected Mr Young's argument that the insurer's email response to the broker had amounted to waiver of its entitlement to be provided with the undisclosed information. The Outer House found that when viewed in context (ie as a reply to the market presentation), the list of assumptions operated as a condition or stipulation of the kinds of moral hazards required to be addressed (which included matters going to prior insolvency of the insured or companies with which he was involved). Further, no reasonable reader would have read the email as a waiver of the insurer's rights to receive material information in relation to any other business capacity in which Mr Young may have acted.

Mr Young appealed. Prior to the appeal hearing, he accepted that the undisclosed information was material and that, had it been disclosed to the insurer, the insurer would not have entered into the policy. He thus conceded both the materiality of the information and that the insurer was induced by the non-disclosure. The only issue for the Outer House to determine was whether the insurer had waived its entitlement to be provided with the undisclosed information.

Decision

The Inner House dismissed Mr Young's appeal, taking the opportunity to analyse an insured's duty of fair presentation and the issue of waiver by an insurer. It did so by reference to case law that pre-dated the Insurance Act 2015 and which it described as uncontroversial.

The Inner House noted that a policyholder seeking the insurance of a risk must assume that any prospective insurer will wish to know every relevant circumstance which would influence the judgment of the notional prudent insurer. If the policyholder is to discharge his duty to make a fair presentation, he must therefore

disclose everything that the notional prudent insurer would want to know. A failure to discharge this duty, said the Inner House, will allow the insurer to avoid the policy for material non–disclosure (which observation presumably is not intended to override the regime of proportionate remedies in the Act).

The Inner House noted that an insurer can impliedly waive an insured's duty to disclose certain information by the questions it asks, for example by using a proposal form. The significance of a proposal form is that, by directing the insured to provide material information by answering specific questions, the insurer takes control of the process of communicating information between it and the policyholder. It chooses the matters on which it requires information, by asking questions directed at that information and, by implication, the matters about which it does not require information where it does not ask questions.

However, in order to show that an insurer impliedly waived its entitlement to disclosure of material information, there must be some sort of enquiry by the insurer directing the insured to provide certain information but not other information. In addition to the wording reproduced above, the insurer's email also stated, amongst other things:

> "Terms have been based on your presentation 13/02/17, our recent discussions and that adequate Risk Management features are in place ie [...] Annual Premium £19,000 + IPT [...] Commission has been based on 20% [...] Given nature of portfolio and recent claim we would need to pitch our terms £19k minimum +IPT".

The Inner House found that there was nothing in the email that amounted to an enquiry by the insurer. The broker had made a presentation of the risk by means of the market presentation. They had requested that the insurer provide a quotation based on the information provided in the market presentation. The insurer responded with an offer to insure on a variety of terms and conditions. That offer was capable of immediate acceptance. It was not an enquiry and did not limit the insurer's concerns about Mr Young's past experience of insolvency, which he was required to disclose in order to make a fair presentation of the risk. The insurer was accordingly entitled to avoid the policy.

Comment

In finding that the insurer had not waived its right to disclosure, the Inner House was influenced by the fact that the insured's market presentation had been put together using the broker's electronic software. This is in contrast to situations where the insured completes a proposal form drafted by the insurer which will usually constitute an enquiry by the insurers and may therefore be found to limit the scope of the information the insurer requires to analyse the risk.

The decision illustrates that while the use of electronic platforms may assist with efficiency in the gathering of information for presentation to insurers, they need to be prepared with a clear understanding of the duty of fair presentation to avoid the risk of an insured inadvertently failing to discharge its duty. The case remains as a reminder to insureds and to brokers about the importance of disclosure of previous matters connected to insolvency. The decision should put policyholders and brokers on notice to elicit and provide this information carefully.

No business interruption cover for Covid-19 closure where policy requires property damage

TKC London Ltd v Allianz Insurance Plc [2020] EWHC 2710 (Comm)

15 October 2020

In a judgment described as a "footnote" to the FCA Business Interruption Test Case, the Commercial Court has given summary judgment to Allianz in relation to a SME claim for business interruption cover for enforced closure.

Background

The Claimant, TKC London Ltd (**TKC**), operated a café restaurant known as The Kensington Creperie. The Kensington Creperie was required to close by the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 from 21 March 2020, and did not re-open until 4 July 2020.

TKC was insured by the Defendant, Allianz Insurance Plc (**Allianz**) under a "Commercial Select" policy, which was largely in Allianz's standard form of wording. In acknowledging this, the judge said that his judgment might be of consequence for other policyholders.

TKC's policy included a section entitled "Business Interruption All Risks Estimated Revenue". However, critically, the policy did not include specific extensions for disease or public authority denial of access similar to those considered in the FCA Business Interruption Test Case.

Decision

The Business Interruption section of the policy provided cover for "Business Interruption by any Event".

"Business Interruption" was defined as "Loss resulting from interruption of or interference with the Business carried on by the insured at the Premises in consequence of an event to property used by the insured at the Premises for the purpose of the Business." "Event" was defined as "Accidental loss or destruction of or damage to property used by the Insured at the Premises for the purpose of the Business".

The Claimant's main argument was that the Business Interruption section could cover the closure of the Creperie, because the enforced closure was plainly an "interruption of or interference with the Business"; "in consequence of" the prohibitions imposed by the Coronavirus Regulations which were "an event to property used by the Insured at the Premises". The Claimant's counsel said that the enforced closure amounted to "accidental loss" of property, where "accidental" means nothing more than "unlooked for or unintended" and loss of property includes temporary loss of use.

Allianz's response was that the temporary closure of the business as a result of the Coronavirus Regulations could not be an "Event" within the meaning of the Policy, either because "accidental loss...of...property" refers only to physical loss and/or because "loss" for these purposes requires "something more than merely transient deprivation".

Whilst the judge accepted that the enforced closure of the Creperie was an "interruption or interference with the Business carried on by the Insured at the Premises", the policy only responded to "Business Interruption by any Event", where "Event" is a defined term.

Considering the definition of "Event", the judge agreed with Allianz's submissions that the word "loss" must take its colour from its context, and accepted that the fact it was followed by the words "or destruction of or damage to" strongly suggested that "loss" was intended to have a physical aspect. The judge also agreed that the definition of "Event" could not sensibly be interpreted as including merely temporary loss of use of property.

The judge also considered the Claimant's alternative argument that deterioration in the stock held at the premises during the period of closure caused relevant Business Interruption for which TKC is entitled to claim under the Policy. Dismissing this, the judge thought the assertion that the deterioration in stock caused the relevant interruption or interference to be "wholly unrealistic". The deterioration of the stock was considered to be a consequence of the interruption or interference, not its cause.

Comment

The judge's conclusion is not unexpected, and is consistent with the FCA's view (as expressed in their 1 May 2020 statement) that most SME insurance policies are focused on property damage so, at least in the majority of cases, insurers are unlikely to be obliged to pay out in relation to the Covid-19 pandemic.

Nevertheless, the judgment will no doubt be disappointing to a number of policyholders. Indeed, the judge expressed sympathy with policyholders and their expectation that an "all risks" business interruption policy would provide cover for the Covid-19 pandemic. The judge referred to an observation that in times of uncertainty, "the law must provide a solid, practical and predicable foundation for the resolution of disputes" and that "[l]egal certainty remains paramount".

As ever, the case acts as a reminder that all policyholders must look at their policy wording carefully, paying particularly close attention to the coverage clauses and relevant definitions.

Aggregation considered under the Minimum Terms and Conditions for solicitors' professional indemnity insurance

Baines v Dixon Coles and Gill [2020] EWHC 2809 (Ch)

28 October 2020

The High Court has ruled that a number of claims brought against a law firm following the misappropriation of money from client accounts could not be aggregated under the Minimum Terms and Conditions for solicitors professional indemnity insurance. This was on the basis that each theft resulted in separate losses and could not be linked either by the method of concealment or by an overarching motivation for the acts.

Background

Solicitors firm Dixon Coles and Gill (**DCG**) discovered in early 2016 that one of its equity partners, Mrs Box, had been dishonestly making unauthorised payments from client accounts. In March 2017 Mrs Box pleaded guilty to 12 offences involving the misappropriation of over £4 million and was sentenced to 7 years imprisonment.

Clause 2.1 of the Law Society's Minimum Terms and Conditions (**MTC**) for solicitors' professional indemnity insurance requires all solicitors to carry professional indemnity insurance with the minimum sum for any one claim being £2 million. In this case, various claims were brought against DCG from clients whose funds had been misappropriated by Mrs Box, and the firm's professional indemnity insurance provided for the minimum permissible cover. This meant that, if the clients' claims were aggregated, the total sum would far exceed the indemnity limit of DCG's policy and therefore result in significant personal liability for DCG's remaining equity partners, Mr Gill and Mrs Wilding.

Clause 2.5 of the MTC governs the aggregation of claims, providing that:

> "The insurance may provide that, when considering what may be regarded as one Claim for the purposes of the limits contemplated by clauses 2.1 and 2.3:
>
> (a) all claims against any one or more insured arising from:
>
> (i) one act or omission;
>
> (ii) one series of related acts or omissions;
>
> (iii) the same act or omission in a series of related matters or transactions;
>
> (iv) similar acts or omissions in a series of related matters or transactions
>
> and
>
> (b) all Claims against one or more Insured arising from one matter or transaction will be regarded as One Claim."

In this case, the insurer asserted that, notwithstanding that Mrs Box misappropriated funds from different parties, the various claims could be aggregated as "one claim" either on the basis that the claims arose from "one act or omission" (pursuant to clause 2.5(a)(i) MTC) or that they were "one series of related acts or omissions" (pursuant to clause 2.5(a)(ii) MTC). This would cap the insurer's liability at £2 million pursuant to the relevant policy. The Claimants, however, asserted that the claims by each separate client should be treated as separate claims and therefore each has the benefit of indemnity cover of £2 million.

The question for the Court was therefore whether the insurer was entitled to aggregate all the various claims for the purpose of the £2m indemnity limit under DCG's professional indemnity insurance.

Decision

The High Court referred to Lord Toulson's Supreme Court judgment in *AIG Europe Limited v Woodman & Others* to confirm that the construction of what is meant by "one claim" for the purposes of the MTC had to be "undertaken on a neutral, objective basis taking matters in the round".

The possibility of aggregating the claims under clause 2.5(a)(i) of the MTC was quickly dismissed by the Court on the basis that the numerous thefts were against different individuals over multiple years. The Court emphasised that, even though Mrs Box's intention may have been the same throughout, this was not enough to unify them for the purposes of becoming "one act or omission".

The real issue that the Court had to grapple with was whether Mrs Box's misappropriations were "related acts or omissions" that thus fell within clause 2.5(a)(ii) of the MTC. Lord Toulson in *AIG* had observed that "use of the word "related" implies that there must be some interconnection" and the Court in this case examined whether there was the necessary "interconnection" here.

The Claimants argued that they each had a separate cause of action which was separate and distinct from each other. However, the insurer argued that the way in which Mrs Box had committed the thefts, by engaging in 'teeming and lading' (ie falsifying accounting entries to hide the fraudulent removal of funds by using multiple accounts), tied the claims together as "related acts". Further, that Mrs Box's dishonesty was a series of related acts because they were all part of the same fraud. The Court, however, rejected the insurer's arguments. It found that teeming and lading was simply a way of concealing the thefts and was not the relevant act for the purpose of aggregation – what had to be related for the purpose of aggregation were the thefts themselves:

> "It was not Mrs Box's dishonesty which was the proximate cause of their loss... Dishonesty is not an act, it is a state of mind. What caused these claimants' losses were the individual thefts from them. True it is that these were motivated by dishonesty but it is the "acts" that matter, not the motivation for the "acts". These acts resulted in different losses to different clients. There cannot, in my view, be said to be a single loss because I am satisfied that the acts of theft were not related on a proper construction of MTC 2.5(a)(ii). Furthermore, I simply do not see that there is sufficient "interconnection" between the acts, to use the words of Lord Toulson in AIG."

The fact that the acts were committed by the same person and concealed by the same process was not sufficient and so there could not be said to be an aggregated loss on a proper construction of MTC 2.5(a)(ii). As such, each separate claim would be subject to its own £2 million indemnity limit.

Comment

The High Court's decision in the present case demonstrates a narrow interpretation of the aggregate provision in the MTC. That said, the judgment stressed that establishing the required connection for the purposes of aggregation is a fact-sensitive matter.

Additional references

AIG Europe Limited v Woodman & Others [2017] UKSC 18

Spire and RSA contest aggregation once more

Spire Healthcare Limited v Royal & Sun Alliance Insurance plc [2020] EWHC 3299 (Comm)

10 December 2020

In *Spire Healthcare Limited v Royal & Sun Alliance Insurance plc*, the High Court held that an insurer was not entitled to aggregate two different groups of claims founded on two separate types of negligent practice by the same individual. The two practices constituted two separate original causes and therefore the insured could recover up to the value of two separate limits of indemnity.

Background

The Claimant (**Spire**) claimed against the Defendant insurer (**RSA**) under a policy (**the Policy**) providing cover for liabilities arising from the acts and omissions of employees and those providing medical or surgical service at its hospitals.

The underlying claims arose from the much publicised activities of Consultant Breast Surgeon Ian Paterson, who was sentenced in 2017 for carrying out unnecessary surgery on patients.

Proceedings against Spire were commenced by former patients of Mr Paterson in respect of surgeries performed at two of its hospitals. The claimant patients could be split up into two groups. One group of patients had required surgery but on whom Mr Paterson performed sub-total mastectomies ("cleavage sparing" mastectomies), a negligent procedure where some breast tissue was left behind (**Group 1**). The other groups of patients were the victims of entirely unnecessary surgery (**Group 2**).

The relevant clause in the Policy provided as follows:

> "The total amount payable by the Company in respect of all damages costs and expenses arising out of all claims during any Period of Insurance **consequent on or attributable to one source or original cause** irrespective of the number of Persons Entitled to Indemnity having a claim under this Policy consequent on or attributable to that one source or original cause shall not exceed the Limit of Indemnity stated in the Schedule"
>
> (emphasis added)

The High Court was asked to determine whether the Group 1 and Group 2 claims were attributable to two separate causes, as argued by Spire, or whether they were attributable to a single source or cause, as maintained by RSA. If attributable to two separate causes then two separate limits of indemnity would apply, entitling Spire to £20 million in cover as opposed to a single limit of £10 million if the cause was the same.

RSA argued that the "one source or original cause" was the conduct of Mr Paterson which was either Mr Paterson's negligence or, in the alternative, deliberate misconduct. It relied on the fact that both Group 1 and Group 2 claims were pleaded as negligence claims and there was a breach of a duty of care in both. In relation to the alternative case of deliberate misconduct, in both cases there was evidence that Mr Paterson was acting deliberately and, in the case of the negligent surgeries, contrary to assurances he had given that he would cease performing procedures of that nature. Spire argued that the causes were different, for Group 1 claims the cause being Mr Paterson performing a negligent procedure where a mastectomy (surgery) was clinically indicated, and Group 2 claims where Mr Paterson deliberated misrepresented the contents of diagnostic tests exaggerate the risk of cancer and carried out surgery where none was necessary.

Decision

The High Court agreed with the Spire. While conceding the aggregation language was broad, necessitating the widest possible search for a unifying factor in the history of the losses, it held that there must be a causative link between what is contended to be the originating cause and the loss and there must also be some limit to the degree of remoteness that is acceptable.

The High Court rejected the argument that Mr Paterson's negligence could be the initial cause. When considering this aggregation wording, the focus of attention was on the factual cause, not the legal classification.

In the view of the High Court there were clear causative differences between Group 1 and Group 2 cases. In the Group 1 cases, the negligent procedure was the result of a rushed or careless surgery or possibly motivated by a desire to produce a better cosmetic outcome. Conversely, Group 2 claimants were subjected to unnecessary surgery for Mr Paterson's financial gain. The dishonesty of Mr Paterson in relation to the Group 1 cases was different from the dishonesty that occurred in the Group 2 cases. The cause of Mr Paterson's negligent acts were particular mis-appreciations or decisions. Although he was a single individual, there were two separate mis-appreciations or decisions and therefore two separate originating causes.

The management issues within Spire that caused the two different strands of misconduct were also entirely different in nature. Group 1 cases involved a failure to apply controls to prevent the development or continuation of the negligent procedure. Other clinicians failed to notice or comment on the

practice even though the fact of such procedures should have been obvious from follow-up procedures. The management failure in relation to Group 2 cases consisted of the failure to challenge the need for the unnecessary surgery.

Comment

This was the third attempt by Spire to access a £20 million aggregate limit under its policy with RSA. It had previously contested that the aggregation clause did not apply to unify the claims for the purposes of the limit of indemnity. That argument failed before the High Court and later the Court of Appeal (*Spire Health Care v Royal & Sun Alliance*).

This judgment was the result of a fresh argument by Spire that the effect of the aggregation was limited to the two different sets of claims, and in succeeding Spire appears to have achieved its initial aim.

The case follows *Lord Bishop of Leeds v Dixon Coles & Gill* in establishing that tracing the actions resulting in claims or losses back to a particular individual is unlikely to be sufficient to ties losses together for the purpose of aggregation. If insurers or policyholders wish to ensure such claims are aggregated for the purpose of applying the limit of indemnity or the deductible, they should ensure that this is made clear from the aggregation language.

Additional references

Lord Bishop of Leeds v Dixon Coles & Gill [2020] EWHC 2809 (Ch)

Spire Health Care v Royal & Sun Alliance [2018] EWCA Civ 317

Supreme Court hands down judgment in FCA's Covid-19 business interruption test case

The Financial Conduct Authority v Arch Insurance (UK) Ltd & Others [2021] UKSC 1

15 January 2021

The Supreme Court handed down judgment in the Covid-19 Business Interruption insurance test case in which Herbert Smith Freehills acted for the FCA who advanced the claim for policyholders.

The Supreme Court unanimously dismissed Insurers' appeals and allowed all four of the FCA's appeals (in two cases on a qualified basis), bringing positive news to policyholders across the country that have suffered business interruption losses as a result of the Covid-19 pandemic.

At first instance the FCA had been successful on many of the issues, and now the Supreme Court has substantially allowed the FCA's appeal on the issues it chose to appeal. The practical effect is that all of the insuring clauses which were in issue on the appeal will provide cover for the business interruption caused by Covid-19.

Briefly:

- The Supreme Court took a narrower approach to identifying the insured peril or trigger in disease clauses, focusing on individual occurrences, but because it found that such individual occurrences could as a matter of law satisfy the test of causation (along with all other such occurrences) the conclusion that there was cover under the disease clauses was confirmed;
- It confirmed that prevention of access/hybrid clauses will be triggered more readily than at first instance – there is no requirement for an actual legislative step ordering closure, and equally losing access for the purposes of a part of a business or access to a part of premises may suffice. On causation, the "source" event (ie the Covid-19 pandemic) will not be a competing cause when assessing if the insured has established causation and hence Insurers' arguments as to the competing causes of loss were rejected.
- The principle underlying the above conclusions was that "but for" causation is neither always necessary nor always sufficient. Here it was not necessary.
- Trends clauses are intended to address losses wholly outside the insured peril; matters inextricably linked to the insured peril or the source of the insured peril are not trends and do not fall to be taken into account.
- The above principles apply also to pre-trigger downturn in revenue; there is no ability to reduce claims by reason of circumstances caused by the source of the insured peril pre-trigger.

Of particular note also to the insurance industry more generally, the Supreme Court has determined that the case of *Orient-Express Hotels Ltd v Assicurazioni General SpA* was wrongly decided and that it should be overruled thus going further than the High Court who merely indicated that they would not have followed it if it was relevant.

The Supreme Court judgment, which followed a "leapfrog" appeal from the High Court and an expedited hearing given the urgency of the questions, brings definitive guidance on the proper operation of cover under certain non-damage business interruption insurance extensions and clarity to policyholders and insurers alike.

Background

The judgment addresses appeals brought by certain of the parties and interveners in the Covid-19 Business Interruption insurance test case, in which the High Court handed down judgment on 15 September 2020.

The High Court proceedings were brought by the FCA, the regulator of the defendant Insurers, as the first test case under the Financial Markets Test Case scheme. Their purpose was to determine issues of principle on policy coverage and causation under sample insurance wordings in the context of the significant business interruption losses suffered by businesses as a result of the Covid-19 pandemic. 21 sample wordings were considered, but the FCA estimates that, in addition to these particular wordings, some 700 types of policies held by 370,000 policyholders across 60 different insurers could potentially be affected by the test case. The FCA advanced the arguments of policyholders, many of which were small to medium sized enterprises. Two action groups were additionally given permission to intervene on behalf of certain policyholders and to present arguments.

The FCA, the Hiscox Action Group (the **Hiscox Interveners**) and six of the eight insurer defendants appealed the High Court decision. The appeals were heard by the Supreme Court under the "leapfrog" procedure which enables an appeal in exceptional circumstances to bypass the Court of Appeal and proceed directly to the Supreme Court. The Supreme Court panel

comprised Lord Reed, President of the Supreme Court, Lord Hodge, Deputy President of the Supreme Court, Lord Briggs, Lord Hamblen and Lord Leggatt. The hearing, conducted remotely due to the pandemic, took place over four days between 16 and 19 November 2020.

Summary of Supreme Court decision

The Supreme Court unanimously dismissed all of Insurers' appeals and allowed all of the FCA's four grounds of appeal, with qualifications attached to two of the four. The Supreme Court also allowed all three of the Hiscox Interveners' appeals, two on qualified terms. The Supreme Court noted that it accepted some of the Insurers' arguments on their appeals, but that they did not affect the outcome of the appeal.

All of the Justices were agreed on the conclusions reached in the joint judgment of Lord Hamblen and Lord Leggatt (with whom Lord Reed agreed), but Lord Briggs (with whom Lord Hodge agreed) disagreed in two respects with the reasoning supporting the conclusions.

Outline of issues appealed

Each appellant appealed on multiple issues but they can be categorised, and indeed the Supreme Court approached them, in the following way:

- The disease clauses – interpretation;
- The prevention of access and hybrid clauses – interpretation;
- Causation;
- The trends clauses;
- Pre-trigger losses; and
- The *Orient Express* decision.

The judgment should be carefully reviewed for a detailed analysis on each issue. What we set out below, adopting the above structure, is a summary of the Supreme Court's conclusions and its reasoning for the same.

Disease clauses – interpretation

A disease clause generally provides insurance cover for business interruption loss caused by the occurrence of a notifiable disease at or within a specified distance of the policyholder's business premises. Policies insured by Argenta, MS Amlin, QBE and RSA contained such clauses and each of these Insurers appealed the decision of the High Court on the proper construction of these wordings. The FCA also appealed the High Court's decision on the construction of certain of the QBE disease clauses. There were some variations among these wordings but, for the reasons outlined further below, the Supreme Court concluded that none of the differences materially altered the correct interpretation of the clauses.

The Supreme Court considered what was meant by the words in the following (typical) insuring clause in a RSA policy: "any … occurrence of a Notifiable Disease within a radius of 25 miles of the Premises". "Notifiable Disease" was defined as "illness sustained by any person resulting from… any human infectious or human contagious disease… an outbreak of which the competent local authority has stipulated shall be notified to them."

Insurers' position was that the clause only covered the business interruption consequences of any cases of a Notifiable Disease which occurs within a radius of 25 miles of the premises insured under the policy (ie losses were only covered to the extent it could be shown that they resulted from the occurrence of the disease within the radius). This interpretation on Insurers' case would severely limit the cover available to the insured because, in the majority of cases, it would be impossible for an insured to show that losses resulted from the localised occurrence of the disease, as opposed to the wider pandemic and the government response generally. The FCA's position was that the clause covered the business interruption consequences of a Notifiable Disease wherever the disease occurs, provided it occurred (ie there is at least one case of illness caused by the disease) within the 25-mile radius. The High Court had accepted the FCA's case, finding that (i) the words of the clause do not confine cover to a situation where the interruption to the business has resulted only from cases of a Notifiable Disease within the 25-mile radius, as opposed to other cases elsewhere; and (ii) the Notifiable Diseases covered by the policies included diseases which are capable of spreading rapidly and widely and it would not make sense for the cover to be confined to the effects only of the local occurrence of a Notifiable Disease.

The Supreme Court took a different position on construction, although its findings as to causation meant that this did not change the fact that cover was operative. It held that the clause does not say that there is cover for an occurrence some part of which is within the specified 25 mile radius but rather that there is cover for "any … occurrence of a Notifiable Disease within" that radius. It is therefore only an occurrence within the specified area that is an insured peril and not anything that occurs outside that area. Further, each case of illness sustained by an individual is a separate occurrence and a "Notifiable Disease" in the sense used in the wording is not the outbreak nor the disease itself but rather the illness sustained by any person resulting from that disease. The words "occurrence of a Notifiable Disease" therefore refer to an occurrence of illness sustained by a particular person at a particular time and place. As a result the Supreme Court found that the disease clause provides cover for business interruption caused by any cases of illness resulting from Covid-19 that occur within a radius of 25 miles of the business premises. It does not cover interruption caused by cases of illness resulting from Covid-19 that occur outside that area.

However, and of critical importance to the scope of cover available to policyholders, the Supreme Court agreed with the High Court that (i) the language of the disease clause does not confine cover to business interruption which results only from cases of a notifiable disease within the 25 mile radius, as opposed to other cases elsewhere, and (ii) that in interpreting the policy wording significance should be attached to the potential for a notifiable disease to affect a wide area. Whilst neither point supported the conclusion that cases of disease occurring outside the specified area are part of the peril insured against, they were important factors in the Supreme Court's approach to causation, which is considered below.

As noted above, there were some variations between the disease clauses in the policies. The Court considered the variations as follows. In each case the same conclusion as for the RSA policy applied:

- The word "occurrence" was not used in the MS Amlin wordings. However, the term "notifiable disease" was defined in the same way as in the other policies and that definition made it clear that the insured peril is not a disease as such but individual cases of "illness sustained by any person resulting from" a relevant disease.
- The disease clause in a QBE policy had as its subject a disease, rather than an occurrence of illness sustained by a person resulting from a disease. The Court concluded that, notwithstanding this difference, the wording was sufficiently clear that the insured peril is not any notifiable disease occurring anywhere in the world but only in so far as it is manifested by any person whilst in the insured premises or within a 25 mile radius of the premises.
- The disease clause in two further QBE policies covered "loss resulting from interruption of or interference with the business in consequence of any of the following **events**... any occurrence of a notifiable disease within a radius of 25 miles of the premises;... provided that the... insurer shall only be liable for loss arising at those premises which are directly subject to the **incident**" (emphasis added). The High Court had considered that the use of the words "event" and "incident" meant that, contrary to its decision in relation to the other disease clauses, the clause was confined to losses resulting only from specific occurrences of the disease within the radius. The Supreme Court held that these words did not have particular significance and that, in line with its conclusions on the other disease wordings, the description of the insured peril as "any occurrence of a notifiable disease within a radius of 25 miles of the premises" made clear that the clause covered losses caused by any cases of illness resulting from Covid-19 that occur within a radius of 25 miles of the business premises.

The Supreme Court therefore construed the disease clauses more narrowly than the High Court and the FCA. However, because it agreed that the wordings were not expressed to apply **only** to occurrences of illness within the relevant radius, and because of its findings on causation, explained below, this did not have the effect that the disease clauses will not in practice respond in the circumstances of the pandemic.

Prevention of access/hybrid wordings – interpretation

A prevention of access clause generally provides insurance cover for business interruption losses resulting from public authority intervention preventing access to, or use of, the insured premises. A "hybrid" clause combines the main elements of disease and prevention of access clauses.

In relation to the disease elements of the hybrid clauses, the Supreme Court reached the same conclusion as it did for the disease clauses, considered above. We consider the Supreme Court's finding on the remaining elements of the clauses below.

The appeals focussed on the following issues:

- **The nature of the public authority intervention required to trigger the clause, specifically whether the intervention of the public authority had to have had the force of law.**

  The meanings of the following words were considered: "restrictions imposed", "closure or restrictions placed", "enforced closure", "action" preventing access, and a denial or hindrance in access "imposed". The High Court had held that the only relevant matters which constituted "restrictions imposed" are those which were promulgated by statutory instrument, eg the 21 and 26 March Regulations. Instructions given by the UK Government which did not have the force of law would not satisfy the description. The point is a significant one – the FCA and the Hiscox Interveners wished to establish that cover was triggered by Government intervention (such as the Prime Minister's instructions in his early national broadcasts to 'stay at home' and that certain businesses should close) before the 21 March and 26 March Regulations were issued so that losses sustained before those dates were capable of being recovered under the insurance.

- **The nature of the prevention or the hindrance of access/use required to trigger the clause.**

  The meanings of the following phrases were considered: "inability to use", "prevention of access" and "interruption". The High Court held "inability to use" required a complete inability to use the premises, save for use that is de minimis and that anything short of complete closure would not constitute "prevention of access" to the premises. It found that "interruption" meant business interruption generally rather than a stop or break, as distinct from "interference". The point is similarly important to the scope of cover for insureds with prevention of access/hybrid wordings, since many have been prohibited from operating only certain parts of their businesses (for example, a restaurant that could continue its takeaway business but not its sit-in dining business) and Insurers have argued that under certain wordings cover would only be available if the entirety of the business and premises could no longer operate.

The Supreme Court's findings were as follows:

The nature of the public authority intervention required to trigger the clause

- Focusing, for convenience, on the language used in Hiscox wordings (while noting that the same analysis applied to the other relevant wordings), it agreed with the High Court that "restrictions imposed" by a public authority would be understood as ordinarily meaning mandatory measures "imposed" by the authority pursuant to its statutory or other legal powers since "imposed" connotes compulsion and a public authority generally exercises compulsion through the use of such powers. However, it did not accept that a restriction must always have the force of law before it can fall within the description. The following guidance can be taken from the judgment:
  - "Restriction imposed" may include a mandatory instruction given by a public authority in the anticipation that legally binding measures will follow shortly afterwards, or will do so if compliance is not obtained.

- An instruction given by a public authority may amount to a "restriction imposed" if, from the terms and context of the instruction, compliance with it is required, and would reasonably be understood to be required, without the need for recourse to legal powers provided such instruction is not only in mandatory terms, but also in clear enough terms to enable the addressee to know with reasonable certainty what compliance requires.
- In most cases the relevant restrictions would be directed at the insured premises or the use of the premises by the policyholder, but they are not required to be so.

- By way of illustration of its conclusions, the Supreme Court agreed with the FCA in holding that the Prime Minister's instruction in his statement of 20 March 2020 to named businesses to close was capable of being a "restriction imposed" regardless of whether it was legally capable of being enforced since it was a clear, mandatory instruction given on behalf of the UK Government which those named businesses would reasonably understand had to be complied with, without inquiring into the legal basis or anticipated legal basis for the instruction. Further, Regulation 6 of the 26 March Regulations, which did not order particular businesses to close but which prohibited people from leaving their homes without reasonable excuse, was also capable of being a "restriction imposed" in the relevant sense.
- The Supreme Court did not, however, rule on whether each of the government announcements and regulations were "restrictions imposed". It directed that this should be left over for agreement or further argument. It commented however that the argument is "clearly stronger" in relation to the following specific instructions to close business and other premises (i) the instructions to schools to close given by the Prime Minister on 18 March 2020; (ii) the instruction to certain businesses to close given by the Prime Minister on 20 March 2020; and (iii) the instruction to certain businesses on 24 March that they should take steps to close for commercial use, as contrasted to the government's more general instructions to stay at home, stop all unnecessary travel and social contact, work from home where possible, and so on.

The nature of the prevention or the hindrance of access/use required to trigger the clause

- "Inability to use" premises: the Supreme Court agreed with the FCA that the requirement is satisfied either if the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities, since in both those situations there is a complete inability of use (recognising however that there would only be cover for that part of the business for which the premises cannot be used). In the first situation, there is a complete inability to carry on a discrete business activity. In the second situation, there is a complete inability to use a discrete part of the business premises. The Court gave an example, which would satisfy both of these scenarios, of a golf course which is allowed to remain open but with its clubhouse closed so that there is an inability to use a discrete part of the golf club for a discrete but important part of its business, namely the provision of food and drink and the hosting of functions. Thus, for example, a restaurant or shop that stayed open for take-away or mail order business may now claim for the loss of in-person business.
- "Prevention of access": the Supreme Court agreed with Arch that prevention means stopping something from happening or making an intended act impossible (as distinct from mere hindrance) but also held, consistent with its analysis of "inability to use", that the wording may, depending on the facts, cover prevention of access to a discrete part of the premises and/or prevention of access for the purpose of carrying on a discrete part of the policyholder's business activities.
- "Interruption": the Supreme Court rejected Hiscox's arguments that this implies a stop or a break to the business as distinct from an interference, holding that the ordinary meaning of "interruption" is capable of encompassing interference or disruption which does not bring about a complete cessation of business or activities, and which may even be slight.

Overall, therefore, the Supreme Court construed the prevention of access/hybrid wordings in issue more widely than the High Court. Policyholders should therefore revisit their wordings in light of the judgment to consider whether the Supreme Court's findings on these particular wordings mean that they now have a valid claim.

Causation

The High Court had found that the question of causation followed its construction of the wordings it considered and it did not therefore need to decide many of the other arguments raised by the parties on causation. In contrast, the question of causation received significant attention from the Supreme Court.

The crux of the issue was that Insurers argued that it is necessary to show, at a minimum, that the loss would not have been sustained but for the occurrence of the insured peril. They contended that, because of the widespread nature of the pandemic, policyholders would have suffered the same or similar business interruption losses even if the insured risk or peril (whether it be occurrence of the disease within the radius, or the public authority action causing a prevention of access) had not occurred, and as such the policies did not respond.

The Supreme Court rejected Insurers' argument, holding that the "but for" test was not determinative in ascertaining whether the test for causation has been satisfied. The causal connection required had to take account of the nature of the cover provided in the particular policies and it may be satisfied where the insured peril, in combination with many other similar uninsured events, brings about a loss with a sufficient degree of inevitability, even if the occurrence of the insured peril is neither necessary nor sufficient to bring about the loss by itself. As such, in relation to the disease and hybrid clauses where this question was of particular significance given the Supreme Court's decision on construction, the clause could respond to cover losses resulting from the localised occurrence of the disease in combination with the wider pandemic, even if the localised occurrence of the disease would not have been sufficient on its own to cause the policyholder's losses.

We look at this conclusion in further detail below. The Supreme Court looked first at how to determine what test is to be applied (ie whether it is one of proximate causation, or another causal link), before then looking at how the test may be satisfied.

Determination of the causation test in the policy

The Supreme Court reiterated the common understanding that the standard position is that the causal link between the insured peril and loss will be one of proximate causation, on the basis that this is the presumed intention of the parties. This is codified in section 55(1) of the Marine Insurance Act 1906, and is treated by the courts as also stating the law applicable to non-marine insurance. This presumption is capable of being displaced if the policy provides some other connection but the Court considered that it would be rare for the test of causation to turn on "nuances of language". This is because although the question of whether loss has been caused by an insured peril is a question of interpretation of the policy, it is not, unlike the questions of interpretation of the disease, hybrid and prevention of access clauses, a question which depends to a great extent on how the words used would be understood by an ordinary member of the public. Rather, the relevant issue is the legal effect of the insurance contract, as applied to a particular factual situation.

How the causation test may be satisfied

The Supreme Court referred to the fact that it is well established that where there are two proximate causes of loss, neither of which is excluded but only one of which is insured, insurers are liable for the loss (per *The Miss Jay Jay*) and that where there are two proximate causes of loss, of which one is an insured peril but the other is expressly excluded, the exclusion will generally prevail (although it is always a question of interpretation) (per *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corpn Ltd*). In both categories the combination of the two causes together made the loss inevitable and neither would have caused the loss without the other. The Supreme Court considered that there is no reason in principle why such an analysis could not be applied to multiple causes which act in combination to bring about a loss. As to this, they agreed with the court below that in the present case it could not be said that any individual case of illness resulting from Covid-19, on its own, caused the UK Government to introduce restrictions which led directly to business interruption. Rather, the Government measures were taken in response to information about all the cases of Covid-19 in the country as a whole and, as such, the situation was one in which "all the cases were equal causes of the imposition of national measures".

This reasoning was of course particularly important because of the approach the Supreme Court took to what the insured trigger was – namely in the case of disease clauses, an individual case of Covid-19 in the relevant policy area.

Insurers' position was that this was insufficient to satisfy the causal link between the insured peril and the loss, because it could not be said that "but for" any individual case of illness the government measures which resulted in policyholder losses would not have been taken (such a test being satisfied in the *Miss Jay Jay* and *Wayne Tank*). The Supreme Court rejected this argument. It recognised that in the vast majority of insurance cases, if an event "Y" would still have occurred irrespective of ("but for") the occurrence of a prior event "X", then "X" cannot be said to have caused event Y. However, it considered that the "but for" test was not always the appropriate test to apply in and of itself because it was inadequate in a number of respects:

- It fails to exclude causes which would not be regarded as an effective or proximate cause, ie it is in some circumstances too wide. The Court gave the example of a cargo that is lost when a ship sinks: an unlimited number of circumstances could be identified but for which the loss would not have occurred, including the decision to manufacture the vessel, the decision of the owner or charterer to deploy the vessel on this particular route and the buyer's decision to purchase the cargo. None of these ought properly to be treated as causes of loss for the purpose of determining cover (and the Supreme Court noted that, for this reason, the "but for" test was often treated as a minimum test for causation).
- It excludes some cases where one event could or would be regarded as a cause of another event, ie it is in some circumstances too narrow. The Court gave the example of two hunters that simultaneously shoot a hiker who is behind some bushes and medical evidence shows that either bullet would have killed the hiker instantly even if the other bullet had not been fired. Applying the "but for" test would produce the result that neither hunter's shot caused the hiker's death. The Court concluded that this was a result which is manifestly not consistent with common-sense principles.
- Of particular relevance to the disease clauses, it excludes cases in which a series of events combine to produce a particular result but where none of the individual events was either necessary or sufficient to bring about the result by itself, ie it is too blunt. The Court referred to an example of a case where the directors of a company unanimously vote to put on the market a dangerous product which causes injuries, although the decision only required the approval of a majority. It could not be said that any individual director's vote was either necessary or sufficient to cause the product to be marketed. However, it is reasonable to regard each vote as causative rather than to say that none of the votes caused the decision to be made. The "but for" test would lead to the conclusion that no director caused the decision to put the product on the market, which the Court considered could not be right. The Court acknowledged that cases in which it has been held or accepted that policyholders are entitled to an indemnity where the "but for" test of causation was not satisfied are rare, but agreed with the FCA that such an example could be found in the cases concerning the recovery of defence costs. Such cases establish that where defence costs are incurred for the dual purpose of defending both insured and uninsured claims under a liability policy, the defence costs that would have been incurred but for the insured claims, because of the uninsured claims to which they were also referable, were nevertheless losses arising from an insured peril and recoverable.

The Court was satisfied, therefore, that:

> "there is nothing in principle or in the concept of causation which precludes an insured peril that in combination with many other similar uninsured events brings about a loss with a sufficient degree of inevitability from being regarded as a cause – indeed as a proximate cause – of the loss, even if the occurrence of the insured peril is neither necessary nor sufficient to bring about the loss by itself."

The Court recognised that the question of causation becomes more difficult when the number of separate events that combine to bring about loss is multiplied many times over, so that the total events combining to produce the loss are in the hundreds of thousands. But it said that what ultimately matters is the policy wording and what risks the insurers have agreed to cover, which is a question of contractual interpretation.

With that in mind we turn to what this meant for the disease clauses and the prevention of access/hybrid clauses that were in issue:

Disease clauses

The Supreme Court held (and in this respect agreed with the High Court) that no reasonable person would suppose that, if an outbreak of an infectious disease occurred which included cases within the relevant radius in the disease clause and was sufficiently serious to interrupt the policyholder's business, all the cases of disease would necessarily occur within the radius. For this reason, it considered it inappropriate to ask whether, but for the cases of disease within the radius, the loss would have been suffered, since the answer may well typically be yes, thus depriving the insured of an indemnity for wide area diseases:

> "We agree with the FCA's central argument in relation to the radius provisions that the parties could not reasonably be supposed to have intended that cases of disease outside the radius could be set up as a countervailing cause which displaces the causal impact of the disease inside the radius."

Accordingly, the Supreme Court concluded that, on the proper interpretation of the disease clauses, in order to show that loss from interruption of the insured business was proximately caused by one or more occurrences of illness resulting from Covid-19, it is sufficient to prove that the interruption was a result of Government action taken in response to cases of disease which included at least one case of Covid-19 within the geographical area covered by the clause. Each case was an approximately equal cause with all the other cases, and the public authority consequences inextricably linked for all the disease cases. The Court made clear that its conclusion does not depend on the particular terminology used in the clause to describe the required causal connection between the loss and the insured peril and applies equally whether the term used is "following" or some other formula such as "arising from" or "as a result of". Rather it was a conclusion about the legal effect of the insurance contracts as they apply to the facts of the case.

Prevention of access and hybrid policies

The Court similarly rejected Insurers' arguments that the "but for" test must be applied to the prevention of access/hybrid clauses as regards concurrent Covid-19-related causes, on the basis that to do so would render cover "largely illusory" in circumstances where that cannot have been intended. Because of the composite nature of the insured peril in these clauses (comprising several component parts), the Court considered that the prevention of access/hybrid clauses may fall into the same category of cases as the two hunters (as referenced above), namely that there are two (or more) causes each of which would by itself have inevitably brought about some loss without the other(s): but for the insured peril (ie all component parts of it) occurring, any one of the component parts of it, for example the effect of the closure order on other businesses (which on its own is not insured) would have caused some losses. It would not be appropriate to apply the but for test in these circumstances.

Rather the Court considered that where insurance is restricted to particular consequences of an adverse event the parties do not generally intend other consequences of that event, which are inherently likely to arise, or the "source" event, to restrict the scope of the indemnity. Applying this principle to the prevention of access and hybrid clauses, the Court held that the elements of the insured peril are inextricably connected in that the elements and their effects on the policyholder's business all arise from the same original cause – in this case the Covid-19 pandemic. It therefore considered it predictable that, even if the elements of the insured peril had not led ultimately to the closure of the insured premises, they would have had other potentially adverse effects on the turnover of the business. The Court considered that such potential effects should not diminish the scope of the indemnity because they arise from the same original fortuity which the parties to the insurance would expect to occur concurrently with the insured peril. Although not part of the insured peril, it said that, in that sense, they are "not a separate and distinct risk".

The Court held that the principle applies equally to an originating cause of loss covered by the policy which is not expressly mentioned in the clause. In this case the originating cause of any local occurrence of disease (and of public authority actions and public reactions to it) is the global Covid-19 pandemic. In circumstances where the policy does not exclude loss arising from such an event, other concurrent effects of the pandemic on an insured business should not reduce the indemnity under the public authority clause.

The Supreme Court therefore concluded that the prevention of access/hybrid wordings indemnify the policyholder against the risk of all the elements of the insured peril acting in causal combination to cause business interruption loss. It did so regardless of whether the loss was concurrently caused by other (uninsured but non-excluded) consequences of the Covid-19 pandemic, which was the underlying or originating cause of the insured peril.

Trends clauses

A critical issue in the case was the proper operation of the trends clauses in the policies. Trends clauses are clauses which form part of the quantification machinery in the policy and which are intended to ensure that the indemnity reflects the cover afforded by the policy, and it is not reduced or inflated by factors unrelated to the cover.

The trends clauses were important because Insurers contended that the effect of the clauses is that, because of the wider consequences of the Covid-19 pandemic, they are not liable to indemnify policyholders for losses which would have arisen regardless of the operation of the insured perils. The trends clauses effectively offered Insurers a second bite of the cherry in reducing the indemnity due to policyholders, this time via the quantification machinery in the policy rather than on the basis of causation. The effect of Insurers' construction was that it would, as the Supreme Court noted, "effectively transform quantification machinery into a form of exclusion", Insurers' arguments relied however upon the application of the "but for" test, the Insurers' proposed application of which, as we have seen, the Supreme Court rejected.

In analysing the trends clauses, the Supreme Court outlined some useful principles:

- The trends clauses are part of the machinery contained in the polices for quantifying loss. They do not address or seek to delineate the scope of the indemnity, which is the function of the insuring clauses.
- The trends clauses should, if possible, be construed consistently with the insuring clauses in the policy.

- To construe the trends clauses consistently with the insuring clauses means that, if possible, they should be construed so as not to take away the cover provided by the insuring clauses (since to do so would effectively transform quantification machinery into a form of exclusion).

Applying these principles the Supreme Court concluded that, consistent with its decision on causation, the simplest and most straightforward way in which the trends clauses can and should be construed is, absent clear wording to the contrary, by recognising that the aim of such clauses is to arrive at the results that would have been achieved but for the insured peril **and circumstances arising out of the same underlying or originating cause**. The trends or circumstances referred to in the clause for which adjustments are to be made should generally be construed as meaning trends or circumstances unrelated in any way to the insured peril. Hence the Supreme Court concluded that the trends clauses in issue should be construed so that the standard turnover or gross profit derived from previous trading is adjusted only to reflect circumstances which are unconnected with the insured peril and not circumstances that have the same underlying or originating cause.

Together with its conclusions on causation, this is very significant for policyholders' Covid-19 claims, since it means that, absent clear wording, insurers cannot reduce the indemnity otherwise due to the insured on the basis that the losses were caused equally by other (uninsured) perils the underlying cause of which was also the Covid-19 pandemic. Covid-19 and its various consequences will not be 'trends' or 'circumstances' that must be assumed to take place when working out what the insured would have earned had the insured peril not taken place.

Pre-trigger losses

A further issue arose in relation to the trends clauses.

At first instance, the High Court held that the proper operation of the trends clauses was such that if there was a measurable downturn in the turnover of a business due to Covid-19 before the insured peril was triggered, then in principle the continuation of that measurable downturn and/or increase in expenses ought to be taken into account as a trend or circumstance in calculating the indemnity payable in respect of the period during which the insured peril was triggered and remained operative.

The effect of this conclusion is that in some circumstances a policyholder's indemnity could be significantly reduced. The Supreme Court gave the example of a pub that suffered a 30% downturn in turnover during the week ending 20 March, due to public concern about contracting Covid-19, but it was not ordered to close (and its policy not triggered) until the Government's instruction of 20 March. On Insurers' case and the High Court decision, the reduction in turnover during the indemnity period would have been calculated by reference to the reduced turnover figure immediately before trigger, ie the indemnity would be smaller than if the pub had not suffered a reduction in business during the week preceding the Government's instruction to close.

Positively for policyholders, the Supreme Court disagreed with the High Court's conclusion. The Supreme Court's reasoning flows from its conclusions as to how a trends clause operates (as outlined above), namely the trends or circumstances for which adjustments may be made do not include trends or circumstances caused by the insured peril or its underlying or originating cause. It considered that this conclusion was also in keeping with the purpose of a trends clause, the aim of which is to seek to ensure that the adjusted figures will represent as nearly as possible the results which would have been achieved during the indemnity period had the insured peril (and its underlying or originating cause) not occurred. Accordingly, the indemnity is calculated by reference to what would have been earned had there been no Covid-19, disregarding any demonstrable revenue drop prior to the policy being triggered that resulted from Covid-19 or its effects.

Orient-Express Hotels Ltd v Assicurazioni General SpA

Insurers' case on causation and the trends clauses at first instance relied heavily on the decision in *Orient Express*. The High Court distinguished *Orient Express* on matters of construction but commented that if it had been necessary for the case they would have concluded that it was wrongly decided and declined to follow it. The Supreme Court went further and decided that the case should be overruled.

By way of recap, in *Orient Express* the claim was for business interruption losses caused by Hurricanes Katrina and Rita. It was a claim under an all risks policy with a trends clause incorporating a "but for" causation test. It also had sub-limited prevention of access and loss of attraction cover. It came before the High Court as an appeal from an arbitral tribunal. Two members of the Supreme Court panel were involved in the case. The arbitral tribunal panel included Mr George Leggatt QC, as he then was, and the judge who decided the appeal was Hamblen J, as he then was.

The premises in question were a hotel in New Orleans. There was no dispute as to cover for the physical damage to the hotel caused by the hurricanes. When it came to the business interruption losses, however, Insurers argued that there was no cover because, even if the hotel had not been damaged, the devastation to the area around the hotel caused by the hurricanes was such that the business interruption losses would have been suffered in any event. Accordingly, the necessary causal test for the business interruption losses could not be met because the insured peril was the damage alone, and the event which caused the insured physical damage (the hurricanes) could be set up as a competing cause of the business interruption. Hamblen J held that this was correct.

In a very clear decision the Supreme Court held that *Orient Express* was wrongly decided and that it should be overruled. It reasons are as follows:

- Applying its analysis on causation, as set out above, business interruption loss which arose because both (a) the hotel was damaged and also (b) the surrounding area and other parts of the city were damaged by the hurricanes, had two concurrent causes, each of which was by itself sufficient to cause the relevant business interruption but neither of which satisfied the "but for" test because of the existence of the other. In such a case when both the insured peril and the uninsured peril which operates concurrently with it arise from the same underlying fortuity (the hurricanes), then provided that damage proximately caused by the uninsured peril (ie damage to the rest of the city) is not excluded, loss resulting from both causes operating concurrently is covered.

The tribunal and the High Court were therefore wrong to hold that the business interruption loss was not covered by the insuring clause to the extent that it did not satisfy the "but for" test.

- Applying its analysis on trends clauses, the Supreme Court considered that the correct approach would have been to construe the trends clause so as to exclude from the assessment of what would have happened if the damage had not occurred circumstances which had the same underlying or originating cause as the damage, namely the hurricanes.

Lord Briggs judgment

As we noted above, Lord Briggs agreed with the conclusions reached in the majority's judgment, and all the reasoning behind it, save in relation to "one major and one minor point". Lord Hodge agreed with him. The "major" point was that Lord Briggs agreed with the High Court's primary position on construction, namely that the insured peril in disease clauses is Covid-19 providing it comes within the relevant radius. The "minor" point was that he expressed caution about treating the cases about defence costs as of any general application outside their specific field. His view was that, although they could be viewed as consistent with a concurrent cause analysis, they are better treated as a unique category. Importantly, however, neither point affected his agreement with the majority's conclusion and indeed he remarked to that effect.

What does this mean for policyholders?

The judgment brings very good news for policyholders. It improves their position significantly beyond that which was already established by the High Court judgment. Although the Supreme Court construed the disease clauses more narrowly than the High Court, it gave broader interpretations to key coverage words in the prevention of access/hybrid wordings (especially as to partial closure of a business) and, most significantly, its findings on causation mean that it will be very challenging for insurers to deny cover, or reduce an indemnity otherwise due to an insured, on the basis that losses that would otherwise be covered under the policy would have resulted in any event from uninsured perils whose underlying cause is the Covid-19 pandemic. This will have significant implications in real terms for the indemnities received by policyholders.

Where does this leave the state of the law?

It is clear now that *Orient Express* was wrongly decided (which has implications for business interruption cover in natural disaster and other physical damage cases), and it has been confirmed at the highest level that the "but for" test is not in all cases determinative in deciding questions of proximate causation. It remains a relevant test, and the Court acknowledged that in most cases it would be appropriate for the test to be applied, but it will not be appropriate where its application results in a narrowing, or removal, of cover in circumstances where, based on the interpretation of the policy as a whole, that cannot have been the intention of the parties.

Further, although the Court's decision on the proper application of concurrent causation to a significant number of multiple causes was based on established authority it does, as Lord Briggs noted, extend it "into new territory".

Related to this, and also of general significance, the judgment suggests that the effects of certain elements of a composite insured peril should not diminish the scope of the indemnity due to an insured if they arise from the same original fortuity which the parties to the insurance would expect to occur concurrently with the insured peril (even if not expressly specified in the coverage clause). Similarly the effects of uninsured perils should not diminish the scope of indemnity where they arise from the same original fortuity as the insured peril. The Supreme Court was careful to make clear that whether such principles apply will turn closely on the construction of the policy wording and the cover it is objectively intended to provide, but the Supreme Court's conclusions certainly have potential significance for determining the scope of cover under insurance policies generally, beyond those considered in the Covid-19 Business Interruption test case.

Readers may also be interested in comments in the judgment showing a realistic SME-focused approach to interpretation of SME insurance policies, and other comments that will have implications for questions of aggregation.

Additional references

Orient-Express Hotels Ltd v Assicurazioni General SpA [2010] EWHC 1186 (Comm)

JJ Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay) [1987] 1 Lloyd's Rep 32

Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corpn Ltd [1974] QB 57

Force Majeure, frustration and material adverse change

The question of when a party can suspend or avoid performance due to an intervening event or change of circumstances has gained particular prominence in recent years, initially in anticipation of Brexit and more recently in light of the disruption caused by the Covid-19 pandemic.

All too often parties may find themselves unable to perform their contractual obligations, or find that their counterparty has been unable or unwilling to perform. In such circumstances, a party may be able to rely on contractual provisions, such as a force majeure or material adverse change (**MAC**) clause, to suspend its contractual obligations or to avoid them altogether. Alternatively, a party may argue that the contract has been brought to an end automatically as a result of the doctrine of frustration.

Top tips for Force Majeure, frustration and material adverse change

- DON'T assume that an occurrence will be covered so long as it falls within the list of force majeure events – it must also affect a party's ability to perform the contract
- DO remember that an event which makes the contract more onerous or less profitable will not necessarily trigger the clause
- DO strictly comply with any notification requirements under the contract
- DO ensure you do what you can to mitigate the effects of the force majeure event, whether or not there is an express obligation to mitigate
- DO continue to monitor the situation to ensure you are ready to recommence performance as soon as the force majeure event has ceased to have an impact
- DON'T assume that all force majeure clauses are equal: the relief available will depend on the wording of the clause
- DO think carefully about the force majeure or MAC provisions in new contracts, taking into account which party is most likely to seek to rely on the clause
- DO consider whether a force majeure clause should require prevention of performance or some lesser threshold (eg delay, hindrance)
- DO consider what should or should not be covered by a force majeure clause, particularly given the continuing effects of the Covid-19 pandemic
- DO think carefully and take legal advice before exercising a right to terminate the contract under a force majeure or MAC clause, or asserting that the contract has been frustrated

Introduction

A dramatic or unexpected event or change of circumstances, such as Brexit or the Covid-19 pandemic, will often cause commercial parties to reconsider their contractual arrangements. This may be because the party itself, or a counterparty, is facing difficulties in performing its obligations, or it may be because the contract has become uneconomic in light of the changed circumstances.

In some such circumstances, a party may be able to rely on contractual provisions to suspend its contractual obligations or to avoid them altogether. The most common types of clause that fall into this category are:

- A force majeure clause: This is a term found in many contracts which excuses one or both parties from performing their obligations if they are prevented from doing so by circumstances outside their control. Force majeure clauses are considered below.
- A MAC clause: This is a term found in some agreements which allows a party (for example a buyer or lender) to refuse to proceed if certain events occur after the contract date. MAC clauses are considered below.

Where the contract does not contain a force majeure or MAC clause (or, potentially, if such clauses do not apply), a party may be able to argue that the contract has come to an end automatically as a result of the doctrine of frustration. This applies where an event occurs after the contract has been entered into, which is not due to the fault of either party, and which makes further performance impossible or renders the obligations radically different from what was contracted for. Frustration is considered below.

Of course, as an alternative to relying on a force majeure or MAC clause or claiming that the contract has been frustrated, a party may seek to terminate the contract either under an

express contractual right or alternatively under the general law as a result of a counterparty's repudiatory breach.

Force majeure

The term "force majeure" does not have a standard or recognised definition in English law. The application and effect of a force majeure clause depends on the language used in the agreement.

A typical force majeure clause will excuse one or more parties from performing their contractual obligations if they are prevented (or, depending on the scope of the force majeure clause, if they are hindered or delayed) from doing so by an event or circumstances outside their control. In considering whether a force majeure clause can be invoked there are a number of points to consider:

- Does the event fall within the definition of force majeure under the contract?
- Has the event had the requisite effect on performance?
- Are there requirements that must be satisfied before the clause can be relied on, such as notification or mitigation?
- What is the effect of reliance on the clause?

Definition of force majeure

Force majeure will often be defined by reference to a non-exhaustive list of events, together with a general "wrap-up" provision to include other events which are not within a party's reasonable control. Some clauses may, however, be in short form, omitting the list of events and simply referring to circumstances beyond a party's reasonable control, or similar wording. Conversely, some clauses may define force majeure by reference to an exhaustive list of events.

Whether a particular event, such as the Covid-19 pandemic or related restrictions, may qualify as force majeure will depend on whether it falls within the list set out in the clause, or any general "wrap-up" provision for events beyond the parties' control. Common categories of force majeure event which may be relevant in the context of the Covid-19 crisis include epidemic or pandemic, changes in law or regulation, acts of governmental authorities, and delays in transportation or communications.

Effect on performance

A force majeure clause will generally be triggered only if the event has the requisite effect on a party's performance of its contractual obligations. The clause may require that the event prevents performance, or it may be drafted more broadly to refer to an event which prevents, hinders or delays performance (or similar wording).

A change in economic or market circumstances which makes the contract less profitable is not generally sufficient to trigger a force majeure clause. An event or circumstance which makes performance more onerous is also unlikely to be sufficient, at least where the clause refers to performance being prevented; there may be more flexibility where the clause refers to hindrance or delay. All will depend on the proper construction of the clause.

In *Thames Valley Power v Total Gas & Power*, the High Court found that a force majeure clause in a gas supply contract was not triggered by a sharp rise in the market price of gas, making it uneconomic for the seller to supply the gas.

The Court agreed with the buyer that the increased cost of gas did not mean the seller was unable to carry out its obligations under the agreement; it merely made the contract less profitable. This was not sufficient. The fact that a contract has become expensive to perform, or even dramatically more expensive, is not a ground to relieve a party from performance on the grounds of force majeure (or indeed frustration).

Similarly, in *Tandrin Aviation Holdings v Aero Toy Store*, the High Court found there was no triable argument that a force majeure clause in an aircraft sale agreement was triggered by the "unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial markets".

The Court referred to the well-established position under English law that a change in economic or market circumstances which affects the profitability of a contract or the ease with which the parties' obligations can be performed is not regarded as being a force majeure event.

It is sometimes argued that a party cannot rely on force majeure because the force majeure event was not the cause of the non-performance. Typically, this argument may be run in two different ways:

- the party could have performed its obligations despite the force majeure event (had some other occurrence not got in the way), so it was not the sole or effective cause of the non-performance; or
- the party could not have performed its obligations even if the force majeure event had not occurred – ie the party cannot meet the "but for" test of causation because it cannot be said that "but for" the force majeure event it would have been able to perform.

Ultimately, the precise causation requirements in a given case will depend on the construction of the particular clause, as the cases referred to below demonstrate.

In *Seadrill Ghana Operations Ltd v Tullow Ghana Ltd*, the High Court considered a clause in a contract for the hire of an oil rig. The clause provided that neither party would be responsible for failure to perform "if and to the extent that fulfilment has been delayed or temporarily prevented by" a force majeure event. The list of events constituting force majeure included a drilling moratorium imposed by the government of Ghana.

The government imposed a drilling moratorium which affected certain of the oil fields in which the company had planned to use the rig. Drilling in other fields was also prevented, but not due to the moratorium – rather, it was because the government did not approve the development plan for those fields.

In the circumstances the Court found that there were two effective causes of the company's failure to perform its obligations, only one of which (the moratorium) was a force majeure event. The force majeure event delayed or prevented the company providing a drilling programme for certain fields but not others. That was not sufficient.

The judge noted that this approach was consistent with the Court of Appeal's decision in *Intertradex v Lesieur*, which he said is regarded as establishing that a force majeure event must be the sole cause of the non-performance. Ultimately, however, the question is one of construction of the relevant contract.

In *Classic Maritime Inc v Limbungan Makmur SDN BHD*, the Court of Appeal considered a clause in a long-term contract for shipments of iron ore pellets. The clause provided that the charterer would not be responsible for failure to deliver cargo "resulting from" causes beyond the parties' control, provided they "directly affect the performance of either party".

The charterer failed to provide cargo for a number of shipments. The trial judge found that it was impossible for the charterer to provide cargo due to a dam burst at the relevant mine. However, if the dam burst had not occurred, the charterer would probably have defaulted anyway.

The Court of Appeal rejected the submission that there was a settled line of authority which established that, where a party relies on a force majeure clause, there is no need to prove "but for" causation. The question is not one of labels, but rather how the particular clause should be interpreted. Comments in the decision do, however, suggest that, in cases of uncertainty, the court may be less likely to find that there is a requirement for "but for" causation where the effect of the clause is to relieve a party of its future obligations, rather than excuse liability for past performance.

Here the Court held there was a requirement to prove "but for" causation, including because of the need for the failure to "result from" a specified event which "directly affected" performance.

It is sometimes argued that, to come within a force majeure clause, an event must have been unforeseeable. In fact there is no general requirement under English law that an event must be unforeseeable to give rise to a claim for force majeure relief – subject of course to the terms of the clause. However, the more an event is foreseeable, the more it may be possible to guard against it having an impact on contractual performance, and so the more a failure to do so may be seen as the real cause of non-performance.

In *2 Entertain Video Ltd v Sony DADC Europe Ltd*, the High Court considered a clause in a contract to provide logistics and distribution services to the Claimants, including storage of their stock at the Defendant's warehouse. The warehouse was destroyed by fire during the 2011 London riots, and the Court found that this was due to the Defendant's negligence in failing to take reasonable security and fire safety measures.

The Defendant sought to rely on a force majeure clause, which provided that neither party would be liable for its failure or delay in performing its obligations "if such failure or delay is caused by circumstances beyond the reasonable control of the party affected including but not limited to … fire, … riot [etc]".

The Court held that the Defendant could not rely on the clause. Although the riots were "unforeseen and unprecedented", the risk of arson was (or should have been) foreseen. If adequate measures had been taken, the attack on the warehouse would probably have been deterred or delayed and any damage significantly reduced. That meant that the fire and resulting losses were not outside the Defendant's reasonable control, and so a force majeure defence was not available.

Notification and mitigation

A force majeure clause will ordinarily include obligations to notify the counterparty of the force majeure event. It will be important for a party wishing to rely on force majeure to comply with these obligations, as a failure to do so may mean that a defence of force majeure is not available. This will depend on whether the requirement to give notice, properly construed, is a condition precedent to reliance on the clause.

There may also be an obligation to notify the counterparty when the force majeure situation has come to an end and the affected party is able to resume performance.

A force majeure clause will also often include obligations to seek to mitigate the effects of the force majeure event. The clause may not be effective to prevent liability arising to the extent that the required efforts to mitigate have not been made. Even if there is no express obligation to mitigate, such an obligation may well be implied as a result of a requirement that the force majeure event is beyond the parties' reasonable control and/or a requirement that it prevents, hinders or delays performance. If the party could have avoided or mitigated the effects of the force majeure event, it may not be able to meet these requirements.

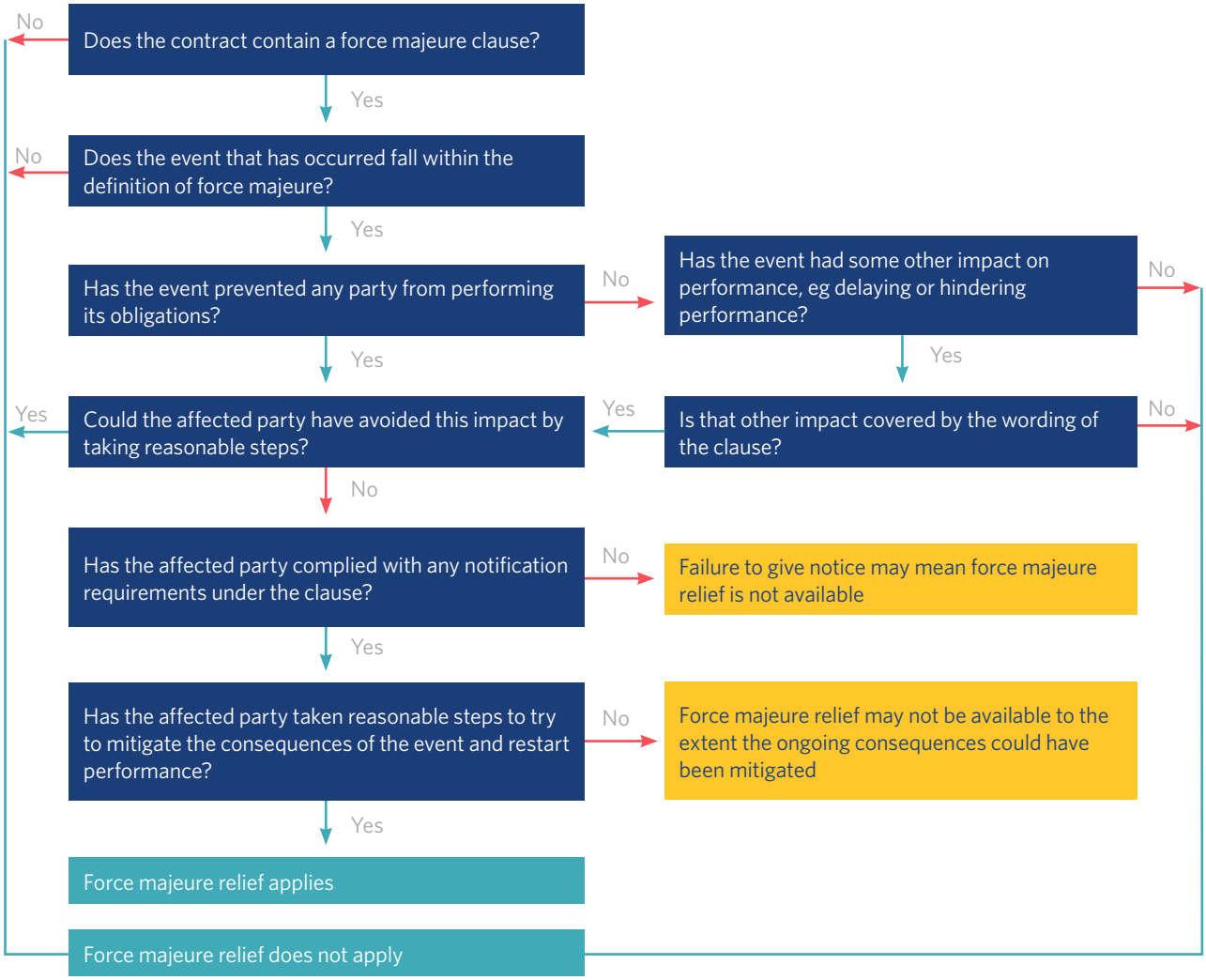
Effect of force majeure

The effect will vary depending on the specific terms of the clause. But, generally speaking, where a force majeure clause is successfully invoked, the parties' obligations under the contract are suspended without liability while the impact of the force majeure event continues.

Parties benefitting from force majeure relief should monitor the situation to ensure they are ready to resume performance as soon as the impact of the force majeure event has come to an end. A failure to do so could result in a party being in breach of contract.

Most force majeure clauses will also give a right to terminate the contract if the force majeure event continues for a specified period of time, which may be defined as a continuous period or alternatively as an aggregate number of days if there are multiple periods caused by the same force majeure event.

Is there a right to force majeure relief?



MAC clauses

A typical MAC clause will allow a party to refuse to proceed with a transaction if certain events occur after the contract date. They are most commonly found in the context of the sale of a company or business (allowing the buyer to walk away if there is a MAC before the deal closes) or a lending transaction (allowing the lender to call a default if there is a MAC affecting the borrower).

The drafting of MAC clauses varies greatly. They may be drafted widely, subject to specific carve-outs of events that will not qualify, or they may be drafted more narrowly to specify particular events that will qualify as a MAC. As with any contract term, the interpretation of a MAC clause will depend on the language used in the context of the contract as a whole, the background facts and the commercial context.

A MAC clause cannot be triggered on the basis of circumstances known to the relevant party on entering into the agreement, although it may be possible to invoke the clause where conditions worsen in a way that makes them materially different in nature. The change relied on must also be material, in the sense that it must be sufficiently significant or substantial, and it must not be merely a temporary blip.

The party seeking to terminate the contract under a MAC clause has the burden of proving that a MAC has occurred.

In *Grupo Hotelero Urvasco SA v Carey Value Added SL*, the Commercial Court considered what it described as a MAC clause in simple form, the borrower representing that there had been no material adverse change in its financial condition since the date of the loan agreement. The lender argued that there had been a material adverse change since the agreement was entered into in December 2007, which meant it could withhold payment in June 2008.

The Court summarised its approach to the clause: the assessment of the borrower's financial condition should begin with its financial information at the relevant times, but would not necessarily be limited to that information if the lender could show other compelling evidence. The adverse change would be material if it significantly affected the borrower's ability to repay the loan. However, the lender could not trigger the clause based on circumstances it was aware of at the time of the agreement.

On the facts, the Court was satisfied that there was a material adverse change in the borrower's financial condition in the relevant period, in particular because it was only in 2008 that the full force of the bursting of the property bubble on the borrower's business became apparent.

Frustration

The common law doctrine of frustration will apply where an event occurs after the contract has been entered into, which is not due to the fault of either party, and which renders further performance impossible or illegal, or makes the relevant obligations radically different from those contemplated by the parties at the time of contracting.

The courts have tended to apply the doctrine narrowly, emphasising that it is not lightly to be invoked to allow a contracting party to escape from what has turned out to be a bad bargain. In determining whether the doctrine applies, the court will consider multiple factors including the parties' knowledge and expectations at the time of contracting, as objectively ascertained. Events which make performance more onerous or more expensive will not necessarily be sufficient to frustrate the contract.

Grounds on which frustration has been argued in previous cases, and which could conceivably amount to frustration depending on the circumstances, include: epidemic or pandemic; a change in law or regulation; cancellation of an expected event; and serious delay.

The fact that an event is foreseeable will not necessarily preclude a finding of frustration, eg if an event such as a strike lasts so long as to render performance radically different from that contracted for. However, the less an event is foreseeable, the more likely it is to lead to frustration.

Where the contract expressly provides for the event which has occurred, the contract will not generally be frustrated – unless the event is significantly more dramatic than envisaged. (For example, the parties may include provisions relating to the possibility of a strike, but if a strike lasts so long as to mean that when the contract can eventually be performed it will be radically different from the performance contracted for, then the contract may be found to have been frustrated). For this reason, the presence of a force majeure clause means frustration is less likely – though it is possible if the clause does not cover the event in question (eg if the list of force majeure events is narrowly and exhaustively defined).

In *Edwinton Commercial v Tsavliris Russ* the Court of Appeal held that a 20 day time charter had not been frustrated by a delay of 108 days in redelivery of the vessel due to its detention by port authorities. The critical question was whether, at the relevant point, the existing and prospective delay would have led the parties to have reasonably concluded that the charter was frustrated.

Applying the doctrine of frustration required a "multi-factorial approach", taking into account for instance the terms of the contract, its context, the parties' (objectively determined) assumptions in particular as to risk, the nature of the supervening event, and the parties' "reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances".

Here the Court based its conclusion on a number of factors, including that the delay came at the very end of the charter, rather than interrupting "the heart of the adventure", and that the contractual risk of such delay was, in the Court's view, firmly on the charterers. It was also relevant that the risk of detention was foreseeable, in general terms, even if the actual circumstances of the detention were unusual.

This conclusion was consistent with the dictates of justice, which provided a "reality check" as to the Court's assessment of the issue of frustration.

In *Canary Wharf (BP4) T1 Ltd v European Medicines Agency*, the European Medicines Agency (**EMA**) argued that its lease of premises in Canary Wharf would be frustrated as a result of Brexit. Its primary case was that, as a matter of EU law, it would lack capacity to make use of the premises or perform its obligations under the lease. It argued in the alternative that there had been frustration of a common purpose, namely to use the premises to provide it with a permanent headquarters for the next 25 years.

The High Court rejected the EMA's case on both grounds. It found that the supervening event was in reality the EMA's involuntary departure from the premises, due to circumstances beyond its control. That involuntary departure was not merely envisaged but expressly provided for in the lease (which allowed assignment or sub-letting), and there was no common purpose outside of the lease. The EMA could not say this was not what it bargained for.

The judge noted that whether a contract is frustrated depends on a consideration of the nature of the parties' bargain when considered in the light of the supervening event said to frustrate that bargain. Only if the supervening event renders the performance of the bargain "radically different", when compared to the considerations in play at the conclusion of the contract, will the contract be frustrated.

The effect of frustration is to bring the contract to an end, immediately and automatically. It does not require an act by the parties to the contract.

The Law Reform (Frustrated Contracts) Act 1943 provides that sums paid (or payable) before the contract was frustrated are to be repaid (or cease to be payable). However, if the recipient incurred expenses before the frustrating event occurred, the court may allow it to retain (or recover) some or all of the relevant sums, up to the amount of those expenses, if the court "considers it just to do so having regard to all the circumstances of the case".

It is possible, however, to exclude the operation of these provisions by making separate provision for the consequences of frustration in the contract.

Additional references

2 Entertain Video Ltd v Sony DADC Europe Ltd [2020] EWHC 972 (TCC)

Canary Wharf (BP4) T1 Ltd v European Medicines Agency [2019] EWHC 335 (Ch)

Classic Maritime Inc v Limbungan Makmur SDN BHD [2019] EWCA Civ 1102

Seadrill Ghana Operations Ltd v Tullow Ghana Ltd [2018] EWHC 1640 (Comm)

Grupo Hotelero Urvasco SA v Carey Value Added SL [2013] EWHC 1039 (Comm)

Tandrin Aviation Holdings v Aero Toy Store [2010] EWHC 40 (Comm)

Edwinton Commercial v Tsavliris Russ [2007] EWCA Civ 547

Thames Valley Power v Total Gas & Power [2005] EWHC 2208 (Comm)

Intertradex v Lesieur [1978] 2 Lloyd's Rep. 509

Impact on civil litigation in England and Wales

The courts' response to the Covid-19 pandemic has been remarkably successful in civil commercial cases, with a widespread move to video and telephone hearings to allow the administration of justice to continue.

The tone was set early on, with a message from the Lord Chief Justice four days before the first lockdown in March encouraging judges in all jurisdictions to continue court business through the use of technology.

While audio and video hearings may not be suitable in all areas, the Lord Chief Justice's Report 2020, which was laid before Parliament in November, notes that for many hearings "remote technology has been very effective, demonstrating the widespread benefits to be gained from modernisation, for example by removing the need to attend court and tribunal centres for short hearings."

That has certainly been the case in the Business and Property Courts where, the report states, 85% of its work was heard remotely and to the original timetable during lockdown, and consideration is being given to the longer-term potential for increased efficiencies through the use of remote hearings in some aspects of the court's work. Although the report notes that remote hearings are not always as efficient as physical hearings (as they are more tiring; can be slowed by technical difficulties; and do not allow for parties to come together in the margins of the hearing to resolve issues outside of court) the convenience offsets some of the negative aspects and "there is no doubt that the lessons learned from operating in a pandemic will lead to greater use of technology in the longer term".

The Lord Chief Justice's Report 2020 notes that, in the High Court overall, there was a slight fall in claims received in April and May 2020 due to the pandemic but overall the levels have remained as high as in 2019. The work of the Business and Property Courts "continues to underpin the position of English law as the global business law of choice with decisions having a wide impact in financial, business, commodities, insurance, shipping and other markets". The Commercial Court, which was in its 125th anniversary year, is recognised as one of the world's leading centres for international business dispute resolution and has attracted a large number of significant and high value claims. 75% of the work in the Commercial Court is international with around 50% having no UK based parties. Business in the Technology and Construction Court has continued to grow with a 6% increase in new cases in the first six months of 2020 compared to the same period in 2019.

With regard to appeals, before the pandemic the Court of Appeal had managed to reduce the time taken to give judgment on a case with permission to appeal by about 35% on average since 2017, reducing the pre-existing backlog of cases and increasing efficiencies. Although a backlog then built up at the start of the pandemic, the court is working through it and does not expect there to be a significant knock-on effect on its work.

PRA and FCA confirm expectations for regulated firms under SMCR

The PRA and FCA have set out their expectations for UK-regulated firms under the Senior Managers and Certification Regime (**SMCR**) in the light of the Covid-19 outbreak.

A joint statement from the PRA and FCA in April 2020 applies to dual-regulated firms (the **Joint Statement**), while the FCA has published a separate statement for solo-regulated firms (the **FCA Statement**). The FCA and PRA also issued updated guidance on 9 November 2020 in relation to Senior Managers' responsibilities for compliance with government guidance on Covid-19 (the **Updated Guidance**).

Some differences in expectations as between solo and dual-regulated firms are highlighted below.

Next steps

Firms should:

- Ensure responsibility for the response to Covid-19 disruption is clearly allocated to one or more appropriate Senior Managers.
- Document internally all decisions relating to the interim re-allocation of Senior Management Functions (**SMFs**) and Prescribed Responsibilities (**PRs**) as a result of temporary absences during this period. Firms should be prepared to share these internal documents with the regulators on request.
- Communicate material temporary changes to the appropriate regulator promptly (this may not need to be by way of usual SMCR notification forms).
- Keep contingency plans under review to ensure they remain up-to-date.
- Take reasonable steps to complete any annual certifications that are due to expire while restrictions are in place.

Key expectations

Allocating responsibility for Covid-19 response

- Firms are not required to allocate responsibility for their response to the disruption caused by Covid-19 to a single Senior Manager. No "one size fits all" approach is being mandate.
- However, the Updated Guidance recommends that the SMF1 Chief Executive Officer function should be accountable for ensuring that firms have an adequate process for following and adhering to government guidance. For firms that do not have a SMF1, this will be most relevant member of the senior management team. In the Joint Statement, the PRA also recommends that dual-regulated firms consider how they respond to unexpected changes to contingency plans, given the possibility of Senior Managers becoming temporarily absent. Solo-regulated firms should consider doing the same.

Temporary arrangements for SMFs and PRs

SMFs

- Where a Senior Manager is unexpectedly absent due to illness (or other Covid-19 related circumstances), firms may choose to allocate SMFs to existing Senior Managers. In addition, under the existing '12-week rule', firms may permit an unapproved individual to perform an SMF role where such arrangements are temporary.
- For solo regulated firms, the FCA intends to issue a Modification by Consent to the 12-week rule to support firms using temporary arrangements for up to 36 weeks. This extended period is not currently available for dual-regulated firms (although this position remains under review).

PRs

- The FCA and PRA expect PRs (for both solo and dual-regulated firms) to be **allocated to existing approved** Senior Managers wherever possible. Where this is not possible (for example due to other Senior Manager absences), the PR can be allocated to an unapproved individual performing an SMF's role on an interim basis.
- All temporary changes to SMFs or PRs throughout this period should be clearly documented on internal records, including in Statements of Responsibilities (**SoRs**) and Responsibilities Maps (where appropriate). These records will need to be available to the FCA and/or PRA on request.

Furloughing staff

- Both statements confirm that furloughed Senior Managers will retain their approved status during their temporary absence and will not need to seek re-approval.
- Certain 'required' functions (such as Compliance Oversight and MLRO) and/or 'mandatory' functions (such as the CEO, CFO and Chair of the Governing Body for Solvency II insurers) should only be furloughed "as a last resort". Firms must arrange cover for those SMFs during the individual's absence.
- Firms have greater flexibility in furloughing Senior Managers whose functions are not mandatory. However, in the Joint Statement, dual regulated firms are cautioned to think carefully about the implications of furloughing non-mandatory SMFs (such as SMFs responsible for business continuity). Solo-regulated firms should also consider the implications of furloughing key senior staff.

Notification requirements during this period

All firms

All firms should update the FCA (and, where relevant, the PRA) by email or by telephone where:

- unapproved individuals are acting as SMFs under the '12-week rule'; and/or
- Senior Managers have been furloughed.

Firms are not required to submit Forms C, D or J in connection with these temporary absences.

Solo-regulated firms

- Solo-regulated firms will not be required to submit an updated SoR for approved Senior Managers if a temporary change is made to their responsibilities. However, solo-regulated firms will still need to notify the FCA of the detail of any changes (by email or by telephone) that would normally be included in updated SoRs.

Dual-regulated firms

- Dual-regulated firms are still required to update and submit SoRs if there are significant changes "as soon as reasonably practical". It is acknowledged that this may take longer than usual due to current operational challenges.

No change to the obligation to certify staff as fit and proper

- Dual-regulated firms should take reasonable steps to complete annual certifications due to expire during this period. What might constitute reasonable steps may be altered given the current situation, and certification policies and procedures may need to be adapted.
- While not specifically addressed in the FCA Statement, in the absence of any new regulatory guidance, the FCA's expectation appears to be that solo-regulated firms should also take reasonable steps to continue with annual certifications during this period.

Certification Regime and Conduct Rules

The FCA published a policy statement in October 2020 confirming that it will delay the implementation deadlines for the Certification Regime and Conduct Rules from 9 December 2020 to 31 December 2021.

Practical tips for renewing your business' insurance programme during the Covid-19 pandemic

Many businesses will be renewing insurance programmes over the coming months. Renewals this year will be undertaken against the background of a changed business environment and a new way of working in light of Covid-19. That will have an impact both on the risks that businesses want to insure against and the practicality of carrying out the renewal. It is vital, therefore, for businesses to get renewal right. So here are our 5 top tips for risk professionals who are renewing their programmes over the coming months.

Don't just accept Covid-19 exclusions at renewal

In our experience, some insurers are seeking to incorporate Covid-19 exclusions into policy wordings. The Lloyd's Market Association (**LMA**) have produced a specific exclusion for this purpose. Other insurers may follow with their own wordings. The LMA exclusion wording is very broad and provides:

"Your Insurance Policy does not/This Insurance does not {delete as applicable} cover any claim in any way caused by or resulting from:

a. Coronavirus disease (Covid-19);

b. Severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2);

c. any mutation or variation of SARS-CoV-2;

d. any fear or threat of a), b) or c) above".

To the extent possible, policyholders will want to resist the insertion of such broad exclusions, even though it now appears that there is an effective vaccination for Covid-19. This could be done by seeking to renew your policy without such exclusion, seeking to narrow the scope of the exclusion, or, if a satisfactory solution cannot be reached in time, by seeking to extend the existing policy pending renegotiation of the terms.

As noted above, if insurers require a Covid-19 exclusion to be inserted, policyholders will want to try to narrow the scope of the exclusion as much as possible. Some of the ways to narrow the exclusion may include seeking to:

- restrict the causal connection required between the claim or loss, such that loose or indirect connections will not be sufficient;
- insert wording to the effect that the exclusion will not apply where there are concurrent causes (one to do with Covid-19 and the other unconnected)
- limit the exclusion to the current known impacts of Covid-19 (eg due to measures already taken by the Government) and not unknown future impacts.

The market is fluid and evolving. Many insurers are reportedly insisting on Covid-19 exclusions. It may not, therefore, be possible (or at least may become difficult or expensive) to access insurance without a Covid-19 exclusion. Where a new policy will contain a Covid-19 exclusion following renewal, it will be critical to ensure that any existing claims, losses or circumstances are notified under the current year's policy prior to renewal, as we discuss below.

Consider what other policy exclusions might bite following renewal in relation to circumstances known or notifications made prior to renewal

Even absent a Covid-19 exclusion, losses arising from Covid-19 may be excluded by virtue of a "prior known circumstances" exclusion or a "prior notice exclusion". Many liability policies contain such exclusions.

"Prior known circumstances" exclusions typically provide in substance that the insured cannot claim under the policy for claims arising out of circumstances which the insured knew or ought to have known about prior to renewal. How such an exclusion will apply in any given situation will depend on the precise wording of the policy and the facts of the matter.

"Prior notice exclusions" operate to exclude from cover claims arising out of matters which have been notified to a previous year's policy. Sometimes the exclusion is narrower in scope and only applies if the insurer under the prior year had accepted the notification.

With regard to "prior known circumstances" exclusions, as a general rule, there must be some causal connection between the facts or circumstances and the claim or loss which occurs. The fact of Covid-19 may not itself be regarded as a known circumstance, but its (known) impact on the business might be to the extent that is relevant to the potential for insured events. For example, whilst each matter is highly fact and policy specific, a business might have a known issue with servicing customers, have cancelled an event, had to make difficult decisions in relation to members of staff, or paused construction on a building site – each of which might result in a future claim against the business.

This has two key practical impacts.

Firstly, claims arising out of circumstances known about before renewal might be excluded from cover under the new policy. Whether or not such issue will amount to a circumstance will depend on the precise factual circumstances. A "prior known circumstances" exclusion will only engage if you do in fact have a circumstance within the meaning of that exclusion.

In any event, policyholders will have to give a fair presentation of the risk to insurers prior to inception of the new policy (as discussed below), including disclosing any material circumstances. In the usual way, insurers might seek to incorporate specific policy exclusions. It may thus become clear during renewal discussions whether insurers consider there to be any circumstances which would be excluded from cover following renewal.

Secondly, if a notification of a claim, loss or circumstance is made to the expiring year, then it is important to gauge in advance what impact that might have on coverage under the new policy in light of any "prior notice" exclusion, particularly if there is any risk that the exclusion under the new policy might have broader application than the language under the expiring policy which attaches the notified matter (and often causally related matters) to that policy. Otherwise, gaps in coverage could result. It will be particularly important to ensure that there is a smooth transition between cover under the different policy years where you are changing insurer.

It is important, therefore, to review the proposed exclusions in the new policy wording holistically and to understand what Covid-19 losses might or might not be covered, taking account of existing knowledge and notifications prior to renewal. Where there is a potential risk of a gap in cover (eg due to an unduly broad "prior circumstances" exclusion), then curing that issue should also be front and centre in any renewal discussion.

Ensure you notify all circumstances, claims and losses to expiring policies prior to renewal

To minimise any risk of falling foul of exclusions in next year's policy, including not least Covid-19 exclusions, it is strongly advisable for policyholders to take the time to consider now what if any matters, such as claims, losses and circumstances in respect of potential claims/losses, are potentially capable of notification to the expiring policy year. This should be kept under review up to renewal – and beyond if grace periods for notifications apply.

When notifying a circumstance to an expiring policy, care should be taken to get the notification right. This sounds easy, but frequently gives rise to insurance disputes. The object is to make the notification in such a way as to attach future claims or losses to the policy year to which the notification was made on as broad a basis as possible. This involves identifying what the insured knows and striking the right balance as to the scope of the notification that can be permissibly made in light of those known facts.

It is possible to notify a circumstance in respect of a problem (or a hornet's nest of problems), even if the insured does not currently know what the cause or impact of the problem may be. For example, on renewal of a D&O policy, consideration could be given to notifying issues with critical decision making outside of usual governance parameters or a drop in the company's stock price if that could lead to a securities action. There is, of course, a balance to be struck because a broad blanket notification of circumstances may not be valid if it is too vague. Ultimately, whether a notification is valid will depend on the precise factual circumstances.

As ever, the policy will typically contain conditions as to how and when notifications may be made, and the insured should take care to comply with these: the golden rule is to 'do what it says on the tin'.

As part and parcel of the above, where a claim or loss has been notified to the expiring policy year, it is also worth considering whether there should also be an accompanying notification of circumstances, particularly where the claim relates to a potential issues that might affect other potential claimants.

Ensure your wording is fit for purpose in light of your new risk profile

The risk profile of businesses will have changed to some extent in light of the current pandemic. The most obvious example perhaps is that businesses have had to adapt and change their ways of working, albeit this may be temporary. It is therefore important for policyholders (together with their brokers) to review the current risk in detail against any proposed new wording, and not simply to roll over existing wording. For example, some property damage policies set a maximum period of time for which premises are permitted to be unoccupied. Such clauses may need to be disapplied or amended to permit longer periods of unoccupancy in the current circumstances. Some insurers are already offering revised terms in that regard. Similarly, practical issues may arise if a notification clause requires notification by a particular means or to a particular person, if that mechanism does not reflect how the recipient insurer is currently operating (or has operated in the recent past).

Comply with the duty of fair presentation in a world of dispersed working

The Insurance Act 2015 requires the insured to make a fair presentation of the risk to the insurer. This involves disclosing every material circumstances which the insured knows or ought to know – or, at least, disclosing sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances. An insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured. The Act requires the insured to make the disclosure in a manner which would be reasonably clear and accessible to a prudent insurer. This duty will still apply notwithstanding the Covid-19 pandemic. It does present insureds with a number of practical challenges. That said, our understanding to date is that renewals have been proceeding relatively smoothly with the necessary adaptations.

Risk managers will need to work out how to carry out a reasonable search whilst many people in the business are working remotely. That will involve identifying early on the individuals within the organisation who will have access to the relevant information and knowledge, and asking them for their input in good time. It will also be important to work out how to present the information to insurers in a clear manner. If the insurer would usually undertake a site visit, that might need

to be replaced with a virtual video tour. Likewise, in-person risk presentations can be substituted with online video calls and presentations.

It is worth bearing in mind that insurers have been adjusting their underwriting methods and getting to grips with remote working themselves. They will be interested in understanding any changes to the business' risk profile in light of Covid-19, as this may affect the pricing of the risk and renewal terms. The renewal process may therefore take longer than usual. It is a good idea to engage early with insurers and have an open dialogue about what underwriting information they will need and how they would like it to be presented to them.

Where an insured or insurer is practically unable to undertake a search or present the risk in the usual way, early communication will be key. For the policyholder in particular, it will be important to make sure the insurer knows what can and can't achieved. What counts as a 'reasonable search' may be different in the current circumstances, but rather than the parties debating after the event what was reasonable, the safer course would be to obtain an acknowledgement from the insurer upfront that the duty of fair presentation is qualified by any limitations which the insured encounters.

The insured should also consider whether their policy contains the best available innocent non-disclosure clauses or other terms dealing with presentation of the risk, in order to minimise the risk of insurers having a remedy, particularly where there has been an inadvertent breach of the duty of fair presentation in consequence of the current circumstances.

Finally, it is worth being aware that there is a possibility that you may be able to obtain a policy extension for a short while if renewal looks like it will need to be delayed. There are a number of auto-extension clauses available in the market eg from the LMA. However, if this is an option that you are considering, a new duty of fair presentation will apply to anything relevant to the extension unless insurers agree expressly or impliedly to waive any further disclosure requirement. Again, early communication and appropriate protective steps will be key.

Conclusion

As always, the best way for an insured to protect its position on renewal is to start early, communicate well and take appropriate steps to lock-in coverage under expiring wordings and seek best in class wordings on renewal. An insured that fails to take appropriate steps, and simply goes through the usual motions, could well find itself with gaps in cover for Covid-19 related claims that could have been avoided. This sounds straightforward, but a proactive and diligent approach could make all the difference to a business's balance sheet where it is faced with Covid-19 related impacts.

Impact of Covid-19 on class actions in the UK

The unprecedented disruption to both daily life and business activity on a global scale caused by the Covid-19 pandemic provides a fertile environment for class actions – an area that has been growing in prominence in the UK courts in recent years in any event. Inevitably, this is something that claimant firms and litigation funders (who are often the instigators of class actions) will be looking at with a keen eye.

So, to assist with horizon scanning for businesses and their insurers, we highlight below some observations on how Covid-19 is likely to affect the UK class action landscape.

Employee claims

Most businesses have, to some extent, continued to operate during the pandemic with employees on site. This includes those businesses designated as providing essential services and therefore able to remain open to the public throughout the periods of "lockdown" (eg food retailers, pharmacies, petrol stations etc.), but also those operating online where physical employee presence (eg at warehouses and distribution facilities) may still be unavoidable.

Employers are of course under a duty to ensure safe working conditions for their staff (with specific duties in respect of any disabled or pregnant staff), and most businesses will have done (and continue to be doing) all they can to meet this obligation. But where there are failures, so that employees are required to work in close quarters and/or with insufficient protection, for example, the risk of claims is obvious. And given that many of these issues will be common to groups of employees in a particular role or business unit, there is the potential for class actions to be brought.

In addition, employees in the UK, faced with what they reasonably believe to be "serious and imminent" danger at work, are protected from detriment if, for example, they leave work, refuse to return to work or take steps to protect themselves and others. Employers may, therefore, be at risk of collective claims from employees invoking such protection during the ongoing pandemic (and in particular, in light of the "second-wave") if they are dismissed or suspended for taking steps to protect themselves. Further, the High Court has recently ruled, in a case brought by the IWGB union on behalf of gig economy workers, that the UK domestic law protecting employees from such detriment should be extended to workers to comply with EU law (as well as the requirement to supply and use PPE in certain circumstances). Subject to any appeal, the UK Government will be expected to amend domestic legislation to extend these protections to all workers and once that is done, there is a potential for class action from a wider proportion of the workforce.

Even if a business does not have employees on site, that does not put an end to the risk of collective claims. If employees are furloughed, for example, employers will need to be mindful of anti-discrimination legislation in putting such arrangements in place (or terminating them). In addition, where employers make staff redundant – or seek to require them to alter their working hours, take unpaid leave or accept reduced pay, with the alternative being to risk losing their employment – any failings in the employer's consultation processes and decision-making (in particular, where collective consultation duties apply) could well lead to claims (again, potentially on grounds of discrimination, or for example for stress at work, breach of contract, unlawful deductions from wages or unfair dismissal (whether actual or constructive)). Where such failings are widespread within the business, these may ground an employee group action.

Such claims may be more likely in a unionised business, if the union is put under pressure from its members to fund such collective employment claims or where the employee representatives are able to bring certain claims (for example, for failure to comply with collective consultation obligations) on behalf of affected employees directly. During the pandemic, there has been a substantial increase in the number of interim relief applications under the UK whistleblowing provisions in relation to breaches of health and safety legislation or alleged furlough-fraud (some of which have been collective actions, backed by unions) and these appear to be some of the few applications being prioritised by the, otherwise, extremely overstretched Employment Tribunals.

However, in certain circumstances, trade unions may not want to bring such claims (because they do not want to damage the ongoing relationship between the employer and the union). In the absence of union support, claimant law firms (acting on a "no win no fee" basis) may approach employees directly and implement mass marketing campaigns to recruit claimants together in one action (as has been seen with the current mass equal pay litigation affecting several retail businesses in the UK).

Supply-chain issues

The current crisis has also given rise to issues across the supply chain, including in relation to business and human rights (**BHR**) and environmental, social and governance (**ESG**) matters.

Given the logistical and financial pressures faced by many businesses during the pandemic, businesses at all levels of the supply chain have been forced to look at their capacity to deliver on contractual obligations. Whether this gives rise to the cancellation of orders or impacts the timing of payment, supply chain disruption inevitably ensues.

How businesses treated their stakeholders and supply chain partners will be critical to the future assessment of their response to the Covid-19 crisis and to their claims to good corporate citizenship generally. Where there are failings, close attention is likely to be paid to public statements made by the relevant company (or other members of its corporate group) on BHR and ESG issues, with potential arguments that the company has thereby assumed obligations to those in the relevant supply chain or others affected by alleged failings. Again, the potential for class actions is obvious.

Private and cyber and data security issues

The very fact that a significant proportion of the workforce worked at home for a significant duration – many using personal devices and networks which may not be secure and operating outside of the direct supervision of their employers – inevitably increases the risk of cyber and data security incidents, including personal data breaches and, by extension, the potential for group litigation arising out of any such incidents. There has been a very significant spike in ransomware attacks during the pandemic. Cyber security incidents cause harm to individuals, including those which affect the integrity of information or lead to information not being available may result in litigation. Financial services regulators, for example, expect firms to be able to deliver operational resilience in their important business services despite disruption. Customers may pursue firms and firms, in turn, may pursue those in the supply chain that are responsible for incidents.

It is also possible that individuals may seek to bring claims either against public bodies or private companies alleging that actions taken during the pandemic breach their right to respect for private and family life. In such cases, the courts will have to balance individuals' rights against the needs of society as a whole.

Competition issues

The pandemic has generated high levels of demand for certain products, such as hand sanitiser and surgical face masks, and businesses will need to ensure they are not falling foul of relevant competition rules. There are examples of investigations into unfair pricing in Italy and France, with authorities from the latter imposing price controls on hand sanitiser and taking over the production of protective face masks.

The UK's Competition and Markets Authority issued an open letter warning firms (in the pharmaceutical and food and drink sectors) against exploiting Covid-19 by inflating the prices of high demand products. Businesses found to have practiced anti-competitive behaviour during the pandemic run the risk of class actions pursued by or on behalf of affected consumers.

Unlike most other areas where businesses may face class actions, competition claims have the added dimension that claims may be brought on an "opt-out" basis, subject to approval by the Competition Appeal Tribunal (referred to as the certification process), under a procedure introduced in 2015. This means that a claim can be issued on behalf of all affected claimants, without the need for individuals to come forward or be identified in the claim – in contrast to the group litigation order procedure used for other types of action, where individual claimants bring claims which are then managed together under the umbrella of the group litigation order. Where the green light is given to an opt-out claim, it is much easier to get the action off the ground – particularly where a large number of consumers has been affected but individual losses may be small.

The Supreme Court's recent ruling in the *Merricks* case (relating to the certification of a £14bn opt-out competition collective action brought against Mastercard) may further encourage such claims, as the Court in this case confirmed the less restrictive approach to certification and brings greater clarity in how claimants need to formulate their claims and what supporting evidence they will need on day one of their claims.

Securities class actions

Given the volatility in the markets that Covid-19 has prompted, and the continued uncertainty as to when and how quickly economies will recover, we are in a period of increased litigation risk for companies making public statements. Companies will be reluctant to make forecasts to the market in the current climate, where they can avoid it, but risk remains in relation to listed companies' compliance with continuous disclosure obligations.

Furthermore, Covid-19 has had a significant impact upon company balance sheets and it is inevitable that, as a result, some companies will be looking to bolster their capital positions, leading to rights issues and other forms of capital raising in 2021. In addition, as the pandemic has reshaped the ways in which many companies operate, there will be companies looking to capitalise on new opportunities through M&A activity.

Particular issues to bear in mind for companies conducting such transactions, and looking to protect themselves against securities litigation include:

- the evidential value in having a written contemporaneous record of the decision not to include something in a circular, prospectus or listing particulars;
- the need for any forward-looking statements to be carefully expressed, with assumptions and limitations made clear; and
- the importance of risk factors engaging with whether there is anything specific about the company, its business or the markets it operates in, which make it particularly vulnerable to the impact of a pandemic.

Issues for claimant firms and funders

Covid-19 related claims present potentially lucrative opportunities for claimant firms and funders – and of course, without the requisite funding, many prospective class actions would struggle to get off the ground.

But only time will tell what the fallout from the crisis may hold for the risk appetite of funders, who may themselves be looking to re-stabilise after a period of considerable turbulence. That may mean an increased focus on "safer bets" in litigation terms, so that those with more uncertain claims are left struggling to find funding. At the same time, since low interest rates are likely to endure for a long while after the crisis abates, one might expect greater investment inflows into litigation funders (among other alternative asset classes). That may drive some funders to entertain claims of a more speculative nature, geared towards extracting early settlements from target defendants perceived as being at their most vulnerable.

Additional references

Mastercard Incorporated & others v Walter Hugh Merricks CBE [2020] UKSC 51

Directors' duties in a Covid–19 world

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In these uncertain times it has never been more difficult for UK company directors to discharge the duties which bind them under the Companies Act 2006 (**CA 2006**) and at common law.

Already dealing with increasingly stringent governance requirements, increased risk of investigation and Parliamentary scrutiny, increased prevalence of shareholder class actions, a growing market in the trading of claims and legal reforms which increase the risk of personal liability (for example, the Pension Schemes Bill), directors are required to make decisions about the best interests of their companies in this uncertain landscape. In that context, it is unsurprising that the terms of D&O insurance policies are coming under increased scrutiny.

We focus below on the issues for directors of companies that are at risk of insolvency as a result of the pandemic. Successful directors, particularly of large and previously stable companies, do not often have experience of decision–making in these circumstances. They are being 'thrown in at the deep end' and will need quickly to digest how their duties are affected by insolvency risk. While directors are familiar with their core fiduciary duty to act in the best interests of their companies, the idea that best interests must be assessed by reference to creditors not just shareholders can feel alien.

Duty to promote the success of the company

Section 172(1) CA 2006 provides that directors must act as they consider, in good faith, would be most likely to promote the success of the company for the benefit of shareholders. The statutory wording appears to require directors always to act in shareholders' interests. However, both CA 2006 and the common law provide safeguards.

The section 172(1) factors

Section 172(1) identifies, non–exhaustively, six factors to which directors must have regard when discharging this duty, including the long term consequences of directors' decisions and the fostering of relationships with suppliers and customers. It does not prescribe how these factors must be weighed but is clear that they cannot override the obligation to act for the benefit of the company's shareholders. Though it is unclear what liability will attach to directors who do not have regard to these factors, directors are unlikely to be liable unless their decision was one that no reasonable director, having regard to the correct factors, would have taken.

Creditors' interests

Section 172(3) preserves common law rules requiring "directors, in certain circumstances, to consider or act in the interests of creditors of the company." Common law has not precisely identified when this duty arises or what is required of directors when it does.

The Court of Appeal gave the most recent and authoritative statement of the common law in *BTI 2014 LLC v Sequana S.A.*, where Richards LJ reviewed many earlier authorities. The Court was asked to consider when the directors' duty to consider or act in the best interests of creditors, termed "the creditors' interests duty", arose.

It is trite that directors do not owe any duty directly to creditors save in an exceptional case where directors have assumed responsibility to creditors (for example, by making a fraudulent statement to creditors or a negligent misstatement to creditors where the law imposes a duty of care). Directors continue to owe their duties only to the company. The issue is broadly when, in discharging their duty to promote the success of the company, directors must measure that success by reference to creditors not shareholders.

The Claimant in *Sequana* unsuccessfully argued that the creditors' interests duty should arise when a company has a real, not fanciful or remote, risk of insolvency. Instead, the Court held that the duty only arises when the directors knew or should have known that their company is, or is more likely than not to become, insolvent. The test as expressed in earlier authorities, using phrases like "doubtful solvency", "marginal solvency" and "serious financial difficulty", was thus clarified.

Arguably, the Court set the point at which the creditors' interests duty will arise quite late in a company's gradual decline, though that will provide directors little comfort given the impact of the pandemic has been anything but gradual. Setting the trigger too early could, per Richards LJ, have a chilling effect on business because it could prevent directors from taking entrepreneurial risks due to a perceived need to preserve capital for creditors.

Though *Sequana* helpfully clarified when the duty arises, important questions remain unanswered:

- The Supreme Court was due to hear an appeal in *Sequana* in March 2020 but this was postponed as a result of the UK lockdown. It is now unrealistic to expect judgment until 2021. The Claimant will ask the Supreme Court to hold that the creditors' interests duty arises at some stage before the company is or is more likely than not to become insolvent. It would be imprudent for directors of companies currently in financial difficulty to postpone all consideration of creditors' interests until such companies are or are more likely than not to become insolvent; any Supreme Court restatement about when the duty arises will have retrospective effect so that directors who rely on the Court of Appeal judgment might unwittingly be in breach of duty by failing to take into account

creditors' interests when they should have done. While ignorance of the law is not generally a defence, if they act reasonably and honestly, and rely on appropriate legal advice, they may be excused of liability under section 1157 CA 2006.

- When the creditors' interests duty arises, what effect does it have? Are the directors required only to consider the interests of creditors and, if so, how should they be weighed against other stakeholders' interests? Or does the duty require directors to act in creditors' interests so that they prevail over all other stakeholders' interests? Neither Sequana nor earlier authorities clearly define the content of the duty – in Sequana, Richards LJ stressed that this issue did not arise. As we explain below, in many cases its effect may not often matter.

Dealing with factual uncertainty

The directors' subjective determination of whether their company is or is more likely than not to become insolvent is relevant following *Sequana*. Companies' fortunes change, sometimes on a daily or hourly basis. A company may be more likely than not to become insolvent, but never actually do so. Companies may swing repeatedly between being likely to become insolvent and being likely to remain solvent. Directors constantly need to monitor whether the creditors' interests duty arises. How should they do so in the current environment?

Insolvency for these purposes is assessed on both a cashflow and balance sheet basis (as under section 123 of the Insolvency Act 1986 (**IA 1986**), by reference to the company's actual solvency position, not potential entry into an insolvency process.

Cashflow insolvency

A company is likely to become cashflow insolvent if it is more likely than not to be unable to meet its debts as they fall due. Put simply, is the company likely to run out of cash?

There are real difficulties with making that assessment currently. Market experience suggests that many companies preparing cashflow forecasts have assumed that they will have much reduced or no turnover for 3 to 12 months. It is unclear whether that is a correct assumption and, even when the current lockdown eases, whether and how quickly turnover will return to pre-pandemic levels. For companies with significant debts falling due in the medium term which they will be unable to meet unless income recovers in the same period, they may even now be more likely than not to become insolvent so that the creditors' interests duty arises.

As to expenditure, many businesses are reducing discretionary spending and cutting costs. Some outgoings may be met via Government schemes, though it is not certain how long these schemes will last and whether support will remain at current levels. The costs of operating businesses in the current climate and when lockdowns ease may increase, for example as a result of adjustments that must be made to respond to health concerns. It is unclear what adjustments may be required and what impact they may have on profitability, but their cost should not be underestimated. Even businesses which are perceived to be experiencing increased demand during the pandemic may not realise profits as a result. Turning to financing obligations, directors may need to re-assess when payments of principal and interest will become due. The pandemic has caused some companies to breach financial covenants with which they were previously unproblematic to comply. Other companies have potentially triggered events of default which are rarely considered in practice, for example in relation to cessation of a substantial part of a borrower's business, material adverse change and non-compliance with an approved business plan. Breaches and defaults will likely permit lenders to accelerate. Directors will be required to take a view on whether lenders are likely to accelerate and, if so, whether the company is likely to be unable to repay in full upon demand. The market has little experience of whether lenders will accelerate debts as a result of these breaches and defaults or whether waivers might be available; there is little precedent to inform directors' views. The likely stance of lenders is more difficult to predict due to their diversity – no longer are lenders exclusively banks – and the complexity of debt capital structures.

Assessing cashflow also requires a view to be taken by directors about their companies' counterparties. In many markets, companies which supply goods and services have not required payment on account. The recipients of those goods and services, anxious to preserve cash, may now seek to withhold or delay payment. Liability under invoices may ultimately be compromised at less than their value. Costly proceedings may be required in order to recover other liabilities. Though directors of these counterparties, at least if they are UK companies, might need to consider whether preserving cash in this way takes appropriate account of the need to foster business relationships with suppliers, being one of the factors listed under section 172(1) CA 2006, the reality for suppliers is that invoices are not being paid as they once were. Directors must consider this when forecasting cashflow.

The best protection for directors is to ensure that their cashflow forecasts use reasonable assumptions, that they genuinely believe them to be reasonable and that the forecasts cover an appropriate period.

Balance sheet insolvency

The balance sheet test is also difficult for directors to apply currently. The current pandemic has made it difficult to value assets and liabilities. For example:

- Where valuation turns upon the availability and robustness of a market, current market stagnation is likely to impact the accuracy and attractiveness of asset valuations.
- Where counterparties are unable or unwilling to pay, the debts due to a company may become more difficult to recover. This is likely to impact the value of the company's receivables (or require bad debt provisioning).

Again, the best protection for directors is to ensure that they are making reasonable assumptions, with appropriate valuation or accounting advice, and that they genuinely believe them to be reasonable.

Content of the creditors' interest duty

When the creditors' interests duty applies, what does it require of directors? There is little guidance in the cases.

When a company is actually insolvent, creditors' interests probably prevail over shareholders' interests because shareholders generally no longer have an economic interest in the company. Though this issue was not determined in *Sequana*, Richards LJ stated that "where the directors know or ought to know that the company is presently and actually insolvent, it is

hard to see that creditors' interests could be anything but paramount."

Even this simple proposition begs questions in the current pandemic. The abrupt change to market conditions and the reaction of many companies seeking to preserve cash is likely to lead to a liquidity crisis, especially for companies in the supply chain. It will be risky for their directors to cause these companies to assume additional debt financing in circumstances where the company is uncertain to be able to make repayments. These companies may therefore already be more likely than not to be unable to pay their debts as they fall due so that the creditors' interest duty applies, despite having adequate assets to make whole all creditors were the company wound up with any surplus being paid to shareholders. Is it right that the interests of creditors should be paramount even where shareholders retain an economic interest in the surplus and it is only a single debt due to a single creditor which cannot be paid when due? The cases do not provide an answer.

Where the company is more likely than not to become insolvent but is not actually insolvent, it is still more unclear how the interests of shareholders and creditors should be balanced. Some academics and limited pre–*Sequana* judicial guidance suggest tentative support for a spectrum in which the more likely a company is to become insolvent, the more weight must be given to the interests of creditors. Put another way, the extent to which creditors' money is at risk affects the regard which must be had to their interests. *Sequana* confirms that the creditors' interest duty does not apply at all until the point on the spectrum at which the probability of insolvency is more than 50%, but does not address the weight of creditors' interests relative to those of other stakeholders beyond that point.

When this question is finally determined by an appellate court, creditors' interests may be held to prevail when a company is actually insolvent but not where a company is merely more likely than not to become insolvent, in which case creditors' interests must be balanced with other interests. It would then be up to the directors to form judgments as to the weight to be given to creditors' interests. Board members may disagree, potentially hampering decision–making and promoting stalemate, at precisely the time when quick and decisive action is required to give the company the best possible chance of survival.

Does the duty's content matter?

The lack of clarity as to timing and content of the creditors' interests duty, and the potential impact for directors' personal liability, can only add to the sense of concern and uncertainty that many directors will currently be experiencing. However, it is arguable that the creditors' interests duty will only rarely impact directors' decision–making or give rise to personal liability. The interests of shareholders and creditors often align – both wish the company to be successful so that they can be paid – so that it does not matter whose interests the directors actually considered.

Reported cases in relation to the creditors' interests duty tend therefore to arise out of transactions where the interests of shareholders and directors conflict, such that a decision in the interests of shareholders necessarily prejudices the interests of creditors. *Sequana* concerned the payment of a dividend to shareholders when, it was alleged, cash ought to have been preserved to meet the company's liabilities. Earlier cases concerned other shifting of value to shareholders: for example, *West Mercia Safetywear v Dodd* concerned payment of money to a holding company and *Kinsela v Russell Kinsela Pty Ltd* concerned a lease granted to directors on favourable terms.

When the courts finally determine the content of the creditors' interests duty, it may be negative not positive – rather than requiring directors to act in or consider the best interests of creditors, it may require only that directors do not prejudice or ignore those interests when a company is actually or more likely than not to become insolvent. That is not a new idea, and was characterised by Professor Sealy as more akin to a duty of care than a fiduciary duty (see (1988) CLJ 175). This negative formulation of the common law duty would be similar to the statutory wrongful trading test, to which we return below. If this is the correct formulation, the duty will require directors to act differently to how they would in a solvent company principally where creditors' interests require assets to be preserved while shareholders continue to have an interest in the company taking entrepreneurial risk.

Why, then, do boards and their professional advisers spend so long considering the interests of creditors? The simple answer is that if creditors' interests are not properly considered, and if the company does enter an insolvency process, an administrator or liquidator may pursue claims against directors in relation to how the directors responded to the company's financial difficulties. Where directors acted to preserve assets which are available for distribution by the administrators or liquidators, they are less likely to be criticised. Favouring a cautious approach so as to minimise the consequences for creditors upon insolvency may also be thought to assist directors responding to post–insolvency investigations (including via the public forum of Parliamentary Select Committees) and disqualification proceedings.

However, too cautious an approach also puts the directors at risk. First, creditors' interests may be best served by continuing to trade, at least if there is real prospect of survival or an opportunity to realise profits with which to minimise losses to creditors in an insolvency process.

Second, if the creditors' interests duty does not require creditors' interests to prevail to the exclusion of other interests, logically the directors must continue to owe a residual duty relating to shareholders' interests. If the company ultimately recovers but does so more slowly due to an overly cautious approach being adopted, shareholder returns may be affected. Unlike creditors, whose only likely remedies against directors are via an insolvency process, shareholders can seek to sue directors in the name of the company via the derivative claims regime under Part 11 of CA 2006. Minority shareholders may also seek other relief in respect of unfair prejudice under section 994 CA 2006 (particularly where the board is largely comprised of majority shareholder appointees). This issue receives little attention but is a potential source of future litigation, especially given the increased prevalence of shareholder class actions and availability of litigation funding. While it may be difficult to imagine that directors who have successfully managed their companies through the pandemic, ensuring survival, will subsequently be criticised for taking too cautious an approach, and while courts are generally slow to find breaches of duty arising out of the honest and reasonable business decisions of directors, the possibility of shareholders de–risking litigation via funding and adverse costs insurance

policies and shareholders' potential access to meaningful recoveries via a directors and officers' insurance policy could well encourage such claims.

Group companies

One aspect of the duty which is likely to have the most significant effect on day-to-day decision making in large corporate groups is the impact on ratification of directors' breaches of duty.

In a solvent situation, directors tend to identify the interests of group companies on a collective basis, reflecting the interests of the group's ultimate shareholders. This potentially gives rise to numerous breaches of the directors' duty to act so as best to promote the success of an individual company within the group, but such breaches can be ratified (including informally under the *Duomatic* principle) by each group company's shareholders.

When a group is in distress, the potential for different companies within that group to have different interests is increased. Some companies may be best served by taking on new debt. Others will be so reliant on their affiliates that their best hope of survival is to secure the affiliate's survival, perhaps via the granting of security or guarantees. Where the creditors' interests duty applies, *West Mercia* and other authorities confirm that shareholders can no longer ratify the directors' breaches.

Directors must therefore identify the interests of each individual group company and, for those companies that are or are more likely than not to become insolvent, must apply the creditors' interest duty. Failing to do so risks liability.

For groups which operate and are managed via group-wide divisional structures, effectively ignoring the separate legal personality of each entity within the group, it is often challenging accurately to assess the individual position of any single group company, more so if each group company is unable to continue trading without the support, services or personnel of its affiliates. As the Nortel Networks insolvency has shown, the costs ultimately borne by creditors when these divisional structures need to be unwound in insolvency can be very significant, as can be the time required to resolve disputes which arise between companies as to their relative entitlement to the proceeds of transfers of a business previously operated jointly by several entities within a group.

Wrongful trading

It is important to distinguish between the common law creditors' interests duty and wrongful trading liability under sections 214 and 246ZB IA 1986.

While the creditors' interests duty will arise wherever a company is more likely than not to become actually insolvent, wrongful trading focuses on directors' acts when there was no reasonable prospect of avoiding insolvent administration or insolvent liquidation. The statutory regime is therefore triggered when it is almost inevitable that creditors' money is at risk, yet requires directors only to minimise losses to creditors (a negative test). By contrast, the common law duty may arise long before insolvent administration or insolvent liquidation is inevitable, and might impose some form of positive duty on directors.

The differences are well illustrated when directors consider entry into administration to facilitate a company's rescue. In order to obtain an administration order, paragraph 11(1)(a) of schedule B1 IA 1986 requires that "the company is or is likely to become unable to pay its debts". This is the same test that triggers the creditors' interests duty at common law. However, if there remains a reasonable prospect of rescue via administration, and avoidance of insolvent administration, directors cannot be liable for wrongful trading. That remains the case even if the rescue subsequently fails and the administration becomes insolvent.

Whilst the wrongful trading regime was temporarily suspended, with retrospective effect from 1 March 2020, that came to an end on 30 September 2020. Further, even when the suspension was in force, it was not correct that companies in difficulty could continue trading without threat of personal liability for directors. Suspension of the threat of wrongful trading liability placed increased emphasis on the creditors' interests duty. If directors would have been at risk of wrongful trading liability but for its suspension, the common law duty must arise: if there is no reasonable prospect of avoiding insolvent administration or insolvent liquidation, the company must also be more likely than not to become insolvent. If the common law duty is a negative one, it may require directors to minimise losses for creditors just as would the wrongful trading regime. If the duty is a positive one, additional steps may also be required of directors.

The continued importance of other duties

Amongst detailed discussion of the creditors' interests duty during the pandemic, directors must not forget their other duties. It is, in truth, relatively easy for an honest director to ensure compliance with the creditors' interests duty because, even though the trigger for the duty incorporates an objective element where the directors should have known that the company was or was likely to become insolvent, the duty itself is subjective. Directors will not be liable if they do what they honestly think best protects creditors' interests. Further, it is relatively rare for the interests of shareholders and creditors to diverge such that directors need choose between them. Even in acute financial difficulty, maximising the value of the company and taking reasonable steps (as opposed to costly gambles) to seek to ensure its survival will often serve both shareholders' and creditors' interests.

If directors should have realised that the company was more likely than not to become insolvent, they will not automatically be liable for breach of duty simply because they did not and failed to take any account of creditors' interests. They may have reached the same decision had creditors' interests been considered or the company's position may have been so dire that, no matter what decision the directors made, the company would have ended up in the same position – in either case, the directors' decision will not have caused loss to the company. Further, if a reasonable director, having taken into account creditors' interests, could have reached the same decision as the directors actually did (absent consideration of creditors' interests), the directors may not be liable: *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*. Even if they are liable, directors' liability can be excused under section 1157 CA 2006 where they acted reasonably and honestly.

It is uncommon for directors to be sued solely for breach of duty where establishing fault turns on the subjective belief of the directors. Breaches of other general duties are more easily proven. Directors will be in breach of duty under section 174 CA 2006 if they fail to exercise the level of skill, care and diligence that a reasonable director having the same knowledge, skill and experience would have exercised. This duty is likely to be broad enough to catch costly gambles made in an attempt to ensure a company's survival. Equally, it can likely catch a director's decision to continue trading when a reasonable director in the same situation would not have done so.

Other duties also create traps for the unwary. Directors cannot take advantage of their company's business opportunity, absent prior authorisation, even if the company is unable to pursue the opportunity due to insolvency: *Davies v Ford*. Consider a group of companies with common directors, where opportunities are made available to the group and the directors allocate them between companies. Absent prior authorisation, each allocation is prima facie a breach of duty – one group company's interests are prioritised over another's. If shareholders cannot ratify the breach because the creditors' interest duty has arisen, a subsequent insolvency officeholder can sue directors for breach and potentially obtain a remedy not only against them but also the group company that took up the opportunity.

And it is not only directors' general duties that must be observed. For example, directors remain required under section 363 CA 2006 to ensure that a company's accounts give a true and fair view. With all of the uncertainty caused by the pandemic and its effect on many aspects of a company's balance sheet, this is not straightforward even with the benefit of skilled advice.

Conclusion

Directors are being asked in this crisis to step up to a role which is alien to many, carrying their companies through distress and continuing to trade even where insolvency is likely. If calls on D&O policies are to be avoided, it is important for directors to understand their duties in these circumstances. While the Government is hoping that directors will steer businesses through, where companies do fail, it is unlikely that directors' decisions will avoid critical scrutiny. For directors, the risks have never been higher.

Additional references

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BTI 2014 LLC v Sequana S.A. [2019] EWCA Civ 112

Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2002] EWHC 2748 (Ch)

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Kinsela v Russell Kinsela Pty Ltd (1986) NSWLR 722

Re Duomatic Ltd [1969] 2 Ch 365

High Court applies SAAMCO principle in case of breach of trust by solicitor

LIV Bridging Finance Ltd v EAD Solicitors LLP (In Administration) [2020] EWHC 1590 (Ch)

18 June 2020

In *LIV Bridging Finance Ltd v EAD Solicitors LLP (in administration)*, the High Court applied the SAAMCO principle to limit the damages recoverable in a case of breach of trust by a firm of solicitors.

Background

The Defendants (**EAD**) were a firm of solicitors engaged by the Claimant (**LIV**) to act on their behalf, as lender, in connection with four loan transactions relating to the development of land. LIV brought a claim against EAD for breach of trust on the basis that EAD (through its employee solicitor Mr Gorman) paid away loan monies without ensuring that proper security had been obtained. The four loans amounted to £800,000, advanced over a period of 10 months.

Judge Halliwell found that Mr Gorman "paid out the monies in the knowledge that this was contrary to his instructions and the conditions on which they were held so as to give rise to a breach of trust…" Once a breach of trust was established, it was necessary to determine whether, and to what extent, LIV was entitled to equitable compensation for the loss it had allegedly sustained. EAD raised issues about the principles governing the quantification of LIV's claim for equitable compensation and, in particular, the application of the SAAMCO principle. The Court was therefore asked to apply the SAAMCO principle to the circumstances of this case.

The SAAMCO principle

The SAAMCO principle is derived from the decision of Lord Hoffman in *South Australia Asset Management Corpn v York Montague Ltd*, as expanded upon by Lord Sumption in *Hughes-Holland v BPE Solicitors*.

The principle operates to limit damages by reference to the scope of duty owed by a professional adviser. The first step in applying the principle is to identify whether the relevant role of the adviser was to (1) provide information to enable his/her client to decide on a course of action (**Adviser of Information**) or (2) advise his/her client what specific course of action to take (**Adviser of Action**).

A negligent Adviser of Information will be liable only for the foreseeable financial consequences of the advice or information being wrong. The recoverable losses are those which would not have been suffered if the advice and/or information had been correct. Losses which would have been incurred even if the information was correct are not recoverable.

A negligent Adviser of Action will have assumed responsibility for the course of action taken and will be responsible for all foreseeable financial consequences which flow from that action.

Application of the SAAMCO principle

Beginning with the scope of EAD's duty, the judge identified the relevant question as "whether [EAD's] role was to guide the decision-making process or merely to provide part of the material on which LIV was to rely". The judge determined that EAD's role was akin to an Adviser of Information on the basis that EAD was required to "implement [LIV's] specific instructions and, pursuant to such instructions, to provide specific advice by confirming LIV had acquired a first charge over the relevant properties". He then determined that EAD was not an Adviser of Action on the basis that Mr Gorman was not expected to guide the whole decision-making process so far as whether the loan was to be made and what security was required. The judge therefore concluded that the SAAMCO principle operated to limit LIV's recoverable losses to those which arose from EAD's "narrower duty to obtain a first charge and confirm that it has been obtained".

The Second and Third Loans, amounting to £100,000 and £150,000 respectively, were not repaid and there was no reason to believe they would be. The judge concluded that, had LIV obtained the first charge over the relevant properties, there was no reason to believe that they would have sustained the relevant loss. The conclusion was that LIV could be taken to have sustained losses under the Second and Third Loans of £250,000 in total.

The First and Fourth Loans amounted to £300,000 and £250,000 respectively. On the basis of the evidence before the Court, it was possible that LIV had already recovered more than the principal amounts of these loans. Nevertheless, LIV claimed that £127,734.14 was due under the First Loan and £182,320.30 under the Fourth Loan on account of arrangement fees and the accrual of interest pursuant to the terms of the loan facilities. The judge found that LIV was not entitled to contractual interest because LIV's losses were to be calculated so as to put it in the position it would have been but for EAD's breaches. In such event, the First and Fourth Loan amounts would not have been drawn down under the respective facilities, and therefore the borrower would not have incurred any contractual liability to pay interest. The judge further found that LIV's claim for arrangement fees was not properly substantiated.

Decision

LIV was awarded summary judgment for £250,000, plus equitable and statutory interest, in respect of the Second and Third Loans. This was on the basis that EAD had no real prospect of successfully defending LIV's claims. With respect to the First and Fourth Loans, it was held that there were aspects of LIV's case which would need to be dealt with at trial, including "the origin and calculation of the amounts that have been applied towards these loans and the calculation of the expenses incurred and, apparently deducted, in realising them". The question of whether equitable or statutory interest was applicable was also left undecided.

Comment

This case is another example of the Court applying the SAAMCO principle to limit the damages a claimant can recover from a firm of solicitors following the provision of what was found to have been incorrect advice.

The case is notable for the fact that the judge considered he could decide on a summary basis rather than after a full trial whether the SAAMCO principle applied.

Additional references

Hughes-Holland v BPE Solicitors [2017] UKSC 21

South Australia Asset Management Corpn v York Montague Ltd [1997] AC 191

Court of Appeal considers application of SAAMCO principle in context of auditor's negligence case

Assetco Plc v Grant Thornton UK LLP [2020] EWCA Civ 1151

28 August 2020

The Court of Appeal has held that, where an auditor negligently failed to detect management's dishonest concealment of the Claimant's insolvency, it was liable for the losses suffered by the Claimant in continuing to conduct its loss-making business.

Background

The Claimant company, AssetCo, was the holding company of a group carrying on businesses related to fire and rescue services. The Defendant accountancy firm audited AssetCo's accounts for the years ending 31 March 2009 and 2010. The accounts presented a picture of a profitable group whereas, in reality, the group was insolvent and the picture presented by the accounts was entirely false. The truth was discovered in 2011, at which point new management was appointed and a scheme of arrangement was concluded with AssetCo's creditors, thereby allowing the company to avoid insolvent liquidation.

AssetCo brought a claim for the losses it had suffered, principally comprising sums paid to AssetCo's loss-making subsidiaries. Its case was that, as a result of the Defendant's negligence, it lost the chance to put in place a scheme and restructuring in 2009, in which case these losses would have been avoided.

The Defendant admitted negligence, in particular in failing to detect management's dishonest representations in the course of the audits, but denied causation and loss. It was common ground between the parties that, at the time the audits were carried out, AssetCo's business was ostensibly sustainable only on the basis of management's dishonest representations to the auditors. It was also common ground that, if the Defendant had not been negligent, it would have been apparent that AssetCo was insolvent by May/June 2009, and that without a scheme of arrangement and restructuring the company would have gone into insolvent liquidation.

The Defendant, however, said that AssetCo's losses arose principally from the continuation of its loss-making business, and these losses fell outside the scope of the Defendant's duty of care. Further, it denied that AssetCo lost a real and substantial opportunity to put in place a scheme and restructuring in 2009 so as to avoid insolvent liquidation.

The High Court largely rejected the Defendant's arguments on causation and loss. It awarded AssetCo damages of just over £22.36 million (£29.8 million reduced by 25% to reflect AssetCo's contributory fault). The Defendant appealed on a number of grounds including the following:

- It challenged the judge's conclusion that the losses claimed fell within the scope of the Defendant's duty of care and that its admitted breaches of duty were the legal or effective cause of the losses.
- It argued that the judge was wrong in his approach to assessing the Claimant's claim for a lost chance to put in place the scheme and restructuring, wrongly failing to discount the damages to take account of a chance that these would not have taken place.

The Defendant also challenged the judge's conclusion that certain benefits obtained by AssetCo did not need to be taken into account as a deduction from the damages. That aspect is not considered further in this article.

Decision

The Court of Appeal largely dismissed the appeal. Lord Justice David Richards gave the lead judgment, with which Lord Justice Phillips and Sir Stephen Richards agreed.

Scope of duty and legal causation

The Defendant complained, in summary, that the judge had wrongly treated discrete breaches of duty (which the Defendant admitted) in failing to identify particular instances of dishonesty as a breach of a supposed duty to identify that AssetCo was being run in a fundamentally dishonest manner. This led the judge to find, in error, the necessary causal connection between the breaches and the losses. Further, the Defendant contended, the judge had failed properly to consider whether the losses claimed fell within the scope of the Defendant's duty.

The judge had found that AssetCo could not recover losses that were suffered simply because AssetCo carried on trading, but it could recover losses suffered as a result of "continuing to trade **in a particular fashion** in reliance on the audit" (the judge's emphasis). He found that, by admittedly failing to detect management's deceit, the Defendant was responsible for all losses incurred by AssetCo in continuing to conduct its business in a fundamentally dishonest manner.

The Court of Appeal accepted the Defendant's criticism that, in fact, it was not common ground between the parties that AssetCo's business was conducted in a fundamentally dishonest manner, though it was common ground that the management team's conduct was fundamentally dishonest in particular respects (making dishonest statements to the

Defendant during the audit process and dishonestly "overfunding" assets). However, that was not the only basis on which the judge found the Defendant liable for the losses in question. The common ground included that, when the audits were carried out, AssetCo's business was ostensibly sustainable only on the basis of management's dishonest representations. The Defendant's negligence in failing to detect the dishonesty had made it appear that the business was sustainable when in truth it was insolvent. The question was whether, in those circumstances, the losses from continuing that business fell within the scope of the Defendant's duty.

The Court referred to previous authority on the general principles applicable to scope of duty and legal causation, in particular the decision *South Australia Asset Management Corpn v York Montague Ltd* (SAAMCO), as considered in *Hughes-Holland v BPE* and *Manchester Building Society v Grant Thornton*.

As these decisions establish, a claimant to a professional negligence claim must establish that its loss fell within the scope of the duty owed by the defendant. In this regard the courts will distinguish between two sorts of case:

- "advice" cases, in which the defendant advised on the merits of the transaction overall and so has a duty to protect the claimant against the full range of risks associated with entering into the transaction; and
- "information" cases, in which the defendant supplied only part of the material on which the claimant decided whether to enter into the transaction, and so is liable only for the financial consequences of the information being wrong (and not the entire financial consequences of the claimant entering into the transaction, if greater). In an information case, importantly, the defendant is not liable for the consequences which would have occurred even if the information that was provided had in fact been correct.

In the present case, the Defendant submitted that the SAAMCO principle applies to audit claims and that such claims are "information" cases, and therefore AssetCo had to establish that the losses it claimed would not have been suffered if the information in the audit reports had been correct. As AssetCo had not asked the judge to determine this question, and he had not done so, AssetCo had failed to establish a necessary element of its claim.

The Court of Appeal said this submission misstated the purpose of the SAAMCO principle. As Lord Sumption said in *Hughes-Holland*, the SAAMCO principle is simply a tool for determining the losses which fall within the scope of the defendant's duty. There may be cases in which a claimant cannot succeed without specifically alleging and proving this point, but in many other cases the answer is established by the evidence as a whole without any need for it to be separately addressed in the course of the evidence. In any event, the fact that the judge was not invited by either party to address the SAAMCO principle did not inhibit the Court of Appeal from doing so.

The Court of Appeal also rejected AssetCo's submission that the SAAMCO principle did not apply in the context of an audit report, as opposed to a situation where information is provided to enable the recipient to decide whether to enter into a particular transaction or pursue a particular course of action. The Court agreed that an audit report has a different purpose, namely to enable the company to hold the management to account and ensure that errors are corrected. But this did not mean the SAAMCO principle should not, in most circumstances, be applied in the audit context, in order to "distinguish the negligent audit that is merely the occasion for the loss from the negligent audit that gives rise to a liability to make good the loss".

There may be exceptions to the application of the SAAMCO principle (most obviously in respect of dividends that could not lawfully have been paid if the accounts had been competently audited – it is well established that these fall within an auditor's liability even though they would have been paid if the information in the audit report had been correct). However, the Court said, the principle is capable of being effectively applied to most types of loss that may be claimed in respect of a negligent audit. David Richards LJ commented, in relation to the SAAMCO principle:

> "It is not a rigid rule of law but … 'simply a tool' for determining the loss flowing from the negligently wrong information as opposed to the loss flowing from entering into the transaction at all. If, in a particular class of case it is incapable of achieving that determination, it is not a tool which the court will use."

Applying the SAAMCO principle to the present case, AssetCo submitted that, if the accounts and audit report had been true, and the group's business was profitable, there was no reason why it should become loss-making in the following two years. The losses would not have been suffered in those circumstances, and therefore they fell within the scope of the duty. The Defendant submitted, to the contrary, that there was no reason to suppose that the losses would not have been incurred in the following two years (through payments to AssetCo's loss-making subsidiaries). There was no finding that the support provided to those subsidiaries was anything to do with AssetCo's management's dishonesty in the preparation of the accounts. In this way, the Defendant argued that there was no sufficient connection between the admitted breaches of duty and the losses.

The Court of Appeal concluded, in favour of AssetCo, that the Defendant's failure to detect the dishonest concealment of the group's substantial losses/insolvency deprived AssetCo of the opportunity to call the senior management to account and to ensure that errors in management were corrected. That was a principal purpose of an audit and, as Lord Hoffmann made clear in SAAMCO, the scope of an auditor's duty is determined by reference to the purposes of the statutory requirement for an audit. Accordingly, liability for the losses suffered was liability for the consequences of the information being inaccurate. The negligence was not merely the occasion for the losses which AssetCo continued to incur but was a substantial cause of those losses.

This was subject to an exception, in respect of one transaction which had involved AssetCo's CEO misappropriating £1.5 million of company funds for his own personal benefit. There was no negligence on the part of the Defendant in respect of transactions of this type in its conduct of the audit, and so there was no effective causal link between the transaction and the Defendant's negligence.

Loss of a chance

Having reviewed the authorities, the judge had held that, where the loss claimed depends on the hypothetical actions of a third party, the claimant must prove on the balance of probabilities what it would have done but need only show that there was a real or substantial chance of any necessary action by the third party. The court will then evaluate the lost chance as part of the assessment of damages.

Applying this approach, the judge concluded that AssetCo would have successfully completed a scheme of arrangement and restructuring in 2009. AssetCo had established that it would have taken all the steps necessary to achieve this and that the chances of third parties doing what was necessary for this purpose were in each case either 100% or so high that they fell to be treated as 100%. Accordingly, he did not discount the amount awarded as damages to take account of any chance that the scheme and restructuring would not have been put in place.

The Defendant challenged this conclusion, both as to the judge's assessment of the specific prospects on a number of relevant contingencies and in treating each contingency as a certainty. On the Defendant's case, for any independent contingency where the judge did not hold the chance to be 100%, he should have multiplied the probabilities to calculate the overall chance. On a number of the contingencies in this case, the judge found that the chances were in excess of 90% but declined to state a precise percentage. The Defendant argued that the judge must be taken to have assessed those contingencies at 90% and then, wrongly, applied a rule that these chances were to be rounded up and treated as 100% chances.

The Court of Appeal rejected the Defendant's submissions. First, it found that there was no basis for interfering with the judge's assessment of the prospects of particular contingencies having occurred, bearing in mind the advantages enjoyed by the trial judge over the appellate court, in particular by having been immersed in the case over an extended period and received detailed written and oral submissions from the parties. And second, it rejected the Defendant's premise that there were any contingencies where the judge assessed the prospects at less than 100%. Having reached an assessment of greater than 90%, the judge was entitled to treat the relevant contingency as being, within the confines of judicial decision making, a certainty. As David Richards LJ put it:

> "In my judgment, the proper analysis of the judge's reasoning is that he was satisfied that the chances of each contingency were so high that they fell to be regarded as certainties, not because of a principle or presumption that 90% equalled 100% but because a distinction between certain and almost certain was in this case meaningless. It was a conclusion that was open to the judge, both as a matter of principle and on the authorities."

Comment

While the decision recognises that a negligent auditor will not be liable for losses suffered simply because a business continues to trade, in the circumstances of this case the Claimant's business was ostensibly sustainable only on the basis of management's dishonest representations to the auditors in the course of the audits. By negligently issuing unqualified audit reports, the business appeared to be sustainable when in truth it was insolvent, and this deprived the Claimant's shareholders or non-executive directors of the opportunity to call the senior management to account. The Court of Appeal found that the Claimant's losses from continuing that business fell within the scope of the Defendant's duty: the negligence was not merely the occasion for the losses but was a substantial cause of them.

The judgment is of particular interest for the Court of Appeal's discussion of the SAAMCO principle. Essentially, this says that where a professional is responsible only for providing information on which a decision will be taken, rather than advising on the merits of a transaction overall, the professional will be responsible only for the consequences of the information being wrong – not all the financial consequences of the transaction. This means that the claimant must establish that its loss would **not** have been suffered if the information had in fact been correct.

In the present case, the Court of Appeal confirmed that the SAAMCO principle applies to general audit cases, even though the purpose of an audit is not to enable a decision to be taken in respect of a particular transaction. However, the decision emphasises that the SAAMCO principle may not need to be addressed in all cases, and in any event is not to be applied mechanistically. It is merely a tool the court may employ for determining which losses fall within the scope of the defendant's duty, and it may be subject to exceptions.

As a result, it was not fatal to the Claimant's case that it had not asked the judge to determine whether the losses it claimed would have been suffered if the information in the audit reports had been correct, and the judge had not done so. However, in cases where the provision of negligent advice or information is alleged, it would be prudent for the parties to consider the application of the SAAMCO principle and be ready to persuade the court, if necessary, why it should not be applied. The SAAMCO principle is due to be considered by the Supreme Court in an appeal against the decision in *Manchester Building Society v Grant Thornton UK LLP*, in which the Court of Appeal applied the principle to conclude that an auditor was not liable for losses suffered following negligent advice regarding the accounting treatment of interest rate swaps. That decision was also considered by the Court of Appeal in the present case.

The present decision is also of interest for the Court of Appeal's discussion of the correct approach to assessing damages in "loss of a chance" cases, where the claimant's loss depends on the hypothetical acts of third parties. The decision illustrates in particular that, in some cases, it may be appropriate to treat the lost chance as a certainty.

Additional references

Manchester Building Society v Grant Thornton UK LLP [2019] EWCA Civ 40

Hughes-Holland v BPE Solicitors [2017] UKSC 21

South Australia Asset Management Corpn v York Montague Ltd [1997] AC 191

FCA review of outsourcing by life insurers

4 March 2020

On 4 March 2020, the FCA published a short set of findings from its review of outsourcing in the UK life insurance sector. Despite the review's narrow scope, the FCA's findings are readily applicable to other outsourcing contexts, so regulated firms outside the life insurance sector should be aware of these. The FCA has tied in this review with its current focus on the operational resilience of regulated firms and the customer impacts caused by disruptions.

The FCA's findings do not break new ground or offer hard solutions. They instead reinforce the good practice steps that the FCA expects any responsible regulated firm to be taking in its outsourcing of services and functions. The FCA's findings focus on firms' ongoing operational management and governance of their outsourcing arrangements – a good reminder that the focus of regulators is on the operational steps taken by a firm to implement contracts with outsourced service providers – whilst the content of the contract is important, it must be seen as but one part of the overall outsourcing lifecycle.

Key takeaways for regulated firms

- Exit and transition out plans should actually explain what steps will be taken to exit and also migrate the outsourced services and functions. Regulated firms should consider and cover all exit scenarios in their exit plans, including unplanned exits.
- Business continuity planning, testing and readiness needs to involve both the customer and the outsourced service provider and both parties' business continuity plans need to be reviewed and tested.
- Regulated firms should ensure that the management information they receive from their outsourced service providers is of sufficient quality to allow those firms to take timely steps to address issues as they arise, including to address the customer impacts connected with those issues.
- Regulated firms need to factor in the customer impacts and ensure customer fair treatment as part of the oversight and control of outsourcing arrangements. The FCA considers customer impacts to be integral to oversight and control.

The FCA's review

The FCA's review sets out its findings in summary form and provides some observations of what it considers to be good and poor practices.

	FCA FINDINGS	NOTES
Exit plans	Some exit plans lacked detail making it impossible to understand how important elements of exit would in fact be carried out in practice. Some exit plans only focused on planned exits and ignored the possibility of sudden, unexpected exits due to termination or insolvency. Exit plans did not always contemplate the migration and transfer of outsourced services and functions, just their exit from the current outsourced service provider.	Encouragement for firms to consider unplanned exits links back to the FCA's observation that there is a concerning reliance on a limited number of outsourced service providers servicing the UK life insurance sector. This concern applies to other regulated sectors too and the FCA and other regulators are looking at this closely throughout 2020 as part of their focus on operational resilience. There is little firms can do to address a concentration among suppliers in the market. But there are practical steps that can be taken, such as identifying likely alternative outsourced service providers, ensuring that data can be readily separated and transferred, and limiting the use of provider-specific IT tools and processes.

	FCA FINDINGS	NOTES
Business continuity planning	A firm which relies on the systems of an outsourced service provider to perform services and functions needs to rely on the provider's business continuity plan and procedures in respect of those systems, so the firm should satisfy itself (through testing) that such a plan and procedures are robust enough	In practice this can be challenging for a firm. Outsourced service providers understandably may not wish to reveal the full details of their business continuity plans and procedures to preserve the confidential information of their other customers. One example of good practice identified by the FCA involved testing being carried out by a qualified third party as a way to overcome this challenge.
Governance and management information	Governance and management of outsourced services and functions should not focus solely on operational performance, but should also consider the outcomes for a firm's customers as an integral part of a firm's control over these outsourced services and functions. A firm needs to ensure that it receives adequate management information from its outsourced services provider which is actionable. The firm then needs to take timely and effective remedial steps to address any operational, compliance or customer-affecting issues, based on that management information. Firms should have in place a clear governance structure to facilitate timely and effective remediation of issues identified. An example of good practice identified by the FCA included joint forums between the firm and the outsourced service provider, with appropriate upwards reporting lines including to the boards of the entities as necessary.	The FCA's findings on governance and management also note the operational steps that firms should take beyond simply having a formal framework. The FCA's observations illustrate how governance forums should in fact work in practice by: addressing issues within their terms of reference; escalating matters where appropriate; and, importantly, keeping a record of issues raised and any action taken in response.

FCA's approach to international firms

23 September 2020

The FCA published a consultation paper (CP20/20) describing its approach to the authorisation of international firms. In the context of Brexit, the FCA's comments are relevant to firms (including insurers and insurance intermediaries) who have established EEA hubs to mitigate the loss of passporting rights, while continuing to conduct some of their activities through a UK branch. In most cases at least, these firms will maintain their authorisation in the UK from the end of the Brexit implementation period by entering the Temporary Permissions Regime. After that, they will require full authorisation in the UK which will bring the FCA's guidance into play.

Key points for firms include:

- **UK presence**

  The FCA expects firms to have an establishment or physical presence in the UK (ie a UK "branch"). This will, of course, be a relevant consideration for EEA firms that currently operate on a services-only basis in the UK but whose activities in the UK nonetheless will require authorisation once passporting rights fall away. The need for a UK branch is, of course, consistent with the practice adopted by the PRA to international insurers.

- **Branch vs subsidiary**

  The FCA will be looking to see how firms mitigate heightened risks that come with conducting business through a UK branch, as compared with establishing a UK-incorporated subsidiary. We can expect the FCA to put pressure on an international firm to convert its branch to a subsidiary where it believes that operating through the branch poses an unacceptable level of risk. Again, of course, this would be consistent with the approach that has already been taken by the PRA to insurers.

- **Cross-border services**

  In assessing the risks of harm, the FCA will look at both (a) risks associated with activities being undertaken through a branch, for example, because it is more difficult for the FCA to take action or because of overlapping regulatory regimes in the home state and the UK; and (b) the nature and scale of activities the international firm intends to conduct from outside the UK which may raise different concerns eg FSCS cover may not be available.

- **Risks of harm**

  Three broad categories of harm identified in the paper are retail harm, client asset harm and wholesale harm, although the FCA will also consider sector and business specific risks as part of its assessment. The FCA will also consider home state regulation and supervision, together with international co-operation.

  Retail harm

  The FCA's key focus in respect of retail harm is that retail customers may not have access to adequate redress (even where UK branches are subject to the FSCS), in cases where a firm is either solvent but does not have sufficient assets in the UK to satisfy a claim, or where a firm is insolvent.

  The FCA will consider the level of prudential scrutiny a firm is subject to in its home state, the comparability of consumer protection rules as well as any firm-specific factors which could be relevant (such as the relationship between the branch and head office) when assessing the mitigants in place for the risks posed to retail customers.

  Client asset harm

  The key risk noted is a mismatch between UK's insolvency laws and those of a branch of an entity incorporated outside of the UK, meaning client assets are not ring-fenced as they would be under CASS.

  Firms will need to provide information on how they intend to safeguard assets, although the FCA notes that in some cases clients of UK branches may actually expect the insolvency law of the home state to apply (for example, where an EEA-based insurance distributor has a UK branch to access the London Market but only serves EEA-based clients through its UK branch).

  Wholesale harm

  Wholesale harm could arise where firms cause disruption in the wholesale markets, which would have a knock-on impact on the whole UK financial system. The FCA acknowledges that there is less scope for UK branches of solo-regulated firms to reach a scale which could trigger systemic issues, as firms of that size would likely be dual regulated, but interconnectedness of the firm, together with its size and nature, will be considered as part of the FCA's assessment. Relevant factors which could mitigate the risk include the level of supervisory cooperation, the prudential regime the firm is subject to and the credibility and quality of its wind-down planning.

- **Limitations and requirements**

  The FCA may impose limitations or requirements as part of any approval given to an international firm if it believes it necessary to ensure that the firm will meet conditions for authorisation on an ongoing basis. For example, it may limit the number or category of customers a firm can deal with.

The consultation will be of particular interest to insurance intermediaries that are only regulated by the FCA in the UK. For insurers, the FCA's comments supplement PRA guidance already issued on this topic (see SS44/15 and SS2/18). The deadline for commenting on CP20/20 was 27 November 2020.

Court of Appeal overturns refusal to approve Prudential/Rothesay Life transfer

In the matter of the Prudential Assurance Co Ltd v In the matter of Rothesay Life Plc [2020] EWCA Civ1626

2 December 2020

The Court of Appeal has allowed an appeal from Mr Justice Snowden's refusal to approve the transfer of some 370,000 annuities from The Prudential Assurance Company Limited (**Prudential**) to Rothesay Life plc (**Rothesay Life**). The Court has confirmed that there were errors in Mr Justice Snowden's approach to the exercise of the court's discretion on insurance business transfers and delivered some much needed clarity to the Part VII process.

The judgment does not change the law. Rather, it clarifies both the principles that a judge should apply in deciding whether to approve a transfer and the circumstances in which those principles should be applied. The transfer will now return to the High Court for a second sanction hearing, with the benefit of up to date financial and actuarial evidence. Both the outcome of this appeal and the content of the judgment will be welcomed by the insurance industry and its advisers.

Key points

The judgment includes the following key points:

- The crucial question for the court remains whether the proposed scheme will have a material adverse effect on policyholders, employees or other stakeholders.
- There can be no single test or single list of factors which can be applied in every case. Instead, in reaching a decision on material adverse effect, the court should look at:
  - the nature of the business concerned (both transferring and non-transferring); and
  - the circumstances surrounding the transfer, to determine the key factors to be taken into account.
- Whilst the court's discretion is a real one, and not a "rubber stamp", it must nonetheless take into account and give proper weight to matters that ought to be considered and ignore other matters that should have no bearing on its decision.
- Absent defects in the reports of the independent expert (**IE**) and the PRA and FCA (together, the **Regulators**), the court should accord "full weight" to their opinions and only depart from their conclusions if there are "significant and appropriate reasons" for doing so.
- An adverse effect will only be material if it is:
  - a possibility that cannot sensibly be ignored, given the nature and gravity of the feared harm;
  - a consequence of the scheme; and
  - material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned.
- Even if the court finds that a scheme will have a material adverse effect on some group(s) of policyholders, there may be reasons that justify its approval, although the court will need to consider whether any particular class of person is disproportionately affected.
- Subjective factors relied upon by objecting policyholders are not relevant to be taken into account in the exercise of the court's discretion.
- The design of a scheme is for the directors of the transferring parties and the court cannot require the applicants to vary or alter a scheme, even though that may sometimes be the effect of it expressing concerns.
- On the facts of this case, the Court of Appeal ruled that given that the relevant Solvency II metrics were satisfied and in the light of the opinion of the IE, the non-objection of the Regulators and the ongoing requirements of the regulatory system applicable to Rothesay Life as transferee, Snowden J was:
  - wrong to conclude that there was a material disparity between the two parties' likely need for, or the availability to them of, external support over the lifetime of the annuity policies;
  - wrong in any event to regard any disparity between the likelihood of non-contractual parental support being available in the future as a relevant factor to be taken into account; and
  - wrong to accord any weight to the subjective choice said to have been made by transferring policyholders for Prudential to provide their annuities on the basis of its age, venerability and established reputation or to the fact that policyholders may reasonably have assumed that Prudential would continue to be the provider of their annuities for their full term.

Comment

We believe that, so far as could have reasonably been expected, the uncertainties arising from the judgment of Mr Justice Snowden have been removed. Part VII transfers can encompass different types of business and take place in a range of circumstances, so it will remain necessary to identify and fully address in evidence the factors which the court is likely to consider relevant to its decision. However, the Court of Appeal's guidance will provide firms with a clear understanding of how to determine those factors. This will enable them to plan transfers, including those which are similar to the Prudential to Rothesay Life transfer, with confidence as to the likely outcome, at least once the final views of the IE and the Regulators are known.

In particular, the decision should remove the risk that an otherwise acceptable transfer might be derailed by subjective views expressed by policyholders, or that speculation by the judge (unsupported by the evidence) as to the effect of the transfer on policyholders and other stakeholders will prevail over the validly held views of the IE and Regulators.

The extensive examination of the availability of, and motivations for, external financial support to the parties, which has become such a feature of certain transfers in recent years, should also no longer be necessary. Where the transferor benefits from a legally binding financial support commitment from its parent, however, the position will require further analysis. Finally, there is no explicit consideration in the judgment of the relevance of the parties' choice (for sound commercial reasons) to enter into a prior reassurance agreement. However, in our view, parties should no longer be deterred from entering into reinsurance arrangements ahead of a transfer by a concern that this may make approval of the transfer less likely.

Background

Events leading up to the appeal are already well understood. In August 2019, Mr Justice Snowden refused to approve a transfer under Part VII of the Financial Services and Markets Act 2000 of some 370,000 annuities by Prudential to Rothesay Life. The transfer was intended as the second stage of a transaction motivated by a wish to reduce Prudential's regulatory capital requirements ahead of a demerger of the Prudential business and the asset management business M&G from the wider Prudential plc group. As is common with this type of transaction, the transfer was preceded by a reinsurance of the transferring business to Rothesay Life, under which Rothesay Life assumed the majority of the economic risk and reward associated with the transferring policies. The Court of Appeal described the two main reasons for Mr Justice Snowden's refusal to approve the transfer as follows:

- Despite the fact that both parties met Solvency II financial standards, Rothesay Life's capital management policies did not match those of Prudential and it could not rely on the support of a large well-resourced group with a reputational imperative to provide that support over the lifetime of the annuities.
- It had been reasonable for policyholders to have chosen Prudential on the basis that it would not seek to transfer their annuity to another insurer.

Prudential and Rothesay Life appealed Mr Justice Snowden's decision on a number of grounds. Participants in the appeal included the parties themselves, the Regulators and a number of policyholders. In addition, the Association of British Insurers, represented by Herbert Smith Freehills, intervened on behalf of the insurance industry.

The Court of Appeal considered how the main authorities that were relevant to its decision, namely Hoffmann J in *Re London Life*, Evans-Lombe J in *AXA Equity & Law* and David Richards J in Re Royal & Sun Alliance, should be applied on future applications and addressed the six key issues raised by the appeal.

Key principles applying to the sanction of Part VII schemes

The Court's decision

The Court of Appeal found that the trial judge has "unfettered and genuine" discretion under Part VII. In exercising that discretion, the judge must:

> "take into account and give proper weight to matters that ought to be considered, and ignore matters that ought not properly to be taken into account"

Starting point for the Court

There can be no single test or single list of factors which can be applied in every case. In order to determine those matters which should and should not be taken into account on a particular transfer, the court's starting point should be to identify the nature of the business being transferred and the underlying circumstances of the scheme. For example, common differences between general and long term business that will need to be taken into account include different policy durations and the existence or absence of discretion vested in the insurer by the policy terms. The circumstances giving rise to the scheme will also be relevant – does the transfer reflect a commercial transaction between the parties, or is it motivated by some external event (such as the prospect of the UK leaving the European Union) or the weak financial position of the transferor?

Primary concern for the Court

Having determined the relevant factors to its decision, the crucial question for the court remains whether the proposed scheme will have a material adverse effect on policyholders, employees or other stakeholders. In this context, "material" means that "there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned". The effect will only be taken into account by the court if:

- ignoring it would not be sensible, taking into account the "nature and gravity" of the particular adverse effect; and
- it would result from the scheme (which usually means that the relevant comparison will be the position of the policyholders if the scheme is and is not implemented). Security of benefits and reasonable expectations

To assess whether a scheme has a material adverse effect on policyholders or other stakeholders, a judge will usually be concerned with the policyholders' security of benefits and their reasonable expectations:

- **Security –** The ongoing financial security of the affected policyholders will be of concern in all Part VII schemes. The Court of Appeal has, however, made it plain that this is primarily a matter of actuarial analysis, favouring Warren J's judgment on the point in *Re Scottish Equitable* over Snowden J's judgment. Where the IE has found a scheme not to have a material adverse effect on the security of policyholders and

the Regulators do not dissent from that opinion, that can ordinarily be expected to be sufficient to satisfy the court on the issue of financial security.

Subjective factors (eg views on the relative venerability of the parties) and speculation (eg how the parties might fare if they experience unexpected and extreme events in the future, or the likelihood of parental support being available where it has no contractual basis) must not be taken into account for these purposes.

Conversely, the fact that the insurers are subject to the Solvency II regime on an ongoing basis is a relevant factor. On this, the Court rejected the contention (made by Snowden J in the judgment at first instance and asserted by the policyholders on appeal) that the Solvency Capital Requirement (**SCR**) is simply a snapshot on a given day.

The Court of Appeal rejected the idea that the significant cover that the Financial Services Compensation Scheme provides to insurance policyholders is relevant to assessing the effect of the transfer on security of policyholders' benefits. However, it is difficult to see that point ever needing to be argued in light of the Court of Appeal's approach to assessing security.

- **Reasonable expectations** – Whether the reasonable expectations of policyholders are relevant will vary from scheme to scheme.

  Actuarial analysis will be relevant here, but may not carry the same weight as it does in the context of the security of policyholder benefits. Expectations that service standards will be maintained will generally be relevant, but that may often be the end of the analysis in respect of reasonable expectations.

  A more complex balancing of competing interests can arise in life transfers, particularly where (as is the case with with-profits business) policy terms afford the insurer some level of discretion in how it will discharge its contractual obligations. As with security of benefits, the test of whether policyholders' reasonable expectations are met will be an objective one. Subjective issues such as the state of mind of an individual policyholder at the point of sale (for example a policyholder's choice based on age, venerability and reputation) will not be relevant, nor will a non-contractual expectation that the policy will never be transferred by the original provider.

  While the Court of Appeal did not give examples of what factors might influence the outcome of the objective test, any change in the contractual terms of the policy as a result of the scheme will clearly raise questions about whether the transferring policyholders' reasonable expectations are being respected by the scheme. Similarly, indications that there will be a change in the way that the contractual discretion of the insurer will be exercised would need to be considered.

Views of IE and Regulators

If the IE and Regulators do not find material adverse effect, the court should give their views significant weight and not take a different view without "significant and appropriate reasons". This is particularly so in respect of the financial and actuarial assessments as to security of financial benefits. This does not mean that the court cannot take into account matters which fall outside the PRA's prudential assessment of the scheme, but such matters should not include the judge's own speculation as to the likely future behaviour of the insurers' owners in relation to the provision of financial support which is not contractually required.

Fairness

Whether a scheme is "fair" will only normally be relevant where the insurer has discretion under the policies, and is closely tied to the reasonable expectations of policyholders (see above). Because of this, this factor receives the most attention where a transfer involves with-profits business (as was the case in *Re London Life* and *Re AXA Equity & Law*). David Richards J found in *Re Royal & Sun Alliance* that the "fairness" principle was not normally relevant to transfers of general insurance. This should not be treated as an inflexible rule, however, as the court would be expected to have concerns if it could be shown that a transfer would have a material adverse effect on some matters that may be at least partly non-contractual (eg service standards).

Recognition of commercial judgment

The commercial judgment of the insurers' directors should be given due recognition. In most cases, this will simply mean recognising that the directors can be assumed to have discharged their duties in proposing the scheme. Where a case involves a more complex balancing of interests, as in both *Re London Life* and *Re Axa Equity & Law*, that recognition may extend to how different and competing interests have been balanced by the scheme.

Some of the Court of Appeal's comments could be read as saying that the insurers will be assumed to have good commercial reasons for proposing the scheme, such that they do not need to be explained in any detail to the court. However, the detail of the insurers' commercial objectives will, in at least some cases, remain relevant to how interests are balanced. For example, a compelling commercial rationale (eg in a rescue situation, and presumably the same has applied in the transfers arising from Brexit) could mean that a scheme is sanctioned in cases where the material adverse impact on some policyholders would otherwise prevent the scheme from being considered to be fair in all the circumstances. The court can be expected to want to understand the detail underlying any such rationale.

"In all the circumstances"

Having taken account of all of the above, and any other circumstances that are peculiar to a given scheme, the court should apply an objective test to determine whether it is appropriate in all the circumstances of the case to sanction the scheme. It should decide either to sanction the scheme or reject it. It should not require changes to a scheme, although the insurers may in practice suggest changes to a scheme in response to concerns that the court expresses.

Six key issues raised by the appeal

On the facts of this particular transfer, the Court of Appeal identified three central issues raised by the appeal, two subsidiary issues and a final issue concerning the consequences for the appeal, as set out in the following table.

ISSUE	COURT OF APPEAL FINDING
"Security of benefits issue" **Central issue 1** Whether (a) Snowden J was wrong to conclude that there was a material disparity between the external support potentially available to the parties, and/or (b) he failed to accord adequate weight to the IE's conclusions that the risk of either party needing external support in the future was remote	On the first two issues, the Court of Appeal found that Snowden J: • was wrong to find that there was a material disparity between the non-contractual external financial support potentially available for each of Prudential and Rothesay Life; • ought not anyway to have regarded such a disparity as a material factor; • failed to accord adequate weight to the IE's conclusion that the risk of either of the parties needing external support in the future was remote; • failed to accord adequate weight to the Regulators' lack of objection to the scheme, and the continuing future regulation of Rothesay Life.
"Regulatory issue" **Central issue 2** Whether the judge failed to accord adequate weight to the Regulators' lack of objection to the Scheme and to the continuing future regulation of Rothesay Life	Key points leading to these conclusions included the following: • Snowden J misunderstood how insurers are regulated and supervised under the Solvency II Directive, including the regard that is paid to forward-looking matters such as risk management and governance. • It is not correct that the PRA and the IE only look at a company's financial security over a 12 month period. The PRA's assessment of a scheme involves consideration of the future, including the ability of each party to take corrective action in the event of a deterioration in their balance sheets. • Reliance placed by Snowden J on non-contractual support that could be expected from the wider Prudential group was misplaced and was not a factor that could be taken to override the conclusions of the IE and the PRA as to the financial resilience of Rothesay Life. Factors for the court to take into account do not include speculation as to what future owners of an insurer may or may not wish to do to help a regulated subsidiary, not least because (as the Court of Appeal recognised), ownership of an insurer may well change over the lifetime of the policies in question. • There was no basis for Snowden J to have displaced conclusions reached by the IE that the risk of Rothesay Life requiring external financial support over the lifetime of the policies was remote with his own speculation that such support might be needed.
"Reputational issue" **Central issue 3** Whether the judge accorded too much weight to the fact that the objecting policyholders chose Prudential on the basis of its age, venerability and established reputation, and reasonably assumed that Prudential would provide their annuity throughout its lengthy term	The Court of Appeal found that the subjective factors relied on by objecting policyholders were not relevant to be taken into account in the exercise of the court's discretion. Snowden J ought not, therefore, to have accorded any weight to these factors in deciding whether to approve the transfer. Key points leading to this conclusion included the following: • The court should not depart from views expressed by the IE and the non-objection of the Regulators as to the financial reliability of a transferee company without a "proper and relevant reason". • Solvency II metrics and other detailed financial information that was available to the court provided a far more relevant guide to the financial strength, record and expectations of an insurer than subjective assessments made by policyholders based on age and reputation. • Therefore, notwithstanding that Prudential may have sold policies on the basis of its reputation and venerability, subjective factors of this nature should not be relevant to the Court's decision given the extensive financial and actuarial evidence that was available to the Court.

ISSUE	COURT OF APPEAL FINDING
"Commercial judgment issue" **Subsidiary issue 1** Whether the judge failed to accord adequate weight to the commercial judgment of Prudential's board	The Court of Appeal rejected the parties' arguments on this point. In the particular context of this transfer of annuities, had Snowden J been right about the existence and relevance of a disparity between the availability of non-contractual external financial support for the transferring parties, even decisions that are reasonable from a commercial perspective would have little, if any, part to play in the Court's decision. Similarly, the commercial judgment of the Prudential Board would have had little relevance if Snowden J had been right that either (a) policyholders' choice of Prudential on the basis of age, venerability and established reputation; or (b) policyholders' reasonable assumption that Prudential would always provide their annuities were relevant factors.
"Prejudice issue" **Subsidiary issue 2** Whether the judge failed to accord adequate weight to the prejudice that a refusal to sanction would cause to the parties	The Court of Appeal did not find that Snowden J had made an error of law in his approach to the question of the alleged prejudice that a failure to sanction the scheme would bring. Had the judge been correct in determining that the transfer would have a material adverse effect on the interests of policyholders, the Court of Appeal did not think that the commercial interests of the parties and their shareholders should take precedence over the interests of the policyholders.
"Disposal issue" If the appellants succeed on one or more of the above issues, what consequences should follow?	As the Court of Appeal had concluded that Snowden J made errors in his approach to the exercise of his discretion under section 111(3) FSMA, his decision could not stand. Consistent with an order made by Patten LJ on 22 June 2020, the question of whether the scheme should be sanctioned should be considered again by the High Court, based on up to date financial and actuarial evidence.

Additional references

Re Scottish Equitable [2017] EWHC 1439 (Ch)

Re Royal & Sun Alliance [2008] EWHC 3436 (Ch)

In the Matter of Axa Equity & Law Life Assurance Society PLC v Axa Sun Life PLC [2001] 1 All E.R. (Comm) 1010

Re London Life (1989, unreported)

FCA publishes Final Report on general insurance pricing practices market study and accompanying Consultation Paper

The Financial Conduct Authority's (**FCA**) Final Report on general insurance pricing practices concludes that retail home and motor insurance markets are not working well for all consumers and confirms proposals to prohibit "price walking".

The FCA's reforms include the following key changes:

- Firms will be prohibited from imposing a "loyalty penalty" on customers at renewal of their policy.
- This prohibition will extend to products sold alongside insurance cover.
- Manufacturers and distributors will be required to consider whether their products represent "fair value" for customers.
- Further measures will aim to stop practices that act as barriers to switching.
- New regular reporting requirements will be introduced to help the FCA's ongoing supervision of home and motor insurance markets.

The deadline for responding to FCA Consultation Paper (CP20/19), which sets out its detailed proposals, is 25 January 2021 and the FCA intends to publish its response in Q2 2021. New rules are planned to take effect four months later.

Background

On 22 September 2020, the FCA published the final findings of its general insurance pricing practices market study which sought to understand whether pricing practices in home and motor insurance support effective competition and lead to good consumer outcomes. The FCA's Final Report (MS18/1.3) confirms many of the findings of its earlier Interim Report (MS18/1.2), which was published in October 2019.

In summary, the FCA's conclusion that retail home and motor insurance markets are "not delivering good outcomes for all consumers" remains unchanged. The FCA proposes a package of remedies, which are set out in Consultation Paper (CP20/19), which was published alongside the Final Report.

The deadline for responding to the Consultation Paper is 25 January 2021 and the FCA intends to publish a Policy Statement responding to the feedback received in Q2 2021. The new rules are planned to come into effect four months after the Policy Statement with both a review of the effects of the remedies, and a full post-implementation evaluation, following approximately one and two years respectively after implementation.

Key findings

The Final Report concludes that general insurance markets are not working well and do not deliver good outcomes for all consumers.

- In particular, the FCA found extensive evidence of "**price walking**". This allows firms to offer policies at a discount to new policyholders but to recover any losses on renewal by increasing the price year on year.
- Firms that practice price walking will make an assessment of how likely a customer is to switch supplier when setting the premium they propose to charge for renewal of the policy. This can lead to some loyal customers paying very high prices as compared to others who, for example, regularly switch insurer or negotiate the cost of their cover.
- A motor insurance customer that has been with their provider for more than 5 years will expect to pay a premium that is on average £85 higher than a new business customer with the same risk. The equivalent increase for a combined buildings and contents insurance customer is £122.
- Some firms also use practices that can discourage consumers from shopping around to find a better a deal with a new insurer. For example, firms may make it difficult policyholders to stop their policy from renewing automatically.
- The FCA argues that these findings suggest that some consumers are not getting "fair value" for their general insurance products. It would not expect this to be the case if markets are working well for all customers, a key priority for the FCA.

Remedies put forward by the FCA are intended to address the following harms.

Higher overall searching and switching costs for consumers

To avoid paying higher prices than they need to, consumers must spend significant time shopping around and switching or negotiating with their existing provider. Shopping around and switching is generally good for competition and can benefit consumers, for example where consumers want to find better quality products or better service. However, shopping around and switching merely to avoid price walking takes time and effort and can impose unnecessary costs on consumers and firms. This can lead to higher prices overall.

Higher prices for customers who do not switch or negotiate, many of whom are less aware of current pricing practices

Firms' pricing practices are complex and opaque and do not make clear the true lifetime cost of home insurance policies. This leads some consumers to believe their renewal price is more competitive than it is. Firms also use practices that can discourage consumers from looking for better deals at renewal. These practices do not enable consumers to make effective and informed choices in these markets.

Distorted competition – firms do not focus on providing long term value to all consumers

Competition can be intense to attract new customers by focusing on offering low headline prices. These prices do not reflect the true long-term cost of home insurance policies. Firms then increase margins for customers who stay with them over time.

High acquisition costs being passed onto customers

The FCA believes that, because firms know that some customers will be very profitable over the long-term, they are willing to spend significant amounts to acquire them.

If the proposed package of remedies is successful, the FCA expects to see a market where:

- Firms compete in effective and innovative ways to provide long term fair value (reflecting both price and quality) for all customers throughout the duration of their relationship with the firm.
- Firms do not engage in practices that limit customers' ability to make informed choices.
- Customers can trust that firms are offering long term fair value
- Differences in firms' products, including the type of service and quality they offer, in the evaluation of insurance risks, and in pricing structures, maintain the incentive for consumers to search and switch in the market.

Proposed package of remedies

The FCA has proposed a package of remedies intended to stop firms systematically increasing prices in home and motor insurance for loyal customers, as well as ensuring firms in the general insurance market focus on providing fair value to all their customers.

Pricing remedy

Scope: applies to firms, including intermediaries, that have a role setting any part of the premium or any other element of the final price paid by the consumer for home or motor insurance products or additional products sold alongside them including premium finance.

- Firms will be required to offer renewal prices to consumers that are no higher than the equivalent new business prices offered by the firm. Where additional products are sold with the insurance, the price-walking prohibition applies to both.
- An anti-avoidance provision will prevent firms "**operating in a way which defeats the intended outcomes of the pricing remedy**". Firms will, however, be able to offer different prices to different customers when they are differentiated on other bases.
- A Senior Manager will be required to confirm annually that the firm's pricing practices comply with the pricing rules, starting with an attestation three months after the rules come into force.
- The pricing remedy is intended to make the quotes a firm offers a customer when switching, a better indication of the price that that customer will pay in future years if they do not search or negotiate. This is intended to "**intensify and improve the nature of competition**".

Enhanced product governance rules to help ensure that firms deliver fair value for all consumers

Scope: applies to firms manufacturing or distributing general insurance policies, additional products sold alongside them including premium finance, and all pure protection insurance (except reinsurance).

The FCA plans to enhance and expand the scope of its existing product governance rules including by:

- Requiring manufacturers and distributors to consider whether their products represent "**fair value**" for customers through their product approval processes.
- Extending the application of the rules on product oversight and governance (in the Product Intervention and Product Governance Sourcebook in the FCA handbook) including the new rules, to all general insurance and pure protection products, regardless of whether they are newly manufactured or have been significantly adapted.
- Introducing a minimum requirement for manufacturers to review products at least every 12 months and complementary changes to the product governance rules for insurance distributors.
- Implementing other changes including requirements in relation to the offering of premium finance.

Remedies to tackle practices that discourage switching

Scope: applies to all firms selling general insurance products.

For all types of general insurance, including home and motor insurance, the proposed rules would require firms to:

- explain to customers whether their policy is set to renew automatically and what this means for them;
- make it easier for consumers to decline auto-renewal of policies at the time of purchase and at renewal; and
- communicate the options available to consumers to stop their contract from auto-renewing both at the point-of-sale and in good time before renewal.

Rules on the reporting and publication of value measures data and value measures product governance rules

Scope: applies to firms, including intermediaries, that have a role setting any part of the premium or any other element of the final price paid by the consumer for home or motor insurance products or additional products sold alongside them including premium finance. Some of the proposed requirements apply to intermediaries that do not have a price-setting role.

- The FCA proposes to introduce a reporting requirement for firms to report data on retail home and motor insurance products and, where applicable, additional products sold alongside, including premium finance.
- The data is to be collected for the purposes of monitoring compliance with the pricing remedy, identifying instances of consumer harm and monitoring the market more generally.
- The FCA does not rule out publishing such data collected in the future, for example if it consider "**there would be value in doing so, for example, to increase scrutiny of firms' pricing practices**".
- The data is proposed to be collected on an annual basis except for an initial 12-month interim period of quarterly reporting starting when the rules come into force.

Based on its modelling the FCA considers that the proposed remedies could deliver a total savings for consumers over 10 years of £4.2bn to £11.2bn depending on the intensity of competition between firms. However, the FCA expects intense competition for new customers to continue.

Practice points for firms

With the FCA's remedies likely to come into effect in H2 2021 firms should begin to take action to align their practices with the proposed remedies and the FCA's emerging expectations. This can include:

- Considering appropriate models and definitions of product value to incorporate into product approvals processes and price frameworks. Within certain parameters, firms have flexibility on the approach and definitions to be adopted but "**fair value**" must involve a reasonable relationship between the overall cost to the end customer and the quality of the product/service and should be sufficiently long-term.
- Conducting a review of factors used in pricing models to eliminate those associated with tenure, and ensuring sufficient operational and organisational infrastructure, as well as sufficient visibility over pricing practices and metrics, to implement the FCA's proposed pricing and reporting remedies. Significantly however, firms will not be prevented from assessing, and determining prices in accordance with, the likelihood a consumer will switch brands, renew or negotiate at renewal, and other non-risk factors (excluding tenure).
- Ensuring that responsibility for product governance and pricing and the role of attestation of compliance with the FCA's pricing remedy are clearly delineated and attributed to the appropriate Senior Manager/(s) under the Senior Management and Certification regime.
- Reviewing the channels and communications available to customers on renewal. Firms should ensure they have operational and organisational processes in place to allow customers to "easily and accessibly" cancel auto-renewal by each of phone, post and email or online. In line with the FCA's wider commitment to fair treatment of all consumer groups, firms should bear in mind the needs of older and more vulnerable customers in considering the ease and accessibility of any communication channel.
- Re-examining business models, distribution channels, marketing and pricing strategies in light of the pricing remedies particularly as the FCA acknowledges that their remedies are likely to cause some firms in the distribution chain (eg price comparison websites and brokers) to have less business as the level of switching falls.

Beyond Brexit – impact on insurers' legacy business

As expected, the terms of the post-Brexit trade deal agreed between the UK and the EU on 24 December 2020 mean that Solvency II passporting rights are no longer available to UK insurers wishing to conduct insurance business in the EU.

For UK insurers with policyholders in European Economic Area (**EEA**) States, this creates a particular concern that they will no longer be licensed to service those policies, including paying claims, unless they have established an authorised branch in each country. An alternative approach, adopted by many insurers, has been to transfer the policies to an EEA carrier.

The risk to EEA policyholders of being unable to claim, post-Brexit, under policies held with UK insurers highlights the importance of understanding limits on individual state discretion in this area.

EIOPA recommendations – February 2019

European Insurance and Occupational Pensions Authority (**EIOPA**) recommendations published in February 2019 provided some helpful guidance. In summary:

- EEA States were encouraged to apply a mechanism for the run-off of EEA business by UK insurers who lose their passporting rights or require those insurers to take immediate steps to become authorised.
- EEA States were also encouraged to recognise that, whilst UK insurers should not be able to write new business (including any renewals, extension or increase of cover) without obtaining a suitable EEA authorisation, policyholders who exercise an option or right in an existing policy to start taking their pension should not be prejudiced.
- Where a policyholder is habitually resident in the UK at the date of entering into a life insurance contract but moves to the EEA afterwards, national authorities should take this into account in their supervisory review.
- National authorities should take the same approach to those classes of non-life business where the risk is treated by Solvency II as situated in the state of an individual's habitual residence (or the state of a legal person's establishment).

The recommendations suggest that a distinction should be drawn between legacy business that was written from the outset on a cross-border basis (**cross-border business**) and policies that were sold in the UK to policyholders who subsequently move to the EEA (**expat business**).

Expat business

It is implicit in EIOPA's recommendations that the state of the risk/commitment under an insurance contract is fixed from the date a policy incepts and does not change if a policyholder subsequently moves his habitual residence (or establishment) from the UK to an EEA State. Applying this approach, a UK insurer that continues to pay claims after a UK policyholder relocates from the UK to an EEA State is not carrying on cross-border business and, under the pre- Brexit regime, did not rely on passporting rights to make those payments. Post-Brexit, the same insurer should, therefore, be able to continue to pay claims into that EEA jurisdiction without needing to obtain a local authorisation.

Equally, a UK insurer that meets its obligations to expat policyholders who exercise an option existing under their policy eg to exercise drawdown rights should not require an EEA authorisation to do so.

In our experience, most, if not all, UK insurers take the same view on this as EIOPA. They have not, as a consequence, included policies held by UK expats in Brexit-related Part VII schemes transferring policies to an EEA carrier.

Cross-border business

By contrast, EIOPA's recommendations suggest that the servicing of policies that were written before Brexit on a cross-border basis will require an EEA authorisation to replace passporting rights that are currently relied upon. In practice, consistent with this view, we understand that most policies in this second category have been transferred to an EEA insurer before the transition period came to an end on 31 December 2020.

Where a Part VII transfer completed before the end of the transition period, a UK insurer has no need to rely on any of the run-off regimes that have been put in place by a number of EEA states. The transitional relief provided by these regimes may, however, be important for:

- firms who have begun the Part VII process but not completed the transfer of policies before 31 December 2020; and
- firms who have decided not to transfer their cross-border business to an EEA-authorised insurer, perhaps because the policies have a very short tail.

One remaining concern, though, is that firms falling into these two categories may end up with a "gap" in authorisation arising from the limited nature of the run-off regimes established by EEA authorities.

PRA guidance – February 2020

In February 2020, the Prudential Regulation Authority (**PRA**) published guidance for UK insurers on their ability to service EEA liabilities once the Brexit transition period came to an end on 31 December 2020.

In our view, the guidance is consistent with the view that expat businesscan continue to be serviced from the UK without an EEA authorisation. It does, however, highlight some important points for firms that do need an EEA authorisation to service their cross-border business (ie those with policies where the risk/commitment was situated in an EEA State at inception).

In particular, the PRA warned that run-off regimes established by a number of EU authorities to ensure ongoing service continuity in relation to EU liabilities in a "no deal, no transition" scenario may not also apply from the end of the transition period. Firms who were intending to rely on those transitional regimes (as a temporary or permanent solution) were, therefore, advised to undertake a thorough analysis of their expected run-off profile, and to discuss their proposed approach with the relevant EU authorities. (The letter expressly referred to EU authorities and EU liabilities but should, in our view, have applied more widely to EEA authorities and EEA liabilities, consistent with the scope of the Solvency II regime.)

More recent FCA guidance for life companies and for general insurers also urges UK insurers affected by this issue to engage with relevant national regulators and take steps available to them to continue to service customers in accordance with local law and national regulators' expectations. Firms are also reminded to the need to communicate with customers and to keep them informed of any new developments.

In practice, a number of EEA States have introduced run-off regimes to enable UK insurers to continue paying claims now that the implementation period has come to an end.

Summary

In our view, the argument that "expat business" is not cross-border business remains a valid one, which means that an EEA authorisation should not be required to continue servicing this type of policy.

For other business, a number of EEA States have introduced run-off regimes to mitigate the impact of UK insurers' loss of passporting rights from the end of the transition period. Each state's regime is, however, different, requiring specific legal advice to be taken in each case as to their effect.

Finally, EIOPA's February 2019 recommendations are not binding, leaving it open to individual states to apply the rules differently, to the extent that it is possible to diverge from other states under EU law.

Supreme Court reduces burden of proof for verdicts of unlawful killing in inquests

R (on the application of Maughan) (Appellant) v Her Majesty's Senior Coroner for Oxfordshire (Respondent) [2020] UKSC 46

13 November 2020

In a recent judgment (*R (on the application of Maughan) (Appellant) v Her Majesty's Senior Coroner for Oxfordshire (Respondent)*), the Supreme Court ruled that coroners' inquests could conclude that an individual had been unlawfully killed by applying the civil standard of proof (balance of probabilities) rather than the traditional criminal standard of proof (beyond reasonable doubt). This has potentially significant consequences, particularly for inquests concerning work-related deaths.

Inquest procedure and verdicts

Coroners have a statutory duty to investigate any death within their area where the deceased "died a violent or unnatural death"; where the cause of death is unknown; or where the deceased died whilst in custody. Coroners must hold inquests, sitting alone or with a jury, in order to determine certain factual issues relating to the death.

Inquests differ from criminal and civil proceedings in a number of important ways. Their purpose, at least in theory, is to make findings of fact and not to assign blame or determine liability. They are an inquisitorial process, led by the coroner, rather than an adversarial process led the parties. Individuals and companies with an interest in the outcome of an inquest can be designated as 'Interested Persons'. The deceased's family and, in cases of work-related deaths, their employer, will typically be Interested Persons. Interested Persons can be legally represented at inquests but their involvement in the process is far more limited than the involvement of parties to civil or criminal proceedings. For example, Interested Persons have no right to call witnesses (although they can suggest to the coroner which witnesses should be called). In addition, whilst they can put questions to the witnesses called by the coroner, they cannot make closing submissions (to the coroner or jury) commenting upon the evidence that has been heard. Finally, Interested Persons have no automatic right to disclosure of documents – this is at the coroner's discretion.

The purpose of an inquest is to determine (and record) (i) the identity of the deceased; and (ii) how, when and where they died. The cause of death can be recorded using one of a number of short form conclusions or in a brief factual narrative. The standard short form conclusions include 'accident/misadventure'; 'natural causes'; 'alcohol/drug related'; 'road traffic collision'; 'lawful/unlawful killing'; and 'suicide'.

The legislation governing inquests says nothing about the standard of proof required to reach a verdict as to the cause of death. However, a footnote to the form on which coroners must record their findings states that "The standard of proof required for the short form conclusions of 'unlawful killing' and 'suicide' is the criminal standard of proof. For all other short form conclusions and a narrative statement the standard of proof is the civil standard of proof". This has long been accepted as a reflection of the seriousness of finding an individual died by suicide or was unlawfully killed. In the recent Supreme Court judgment, Lord Carnwath described these conclusions as "a solemn pronouncement … [with] clear resonance beyond those of other short form conclusions", justifying the higher burden of proof that had traditionally been applied.

Supreme Court decision

The different standards of proof applying to different potential verdicts can, at least in theory, lead to anomalous results. If, for example, a coroner or jury believed, on the balance of probabilities, that a person had died by unlawful killing or suicide but could not be sure of this beyond reasonable doubt, they could not give a short form conclusion of unlawful killing or suicide but could give a narrative conclusion which made clear the view they had reached.

The Inquest into the death of James Maughan was one such case where this "logical difficulty" (as Lady Arden put it) arose in practice. Mr Maughan was found dead, hanging by a ligature from the bedframe in his prison cell. Having heard evidence, the Coroner directed the jury that they could not be sure beyond reasonable doubt that this was a case of suicide and that the short form verdict of suicide was therefore not open to them. They were entitled, however, to give a narrative verdict setting out the facts as they had found them to be on the balance of probabilities. The jury's narrative verdict was that "on the balance of probabilities the deceased intended fatally to hang himself".

The Supreme Court was required to consider whether, in these circumstances, the jury should have been able to return a short form verdict of suicide. On a 3-2 majority, the Court found that the short form verdicts of both suicide and unlawful killing could

now be reached on the civil standard of proof. In reaching this view, Lady Arden (who gave the leading judgment) held that:

- The footnote (quoted above) referring to the different standards of proof did not have statutory force. It was merely a statement of the common law position at the time it was written.
- The common law can, of course, be changed. The Supreme Court was not bound by the numerous decisions of lower courts which had accepted and applied the higher standard of proof for unlawful killing and suicide.
- It would be more consistent with legal principles (and would also accord with certain policy considerations and changes in societal outlook) for the standard of proof required to find unlawful killing or suicide to be lowered to the balance of probabilities.

Consequences of the ruling

Whilst this change may appear to be somewhat technical in nature, it in fact has significant implications, particularly for employers (and other businesses) in the event of work-related deaths. In such cases, verdicts of unlawful killing are (incorrectly, but perhaps inevitably) often seen by the public as a finding against the employer (or against an individual director or employee who was involved in the events leading up to the death).

The most obvious consequence of the Supreme Court's ruling is that there will now be more cases in which verdicts of unlawful killing are returned. This will be a cause of concern for employers.

A finding of unlawful killing in relation to a work-related death is not, technically, a finding against the employer (or against any individual director or employee). As explained above, an inquest verdict is a finding of fact, not liability. A short form verdict of unlawful killing does not identify who the coroner or jury may consider to be responsible and the legislation provides that narrative verdicts "must not be framed so as to appear to determine any question of criminal responsibility on the part of any named person or any civil liability". In practice, however, where an inquest hears evidence in relation to workplace health and safety failings that are said to have contributed to the employee's death and then returns a verdict of unlawful killing, the inescapable conclusion is that they considered the employing company or an individual director or employee to have been criminally liable for the death. The public and media are unlikely to focus upon the precise legal status of the finding.

This has at least two consequences. First, the adverse publicity faced by an employer can be significant and can directly affect the company's relationships with its customers and other stakeholders, the morale of its workforce and, ultimately, its bottom line. Secondly, an inquest finding of unlawful killing might make it more likely, particularly in a case which is in the media spotlight, that the employer or an individual director/employee will be prosecuted for health and safety offences or for manslaughter (Corporate Manslaughter in the case of the employing company or common law manslaughter in the case of an individual). As a matter of principle this should not be the case, since the Health and Safety Executive and police/Crown Prosecution Service will appreciate the status of an inquest verdict and the fact that the finding of unlawful killing has only been made on the balance of probabilities. However, those institutions are often subject to public pressure to prosecute employers (or individual directors/employees) following work-related deaths and a legal finding that a crime has been committed may make it more difficult for them to resist this pressure even in cases where prosecution is not merited.

Lady Arden recognised this concern for "the protection for a person implicated in any conclusion of unlawful killing. Such conclusion might make it more likely that a criminal prosecution is brought. In practice ... the name of that person may be more likely to be identified if the standard of proof for unlawful killing is the civil standard, because that standard may be more easily met".

The reduction in the standard of proof required for a verdict of unlawful killing highlights the invidious position of an employer at an inquest into a work-related death. If a verdict of unlawful killing is returned it will be (wrongly) perceived as a criminal finding against the employer but the employer is not given the same opportunity to defend itself that it would have at a criminal or civil trial. As explained above, employers are usually legally represented at inquests but there are limits to their legal team's ability to participate in the process. This was always the case but the fact that it will now be far easier for coroners and juries to reach a finding of unlawful killing certainly highlights the point and makes it more important than ever for employers and their legal representatives to engage as fully as possible in the process.

Criminal Liability for Defective Products

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When a business discovers that one of its products may be unsafe, its first concerns will often be the negative publicity that will follow a recall and the potential civil claims from end-users and/or other companies in the supply chain.

However, the possibility of a criminal prosecution should also be given close attention from the outset. The reputational damage from having been prosecuted for a criminal offence can be a significant concern in itself and for the most serious offences (ie corporate manslaughter and breaches of health and safety law) companies can face very significant fines under sentencing guidelines that have been in force since February 2016. In addition, individual directors/employees can in some cases face fines and/or imprisonment.

This article discusses the various criminal offences which arise in the context of defective products. We consider in turn offences under the General Product Safety Regulations 2005, the Consumer Protection Act 1987, the Health and Safety at Work etc. Act 1974 and the Corporate Manslaughter and Corporate Homicide Act 2007.

The General Product Safety Regulations 2005

The main regulatory regime that imposes criminal liability on producers and distributors of unsafe products in the UK is set out in the General Product Safety Regulations 2005 (**GPSR**). The GPSR give effect to the European General Product Safety Directive (2001/95/EC) and apply to all products except to the extent that they are subject to sector-specific regulations (eg food and drink, toys and cosmetics). The Regulations impose broad safety requirements backed up by criminal sanctions.

Impact of Brexit

The GPSR are part of UK law (albeit their purpose is to implement EU law) and will therefore remain in force after the UK ceases to be bound by EU law at the end of the Brexit transition period (which is currently expected to last until the end of 2020). However, various aspects of the GPSR are tied into the EU-wide system of product safety regulation that may or may not be recognised in the UK after the transition period. For example, when defining the concept of a 'safe product' the GPSR refer to applicable European standards (as well as UK standards). The GPSR also refer to the UK government using the EU RAPEX system to notify governments of other Member States of products that pose a serious risk. Decisions on issues such as the UK's continuing recognition of European standards and participation in the RAPEX system may be taken during the transition period. In the meantime, Parliament has passed a statutory instrument amending the GPSR to remove these references to EU-level regulation. These amendments will automatically come into force at the end of the transition period in the event that no alternative arrangement is agreed as part of that process.

Changes to EU law

In 2013, the European Commission published a new draft Regulation on Consumer Safety which, when enacted, will repeal the General Product Safety Directive 2001 (ie the EU law which is implemented in the UK by the GPSR). If enacted in its current form, the new Regulation will maintain the most important features of the existing regime but there will be some additional requirements including clearer rules for marking products to assist in any recall. Unlike the General Product Safety Directive 2001, the new Regulation on Consumer Safety will have direct effect in all Member States. If the new Regulation is passed by the European Parliament before the end of the transition period, it will take effect in the UK and it is considered likely that it would then be adopted automatically as part of UK law at the end of the transition period. If, on the other hand, the new Regulation is not passed by the European Parliament before the end of the transition period, it will not automatically become law in the UK. It will then be a decision for the UK government whether or not to update the GPSR to reflect the new Regulation in order to keep UK law consistent with EU law in this regard. Whether or not the UK government would choose to do so may depend upon the nature of the future trade arrangements agreed during the transition period.

General safety requirement

Producers

The core requirement under the GPSR is that producers must not place any product on the market unless it is a safe product (Regulation 5). A safe product is defined broadly in Regulation 2 as one which, under normal or reasonably foreseeable conditions of use, does not present any risk or only the minimum risk compatible with the product's use.

There is a presumption that the general safety requirement is met where the product conforms to either: (i) any applicable specific health and safety requirements laid down by UK law; or (ii) a voluntary national standard which gives effect to a European standard (reference to which has been published in the Official Journal of the European Union). As noted above, the reference to European standards may not be retained at the end of the Brexit transition period.

For certain types of products (eg refrigerators, freezers, hot water boilers, etc.), the producer is required to certify conformance with the relevant EU level safety standards by displaying the 'CE mark' on the product (or, if that is not practical, on its packaging). Subject to the outcome of the Brexit transition period, the references to CE marking may be

removed and replaced with reference to a new UK system of marking (**UKCA**) (this potential new system was first mooted during 2018/19 and would have come into effect in the event of a no-deal Brexit).

In many cases it will be clear that a product is unsafe but, in others, the complicated definition provided by Regulation 2 might allow room for uncertainty. Difficult questions could arise from the range of factors to be considered in determining whether a product is unsafe, including:

- the characteristics of the product including its composition, packaging and instructions;
- the presentation of the product, its labelling, any warnings and instructions for use;
- the effect of the product on other products; and
- whether vulnerable consumers, such as children and the elderly, are at risk.

In addition, Regulation 6(3) provides that one factor in assessing whether or not a product is safe is "reasonable consumer expectations concerning safety". This underlines the point that different levels of risk will be acceptable in respect of different types of product.

There is a distinction in the GPSR between unsafe products that pose a "serious risk...requiring rapid intervention" and those that do not. Severity of risk is determined through a structured risk assessment (discussed in more detail below). This distinction is primarily relevant to the government rather than the producer, since the government is required to share information on products posing serious risks via the European RAPEX system but the distinction is also relevant to producers (and distributors) because it affects the speed with which they are expected to notify the authorities. RAPEX is a system which facilitates rapid exchange of information concerning dangerous products between governments of Member States and the European Commission. The UK will not automatically continue to participate in RAPEX after the end of the transition period, although it has been suggested that it will seek to remain part of RAPEX (whether as a full participant or in some other way).

Under the GPSR, the very fact of placing an unsafe product on the market is itself a criminal offence. It is an offence of strict liability subject only to the defence of due diligence, which is discussed below. The maximum penalty is a fine not exceeding £20,000 or imprisonment for a term not exceeding 12 months or both.

The relevant prosecuting authority will always have a discretion whether or not to prosecute. Our experience is that the authority will normally choose not to prosecute where the producer is a reputable business and is seen to be taking responsible measures to address the risk created by the product. However, the fact that an offence will often already have been committed by the time the defect is discovered provides the authority with a helpful enforcement tool should the producer not take what the authority considers to be the required remedial action, or fail to do so in the way the authority wishes it to, or within its desired timetable.

Distributors

The equivalent obligation placed upon a distributor is not to supply (or possess for supply or offer or agree to supply) a product that he knows (or should have presumed on the basis of the information in his possession and as a professional) is a dangerous product.

In practice, it is more difficult for a prosecutor to establish that a distributor has committed an offence than it would be in respect of a producer. This is because it is necessary to prove knowledge or implied knowledge on the part of the distributor that the product was unsafe (whereas, for a producer, there is no such requirement). The maximum penalty is the same as for a producer: a fine not exceeding £20,000 or imprisonment for a term not exceeding 12 months or both.

Duty to notify

One of the most difficult judgments to make in practice is when to notify the enforcement authority that a product is (or may be) unsafe. After a producer (or distributor) first becomes aware of a potential issue it will want to carry out tests, which can be time-consuming, to understand the nature and extent of the problem before deciding on a course of action. There may be some uncertainty as to whether or not the product is unsafe and, even if it clearly is, a producer will usually want to establish the risk it poses and, crucially, how many units of the product have been supplied, where and to whom. The most effective recalls in our experience are those in which the producer is able to supply the enforcement authorities with this relevant information and explain what steps it is taking.

Regulation 9, however, requires that once the producer or distributor knows that the product is unsafe (ie that it poses risks to the consumer that are incompatible with the general safety requirement), they must notify the enforcement authority "forthwith". European Commission Guidelines to producers and distributors interpret this to mean that notification should be made as soon as relevant information has become available and, in any event, (i) within 10 days, or (ii) immediately and not later than three calendar days where a serious risk is identified. The Guidelines are not strictly binding but are likely to receive judicial notice (this may well be the case even after the end of the Brexit transitional period given that: (i) the wording of the GPSR will remain unchanged and the guidance is therefore still likely to be seen as relevant; and (ii) producing new guidance is unlikely to be a priority for the UK government).

Failure to notify in accordance with Regulation 9 is a criminal offence and it is committed by a producer or distributor where it is proved that he ought to have known that the product posed risks to consumers that are incompatible with the general safety requirement and failed to notify "forthwith". In our experience, some latitude is given and the enforcement authorities tend to focus on ensuring proper steps are taken to counter the risk rather than on prosecuting companies for technical breaches. However, the position might be different if a consumer has been injured before the authorities are notified. In such circumstances the risk is that the matter will be viewed with the benefit of hindsight and it will be more difficult for the producer/distributor to show that they ought not to have known the product posed a risk. There is, therefore, always some risk in delaying notification.

As noted above, because of the different expectations regarding speed of notification, a company that has determined that a product is unsafe will need to undertake a further assessment to determine whether or not the risk is "serious". The European Commission Guidelines for producers and distributors (referred

to above) set out a risk assessment methodology. This requires producers to determine:

- The severity of injury that could be caused by the product (slight, serious or very serious).
- The probability of an injury occurring. This will depend on (i) the proportion of products likely to exhibit the defect, and (ii) the likelihood of the defect leading to harm. For example, if the defect affects at least 10% of the products and the consequential hazard is likely to occur during normal use, the overall probability of injury is high. If, alternatively, 1% or less of the products are affected and the hazard is less likely to occur, the overall probability of injury is low.
- Whether or not the hazard is likely to affect particularly vulnerable people.
- Whether the danger is obvious or addressed by adequate warnings/safeguards.

Combining the outcomes of these different elements will lead to a classification of low, moderate or serious risk.

Separate Commission Guidelines aimed at Member State governments (which are required to determine whether or not a risk is serious for the purposes of RAPEX notification) provide a more sophisticated risk assessment methodology. For example: (i) they provide far greater detail on the classification of different types of injury; and (ii) they require the user to consider the factual scenario that could lead to an injury and to assess separately the probability of each step in that story in order to come to an overall probability of injury. Although Member State Guidelines are not directly applicable to them, producers would be well advised to consider these since they are used by the enforcement authorities. As explained above, it remains to be seen whether or not the UK will continue to participate in the RAPEX system in future.

Other obligations of producers

Criminal sanctions can also follow non-compliance with the following obligations placed upon producers under Regulation 7:

- the obligation to provide consumers with the relevant information to enable them to assess the risks inherent in a product and to take precautions against those risks where such risks are not immediately obvious; and
- the requirement to adopt appropriate measures to enable a producer:
- to be informed of the risks which a product might pose. For example, by (i) marking the product or its packaging with the name and address of the producer and the product reference, and (ii) investigating and, if necessary, keeping a register of complaints concerning the safety of the product; and
- to take appropriate action to address any safety issue it becomes aware of (including withdrawal and/or recall of products). In 2018 the government published a new Code of Practice ("Supporting Better Product Recalls") which includes guidance on the type of measures that a company should have in place to enable it to effectively withdraw/recall products where necessary. This includes, in particular, an expectation that companies will have a written Product Safety Incident Plan. Such a plan is expected to include, amongst other things: (i) information on product and customer traceability; (ii) a plan for monitoring product safety; (iii) a plan for notification of the relevant authorities; (iv) a risk assessment procedure; and (v) a mechanism for deciding upon appropriate corrective action.

Other obligations of distributors

Distributors are required under Regulation 8, within the limits of their activities, to participate in the monitoring of product safety by:

- passing on information on the risks posed by a product;
- keeping documentation necessary for tracing the origin of a product and producing that documentation when required; and/or
- co-operating with the enforcement authority and/or the producer to avoid the risk posed by an unsafe product.

Again, these obligations are reinforced by criminal sanctions.

A successful prosecution under Regulations 7 or 8 will result in a fine or imprisonment for a term not exceeding three months or both.

Safety notices

An enforcement authority has the power under the GPSR to serve upon a producer or distributor a variety of safety notices including:

- Suspension notices (Regulation 11) which prevent the producer/distributor, for the period of the notice, from placing the product on the market or supplying it. This type of notice is appropriate where the authority needs time to organise its own safety evaluation of the product.
- Requirements to mark or warn (Regulations 12 and 13). These notices are appropriate where the authority considers the product could pose risks in certain circumstances. The notices ensure the producer/distributor either marks on the product or provides warnings with the product.
- Withdrawal notice (Regulation 14) – which prohibits the producer/distributor from placing the product on the market or supplying it. This is an extreme step and will be taken only if an enforcement authority considers (i) that the product poses a serious risk (requiring urgent action), or (ii) that the action being taken by the producer/distributor to remedy the problem is insufficient.
- Recall notices (Regulation 15) enable the enforcement authority to require a producer/distributor to recall a product. It is a power of last resort and may only be used where other action provided for under the Regulations would be insufficient. Unless the product poses a serious risk (requiring urgent action) a recall notice can only be issued if the action taken by the producer/distributor is unsatisfactory or insufficient and the authority has given not less than 10 days' notice of the recall. It is very rare indeed for a recall notice to be imposed on a reputable business since they almost invariably recall dangerous products voluntarily at an early stage.

Contravention of any of these notices is a criminal offence with maximum penalties of a fine not exceeding £20,000 or imprisonment for a term not exceeding 12 months or both.

Defence of due diligence

In relation to each of the offences referred to above, it is a defence for the producer/distributor to show (on the balance of probabilities) that it took all reasonable steps and exercised all due diligence to avoid committing the offence.

Although the burden of proof is only to the civil standard of the balance of probabilities, in practice it is a difficult defence to establish because it requires the corporate entity not only to prove the existence of suitable systems and procedures but, in addition, that the corporate entity sought to ensure that the system was in practice followed correctly. Thus, though the existence of a rigorous regime of safety testing, quality control and inspection might indicate a company has taken reasonable steps – at a structural level – to avoid marketing an unsafe product, demonstration that these rules have been consistently complied with – at a practical level – is also required.

The prosecution of individuals

Regulation 31(2) provides that where a corporate entity is guilty of an offence under the Regulations, in respect of any act or default which is shown to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, manager, secretary or other similar officer, then that individual, as well as the corporate entity, shall be guilty of that offence and shall be liable to prosecution.

Although the wording of the section would appear to potentially include any number of people within a corporate entity holding different positions of seniority, case law has clarified that in most instances the prosecution against individuals will be limited to directors. In the case of *R v Boal* the Court of Appeal held, in relation to a similar provision in the Health and Safety at Work etc. Act 1974, that the section was only aimed at those who are in "a position of real authority, the decision makers within the company who have both power and responsibility to decide corporate policy and strategy".

Consent will be established where a director, knowing of the material facts by which the corporate entity committed the offence, agrees to conduct the business on the basis of those facts. The prosecution must therefore prove both that the director was aware of the state of affairs and that he agreed to it.

Connivance arises where a director is equally well aware of what is going on, but his agreement is tacit. He does not actively encourage what happens, but lets the state of affairs continue. Connivance, therefore, requires the prosecution to prove awareness on the part of the individual, although this can be established by inference.

In contrast, neglect will be established where the director ought to have known about a particular practice given his specific role and position within the company. Neglect, therefore, presupposes the existence of a particular duty on the part of the person charged with the offence. The question will be whether, in any given factual scenario, the director had failed to take some step and whether the taking of that step either expressly fell within the scope of his particular responsibilities or should have done so.

Powers of enforcement authority

The enforcement authority is usually the trading standards office of the local authority in the area where the defective product is first discovered. Trading Standards Officers are given wide powers under the GPSR to conduct investigations, including the power to enter premises and inspect any record or product or any procedure connected with the production of a product, provided it is not covered by legal privilege. In addition, they have the power to seize or detain samples of the product.

It is an offence to intentionally obstruct an officer in carrying out his duties punishable with a fine.

The Consumer Protection Act 1987

The Consumer Protection Act 1987 (**CPA**) gives effect to the European Product Liability Directive (1985/374/EEC) and acts as an umbrella under which detailed regulations applying to some specific types of products (eg toys and cosmetics) are promulgated. Other products, such as food and drink, have their own sector-specific regimes outside the CPA. Where a class of products is subject to a sector-specific regime, the provisions of the GPSR will still apply to the extent that the specific regime does not include an equivalent provision (ie the GPSR fills any gaps in the specific regimes).

The CPA provides the Secretary of State with the power to make safety regulations and it is under this umbrella that numerous regulations have been made which seek to ensure the safety of goods. Regulations made under the CPA include such diverse matters as the composition, design, construction, finishing or packaging of goods as well as regulations which specify the required approval and testing regimes for specific goods and identify what markings, warnings and instructions should be provided.

The CPA grants the enforcement authority the power to impose suspension notices which are similar to the provision under the GPSR but which may be used where the enforcement authority has reasonable grounds for suspecting that any safety provision has been contravened. The CPA also provides the enforcement authority with similar powers of entry and search to those provided under the GPSR.

The sector-specific regulations made under the CPA are similar in structure to the general regime set out under the GPSR in that they provide a specific safety standard and a means of demonstrating compliance. The specific regulations then refer back to the CPA which contains provisions relating to the defence of due diligence and the liability of individuals, identical to those in the GPSR.

Breaches of Regulations made under the CPA are punishable by an unlimited fine or imprisonment for a term not exceeding six months or both.

The CPA also creates a no-fault liability regime under which individuals who have suffered personal injury or property damage caused by a defective product can seek compensation from the manufacturer (and, potentially, other entities deemed to be responsible for the product). This forms part of the civil law applicable to product liability claims and is therefore outside the scope of this article which focuses on the criminal/regulatory regime.

The Health and Safety at Work etc. Act

Under the Health and Safety at Work etc. Act 1974, specific duties are placed upon manufacturers and others in relation to articles and substances for use at work.

Under section 6 of the Act, it is the duty of any person who designs, manufactures, imports or supplies any article for use at work, so far as is reasonably practicable:

- to ensure that the article is so designed and constructed that it will be safe and without risks to health at all times it is being set up, used, cleaned or maintained by a person at work;
- to carry out or arrange suitable testing to ensure the safety of persons whilst the article is being used at work;
- to take necessary steps to ensure the persons who are supplied with the article are provided with adequate information about its use to ensure that it will be safe and without risks to health at all times when it is being set up, used, cleaned or maintained by someone at work; and
- to ensure that revisions of information are provided.

The duty owed in each case is a qualified one namely to take steps so far as is reasonably practicable. The Act makes it clear that the duty is imposed only so far as the matter is within the control of the employer.

The maximum penalty for breach of duties under the Health and Safety at Work etc. Act 1974 is an unlimited fine or imprisonment for up to two years, or both.

Corporate Manslaughter

Where a defect in a product causes death, the Corporate Manslaughter and Corporate Homicide Act 2007 may be engaged. Corporate Manslaughter is a statutory offence that applies only to organisations (individuals can be prosecuted for the common law offence of gross negligence manslaughter) and is designed to punish failures in the way in which an organisation manages or organises its activities which are considered by a jury to be sufficiently serious to amount to gross breach of the duty of care owed to the deceased.

Although the Act has now been in force for almost 12 years, we are not aware of a prosecution involving a defective product having been brought. However, the wording of the Act makes clear that it does apply in respect of duties of care owed by organisations involved in "the supply … of goods or services (whether for consideration or not)".

The offence is only committed where there is a gross breach of a relevant duty of care owed by the corporate entity under the law of negligence. The Act sets out relevant duty of care situations which, as noted above, expressly include duties owed by an organisation supplying products.

Importantly the offence is only made out where it can be established that a senior manager, or managers, played a substantial role in the organisation's failure. This means that an organisation will not be guilty of manslaughter where the failure of junior employees causes death and that failure cannot be attributed to a failure by a senior manager or managers.

Management or organisational failure

The central question will be whether the death was attributable to a management or organisational failure. In this context evidence of a failure by a senior manager or managers to follow expected systems and practices to properly identify or rectify a defect in a product which subsequently causes death will be relevant.

During the consultation process, the government explained that its intention was that:

> "The prosecution shall be based not only on the immediate events that led to the death but on the wider context in which those events were able to take place. The wider context could include concepts of corporate culture if appropriate. It could also include a failure to have systems in place or to control risks for the carrying out of particular activities or failure to enforce systems; inappropriate delegation of health and safety responsibilities or inadequate supervision of delegated responsibilities."

The Act itself ensures that broad concepts of corporate culture will be considered by specifically providing that the jury may consider the extent to which the evidence shows there were attitudes, policies, systems or accepted practices within the organisation that were likely to have encouraged any failure. It is likely that the judge in his summing up will specifically direct the jury to have regard to these matters.

A gross breach of a duty of care

A gross breach is defined in the Act as "conduct falling far below what can reasonably be expected of the organisation in the circumstances". It is a matter for the jury to decide what standard the organisation should have met and whether the organisation fell far below that standard.

Senior managers

A senior manager is defined as someone who plays a significant role in the making of decisions about how the whole, or a substantial part, of the organisation's activities are to be managed or organised and/or someone who is actually managing or organising the whole or a substantial part of the activities.

Whether or not an individual is a senior manager is a question of fact which will be decided by considering all the circumstances. In any prosecution there is likely to be a substantial amount of argument over the identity of the senior managers.

Sentencing

New sentencing guidelines have been in force since February 2016 covering corporate manslaughter and offences under the Health and Safety at Work etc. Act. The guidelines do not apply to offences under the GPSR or CPA (although they do apply to offences relating to the safety of food products which, as noted above, are subject to a separate regime which is outside the scope of this article).

The guidelines, therefore, apply to unsafe products only where there is a prosecution for corporate manslaughter (where a dangerous product has caused death) or under the Health and Safety at Work etc. Act (for example, in the context of a workplace accident involving an unsafe product). We are not

aware of any plan to introduce similar guidelines in relation to product safety offences under the GPSR and CPA. However, it may well be that the imposition of higher (and more carefully assessed) fines for corporate manslaughter, health and safety and food safety offences indicates a direction of travel.

The guidelines represent a much more mathematical and structured approach to sentencing corporate manslaughter and health and safety offences than existed previously. The guidelines are based upon the following public policy objectives:

- Sentences (for all offences and all categories of offender) should be proportionate to the offence. A fine must therefore reflect the seriousness of the offence and take into account the financial circumstances of the offender.
- Sentences should punish and deter wrongdoing. Fines must therefore "be sufficiently substantial to have a real economic impact which will bring home to both management and shareholders the need to comply with legislation".

The guidelines aim to meet these objectives via a multi-stage approach to sentencing:

- First, a judge must categorise the offence by reference to the level of the company's culpability and the risk of harm it created. In the case of corporate manslaughter there may be relatively little to distinguish between different offenders (since the harm will always be of the most serious kind and the level of culpability must be high for the offence to have been committed). However, the guidance does recognise that some cases will be worse than others (eg where there are multiple fatalities and/or other injuries the offence will be seen as more serious than if there was only one fatality and where there may have been additional causes other than the offender's conduct).
- The judge must then consider the size and financial means of the company. The guidelines classify corporate entities by reference to turnover: "micro" up to £2 million turnover; "small" £2 million – £10 million; "medium" £10 million – £50 million; and "large" more than £50 million. The guidelines also envisage that higher fines may be appropriate for "very large organisations" being "those whose turnover very greatly exceeds [£50 million]". Although there is no clarity on what is meant by "very greatly exceeds", commentary in the guidelines, and in the judgments in which the guidelines have been applied, suggest that a turnover of £300 million would not necessarily make a business "very large" but a turnover of £900 million might well do.
- For a large company (ie more than £50 million turnover) the range of fines available on conviction for corporate manslaughter is £3 million to £20 million. What fine might be imposed within this range would depend primarily on the category of offence (ie the level of culpability and the severity of harm). For a 'very large company' an even higher fine might be possible.
- Finally, the court will, if necessary, adjust the fine to take account of any aggravating or mitigating factors and to ensure that it meets the public policy objectives set out above.

The new sentencing guidelines have led to a number of very significant fines since February 2016 although to date none of these has arisen from prosecution relating to a dangerous product.

Finally, the Corporate Manslaughter and Corporate Homicide Act empowers the courts to make Publicity Orders. These require companies to publicise the fact of their conviction, details of the offence and the amount of the fine. The Guidelines indicate that these should normally be imposed as part of the sentence. The Order will specify the place where the public announcement should be made and this should ensure the conviction becomes known to shareholders.

Additional references

R v Boal [1992] 2 WLR 890

High Court confirms the interpretation of "defect" under the Consumer Protection Act 1987 and highlights the duty of claimants to continually assess the merits of their case

Sandra Bailey & Others v GlaxoSmithKline UK Limited [2020] EWHC 1766 (QB)

3 July 2020

The High Court ruling in *Sandra Bailey & Others v GlaxoSmithKline* appears to mark the end of the long-running Seroxat Group Litigation.

The judgment confirms the courts' approach to determining whether or not a product is "defective" for the purposes of the Consumer Protection Act 1987. It also serves as a reminder of the importance of carefully framing the issues to be determined by the court and of the duty of claimants to keep under review the merits of their case.

Background

This long-running litigation concerned an anti-depressant manufactured by GlaxoSmithKline (**GSK**) and marketed as Seroxat in the UK and Paxil in the United States. Seroxat is one of a class of prescription only anti-depressants described as Serotonin Re-Uptake Inhibitors (**SSRIs**).

A group action against GSK commenced in 2007, alleging that Seroxat was defective within the meaning of the Consumer Protection Act 1987 (**CPA**). Section 3 of the CPA provides that a product is defective if its "safety … is not such as persons generally are entitled to expect". The Claimants' case was that Seroxat had the capacity to cause adverse effects upon discontinuance or withdrawal which were more significant than those associated with other SSRIs making it more difficult to stop using Seroxat than other SSRIs. This came to be referred to as the "worst in class" argument.

The litigation was effectively stayed between 2010 and 2015 after public funding was withdrawn on merits grounds. Whilst most of the original Claimants discontinued their claims, a smaller group obtained third party funding and the action began again in 2015.

Whilst the revived Seroxat Group Litigation was progressing, the High Court handed down two significant judgments on the meaning of defect under the CPA: *Wilkes v DePuy International Ltd* and *Gee & Others v DePuy International Ltd* (the **Pinnacle Metal Hip Litigation**). Following these judgments, the test for determining whether a product is "defective" is whether or not it has an abnormal tendency to result in damage or harm, as compared with appropriate comparator products. The court will adopt a flexible approach and look holistically all the risks and benefits of a product.

> "the Court must maintain a flexible approach to the assessment of the appropriate level of safety, including which circumstances are relevant and the weight to be given to each, these factors being quintessentially dependent upon the particular facts of any case."

This approach to the assessment of "defect" presented a challenge to the Claimants in the Seroxat Group Litigation because their pleaded case was limited to the single issue of whether or not Seroxat was worst in class in relation to discontinuation symptoms. This did not allow for the broader consideration of the risks and benefits of Seroxat that would be necessary for the Claimants to establish that it was defective.

GSK's case from the outset was twofold. They asserted that Seroxat did not cause the alleged adverse effects to a greater extent than comparator products and also, even if that was not the case, that a prescription drug could not be held to be defective under the CPA solely by "comparing the incidence and/or severity of a particular adverse reaction associated with that medicine against the incidence and/or severity of that adverse reaction associated with another prescription only medicine". Following the Pinnacle Metal Hip litigation, GSK argued, "the only lawful approach to defect within the meaning of the CPA involved a much wider comparison of the relative risk/benefit profiles of Seroxat as against the medicines being compared, both generally and for the particular Claimant in question".

In opening submissions before the High Court, the Claimants sought to argue that their case was not limited to the "worst in class" argument. At the close of the parties' openings, Lambert J ruled that the Claimants' case was indeed limited to that argument and could not be extended to cover all of the relative risks and benefits of Seroxat. The Claimants appealed but the Court of Appeal upheld Lambert J's ruling, saying that it was now "far too late to expand the scope of the trial to include

evidence of risks/benefits". Two days before the resumption of the High Court hearing, the Claimants submitted to judgment being entered in favour of GSK. As Lambert J put it, the Claimants had framed their allegations too narrowly and as a result they had been pursuing a case "which was, quite simply, unarguable".

As a result of the Claimants' submission to judgment against them, the only issues to be determined related to costs.

Decision

The Seroxat Litigation began before the introduction of the current Qualified One Way Costs shifting regime. As such, the starting point was that GSK, having successfully defended the action, should recover its costs which were considerable (more than £9 million). The Claimants argued that there should be no order as to costs (meaning each party should bear its own costs) save for payment of GSK's costs in relation to a specific application. GSK submitted that it should recover its costs on the indemnity basis.

The Claimants' case was, in short, that the normal adverse costs rule should not apply because both parties had failed to comply with their obligation to assist the Court in giving effect to the overriding objective (namely to deal with cases justly and at a proportionate cost). They argued that although GSK had argued for a number of years that the Claimants' case was "flawed and not legally tenable" it had never applied for summary judgment or strike out (which would have resolved the claim quickly and cost-effectively, thereby promoting the overriding objective). Lambert J did not accept this. She reaffirmed that the duty to run the Claimants' case rests with the Claimants' legal team. It was up to the Claimants' legal team to "evaluate and re-evaluate the merits of the action as the litigation unfolded and make decisions accordingly". She noted that, whilst there have been many cases in which claimants have been penalised for continuing to prosecute weak claims, there is no authority for the Defendant to be penalised for failing to make an application for summary disposal of a weak claim. By arguing that they could avoid paying GSK's costs by reason of the weakness of their own claim, the Claimants were seeking to "have their cake and eat it".

As to whether GSK should recover costs on the standard basis or the indemnity basis, Lambert J confirmed that the relevant question was the one raised in the case of *Lejonvarn v Burgess*, namely "whether at any time following the commencement of the proceedings a reasonable claimant would have concluded that the claim was so speculative or weak or thin that it should no longer be pursued". Lambert J held that this threshold had been crossed once the judgment in the Pinnacle Metal Hip Litigation was handed down. Thereafter the Claimants' continued pursuit of the claim was "unreasonable to a high degree".

The Claimants were therefore ordered to pay GSK's costs on the standard basis until 21 June 2018 (that is, 28 days following the handing down of the judgment in the Pinnacle Metal Hip Litigation), and on the indemnity basis thereafter, save for the appeal costs which were to be assessed on the standard basis. The Court ordered the Claimants to pay £4.5 million on account of GSK's costs.

Comment

This case highlights a number of key points to be borne in mind by claimants and defendants alike.

- Lambert J's ruling reinforces the landmark decision the Pinnacle Metal Hip Litigation that a product's safety under section 3 of the CPA must be assessed holistically by looking in the round at its risks and benefits compared to other products in the same class.
- The difficulty faced by the Claimants emphasises the importance of carefully framing the issues for determination by the Court. There were times in the long history of the Seroxat Group Litigation when the Claimants could have sought to expand their pleaded case beyond the "worst in class" argument. They did not seek to do so until it was too late.
- The ruling also highlights the expectation that claimants and their legal advisors must continually assess and keep under review the merits of their claims. Failure to do so can, as in this case, lead to substantial costs penalties.

Additional references

Lejonvarn v Burgess [2020] EWCA Civ 114

Gee & Others v DePuy International Ltd [2018] EWHC 1208 (QB)

Wilkes v DePuy International Ltd [2016] EWHC 3096 (QB)

Legal advice privilege: a dominant purpose test, but to what end?

The Civil Aviation Authority v R on the application of Jet2.com Ltd [2020] EWCA Civ 35

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28 January 2020

In *The Civil Aviation Authority v R on the application of Jet2.com Ltd*, the Court of Appeal has developed the test for legal professional privilege and has held that legal advice privilege applies only to confidential communications between lawyer and client that are made for the dominant purpose of seeking or obtaining legal advice. In practice, however, the addition of the word "dominant" seems likely to add little to the existing test.

Jet2.com also considers how legal advice privilege applies in the context of multi-addressee emails that include both lawyers and non-lawyers. This is a common scenario, particularly in the in-house context, so it is disappointing that the Court's decision did not offer more in the way of clear practical guidance.

Continuum of communications

English law applies a highly restrictive interpretation of the "client" for the purposes of legal advice privilege, as established by the notorious Court of Appeal decision in *Three Rivers District Council & Others v The Governor and Company of the Bank of England (Three Rivers No. 5)*. So for a corporate entity, it covers only communications between the lawyers advising the company and the individuals tasked with obtaining that advice on the company's behalf. Individuals who are authorised merely to provide information to the lawyers are not included.

However, once there is a lawyer and a client in this sense, the protection afforded by legal advice privilege is very broad. First, legal advice is not confined to telling the client the law but also includes advice as to what should be done in the relevant legal context. Secondly, the privilege covers not only specific requests for, and the provision of, advice, but also includes the entire exchange aimed at keeping them both informed so that advice may be sought and given as required, known as the "continuum of communications". So while it has long been recognised that, for legal advice privilege to apply, a communication has to be broadly for the purpose of legal advice, the notion of a dominant purpose test has not been viewed as an easy fit.

It is clear, however, that *Jet2.com* does not seek to narrow this broad concept of legal advice, which was in any event established at House of Lords level (*Three Rivers No 6*). The privilege will not apply if the dominant purpose of consulting the lawyer is to obtain commercial input rather than legal advice; for example, if an in-house lawyer has dual roles. And even where the dominant purpose of consulting the lawyer is to obtain legal advice, a communication will not be privileged if it falls outside of that context. However, in general terms, the protection of the privilege should remain broad.

Rationale for a dominant purpose

In coming down in favour of a dominant purpose test, the Court was heavily swayed by the test for litigation privilege, where the document in question must have been prepared for the dominant purpose of litigation that was reasonably in contemplation at the relevant time. As legal advice privilege and litigation privilege are both limbs of legal professional privilege, the Court could not see a compelling rationale for differentiating between them. It also looked at the common law in Australia, Singapore and Hong Kong, where a dominant purpose test applies to both limbs of the privilege, and said that there was an advantage in adopting similar principles in this area.

It is important to note, however, that litigation privilege, as well as legal advice privilege as it has developed in those common law jurisdictions (which chose not to follow *Three Rivers No 5*), is not restricted to communications between lawyer and client and, in some cases, even applies to third-party communications. In those circumstances, it is necessary to have some limiting factor, which is supplied by the dominant purpose test.

In contrast, legal advice privilege under English law is already tightly restricted, as it applies only to communications between lawyer and client as narrowly defined by *Three Rivers No 5*. The adoption of a dominant purpose test for legal advice privilege would be understandable if English law were to follow other common law jurisdictions in removing the requirement for a lawyer to client communication. As things stand, however, arguments based on harmonising the law seem less compelling.

Multi-addressee communications

The Court in *Jet2.com* also discussed the application of legal advice privilege in the context of emails sent to both lawyers and non-lawyers. Unfortunately, this aspect of the decision is not easy to follow.

At some points, the Court appears to suggest that the dominant purpose test should be applied to the multi-addressee communication as a whole, so that if the dominant purpose is to seek legal advice from the lawyer then it is privileged, but if it is to seek commercial views then it is not privileged, even if a subsidiary purpose is to obtain advice from the lawyer.

However, the judgment also clearly states that the Court's preferred view is that each communication between the sender and each recipient should be considered separately, as legal advice privilege essentially attaches to communications. Therefore, the question of whether a communication to a non-lawyer is privileged should not be dictated by its form, that is, whether it has been sent in the same email as a communication to a lawyer or whether the emails have been sent separately.

The proper analysis of multi-addressee communications appears to be as follows:

- An email sent by a client to a lawyer is privileged if it is for the dominant purpose of seeking legal advice in the broad sense. Conversely, it is not privileged if the lawyer is being asked for commercial input. The fact that non-lawyers are copied in for information does not affect its privileged status.
- An email between two non-lawyers is not covered by legal advice privilege, given the need for a lawyer-client communication. The fact that a lawyer is copied in for information does not change that. If, however, the email reveals a privileged communication, such as reporting legal advice, the relevant section is privileged and can be redacted.
- Combining a privileged communication to a lawyer with a non-privileged communication to a non-lawyer does not protect the otherwise non-privileged communication. So where an email is addressed equally to a lawyer and a non-lawyer, seeking both legal and non-legal input on a given set of facts, it will likely have to be disclosed. However, where the email contains a specific request for legal advice from the lawyer, or reports legal advice previously received, then again it can be redacted to that extent.
- In each of the above scenarios, the lawyer's response is privileged provided that it is for the dominant purpose of providing legal advice, in the broad sense, rather than providing commercial input.
- The same principles apply to meetings attended by lawyers and non-lawyers. Legal advice that is requested and given at a meeting is privileged, but the mere presence of a lawyer does not mean that the whole meeting is protected by legal advice privilege.

Commentary on *Three Rivers No 5*

As in *SFO v ENRC*, the Court in *Jet2.com* was highly critical of the narrow approach established in *Three Rivers No 5* to the question of who is the client for the purposes of legal advice privilege, and would not have been inclined to follow that decision if it were free to depart from it. This helpfully adds to the weight of criticism of *Three Rivers No 5*. However, any change to the law will have to wait for a suitable case to go to the Supreme Court.

Jet2.com is somewhat confusing in appearing to suggest, in places, that a communication between two non-lawyers may be covered by legal advice privilege if it is for the dominant purpose of settling instructions to the lawyer. However, the Court notes repeatedly that this is subject to *Three Rivers No 5*, which in fact rules out that idea due to its emphasis on the need for a lawyer or client communication. Perhaps, therefore, the Court's comments in *Jet2.com* regarding communications between non-lawyers should be understood as applying only if *Three Rivers No 5* is overturned in future.

Additional references

SFO v ENRC [2018] EWCA Civ 2006

Three Rivers District Council & Others v The Governor and Company of the Bank of England (Three Rivers No 6) [2004] UKHL 48

Three Rivers District Council & Others v The Governor and Company of the Bank of England (Three Rivers No 5) [2003] EWCA Civ 474

High Court orders security for costs against member of Association of Litigation Funders

Rowe v Ingenious Media Holdings PLC [2020] EWHC 235 (Ch)

10 February 2020

In the group litigation brought in respect of the Ingenious Media film partnerships, the High Court has granted the Defendants' application for security for costs against the Claimants' litigation funder, Therium.

The decision follows the Court's approach to security applications against litigation funders in the *RBS Rights Issue Litigation* and is the first successful such application against a member of the Association of Litigation Funders.

As in the *RBS* case, it was a significant factor in granting security that, if the claim failed, the Claimants would each be liable for only a proportion of the Defendant's costs, in light of the Court's order providing for several rather than joint liability. It was also significant that the funder had provided no evidence as to its financial position, and therefore the Court could not be confident that it would meet any order for costs made against it. Whilst some value was attributed to the after-the-event (**ATE**) insurance policies the Claimants had in place in respect of their potential adverse costs liability, those policies were not a complete answer to the application given the risk that they would not respond in full.

Background

The applications were made as part of the Ingenious Litigation, in which claims are brought by over 500 individual Claimants in relation to their investments in the Ingenious Media film partnerships. The Ingenious partnerships were promoted from 2002 to 2007 as tax-efficient vehicles involved in the production of films and video games, through which investors could set off the trading losses of the relevant partnership against their own taxable income. HMRC challenged the tax treatment of the partnerships, and that challenge was upheld on appeal to the First Tier Tribunal and the Upper Tribunal. The result is that, subject to any further appeal, no loss relief is available to investors.

The Claimants seek to recover their losses from various companies and individuals associated with the Ingenious Media group. A large number of the Claimants also claim against the financial institution which provided lending to facilitate the investments, and some of the Claimants claim against the financial advisers to the Claimants. The majority, but not all, of the claims are funded by Therium Litigation Finance AF IC. The claims are being case managed together, though no Group Litigation Order (**GLO**) has been made. The vast majority of the claims have been stayed while a few select claims proceed through to trial as test claims.

The Claimants applied for an order that their potential liability for adverse costs should be several and not joint, and that each Claimant's liability should be pro-rated to the value of their individual investments in the partnerships rather than per capita. The Defendants applied for security for costs against Therium.

Decision

The High Court (Nugee J) granted both applications.

Several vs joint liability

Nugee J did not accept that the starting point was that the Claimants would be jointly and severally liable for adverse costs. He commented, "Costs are always in the discretion of the court, and cases vary infinitely." In a simple case where two parties have a joint claim, or bring what is in effect a single case, one would expect them to be jointly liable for adverse costs. But it did not follow that the same applied to litigation with hundreds of individual claimants, who each have their own independent claims which vary in value. In such cases it was not obvious that the claimants should be jointly and severally liable for the potentially large costs of the proceedings, regardless of how small their personal stake may be, simply because the claims are being heard together.

The appropriate question for the Court was not therefore whether to depart from the default position of joint and several liability, but rather whether it was just in all the circumstances for a several liability order to be made. This turned on the question of whether the risk of non-collection from individual Claimants should lie with the Defendants or with the other Claimants.

Nugee J referred to the decision in *Ward v Guinness Mahon plc*, in which the Court of Appeal considered it to be demonstrably fairer that the defendants should bear this risk, rather than a small number of claimants being forced to pay the entire amount and failing to be reimbursed by the remaining claimants.

Nugee J did not consider that changes in the legal landscape since the decision in *Ward*, namely the rise of litigation funders and ATE insurance, mitigated against the risk of individual claimants' claims being stymied by the threat of substantial adverse costs orders. There was no reason to think the risk of joint liability had ceased to limit access to justice for individual claimants; those of modest means were likely to consider substantial costs risks to outweigh the benefits of recovery, and wealthier claimants were likely to fear being a defendant's first port of call for satisfaction of a joint and several costs award. He noted that he had not been shown any example of a case in

which joint liability had been imposed for adverse costs, either under a formal GLO or where cases had been managed together without a GLO.

He therefore ordered that the Claimants' liability for adverse costs should be several.

Apportionment of liability

While the Ingenious Litigation is not subject to a formal GLO, Nugee J considered that the principles set out in CPR 46.6 regarding costs sharing in group litigation should apply in the same way, as it is characteristic of the sort of case which would be suitable for a GLO.

The default position under CPR 46.6 is that liability for common costs in group claims will be shared equally by each claimant (ie per capita), but the Court can order that costs be shared some other way, and this was done in *RBS*. In his judgment in that case, Hildyard J stated:

> "Where there is ... a very considerable disparity between the values of the claims of different parties, if they are all unsuccessful the default rule is unlikely to meet the requirement of fairness. It is not fair or equitable that an institutional investor with millions, in some cases hundreds of millions, at stake should pay an equal contribution as an individual claimant with claims in the hundreds, or even hundreds of thousands."

Nugee J agreed with this statement, saying it seemed fairer that the risks to a claimant of participating in the litigation should be proportionate to the reward they might obtain from the litigation. In the present case, the Claimants' investments ranged from £36,000 to £10.5 million. While the disparity was greater in *RBS*, the principles did not only apply in the most extreme cases. Nugee J therefore held that the appropriate order would be to apportion liability pro rata by reference to the amount of each Claimant's investment in the partnerships.

Security for costs

It was common ground that the Court had jurisdiction to order security for costs against Therium under CPR 25.14(2)(b), which allows security to be granted against those who fund litigation in return for a share of the proceeds.

But it was not appropriate to order security against Therium in respect of the self-funded claims, as opposed to the claims Therium was funding, as there was no principled basis on which Therium could be made liable for the costs of those claims under s.51 of the Supreme Court Act 1981. However, this was subject to exceptional circumstances; it was in theory possible that Therium might behave in such a way as to render itself open to an order for costs in relation to the self-funded Claimants, but the circumstances would have to be "fairly unusual".

Nugee J referred to the principles set out by Hildyard J in *RBS* in considering an order for security for costs against a funder. In particular, while the whole matter must be looked at in the round, the most significant question for the Court is whether there is a real and not fanciful risk that the Defendants will not be paid if they obtain an adverse costs order in their favour.

In considering that question, it was necessary to assess the level of costs that each Defendant might reasonably expect to recover. For those Defendants facing allegations of dishonesty, Nugee J held that there was a real possibility that they would be awarded costs on the indemnity basis if successful, and therefore it was appropriate to order security for 75% of the costs. In relation to the claims which do not involve allegations of dishonesty, and would most likely fall to be assessed on the standard basis, and given the reasonableness of the costs of the Defendants in this case, a figure of 70% was appropriate.

Nugee J considered whether the Defendants would have recourse to sufficient resources to meet any adverse costs order in their favour, so that there was no need for any security. He adopted the following approach in relation to each of the sources potentially available to meet such liability:

The litigation funder

Nugee J noted that it was "striking" that Therium (a Jersey-incorporated entity) provided no information in relation to its financial position but instead relied on the fact that it was a founding member of the Association of Litigation Funders (**ALF**), was subject to the ALF Code in relation to capital adequacy requirements and had a track record of having been involved in over 50 cases to date without having defaulted on any adverse costs liability. Nugee J was not persuaded that this was sufficient to remove the risk to the Defendants.

The Claimants' own resources

The Claimants' solicitors provided some financial information regarding the wealth of the 33 Claimants with the largest investments, but provided no indication as to their assets or ease of enforcement against those assets. Nugee J commented that a snapshot of a person's wealth at the present moment did not give any guarantee that the position will be the same in a number of years' time when the proceedings have concluded. A number of the Claimants are facing demands from HMRC and some have become bankrupt since the proceedings began.

Further, the provision of financial information for the largest investors only provided comfort that the Defendants would recover those Claimants' shares of their costs. In light of Nugee J's decision regarding the apportionment of adverse costs liability between the Claimants, this amounted to less than 50%. The fact that there were a number of wealthy Claimants therefore did not mean that there was no real risk of the Defendants not being paid.

The ATE policies

While the Claimants had the benefit of ATE insurance, Nugee J found the ATE policies to provide inadequate protection to the Defendants against the risk of non-recovery. First, the amount of cover was insufficient to meet the Defendants' costs in the percentages set out above. Second, there was a real risk that the policies would not respond (through, for example, the likelihood that insurers might seek to avoid cover if the judge expressed adverse views as to the Claimants' truthfulness, in light of the fraud/deliberate non-disclosure provisions in the policies). Accordingly, Nugee J discounted the value attributable to the ATE policies to account for these deficiencies.

Given the above, Nugee J held that there was a real risk that the Defendants would not recover their costs and he awarded security in the above percentages, while giving credit for between one half and two thirds of the cover available to the funded Claimants under the ATE policies to reduce the amount of security to be paid.

Comment

With litigation funding and group proceedings expected only to increase over coming years, this decision is a timely reminder on the importance of security for costs applications which will be of interest to policyholders, funders and insurers alike.

Additional references

RBS Rights Issue Litigation [2016] EWHC 3161 (Ch)

Ward v Guinness Mahon plc [1996] 1 WLR 894

Court of Appeal finds regulator cannot demand production of client's privileged documents unless statute overrides privilege

Sports Direct International Plc v The Financial Reporting Council [2020] EWCA Civ 177

18 February 2020

The Court of Appeal has held that an audit client was not required to hand over its privileged documents in response to a notice from its auditor's regulator requiring the production of documents in connection with an investigation into the auditor's conduct.

Background

The Financial Reporting Council (**FRC**) sought a court order compelling the respondent (**SDI**) to comply with notices requiring the production of documents to assist with an investigation being conducted by the FRC into the conduct of SDI's former auditors. The applicable regulations contain a carve-out for information or documents which a person "would be entitled to refuse to provide or produce in proceedings in the High Court on the grounds of legal professional privilege".

SDI argued that it was entitled to withhold certain documents from production on grounds of legal advice privilege. These comprised emails sent between SDI and its legal advisers, and attachments to those emails.

The FRC argued that:

- even if the emails were privileged, there would be no infringement of SDI's privilege if the emails were handed over (**the Infringement Issue**);
- in the alternative, even if the emails were protected by privilege, some of the attachments were pre-existing documents and were not protected by privilege simply by being attached to privileged emails (**the Communication Issue**).

The High Court (Arnold J) accepted the FRC's arguments on both issues and ordered that the emails and attachments be disclosed. SDI appealed.

Decision

The Court of Appeal allowed the appeal on the Infringement Issue but dismissed the appeal on the Communication Issue. Rose LJ gave the leading judgment, with which Lewison LJ and the Master of the Rolls agreed.

The Infringement Issue

Rose LJ referred to the House of Lords decision in *R (Morgan Grenfell & Co Ltd) v Special Commissioner of Income Tax*, in which she said Lord Hoffmann referred to two principles that were not in dispute: first, that legal professional privilege is a fundamental human right; and second, that a statute can only override privilege expressly or by necessary implication. In the present case, the FRC's statutory powers contained an express carve-out for privilege and so could not be interpreted as overriding privilege. However, the FRC relied on comments made by Lord Hoffmann in *Morgan Grenfell* in support of its position that SDI was nevertheless required to produce privileged documents.

Those comments related to the rationale behind *Parry-Jones v Law Society*, in which the Court of Appeal held that a solicitor being investigated by the Law Society could not refuse to hand over documents requested pursuant to the Law Society's statutory powers on the grounds that they were subject to his clients' privilege. In *Morgan Grenfell*, Lord Hoffmann stated:

> "...I think that the true justification for the decision was not that Mr Parry-Jones's clients had no LPP [ie legal professional privilege], or that their LPP had been overridden by the Law Society's rules, but that the clients' LPP was not being infringed. The Law Society were not entitled to use information disclosed by the solicitor for any purpose other than the investigation. Otherwise the confidentiality of the clients had to be maintained. In my opinion, this limited disclosure did not breach the clients' LPP or, to the extent that it technically did, was authorised by the Law Society's statutory powers. It does not seem to me to fall within the same principle as a case in which disclosure is sought for a use which involves the information being made public or used against the person entitled to the privilege."

The FRC submitted that, in that paragraph, Lord Hoffmann recognised a further exception to legal professional privilege to the effect that, where a regulator has a statutory power to request documents, there is no infringement of the privilege when documents are handed over in response to a request made under that power (the no infringement exception) – or, in the alternative, any infringement is "technical" only and therefore can be overridden on the basis of a less stringent test than that applied in *Morgan Grenfell* (the technical infringement exception).

The FRC accepted that for either exception to apply, three conditions must be met: (i) the request for the information must come from a regulator; (ii) the regulator must be bound by duties of confidentiality in its use of the information; and (iii) the holder of the privilege must be someone other than the person who is at risk of some adverse finding as a result of the use of the information by the regulator.

Following a detailed analysis of *Morgan Grenfell* and subsequent case law, Rose LJ held that there was no justification for regarding Lord Hoffmann's comments as authority for the existence of a "no infringement exception", or for the application of some lower threshold for implying a statutory override to privilege on the grounds that any infringement would be "technical". Accordingly, Arnold J had erred in ordering disclosure of the privileged documents on the grounds that SDI's privilege would not be infringed as a result, or that any infringement would be merely technical and was authorised by the statutory powers.

The Communication Issue

Rose LJ referred to Arnold J's conclusion, based on authorities including *Ventouris v Mountain*, that pre-existing documents which are not themselves privileged do not achieve the protection of privilege by being attached to a privileged communication.

SDI's counsel accepted that pre-existing documents are not covered by privilege simply because they are sent to a legal adviser. However, he sought to draw a distinction between, on the one hand, whether an attachment was privileged in itself and, on the other, whether the communication of that attachment was privileged.

Rose LJ held that such a distinction could not survive the judgment in *Ventouris v Mountain* and the authorities cited in that case.

Comment

The decision is helpful in reinforcing the protection of privilege in the regulatory context, whether the privilege belongs to the person who is subject to a regulatory investigation or a client of that person. In either case, privilege will be a defence to a notice requiring production of documents under a regulator's statutory powers, unless the statute overrides privilege either expressly or by necessary implication.

The decision also confirms that privilege cannot be claimed for non-privileged documents merely because they are attached to privileged communications. The Court rejected an attempt to distinguish between a non-privileged attachment and the communication of that attachment between lawyer and client.

Additional references

R (Morgan Grenfell & Co Ltd) v Special Commissioner of Income Tax [2002] UKHL 21

Ventouris v Mountain [1991] 1 WLR 607

Parry-Jones v Law Society [1969] 1 Ch 1

Court of Appeal confirms funders' adverse costs liability not limited to amount of funding provided: *Arkin* "cap" not a binding rule

ChapelGate Master Fund Opportunity Ltd v Money [2020] EWCA Civ 246

25 February 2020

The Court of Appeal dismissed an appeal against a decision that a commercial funder of a failed claim was liable for all of the Defendants' costs from the date on which the funding agreement was entered into. There was no basis for interfering with the judge's discretion in declining to apply the so-called *Arkin* cap to limit the funder's liability to the amount of the funding it had provided.

Background

The Claimant brought various claims against the Defendants with the benefit of litigation funding provided by a commercial funder, ChapelGate. Under the original funding agreement, entered into on 23 December 2015, ChapelGate was to provide £2.5 million, including the cost of an ATE insurance premium, in return for the greater of 2.5 times its committed funding or 25% of net winnings. The Claimant failed to obtain ATE insurance, in breach of a condition of the funding agreement, and the agreement was amended to waive that condition and reduce ChapelGate's total funding commitment to £1.25 million, but with its return calculated on the basis of the original £2.5 million commitment. ChapelGate later purchased ATE cover in the sum of £650,000 to limit its own exposure to adverse costs.

The claims failed in their entirety and the Claimant was ordered to pay the Defendants' costs to be assessed on the indemnity basis. The Defendants applied for a non-party costs order against ChapelGate. ChapelGate accepted that a non-party costs order should be made against it on the same indemnity basis as the order made against the Claimant, but argued that its liability should be: (i) limited to costs incurred after 23 December 2015 (the date of the original funding agreement); and (ii) capped at the overall amount of funding it had provided, applying the so-called *Arkin* cap derived from the case of *Arkin v Borchard Lines Ltd (Nos 2 and 3)*.

The Defendants claimed to have incurred costs of some £4.33 million after 23 December 2015 and about £3.15 million before that date.

The High Court (Snowden J) found in favour of ChapelGate on the first issue, ie that its liability should be limited to costs incurred after 23 December 2015, but found against it on the second, ie the application of the *Arkin* cap. ChapelGate was therefore ordered to pay the Defendants' costs on the indemnity basis from 23 December 2015 without any cap.

ChapelGate appealed.

Decision

The Court of Appeal dismissed the appeal (Newey LJ giving the lead judgment with which Patten and Moylan LJJ agreed). It found that Snowden J was right to conclude that judges do not necessarily have to adopt the *Arkin* approach when determining the extent of a commercial funder's liability for costs.

Newey LJ referred to indications in *Arkin* that the Court of Appeal was not attempting to lay down a binding rule. In particular, the Court had spoken of commending an approach and suggesting and proposing a solution, and had foreseen certain consequences if the course it proposed became generally accepted. Those words did not suggest a binding approach.

In Newey LJ's view, that may well have reflected the Court of Appeal's perception that a decision as to what, if any, costs order to make against a commercial funder is in the end discretionary. As Moore-Bick LJ noted in *Deutsche Bank AG v Sebastian Holdings Inc*, when it comes to costs orders against non-parties, "the only immutable principle is that the discretion must be exercised justly".

Newey LJ pointed out that it is possible to envisage circumstances in which applying the *Arkin* cap might not be considered "just", for example if the funder would have received a very large proportion of any winnings. In such a case, he said, a judge might wish to have regard to what the funder had stood to gain, whereas the *Arkin* approach focuses exclusively on the extent of the funding provided.

It was also relevant that *Arkin* was decided when third party funding of litigation was still "nascent" and conditional fee agreements and ATE insurance relatively new. Now that such arrangements are much more established, the risk of deterring funders through an uncapped costs liability has diminished.

Newey LJ emphasised that he was not saying the *Arkin* approach had become redundant; there would no doubt continue to be cases in which judges decide that it is right to follow that course, particularly on facts closely comparable to those in *Arkin* where the funder had funded a discrete part of the claim (ie the costs of instructing expert witnesses). However, the *Arkin* approach does not represent a binding rule. Judges

retain a discretion and may consider it appropriate to take into account matters other than the extent of the funding provided.

In the present case, Newey LJ found, there was no basis for criticising the exercise of the judge's discretion in deciding not to adopt the *Arkin* approach. While a different judge might or might not have arrived at the same conclusion, the order made was reasonably open to him and it could not be said to have been founded on irrelevant considerations.

Comment

This is a significant decision as it confirms that the *Arkin* cap is not a binding rule. The court retains a broad discretion as to the extent to which a funder should be liable for adverse costs, and need not limit the funder's liability to the amount of funding provided. The decision suggests that, in some cases, the courts may wish to take into account the extent to which the funder stood to gain from a successful claim, as well as the extent of the funding provided. In other cases, however, it may be appropriate to apply the *Arkin* approach, particularly where the funder funded a discrete part of the claim.

The decision will be welcome to defendants facing claims supported by litigation funders, as it reduces the risk of facing irrecoverable costs due to an automatic application of the *Arkin* cap.

Additional references

Deutsche Bank AG v Sebastian Holdings Inc [2016] EWCA Civ 23

Arkin v Borchard Lines Ltd (Nos 2 and 3) [2005] EWCA Civ 655

High Court finds "control" for the purposes of disclosure includes third party documents that the litigating party can access under a standing consent short of an enforceable right

Pipia v BG Group Ltd [2020] EWHC 402 (Comm)

26 February 2020

The High Court found that the documents of two of the Defendant's subsidiary companies were within its "control" for the purposes of disclosure. Although the decision was reached under the rules for the Disclosure Pilot Scheme currently progressing in the Business and Property Courts, the decision is clear that the same principles apply in non-pilot cases.

Background

The Defendant, BG UK, applied for a declaration that, for the purposes of disclosure, it did not control documents held by two of its subsidiaries, referred to in the judgment as (i) BG Georgia, a wholly owned subsidiary of BG UK, and (ii) BoG, which is 79.75% owned by BG Georgia (together the **Subsidiaries**).

Under the disclosure pilot practice direction (**PD 51U**) "control" in the context of disclosure is defined to include "documents: (a) which are or were in a party's physical possession; (b) in respect of which a party has or has had a right to possession; or (c) in respect of which a party has or has had a right to inspect or take copies". This is similar to the definition of control at CPR 31.8 for cases which fall outside the pilot.

The Claimant initially brought proceedings against BG UK and seven other Defendants, including the Subsidiaries, but the claims against the other seven Defendants were discontinued in April 2018.

By two letters dated 30 March 2018 (the **30 March Letters**), the CEO of BG UK wrote to each of the Subsidiaries requesting that they provide BG UK with "all the documents pertaining to [the Claim] as requested by us or our advisors". The letters were countersigned to indicate agreement on behalf of the Subsidiaries.

A number of documents were sought by BG UK and provided by the Subsidiaries, and it was accepted that those documents were effectively then within BG UK's control for the purposes of disclosure. The application concerned documents held by the Subsidiaries which had not in fact been provided to BG UK.

In June 2019, BG UK wrote to the Subsidiaries requesting that BG UK be provided with open access to their documents and data so that BG UK's solicitors could search for documents relating to the issues in dispute. BoG responded that it was unable to fulfil BG UK's request due to Georgian law relating to bank secrecy, which meant it could disclose information only in specific cases and to specific recipients provided for in legislation. BG Georgia also replied that it was "unable to comply" with the request.

Decision

The High Court (Baker J) held that BG UK had control over the Subsidiaries' documents to the extent that they fell within a standing consent to provide documents relating to the claim on request, as put in place as a result of the 30 March Letters.

The principles relating to control of a subsidiary's documents

The judge noted that the parties were "mostly agreed" on the correct approach where it is alleged that a parent company controls documents held by its direct or indirect subsidiaries. The starting point is that the parent does not exercise control over such documents merely by virtue of its shareholding: *Lonrho Ltd v Shell Petroleum Co Ltd (No 1)*. A parent would however have control for the purposes of CPR 31.8 and PD 51U where:

- the parent company has a presently enforceable legal right to obtain the documents from its subsidiary; or
- there is an existing arrangement or understanding, whether or not legally enforceable as a contract, that in practice provides the parent with a right of access to documents held by its subsidiary.

In relation to the second of these, however, the parties disagreed as to whether the right of access would have to be "free and unfettered", and if so what that meant.

Free and unfettered access?

The Defendant submitted that, to amount to "control", a standing consent must grant unrestricted access to a third party's documents so that the litigating party can go through them to identify relevant documents. The judge rejected that submission.

He referred to two cases that were relevant to this point. In the first, *Schlumberger Holdings Ltd v Electromagnetic Geoservices AS*, the defendant argued that the claimant had control over the documents of other companies in its corporate group. The evidence showed that, in general, group companies would provide documents requested by the claimant except where the documents were especially commercially sensitive, in particular corporate acquisition documents, or the requests were onerous. Floyd J held that the documents were within the claimant's control, saying:

> "...[W]hat happens where the evidence reveals that the party has already enjoyed, and continues to enjoy, the co-operation and consent of the third party to inspect his documents and take copies... and where there is no reason to suppose that that position may change? Because that is the factual situation with which I am confronted here. ... My decision depends on the fact that it appears from the evidence that a general consent has in fact been given to the claimant to search for documents properly disclosable in this litigation, subject only to the caveats ... concerning corporate acquisition documents and unreasonably onerous requests."

In the second case, *Ardila Investments v ENRC*, Males J referred to *Schlumberger* and found that documents held by two of the defendant's subsidiaries in *Ardila* were not within its control in the necessary sense, on the basis that it did not have free access to the subsidiaries' documents. Past cooperation as to compliance with specific requests did not amount to evidence that the defendant had the necessary control, Males J said, as it did not indicate that the defendant would be "entitled to send its solicitors into [the subsidiaries'] premises and to insist on searching [their] computers".

In the present case, Baker J said it was important not to read too much into that quotation from Males J's judgment in *Ardila*. In both *Schlumberger* and *Ardila*, what was alleged to exist was an arrangement granting general access to the third party's documents. That did not mean there could not be "control" unless there was a grant of that kind of wholesale access to documents. There can, the judge said, be "control" that extends to a single document only.

A general control arrangement prior to the 30 March Letters?

The Claimant submitted that there was a general control arrangement between BG UK and the Subsidiaries that was in place prior to and independently of the 30 March Letters, or alternatively that those letters created the necessary control arrangement.

The judge rejected the first of these submissions, agreeing with BG UK that the 30 March Letters were inconsistent with the notion that there was a pre-existing standing consent.

He did not accept the Claimant's submission that the court should draw an adverse inference against BG UK as to the existence of a control arrangement, due to their failure to make "sensible requests" for documents from the Subsidiaries, in particular following on from the responses to the June Letters. He accepted that such a failure may justify an adverse inference that there is in fact a right of access, on the basis that the failure to make sensible requests may stem from the knowledge that they would be responded to in such a way as would evidence the existence of that right. On the facts of this case, however, he did not accept that BG UK's failure to press the point was only sensibly to be explained by a fear that it would generate evidence showing that some such arrangement existed.

Baker J also commented that a conclusion that a third party would probably provide documents, if asked by the litigating party to help, does not mean that control has been established. Absent control, a litigating party is under no obligation to ask a third party to provide documents. However, he said, depending on the circumstances, it may be appropriate to draw an adverse inference going to the merits (either generally or on some particular issue or issues) on the basis of the failure to seek that assistance.

Effect of the 30 March Letters

The judge accepted the Claimant's fallback argument that the 30 March Letters created a control arrangement. By those letters, BG UK sought and obtained the Subsidiaries' agreement to provide all documents pertaining to the claim that it might request. Andrew Baker J commented:

> "It was a standing promise and, in line with the authorities, it does not matter whether it would be enforceable as a contract. It was thus a standing consent... to provide documents on request."

Under the terms of the standing consent, it was necessary for BG UK to identify and request documents that the Subsidiaries could provide to it as relevant to the claim. But that did not affect the quality of the consent given, which was a standing consent giving BG UK unfettered access to such documents on request.

That was, in the Court's judgment, "control" for disclosure purposes under CPR 31.8 or CPR PD 51U, as regards the documents covered by the arrangement.

Although the control arrangement constituted by the 30 March Letters was put in place when the Subsidiaries were co-defendants to the Claim, it was not expressed to be conditional on the claim continuing against them and was not terminated when the claim was discontinued against them. Further, the judge commented, "for it to be terminated now would risk an inference being drawn in due course that it was terminated, in the face of BG UK's disclosure obligations, because [the Subsidiaries] held documents not provided to BG UK that would be unhelpful to BG UK's defence of the Claim".

The June Letters proposed a different control arrangement, allowing open access to the Subsidiaries' documents, so that they could be searched and disclosed as appropriate. If the Subsidiaries had consented to that arrangement, it might have superseded the 30 March Letters. However, there was no suggestion that the arrangement put in place by those letters was to be terminated if the new proposed arrangement was not accepted. Accordingly, the Court concluded that that arrangement had not been terminated.

The effect on the appropriate disclosure order

The judge said that, while it would be a matter for a future CMC, his provisional view was that the appropriate disclosure obligation on BG UK, deriving from the control arrangements under the 30 March Letters, would be to make reasonable and proportionate requests to the Subsidiaries for documents falling

within that arrangement. That might, he said, lend itself most naturally to the adoption of "Model C" for disclosure of those documents, so as to identify the document requests that should be made to the Subsidiaries.

The judge commented that, under Model C, any documents located upon a reasonable and proportionate search that fall within the scope of a Model C request will be disclosed; there is no further restriction based on relevance or some other criterion. He said:

> "Model C Requests therefore should be defined with that end result in mind; and a request for a disclosing party to search for "any or all documents relating to" a topic is not, to my mind, a Model C Request at all...".

In the present case, the draft Model C request which appeared to have been provisionally agreed, subject to the question of control, sought disclosure of any emails, Word documents, etc initiated or received by certain individuals in a defined period "in relation to" a particular issue. The judge said his provisional view was that this was not a competent Model C request at all:

> "Rather, it is a broadly-defined category of documents that it is envisaged will be collected together for review against some disclosure standard (unstated, but perhaps intended to be the Model D standard), the results of which will define what is finally disclosed out of that category of documents."

In the run-up to the CMC, the parties would need to engage in constructive dialogue to define proper Model C requests that could then be made by BG UK to the Subsidiaries pursuant to the 30 March Letters, assuming that Model C was to be adopted.

Comment

The decision is of particular interest in finding that, to fall within this principle, there is no need for the litigating party to have wholesale access to the third party's documents; the arrangement or understanding may relate to a more restricted class of documents, in which case only those documents will be within the party's control. This is, however, distinct from a mere finding that the third party would probably provide documents if asked to do so. That does not, in itself, justify a finding of control.

The judgment contains a number of interesting comments as to the circumstances in which the court may draw adverse inferences, either regarding the existence of a control arrangement over documents or as to the underlying merits of the case. The decision suggests that:

- In some circumstances, it may be appropriate to draw adverse inferences to the effect that a litigating party has control over a third party's documents due to its failure to make "sensible requests" for documents from that party. The reasoning is that the reluctance may stem from the knowledge that the third party would respond in a way that demonstrated the existence of an arrangement or understanding amounting to control.
- If a third party's documents are not within the control of a litigating party, there is no obligation on the litigating party to ask the third party to provide documents for disclosure, even if the third party would probably provide the documents. However, depending on all the circumstances of the case, a failure to request the documents may mean the court is justified in drawing an adverse inference going to the merits of the case, either generally or on some particular issue.
- Where the court finds that a control arrangement existed but has been terminated, and again depending on all the circumstances, the party which has terminated the arrangement may be at risk of an inference being drawn that the reason for termination was because the third party held documents that would be unhelpful to the party's position.

Finally, the decision contains interesting commentary on one of the disclosure models under the pilot, "Model C", which is defined as "disclosure of particular documents or narrow classes of documents relating to a particular Issue for Disclosure", by reference to requests set out in the parties' Disclosure Review Document or otherwise defined by the court. The judge expressed the provisional view that, where Model C disclosure is ordered, any documents a party locates which fall within the scope of the requests must be disclosed, whether or not they are relevant to the issues in the case. If that approach is followed in future cases, it will be crucial for parties to take care in seeking to formulate and agree any Model C requests.

Additional references

Ardila Investments v ENRC [2015] EWHC 3761 (Comm)

Schlumberger Holdings Ltd v Electromagnetic Geoservices AS [2008] EWHC 56 (Pat)

Lonrho Ltd v Shell Petroleum Co Ltd (No 1) [1980] 1 WLR 627

High Court finds in favour of novel duty of care on employers (or quasi-employers) to protect against economic loss by providing an "ethically safe" work environment

Rihan v Ernst & Young (Global) Ltd [2020] EWHC 901 (QB)

17 April 2020

The High Court has awarded a former partner of *Ernst & Young* (**EY**) damages exceeding $11 million, broadly equating to past and future earnings for the rest of his career. The Claimant, Mr Rihan, was a whistle-blower who publicly disclosed suspected irregularities arising out of an audit for a client for whom he was the audit engagement partner, and unilaterally left EY.

Background

The complex facts in the case, as found by the trial judge (Kerr J), can be summarised as follows:

- The Claimant was a partner in EY working in Dubai. He was the audit engagement partner for a Dubai corporate client, Kaloti Jewellery International (**Kaloti**), which is Dubai's biggest gold refiner, and had been tasked with providing an "assurance audit" of Kaloti. This would provide an independent view on the quality and propriety of Kaloti's business practices. He discovered irregularities in Kaloti's business concerning the suspected unlawful smuggling of gold bullion coated in silver out of Morocco and into Dubai. Indeed it was common ground that this gave rise to a reasonable suspicion that Kaloti was involved in money laundering.
- The Claimant reported his concerns within EY, but EY failed to act on the Claimant's concerns and sanitised the findings of the report. The Claimant refused to sign the sanitised report and was replaced by an accountant who "improperly [lent EY's] name to a flagrantly misleading assurance reporting process".
- The Claimant became concerned for his personal safety and that of his family, and fled to England. Ultimately, the Claimant resigned from EY and made public his allegations which subsequently featured in a Panorama programme.
- The Claimant brought claims in the High Court – not against the entity of which he was a partner (EY MENA Ltd), but against various UK-based entities. The Claimant alleged that the UK Defendants had acted together in such a way as to breach duties of care owed to him in the conduct of the audit and had failed to protect him as a bona fide whistle-blower.
- Specifically, the Claimant alleged that EY owed him two duties of care, both expressed as duties not to cause him financial loss:
  - a "safety duty" – a duty to take reasonable steps to prevent the Claimant from suffering loss of earnings as a result of his reasonably apprehended concerns for his safety and that of his family if he were to return to Dubai; and
  - an "audit duty" – a duty to take reasonable steps to prevent the Claimant from suffering loss of earnings by reason of EY's failure to conduct the Kaloti audit in an ethical and professional manner.

Decision

It was common ground that the Claimant was not able to seek a remedy under the UK whistle-blower legislation: firstly, because he was not a worker at any of the Defendant entities; and secondly, because he lived and worked outside the UK. Yet the Court observed that if this had been a "conventional whistle-blower case", the Claimant would have had a strong claim. Although the Claimant (as a partner) was not an employee of any EY entity, Kerr J (perhaps because of his employment law background and the fact that he also sits in the Employment Appeal Tribunal) invoked a number of analogies with employees or those in a "quasi-employment relationship". Indeed there is no discussion in the judgment of the Claimant's rights as a partner of EY.

In deciding whether either duty of care identified by the Claimant should be recognised, the Court recognised first that there was no general duty to protect an employee against economic loss suffered after the end of his employment.

The Court proceeded to consider each of the alleged duties in turn, applying the three classic tests used to determine the existence of a tortious duty of care in respect of economic loss: (1) assumption of responsibility; (2) the three-fold test in *Caparo Industries plc v Dickman* (foreseeability, proximity and whether it is "fair, just and reasonable" to impose a duty); and (3) the incremental test (whether the addition to existing categories of duty would be incremental rather than indefinable).

Safety duty

The Court rejected the existence of the safety duty, finding that it would be an illegitimate extension of the law to make the leap from the standard employer's duty to safeguard its employees

against personal injury, to a broad duty to safeguard them against pure economic loss incurred as a result of the Claimant's need to cease working to avoid a threat to his physical safety.

The Court held that EY had not assumed responsibility for such a duty and the threefold *Caparo* test was not met. Even if it was assumed that the Claimant's losses were foreseeable and that asufficient relationship of proximity existed between the Defendants and the Claimant, in the Court's view it was not "fair, just and reasonable to impose on the defendants a duty of such width as to go far beyond the conventional duty to safeguard an employee against personal injury and loss of earnings consequent on such injury".

Audit duty

The Court found that, on the facts of the present case, the audit duty of care did not fit the "assumption of responsibility" analysis favoured in the paradigm cases where a person provides services or advice to another in circumstances where there is no contract but the provider knows or should know that the other will rely on the professional care, skill and judgment.

Having found that the proposed audit duty was novel, the Court proceeded to consider whether the duty should exist by adopting an incremental approach to development of the law, by analogy with decided cases (see Lord Mance in *Robinson v Chief Constable of West Yorkshire*). On the other hand, however, the Court also invoked the dictum of Lord Steyn in *Williams v Natural Life Health Foods Ltd* that "the law of tort, as the general law, has to fulfil an essentially gap filling role".

The Court set out nine legally significant features drawn from analogous cases to decide whether they provided a sufficient basis to recognise the duty of care identified by the Claimant, applying the threefold test set out in *Caparo*.

Foreseeability

In the Court's view, it was readily foreseeable that the Claimant would suffer financial loss if the audit was conducted and concluded in a manner the Claimant considered unethical and unacceptable.

As to whether the loss was foreseeable by the four EY Defendants specifically, the Court was "not especially concerned with the precise contractual position of the Claimant within the EY organisation". Although the Claimant had what the Court described as "a partnership contract" with EY MENA Ltd, he owed duties to the EY organisation far beyond those owed to EY MENA Ltd. Similarly, the Claimant regarded the EY organisation as "acting in concert with and through its various subordinate associated bodies" which all dealt closely with each other. The Court regarded the knowledge and perceptions of EY global and regional leaders as attributable to all four Defendants.

Proximity

The Court found that the requirement of proximity was met in relation to the audit of Kaloti and rejected arguments against this on the basis of EY's corporate structure. It took comfort in this regard from recent appellate decisions including *Vedanta Resources plc v Lungowe* and *Chandler v Cape plc* in which parent companies had (on an arguable basis only in the case of *Vedanta*, which arose in the context of a jurisdiction challenge) been found to owe duties to third parties/employees of their subsidiaries in circumstances where they exercised a high degree of influence in the business of the latter. This step in his reasoning was important because it enabled him to circumvent the fact that the Claimant had no contractual relationship with any of the Defendant entities.

Fair, just and reasonable

Turning to the final "policy" element in the test, the Court found that it was fair, just and reasonable for the law to impose the audit duty on EY. In reaching this conclusion, the Court highlighted the following points in particular:

- The Court felt that the Claimant, who had otherwise been denied a remedy as a "conventional whistle-blower", should have a remedy: "professionals like accountants should not be pressured to act unethically".
- In the Court's judgment, conceptually it was not a huge leap from imposing a duty of care to protect against physical injury and consequent financial loss by providing a physically safe work environment, to imposing a duty of care to protect against economic loss (in the form of loss of future employment opportunity) by providing an ethically safe work environment, free from professional misconduct.
- The Court reviewed a number of previous authorities including *Scally v Southern Health Board* and *Spring v Guardian Assurance*, in which the courts had held that employers were obliged to take reasonable steps to protect the post-employment economic interests of their employees, but found that "the cases do not differentiate sharply" between those featuring employees/former employees and what the Court termed "quasi employees". Interesting in this connection are the references throughout the judgment to employment law analogies and references which the Court applied in relation to the facts of this case (eg the rights of whistle-blowers, the implied duty of trust and confidence and the concept of constructive dismissal). However, it must be doubtful whether a partnership relationship can really be termed one of "quasi employment". Further, while members of limited liability partnerships (and possibly partners) are now recognised as falling within the ambit of the UK whistle-blowing legislation, the other two concepts do not apply to a partnership relationship under UK law.
- On policy grounds, the Court said it would not have recognised the audit duty had it cut across any UK statutory rights of the Claimant (in a nod to the decision in *Johnson v Unisys Ltd*). Here, the Court found that the duty sat alongside the UK whistle-blower legislation and, duly fulfilling its "gap filling" role, the Court did not engage with the question of whether Parliament deliberately decided that these rights should not be available to those living and working abroad.

Finding in favour of the audit duty, the Court was clear that the scope of the duty would have limited application. Specifically, it imposes a new duty of care on employers – and other quasi employers including partnerships and LLPs – to protect against economic loss to an employee/quasi employee's loss of future job opportunity by providing an ethically safe work environment, free from professional misconduct in a professional setting. However, the Court said the ambit of the duty would extend only to the team members in the Kaloti audit in the present case. More generally, the decision would apply only to "a small class of exceptional cases" and was "an outlier with a factual basis that will rarely if ever recur".

Having found that the audit duty was owed by EY, the Court was satisfied that it had been breached and awarded the Claimant damages for loss of past and future earnings.

Comment

While the facts of the case arose in an audit and accounting context, the decision will be of interest more generally. In particular, the duty of care found to have been owed by EY to Mr Rihan was to protect against economic loss (in the form of loss of future employment opportunity), by providing an "ethically safe" work environment, free from professional misconduct. Further, although Mr Rihan was a partner in EY working in Dubai, the Court found that this duty was owed (and breached) by four UK-based EY entities.

The decision has a number of unusual features, not least that: Mr Rihan had no contractual relationship with any of the Defendant entities; his public disclosure was a criminal offence under local UAE law; the award of damages was the product of an exercise in judicial creativity involving the identification of a novel duty of care, albeit limited in ambit; and finally, the reasoning for the identification of this duty owed a considerable amount to features of UK employment law and yet Mr Rihan was not employed by any EY entity, being a partner.

EY has been granted permission to appeal. If the decision survives an appeal, it remains to be seen how widespread its effect will be as the Court stressed the exceptional nature of the relevant facts which had given rise to the duty.

Additional references

Vedanta Resources plc v Lungowe [2019] UKSC 20

Robinson v Chief Constable of West Yorkshire [2018] 2 WLR 595

Chandler v Cape plc [2012] EWCA Civ 525

Johnson v Unisys Ltd [2003] 1 AC 518

Williams v Natural Life Health Foods Ltd [1998] 1 WLR 830

Spring v Guardian Assurance [1995] 2 AC 296

Caparo Industries plc v Dickman [1990] 2 AC 605

Scally v Southern Health Board [1992] 1 AC 294

High Court takes expansive view of when reference to legal advice may result in broader waiver

PCP Capital Partners LLP v Barclays Bank Plc [2020] EWHC 1393 (Comm)

1 June 2020

The High Court has held that a bank waived privilege in all contemporaneous communications with its lawyers relating to particular transactions that were alleged to be a sham, as the bank had deployed the lawyers' advice that the transactions were lawful in order to support its case on the merits. That was regardless of whether the particular documents relied on had already lost privilege by the time the bank had deployed them.

This is an application of the principle of collateral waiver, or the "cherry picking rule", which says that a party who relies on privileged material to support its claim may be required to disclose other privileged material relating to the same issue or transaction. The principle is designed to avoid the unfairness which might result if the court were denied the full picture.

Background

The underlying claim relates to the Defendant bank's capital raisings following the 2008 financial crisis. The Claimants allege that the bank made knowingly false representations as to the terms on which the Claimants' investment was being made, and in particular how those terms compared with the terms offered to other investors, namely the state of Qatar and related entities and persons (**the Qataris**).

Central to the claims are allegations that certain advisory services agreements (**ASAs**) entered into between the bank and the Qataris were shams, as no real advisory services were ever intended to be provided.

The Serious Fraud Office (**SFO**) brought criminal charges in relation to these matters against the bank and certain of its senior executives. The charges against the bank were ultimately dismissed and the senior executives acquitted. However, as part of its criminal investigation, the SFO sought disclosure of certain documents over which the bank claimed legal professional privilege. The bank agreed to provide the documents under a "limited waiver of privilege", so that the SFO could use them solely for the purposes of its investigation, prosecution and related criminal proceedings.

The SFO subsequently used a number of the bank's documents in the criminal trial. It was common ground that the documents referred to at trial (referred to as **the Open Documents**), lost the privilege previously attaching to them at that point.

In the bank's witness statements and opening statement in the present proceedings, there were a number of references to legal advice received by the bank. The Claimants alleged that the bank had thereby waived privilege and must therefore disclose any contemporaneous documents which relate to the ASAs and which the bank had previously withheld from disclosure on the ground of privilege.

The bank argued that there had been no waiver on a number of grounds, including that:

- the nature of the references to the legal advice did not give rise to a waiver (the **Basic Point**); and
- all of the references were to the Open Documents which were no longer privileged because of their use in the criminal trial (the **Timing Point**).

If there was a waiver, the question would then arise as to its scope (the **Scope Point**).

Decision

The High Court (Waksman J) held that there had been a waiver of any privilege in contemporaneous documents relating to the ASAs. The bank would therefore have to disclose all of the documents sought, unless it withdrew its reliance on the privileged material.

The legal principles

The judge noted that it is "not easy to find a succinct and clear definition" in the case law of when a party has waived privilege, but said that on any view:

- the reference to the legal advice must be sufficient; and
- it must be relied on in some way to support the relevant party's case on an issue the court has to decide.

A mere reference to the fact of legal advice would not be a waiver, for example: "My solicitor gave me detailed advice. The following day I entered into the contract". In contrast, he said, it would be a waiver to say: "I entered into the contract as a result of that legal advice".

The judge referred to the "vexed question which still confounds the law of privilege", namely the distinction between a reference to the "effect" of the legal advice and a reference to its "contents", with only the latter giving rise to a waiver.

The distinction was applied by the Court of Appeal in *Marubeni v Alafouzos*, where on an ex parte application for leave to serve out of the jurisdiction, in deposing to the merits of the proposed claim, the claimant's solicitor said: "The plaintiffs have obtained outside Japanese legal advice which categorically states that this agreement does not render performance of the sale contract illegal in any way whatsoever." The Court of Appeal said there was no waiver, as the claimant was relying on the effect of the document rather than its contents.

Waksman J noted that, in that case, there was a clear reference to the legal advice and its conclusion, though not the underlying reasoning or any detail as to its contents. He said that by the "effect" of the advice, the court must have meant its conclusion or outcome. However, if the distinction is between a reference to the conclusion of legal advice and its detailed contents, it is "then very difficult to understand how that distinction works if applied mechanistically and without any reference to context and purpose".

He commented that the distinction might have some superficial attraction, as generally a party won't refer to large sections of legal advice unless it is being relied upon in some way, whereas a reference to the effect or outcome may (perhaps) indicate something different. In *Marubeni*, for example, the solicitor had to depose to the advice received because it was a procedural requirement under the rules for service out, but once that was done the legal advice had no further relevance.

Waksman J concluded that the content/effect distinction cannot be applied mechanistically to determine whether there has been a waiver. Instead:

> "Its application has to be viewed and made through the prism of (a) whether there is any reliance on the privileged material adverted to; (b) what the purpose of that reliance is; and (c) the particular context of the case in question. This is an acutely fact-sensitive exercise."

He emphasised that, applying that approach, a waiver may arise even if only the conclusion of the legal advice is referred to as opposed its detailed contents.

If there is a waiver, the question arises as to its scope. It was common ground that, in essence, the court has to decide the issue or "transaction" with which the waiver was concerned. All privileged materials falling within that issue or transaction must then be produced. He added:

> "The transaction analysis itself is driven by the concept of fairness. It is why one has to ascertain the transaction, because then that establishes the playing field, as it were. If the playing field is in truth wider than the documents which have been referred to so far, then it is not level as far as the non-waiving party is concerned because disclosure has in truth been only partial."

The Basic Point

In the present case, Waksman J found that the statement in one witness's evidence that he "took comfort from and adhered to the lawyers' advice in these matters" amounted to a general statement that the lawyers advised that what he did was lawful. It was more than a mere reference to the fact of advice. Although in a sense the reference was only to the effect of the advice, if "effect" meant conclusion, that could still be sufficient for waiver.

With regard to reliance, Waksman J found that the witness was relying on the advice because he was saying he followed the advice in connection with the ASAs alleged to be shams. The purpose of that reliance was, essentially, to support the bank's case as to the proper characterisation of the ASAs, in that if the lawyers advised they were lawful, it is less likely they should be regarded as shams.

Other references to the advice in the various witness statements and in the bank's opening were held to be to similar effect.

Accordingly Waksman J held that, subject to the Timing Point, it was plain that waiver had occurred.

The Timing Point

The bank's essential point was that all of the references to legal advice concerned the Open Documents, which were no longer privileged, so deploying them did not involve waiver at all.

Waksman J did not, however, accept that a once-privileged document which has lost that status has therefore become irrelevant from a privilege point of view. The Claimants pointed out that, if that were the case, a party could avoid the consequence of any waiver by deliberately making the documents open beforehand (eg by putting the documents in the public domain).

The bank argued that the present case was different, as the Open Documents had not lost their privileged status because of steps taken by the bank, but rather because the SFO had deployed them in the criminal proceedings. The judge rejected that argument. While it was true that the documents had been deployed by the SFO, the privilege had belonged to the bank and the bank had given a limited waiver in the full knowledge that some of the documents would be used at trial. Therefore it could not be said that the bank had nothing to do with their deployment.

The Scope Point

Waksman J went on to determine the transaction in relation to which waiver had occurred. He concluded that considerations of fairness plainly dictated that the relevant transaction was the legal advice in relation to the ASAs, and so any privileged material relating to the ASAs had to be disclosed.

He rejected the bank's submission that the Court should examine each reference to legal advice which constituted waiver and consider the particular transaction to which that relates. The bank was relying on all the references to legal advice to make its point about the lawfulness of the ASAs, and therefore could not argue for some narrower transaction.

In the judge's view, the witnesses could not be properly cross-examined about their belief that the lawyers approved the transaction unless the Claimants had the full picture regarding the advice given on the ASAs, including the instructions given to the lawyers.

Comment

The decision is of particular interest for two reasons:

- In many previous cases the court has held that privilege will not be waived if a party relies on the "effect" of privileged material rather than its "content" – though the dividing line in practice has been far from clear. The Court in this case equates the "effect" of legal advice with its conclusion or outcome, but says the distinction cannot be applied mechanistically. Instead, the question of whether privilege has been waived depends on an "acutely fact-sensitive exercise" as to whether there is reliance, the purpose of that reliance and the particular context. It's clear that, if this approach is followed in other cases, a waiver may result even if only the conclusion of legal advice is relied on. But beyond that, the decision arguably makes it no easier to draw a line between references that will result in a waiver and those that will not.
- Unusually for cases involving waiver, the documents relied on in this case had already lost their privileged status by the time the bank deployed them, as they had been provided to the SFO under a limited waiver of privilege and relied on by the SFO in criminal proceedings. The Court rejected the argument that, because of this, reliance could not result in a waiver. The bank had provided the documents to the SFO knowing they might be deployed at the criminal trial. The decision leaves open whether the position might have been different if the bank had no involvement at all in their deployment.

Additional references

Marubeni v Alafouzos [1986] 11 WLUK 46

Untangling, but not killing off, the Japanese knotweed: Supreme Court confirms existence and scope of "reflective loss" rule

Sevilleja v Marex Financial Ltd [2020] UKSC 31

15 July 2020

The Supreme Court's judgment in *Sevilleja v Marex Financial Ltd* has been eagerly anticipated by financial institutions and brings much needed clarity in respect of the so-called "reflective loss" principle, first established in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*.

By a majority of 4-3, the Supreme Court confirmed that the "reflective loss" rule in *Prudential* is a bright line legal rule of company law, which applies to companies and their shareholders. The rule prevents shareholders from bringing a claim based on any fall in the value of their shares or distributions, which is the consequence of loss sustained by the company, where the company has a cause of action against the same wrongdoer. However, the Supreme Court unanimously held that the principle should be applied no wider than to shareholders bringing such claims, and specifically does not extend to prevent claims brought by creditors. In doing so, the entire panel rejected the approach in cases since *Prudential* where the principle has been extended to situations outside shareholder claims, in a way that has been likened to a legal version of Japanese knotweed.

Background

Mr Sevilleja was the owner and controller of two companies incorporated in the British Virgin Islands, Creative Finance Ltd and Cosmorex Ltd (the **Companies**), which he used as vehicles for trading in foreign exchange. Marex Financial Ltd (**Marex**) brought proceedings against the Companies in the Commercial Court for amounts due to it under contracts which it had entered into with them. In July 2013, Marex obtained judgment against the Companies in excess of US$5 million.

Marex alleged that Mr Sevilleja had stripped the Companies of assets, in breach of duties owed to the Companies, to prevent the judgment debt from being satisfied.

The Companies were placed into insolvent voluntary liquidation in the BVI by Mr Sevilleja in December 2013, with alleged debts exceeding US$30 million owed to Mr Sevilleja and others (allegedly persons and entities associated with Mr Sevilleja or controlled by him). Marex claimed to be the only non-insider creditor.

A liquidator was appointed in the BVI, but on Marex's case, he was effectively in the pocket of Mr Sevilleja and had not taken any steps to investigate the Companies' missing funds or to investigate the claims submitted to him, including claims submitted by Marex. Nor had he issued any proceedings against Mr Sevilleja.

Marex brought a claim against Mr Sevilleja directly, seeking damages in tort for: (1) inducing or procuring the violation of its rights under the July 2013 judgment; and (2) intentionally causing Marex to suffer loss by unlawful means. Marex sought and obtained an order giving permission for service of proceedings on Mr Sevilleja out of the jurisdiction.

The present appeal arose from Mr Sevilleja's application to set aside the order to serve out. Mr Sevilleja argued that Marex did not have a good arguable case against him because the losses that Marex was seeking to recover were reflective of loss suffered by the Companies, which had concurrent claims against Mr Sevilleja, and were therefore not open to Marex to claim.

High Court decision

At first instance, the Commercial Court ruled in favour of Marex and held that the so-called rule against "reflective loss" did not bar Marex's ability to show a completed cause of action in tort. Permission to appeal was granted only in relation to the ruling on reflective loss.

Court of Appeal decision

The Court of Appeal (Lewison, Lindblom and Flaux LJJ) allowed Mr Sevilleja's appeal.

The question for the Court of Appeal was whether the rule against reflective loss applies to claims by unsecured creditors who are not shareholders of the relevant company. In a unanimous decision, it held that the distinction between shareholder creditors and non-shareholder creditors was artificial and therefore the rule should apply equally to all creditors.

The Court of Appeal also considered the scope of the exception to the rule which applies where the company is unable to pursue a cause of action against the wrongdoer. It confirmed that this exception can only be invoked in limited circumstances, where the defendant's wrongdoing has been directly causative of the impossibility the company faces in bringing the claim.

Marex appealed to the Supreme Court.

Supreme Court decision

The Supreme Court convened as an enlarged panel with the object of examining the rationale for the so-called "reflective loss" principle and providing greater coherence of the law in this area. In view of the significance of the case, the Supreme Court granted permission to the All Party Parliamentary Group on Fair Business Banking to intervene by oral and written submissions in support of Marex's appeal.

The Supreme Court unanimously concluded that Marex's appeal should be allowed. There was no disagreement within the Court that the expansion of the so-called "reflective loss" principle was an unwelcome development of the law, and in the context of the present case would result in a great injustice. However, there was a clear division on the nature and effect of the "reflective loss" principle, with Lord Reed giving the majority judgment (with whom Lady Black, Lord Lloyd-Jones and Lord Hodge agreed) and a minority judgment given by Lord Sales (with whom Lady Hale and Lord Kitchin agreed).

Majority decision

The majority reaffirmed the rule in *Prudential* (often referred to as the "reflective loss" principle), as a rule of company law which, when it applies, prohibits a claim being brought by shareholders for the loss of value in their shareholding.

Lord Reed referred back to the origins of the reflective loss principle, in the case of *Prudential*, where the directors of a company were alleged to have made a fraudulent misrepresentation in a circular distributed to its shareholders, so as to induce them to approve the purchase of assets at an overvalue from another company in which the directors were interested. Prudential, which was a minority shareholder in the company, brought a personal and a derivative action against the directors. Prudential's personal claim was disallowed on the ground that it had not suffered any loss distinct from its loss of value in its shareholding, with the following reasoning from the High Court:

> "...what [the shareholder] cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a 'loss' is merely a reflection of the loss suffered by the company."

Lord Reed noted that this has been treated in subsequent cases as establishing the principle of "reflective loss" (most notably in *Johnson v Gore Wood & Co*).

In an important clarification of the scope of this principle, Lord Reed confirmed as follows:

> "...what the court meant, put shortly, was that where a company suffers actionable loss, and that loss results in a fall in the value of its shares (or in its distributions), the fall in share value (or in distributions) is not a loss which the law recognises as being separate and distinct from the loss sustained by the company. It is for that reason that it does not give rise to an independent claim to damages on the part of the shareholders."

Lord Reed said that it is necessary to distinguish between:

- Cases where claims are brought by a shareholder in respect of loss which he/she has suffered in that capacity, in the form of a diminution in share value or in distributions, which is the consequence of loss sustained by the company, in respect of which the company has a cause of action against the same wrongdoer; and
- Cases where claims are brought, whether by a shareholder or by anyone else, in respect of loss which does not fall within that description, but where the company has a right of action in respect of substantially the same loss.

In cases of the first kind, Lord Reed said that the shareholder cannot bring proceedings in respect of the company's loss, since he or she has no legal or equitable interest in the company's assets. It is only the company that has a cause of action in respect of its loss under the rule in *Foss v Harbottle*. He said that the position is different in cases of the second kind, which would include claims (like Marex's claim) brought by creditors of the company. This is because there is no correlation between the value of the company's assets/profits and the loss which that party has suffered.

The majority therefore confirmed that the rule established in *Prudential* applies to cases of the first kind, but not the second. In doing so, Lord Reed and Lord Hodge emphasised the following key aspects of the rule:

Rule of company law

Lord Reed said that the decision in *Prudential* established a rule of company law, which applies specifically to companies and their shareholders in particular circumstances. It has no wider ambit.

He noted that this rule is necessary in order to avoid the circumvention of the company law rule in *Foss v Harbottle*, which provides that the only person who can seek relief for an injury done to a company, where the company has a cause of action, is the company itself.

The judgment of Lord Hodge echoed Lord Reed's statement that the rule in *Prudential* was a principled development of company law which should be maintained. In particular, he explained that the rule upholds the default position of equality among shareholders in their participation in the company's enterprise: each shareholder's investment "follows the fortunes of the company"; it maintains the rights of the majority of the shareholders; and it preserves the interests of the company's creditors by maintaining the priority of their claims over those of the shareholders in the event of a winding up.

However, in the opinion of Lord Hodge, the principle should not be applied in other contexts, given the particular characteristics of a shareholding (and the rights and protections provided to shareholders), which justify the law's refusal to recognise a diminution of value claim. The problems and uncertainties that have emerged in the law have arisen because the principle of reflective loss has broken from its moorings in company law.

Distinct from double recovery principles

Lord Reed stated, categorically, that the avoidance of double recovery is not in itself a satisfactory explanation of the rule in *Prudential*.

Lord Reed noted the general position that, while two different persons can have concurrent rights of recovery based on different causes of action in respect of the same debt, the court will not allow double recovery (*The Halcyon Skies*). This principle has its roots in the law of damages, and so it does not prevent the claims in themselves, but rather leaves the court to determine how to avoid double recovery in situations where the issue properly arises. For example, by giving priority to the cause of action held by one person with the claim of the other excluded so far as necessary (*The Liverpool (No 2)*); or by subrogation (*Gould v Vaggelas*); or the imposition on one claimant of an obligation to account to the other out of the damages it has received (*O'Sullivan v William*).

He said that Lord Millett in *Johnson* had incorrectly treated the avoidance of double recovery as sufficient to justify the decision in *Prudential*, which paved the way for the expansion of the reflective loss principle beyond the narrow ambit of the rule in *Prudential*. Lord Millett's approach has in fact led in some cases, subsequent to *Johnson*, to a circumvention of the rule in *Foss v Harbottle*. For example, in *Peak Hotels and Resorts Ltd v Tarek Investments Ltd*, the court considered it arguable that the "reflective loss" principle – as explained by Lord Millett in *Johnson* – did not bar a claim for injunctive relief, even though the proceedings were brought by a shareholder who complained of a fall in the value of his shares resulting from loss suffered by the company in respect of which the company had its own cause of action. This was because the relief sought was not in damages and so there could be no danger of double recovery.

Pragmatic advantages of a bright line legal rule

Lord Reed also emphasised the pragmatic advantages of a clear rule of law that only the company can pursue a right of action in circumstances falling within the precise ambit of the decision in *Prudential*. He referred to Lord Hutton's speech in *Johnson*, saying that the rule in *Prudential* has the advantage of establishing a clear principle, rather than leaving the protection of shareholders of the company to be given by a judge in the complexities of a trial.

Scope of personal claims by shareholders prohibited

The majority articulated the type of claim that will be prohibited by the rule against "reflective loss". To fall within the rule, a claim must:

- be brought by a shareholder;
- relate only to the diminution in value of shares or in distributions which the shareholder suffers in his or her capacity as a shareholder;
- result from the company having itself suffered actionable damage; and
- be brought by the shareholder and the company against the same wrongdoer.

The majority confirmed that, where a shareholder pursues a personal claim against a wrongdoer in another capacity, such as guarantor or creditor of the company, the "reflective loss" rule has no application.

Where the company does not bring a claim

Lord Reed stated that the rule in *Prudential* will apply even if the company fails to pursue a claim that a shareholder says ought to have been pursued, or compromises its claim for an amount which, in the opinion of a shareholder, is less than its full value.

He said the critical point is that the shareholder has not suffered a loss which is regarded by the law as being separate and distinct from the company's loss, and therefore has no claim to recover it. It follows that the shareholder cannot bring a claim, whether or not the company's cause of action is pursued.

Lord Reed justified this approach on the basis that shareholders entrust the management of the company's right of action to its decision-making organs; and the company's control over its own cause of action would be compromised, and the rule in *Foss v Harbottle* could be circumvented, if the shareholder could bring a personal action for a fall in share value (or distribution) consequent on the company's loss, where the company had a concurrent right of action in respect of its loss.

The same will apply even where the wrongdoer has abused his or her powers as a director of the company so as to prevent the company from bringing a claim under which it could have recovered its loss. Lord Reed noted that shareholders (unlike a creditor or an employee) have a variety of other rights in this scenario, including the right to bring a derivative claim to enforce the company's rights if the relevant conditions are met, and the right to seek relief in respect of unfairly prejudicial conduct of the company's affairs.

A derivative action is an exception to the rule in *Foss v Harbottle*, and whether or not a shareholder can bring such an action depends on whether the relevant conditions are satisfied.

The position of creditors

As will be clear from the above, the majority confirmed that the reflective loss rule does not apply to creditors. This is essentially because the potential concern arising from the rule in *Foss v Harbottle* is not engaged by claims brought by creditors, as distinct from shareholders.

However, Lord Reed noted that the principle that double recovery should be avoided may well be relevant to creditor claims (although this will not always necessarily be the case: in *International Leisure Ltd v First National Trustee Co UK Ltd* the company and a secured creditor had concurrent claims, but the double recovery principle was not engaged).

Lord Reed explained that how the Court will address the risk of double recovery in creditor claims will depend on the circumstances, and did not mean that the company's claim must automatically be given priority to that of the creditor. He also warned that the pari passu principle does not give the company (or its liquidator) a preferential claim on the assets of a wrongdoer, over the claim of any other person with rights against the wrongdoer, even if that claimant is also a creditor of the company. This means that a creditor can enforce his or her own right to recover damages from the wrongdoer concurrently with any action brought by the company. Lord Reed contrasted the situation where an insolvent company has made a recovery from the wrongdoer. In this situation, the proceeds will form part of the insolvent company's assets available for distribution, where the pari passu principle may restrict the creditor's receipt of a dividend.

Lord Reed also noted that double recovery arising in connection with creditors' claims may be avoided by other means, such as subrogation.

In the light of the above, the majority held that the rule in *Prudential* had no application to the present case, since Marex was not a shareholder. Marex's appeal was therefore allowed.

Minority decision

Lord Sales delivered the minority judgment. By contrast to the majority, in his opinion, the Court of Appeal in *Prudential* did not lay down a rule of law and (in any event) such a rule was not correct as a matter of principle. Whilst the rule would produce simplicity, this would be at the cost of serious injustice to a shareholder who (apart from the rule) has a good cause of action and has suffered loss which is real and is different from any loss suffered by the company.

In his view, the Court in *Prudential* simply set out reasoning why it thought the shareholder in such a case in fact suffered no loss. However, he believed that that reasoning could not be supported, because in most cases shareholders suffer a loss which is different from the loss suffered by the company. In Lord Sales' view, the whole premise of the "reflective loss" principle is flawed because it assumes correspondence between the losses suffered by company and shareholder. By contrast, in the real world, even if the company is successful (some time later) in recovering its loss, the shareholder whose shares were reduced in value by the wrong will not be restored to the position it would have been in but for the defendant's wrongdoing. Whilst, as a matter of basic justice, the defendants should not be liable twice for the same loss, the correct approach to that issue would be to carefully assess whether the loss is indeed the same and if (and only if) it is the same, to be reflected in the calculation of each claimants' loss.

In Lord Sales' view, even if the "reflective loss" principle was appropriate in respect of shareholder claims, it could not be justified as a principle to exclude otherwise valid claims made by a person who is a creditor of the company. Accordingly, the minority also allowed Marex's appeal.

Comment

The majority of the Supreme Court emphasised that the "reflective loss" rule is underpinned by the principle of company law in *Foss v Harbottle*: a rule which (put shortly) states that the only person who can seek relief for an injury done to a company, where the company has a cause of action, is the company itself. On this basis, a shareholder does not suffer a loss that is recognised in law as having an existence distinct from the company's loss, and is accordingly barred.

The division of the Supreme Court focused on whether or not to reaffirm the "reflective loss" principle as a legal rule which prohibits a shareholder's claim, which was the view of the majority, or whether it is simply a device to avoid double-recovery (and therefore a question that arises when it comes to the assessment of damages), which was the view of the minority.

Putting the decision in context, the reflective loss rule was one basis (amongst several others) on which the recent shareholder class action against Lloyds and five of its former directors (*Sharp & Others v Blank & Others*) was dismissed by Mr Justice Norris. The Court held that – if the elements of the shareholders' claim had been proven – any alleged loss suffered by shareholders as a result of a fall in the price of Lloyds shares was reflective of what the company's loss would have been. Of course, in the securities litigation context, sections 90 and 90A of the Financial Services and Markets Act 2000 (the usual basis of a shareholder class action) provide a statutory exemption to the reflective loss rule.

Additional references

Sharp & Others v Blank & Others [2020] EWHC 1870 (Ch)

Peak Hotels and Resorts Ltd v Tarek Investments Ltd [2015] EWHC 3048 (Ch)

International Leisure Ltd v First National Trustee Co UK Ltd [2013] Ch 346

Johnson v Gore Wood & Co [2002] 2 AC 1

O'Sullivan v Williams [1992] 3 All ER 385

Gould v Vaggelas [1984] HCA 68

Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204

The Halcyon Skies [1977] QB 14

The Liverpool (No 2) [1963] P 64

Foss v Harbottle (1843) 2 Hare 461

Court of Appeal gives wide interpretation to "damage" for the purposes of the common law jurisdictional gateway for tort claims

FS Cairo (Nile Plaza) LLC v Christine Brownlie [2020] EWCA Civ 996

29 July 2020

The Court of Appeal has held, by a majority, that direct damage in the jurisdiction is not required in order for a claim to come within the tort jurisdictional gateway in the CPR. In doing so it followed obiter comments made by the majority in the Supreme Court in an earlier judgment in the case.

Background

Lady Brownlie was injured and her husband died in a car accident in Egypt during an excursion organised through the concierge at the Four Seasons Hotel Cairo. Other family members also died or were injured. It was Lady Brownlie's case that the Four Seasons chain of hotels was run by Four Seasons Holdings Incorporated (**Holdings**), a Canadian company, and that it was liable for the damage suffered.

Lady Brownlie brought proceedings in England against Holdings to recover damages in contract and in tort. She obtained permission to serve outside the jurisdiction. That permission was overturned by the Court of Appeal on the basis that the claim did not come within the tort gateway in the CPR. Permission was granted to appeal to the Supreme Court, given the uncertainty over how the tort gateway should be interpreted.

The Supreme Court, however, following the admission of further evidence, considered there was no good arguable case that Holdings was in fact the owner or operator of the hotel and therefore overturned the grant of permission to serve outside the jurisdiction. In those circumstances, the correct interpretation of the tort gateway did not arise. However, the appropriate test was considered by the Court at length in obiter comments. The majority (Lady Hale and Lords Wilson and Clarke) considered that direct damage in the jurisdiction was not required in order to come within the tort gateway. Lords Sumption and Hughes disagreed (agreeing with the decision on this point in the Court of Appeal, although not the reasoning).

In light of the finding concerning the ownership of the hotel, Lady Brownlie then sought from the High Court, and was granted, permission to substitute Holdings with FS Cairo (Nile Plaza) LLC (**FS Cairo**), an Egyptian company, and to serve the claim outside of the jurisdiction.

FS Cairo appealed to the Court of Appeal. The two issues before the Court were whether the claims came within the tort gateway in the CPR and whether the claims made had a reasonable prospect of success (which entailed considering to what extent foreign law needed to be pleaded and proved). This article deals only with the decision in respect of the tort gateway.

The tort gateway in the CPR provides (PD 6B, para 3.1(9)):

> "3.1 The claimant may serve a claim form out of the jurisdiction with the permission of the court under rule 6.36 where....
>
> (9) A claim is made in tort where –
>
> (a) damage was sustained or will be sustained within the jurisdiction; or
>
> (b) damage which has been or will be sustained results from an act committed, or likely to be committed, within the jurisdiction."

Decision

The Court of Appeal held, by a majority (Arnold LJ dissenting), that the claims came within the tort gateway.

Judgment of McCombe LJ

McCombe LJ, who gave the first judgment on this issue, observed that the appeal in the case went precisely to the point considered by the Supreme Court in very full obiter dicta and (like the trial judge) he would feel strongly inclined to follow the majority conclusion unless there was other binding authority or he was clearly persuaded not to do so.

After analysing the various arguments raised, he reached the conclusion that the views of the majority were correct. The proper question to ask was whether a claimant had suffered "significant damage" in the jurisdiction. There was no need to import the legalistic niceties inherent in the concepts of direct and indirect damage.

As regards those arguments:

- The court rules which applied to common law cases were amended in 1987 so as to apply where damage from a tort was suffered in the jurisdiction, as well as when the acts

giving rise to the tort were committed here. That change was made in light of the CJEU decision in *Handelswerkerij GJ Bier BV v Mines de Patasse d'Alsace CA* (Case 21/76). That case had interpreted the phrase "where the harmful event occurred" in the Brussels regime as meaning either where the damage was sustained or where the act took place that gave rise to the damage. Without the change to the court rules, the tort gateway in common law (ie non EU) cases would have been much narrower than the tort provision in the Brussels regime.

- That change, effected by entirely different language to that used in the Brussels regime, did not mean the subsequent narrow interpretation of "damage" adopted in CJEU decisions on the Brussels regime also applied to interpret the English common law gateway.
- It was clear from the decision in *Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc* that there were differences between the EU rules and the common law gateway. Under EU rules, if damage is sustained where the causal act took place, there is no jurisdiction in a second state, even if significant further damage is suffered there. That is not the case in England in light of the *Metall und Rohstoff* case.
- As regards other cases relied on, in particular *Societe Commerciale de Reassuance v Eras International* and *ABCI v Banque Franco-Tunisienne* the facts were very different and there was little relevant comparison with personal injury cases.
- The residual discretion afforded by the doctrine of forum conveniens in common law cases was an important factor to take into account.
- Interpretation of "damage" in the gateway could not be assisted by looking at the Rome II Regulation on the law applicable to non-contractual obligations.

Judgment of Arnold LJ

Arnold LJ took the view that the Court should make up its own mind as to the correct answer, given that the Supreme Court's views were obiter, there was only a bare majority in favour of the broader interpretation and two of the majority acknowledged the need for caution in relying upon the view they expressed.

His starting point was that the word "damage" in the gateway was capable of being interpreted broadly or narrowly so it was important to have regard to the context and purpose of the rule, which applied to all tort claims, not just personal injury claims.

He concluded that what must be shown is that direct damage was suffered in the jurisdiction and indirect damage is insufficient. Only this would represent a sufficient connection with this jurisdiction to justify the English court asserting jurisdiction over a foreign defendant. Otherwise it would not only confer on the courts what Lord Sumption described as "universal jurisdiction to entertain claims by English residents for the more serious personal injuries suffered anywhere in the world", but an equally broad jurisdiction over torts causing purely economic damage.

As regards the various arguments raised:

- The amendment of the court rules in 1987 supported the conclusion that the gateway should be interpreted at least as broadly as the tort provision in the recast Brussels Regulation but did not go further and mean it should not be interpreted more broadly. To that extent he agreed with Lord Wilson's comments in the Supreme Court.
- He was unimpressed however with the argument that the CJEU's decisions on the meaning of "damage" post-dated the amendment in 1987. Where domestic legislation is adopted to be consistent with European legislation, it should be interpreted consistently with how it is interpreted from time to time by the CJEU.
- The power to refuse jurisdiction on the basis of forum non conveniens was a factor favouring a broader rather than narrow construction of gateways but it was important not to place too much weight on this. Disputes as to appropriate forum are expensive and uncertain. Adopting an interpretation of the gateway which left most of the work in identifying appropriate cases for determination in England to the forum conveniens rules would be a recipe for litigation.
- The decision in *Metall und Rohstoff* was only authority for the proposition that, if most of the damage has been sustained in the jurisdiction, it is immaterial that a small amount has been suffered outside. The decision in *ABCI*, on the other hand, was strongly persuasive of the need for direct damage in the jurisdiction.
- The Supreme Court had unanimously agreed that the Rome II Regulation on the law applicable to non-contractual obligations was not directly relevant when interpreting gateways, as jurisdiction and applicable law are distinct concepts. However, the reasoning in *Lazar v Allianz SpA* was, he thought, persuasive when it came to identifying the relevant connecting factors for the purposes of jurisdiction.

So far as the damages claimed were concerned, Arnold LJ's view was that damages for bereavement and loss of dependency were indirect consequences of the death of Sir Ian in Egypt and Lady Brownlie's claims for pain, suffering and loss of amenity were the direct consequences of the tort which took place in Egypt. There was therefore no good arguable case that the claims fell within the tort gateway.

Judgment of Underhill LJ

Underhill LJ took the view that the approach which accorded proper weight to a fully considered but obiter view of a majority of the Supreme Court should be the same as that which a first instance court takes to a decision of a court of co-ordinate jurisdiction, namely it should follow the decision unless it was clearly wrong.

Applying that test, he was not persuaded that the view of the majority in the Supreme Court was wrong. He therefore agreed as to the outcome with McCombe LJ.

However in his view there were powerful arguments to be made on both sides and he did not think there was any value in his contributing to the debate about which of the two approaches would be preferable or more in accordance with the case law.

Comment

How the tort gateway should be interpreted is clearly controversial. It has been considered by many judges and opposite views reached. In this case alone, there are only two reasoned judgments on this question and they reach opposite conclusions. Further guidance from the Supreme Court would therefore be welcome.

While arguments that the common law gateway does or should mirror the test in the Brussels regime may diminish post-Brexit, there is however a more fundamental issue to be decided – what is or should be a sufficient connecting factor to justify the English court taking jurisdiction in a tort claim over a foreign defendant. Resolving that issue includes deciding whether gateways should be widely interpreted, given the court's discretion to refuse jurisdiction where England is not the forum conveniens, or whether a more narrow interpretation, which gives greater certainty to parties and reduces the likelihood of lengthy jurisdiction challenges, should be adopted.

Additional references

Lazar v Allianz SpA (C-350/14) [2015] 12 WLUK 326

ABCI v Banque Franco-Tunisienne [2003] 2 Lloyd's Rep 146

Societe Commerciale de Reassuance v Eras International [1992] 1 Lloyd's Rep. 570

Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc [1990] 1 QB 391

Handelswerkerij GJ Bier BV v Mines de Patasse d'Alsace CA (Case 21/76) [1978] QB 708

High Court finds claims arising out of oil spill cannot proceed as representative action under CPR 19.6

Jalla v Shell International Trading and Shipping Company Ltd [2020] EWHC 2211 (TCC)

14 August 2020

The High Court has struck out the representative element of a claim purportedly brought on behalf of large numbers of Nigerian individuals and communities seeking remediation for damage allegedly caused to their land and water supplies by a 2011 oil spill. The Court found that the claim could not be brought using the representative action procedure under CPR 19.6 as the Claimants failed to satisfy the "same interest" requirement under that rule.

Background

These proceedings were brought by the two lead Claimants on their own behalf and on behalf of more than 27,500 individuals and 457 communities in Nigeria that were alleged to have been affected by an oil spill off the Nigerian coast in December 2011. The lead Claimants purported to bring the claims under CPR 19.6, which allows a claim to be brought by (or against) one or more persons as representatives of any others who have the "same interest" in the claim.

The Claimants allege that the Defendants are responsible for the 2011 oil spill, which is said to have caused serious and extensive damage to the Claimants' land and water supplies and the fishing waters in and around the Claimants' villages. The Claimants initially claimed damages as well as an order requiring the Defendants to take measures to remediate the negative environmental impact from the oil spills, or alternatively to pay the value of the remediation works so that the Claimants can put the work in hand.

The Defendants do not accept that any oil from the spill reached the Claimants' coastline or caused the damage alleged. They applied to strike out the proceedings on various grounds, including that the proceedings are not properly constituted as a representative action because the lead Claimants and those they purport to represent do not all have "the same interest" under CPR 19.6.

Pending the hearing of the strike-out application, the Claimants issued fresh proceedings (referred to in the judgment as the **Protective Proceedings**) which largely mirror the claims in the present action but are brought in the names of each of the individuals and communities included in the present action (plus some additional claimants). The Claimants then applied to consolidate the two actions and said that they were abandoning their "individualised" claims for damages in the present action, leaving those to be pursued in the Protective Proceedings, so that the present action was principally for remediation relief.

Decision

The High Court (Stuart-Smith J) held that the proceedings cannot continue as a representative action because the represented Claimants do not satisfy the "same interest" requirement. He therefore struck out the representative elements of the proceedings, leaving the personal claims of the two lead Claimants to continue (as well as the Protective Proceedings).

The judge noted that the parties disagreed about the scope and meaning of the "same interest" requirement, with the Claimants pressing for what he called a more relaxed and generous interpretation and the Defendants arguing for a strict interpretation.

Having reviewed the relevant authorities in some detail, including *Emerald Supplies v British Airways Plc* and *Lloyd v Google*, the judge summarised the relevant principles as including the following:

- The "same interest" requirement in CPR r. 19(6)(1) is statutory and is not to be abrogated or substituted by reference to the overriding objective. It is, however, to be interpreted having regard to the overriding objective and should not be used as an unnecessary technical tripwire.
- The "same interest" which the represented parties must have is a common interest, which is based upon a common grievance, in obtaining relief that is beneficial to all represented parties. It is not sufficient that multiple claimants wish to bring claims which have some common question of fact or law.
- It is not necessary that the claims or causes of action of all represented parties should be congruent, provided that they are in effect the same for all practical purposes.
- The existence of individual claims over and above the claim for relief in which the represented parties have the same interest does not necessarily render representative proceedings inapplicable or inappropriate. The question is whether the additional claims can be regarded as "a subsidiary matter" or whether they affect the overall character of the litigation.

- Similarly, while the court will pay little attention to potential individual defences that are merely theoretical, the existence of potential defences affecting some represented parties' claims but not those of others tends to militate against representative proceedings being appropriate.
- If the criterion of "the same interest" is satisfied the court's discretion to permit representative proceedings to continue should be exercised in accordance with the overriding objective.

The judge noted that it was common ground in the present case that it must be possible to identify the members of the represented class at all stages of the proceedings, not just at the end, and that the represented class must be defined with a sufficient degree of certainty – though it was not necessary that its membership should remain constant throughout the proceedings.

Applying the principles to the present action, the judge said there could be no doubt that the claims raise some common issues of law and fact, including the fact of the oil spill, how and why it occurred, and whether its occurrence was caused by a breach by the Defendants of any duty owed to the Claimants. But even assuming that these issues were resolved in the Claimants' favour, that would not give rise to a right to relief. Each individual Claimant or community would have to go further and prove that the oil spill caused them damage.

That was not changed by the Claimants abandoning their individualised claims for damages, as they would still have to show that they had suffered damage to an extent that justified their claim for remediation relief. Putting aside the question of whether the English court could order remediation of land situated in Nigeria, the Court could not make such an order (or an order to pay the costs of remediation works) without investigating what damage was suffered and where, and whether it was attributable to the 2011 oil spill. It was, the judge said, a misuse of language to characterise the remediation relief that an individual or community claimant sought as being relief that was beneficial for all those represented.

The judge noted that, in principle, the existence of individualised claims would not necessarily prevent an order for representative proceedings – the question is whether the individualised claims can be regarded as "subsidiary" to the main issue in the proceedings. But on the facts here, that was not possible: the issues of loss, damage and causation were not "subsidiary" but were an integral part of the issues raised by the proceedings.

The judge accepted that it was obviously desirable that, if these issues were to be litigated in England, they should be litigated once and in the context of a structure that accommodates all potential claimants. However, that could be achieved by other means including the making of a Global Litigation Order (**GLO**) or common case management of the various actions.

Comment

The decision re-emphasises the strict test that must be met for claims to be brought as a representative action under CPR 19.6 – which is essentially an "opt-out" class action procedure as it does not require individual claimants to be joined as parties to the action or even identified individually. To bring a representative action, it is not enough that the claims raise some common issues of fact or law. While it is often desirable for similar claims to be litigated together, there are other procedural tools available to achieve that, most obviously the GLO procedure.

The proper scope of the CPR 19.6 representative action is due to be considered by the Supreme Court, following permission to appeal having been granted in the case of *Lloyd v Google LLC*. That case concerns a claim for compensation for the loss of control of personal data, in circumstances where the claimants have disavowed any claims which rely on their individual circumstances. While the Claimants in the present case sought to draw parallels with *Lloyd v Google* by abandoning their individual damages claims, and instead focusing on their claims for remediation, the Court found that the Claimants would still have to show causation and loss on an individual basis in order to establish the remediation claims.

The Court recognised that the existence of some individual elements, over and above the claim in which the parties have the "same interest", will not necessarily prevent an action proceeding on a representative basis. However, those individual elements must be "subsidiary" to the main issue in the proceedings, and on the facts that was not the case: the issues of causation and damage were an integral part of the issues raised by the proceedings.

Additional references

Lloyd v Google LLC [2019] EWCA Civ 1599

Emerald Supplies v British Airways Plc [2010] EWCA Civ 1284

Vicarious liability in the spotlight

Barclays Bank plc v Various Claimants [2020] UKSC 13

WM Morrisons Supermarkets plc v Various Claimants [2020] UKSC 12

Chell v Tarmac Cement and Lime Ltd [2020] EWHC 2613 (QB)

The law in relation to vicarious liability has stepped back from the march towards expansion of the doctrine seen in recent years, to put it on what might be regarded as a more sensible and pragmatic footing. This article addresses the impact of two recent key Supreme Court judgments relating to vicarious liability. These are *Barclays Bank plc v Various Claimants* (***Barclays***) and *WM Morrisons Supermarkets plc v Various Claimants* (***Morrisons***). Both of these judgments were handed down on 1 April 2020 and represent a welcome clarification of the law of vicarious liability. Their approach was followed in the recent High Court judgment in *Chell v Tarmac Cement and Lime Ltd* (***Chell***), which this article also considers. This article comments on what these cases mean from an insurance perspective.

The test

Vicarious liability applies when an employer is held liable for the tortious acts of his employees. The test for determining whether there is vicarious liability consists of two limbs:

- The person who committed the tort must be an employee; and
- The tort in question needs to be committed "in the course of employment".

The *Barclays* case addressed the first limb of the test. The *Morrisons* case addressed the second limb.

The *Barclays* case

In this case, the Supreme Court was asked to decide whether Barclays Bank would be vicariously liable for the abuse committed by a doctor, Gordon Bates. Dr Bates was a self-employed medical practitioner whose work included conducting medical assessments and examinations of prospective Barclays employees. Barclays required job applicants to pass a pre-employment medical examination as part of its recruitment and employment procedures. Barclays paid a fee for the report that the doctor produced, but he was not paid a retainer. The doctor misused his role and abused the Claimants, who sought damages from Barclays.

At first instance, the judge held that Barclays was vicariously liable for the assaults. The Court of Appeal agreed and dismissed Barclays' appeal. Barclays then appealed to the Supreme Court.

The Claimants argued on appeal that the law had been broadened by the Supreme Court in the recent cases of *The Catholic Child Welfare Society and Others v Various Claimants (FC) and The Institute of the Brothers of the Christian Schools and Others, Cox v Ministry of Justice and Armes v Nottinghamshire County Council*. They contended that these cases showed the court expanding the scope of the first limb of the test, such that vicarious liability could apply even in situations where there was no formal contract of employment. In these case the courts considered a very wide range of factors to decide on the scope of liability, which overall included asking whether it was "fair, just and reasonable" to impose vicarious liability.

The Supreme Court did not accept this argument. It was unanimously held that Barclays was not vicariously liable for Dr Bates' alleged wrongdoing. Referring back to the two-limb test, it was held that Dr Bates was an independent contractor and not a Barclays employee at any time. The doctor was a true independent contractor: he carried his own portfolio of clients and work; he was not subject to a retainer and he was free to refuse work from Barclays. Whilst he did do work for the bank, the same could be said of a window cleaner hired to clean the bank's windows.

In the judgment, Lady Hale commented on aligning the concept of an 'employee' with today's gig economy, rather than trying to force the employment law definition. She distinguishes between two types of workers: the first type being an employee with a formal contract, and the second type being a gig economy worker, ie someone who is providing a service but isn't bound by any formal contract. In this case, the doctor was the second type of worker; an independent contractor who had no formal connection with Barclays. Thus Barclays could not be vicariously liable for his actions.

The *Morrisons* case

This case involved a disgruntled Morrisons employee, Andrew Skelton, who worked in the Morrisons internal audit team. He was tasked with transmitting payroll data for Morrison's entire workforce to its external auditors. He did this, but also made and kept a personal copy of the data. He then illegally uploaded the data to a publicly accessible file sharing website. He also sent the data anonymously to three UK newspapers, pretending to be a concerned member of the public who had found the data online. His intention was to harm Morrisons. The data was uploaded from Mr Skelton's personal computer in his own home outside his working hours.

The Claimants brought proceedings against Morrisons on the basis of its vicarious liability for Mr Skelton's acts. Their claims were for breach of statutory duty under the Data Protection Act, misuse of private information, and breach of confidence. At trial, the judge ruled in favour of the Claimants; and Morrisons' subsequent appeal to the Court of Appeal was also dismissed. Morrisons appealed to the Supreme Court.

In this case, the first strand of the vicarious liability test was satisfied – there was no doubt that Skelton was an employee of Morrisons. What was in dispute here was the second limb of the test, namely whether Mr Skelton's actions were performed during the course of his employment. The Claimants argued that Mr Skelton's actions were carried out in the course of his employment as it was part of his role to have access to the data which he released.

The Supreme Court unanimously rejected this argument and allowed Morrisons' appeal. It was held that the Court of Appeal had misunderstood the principles of vicarious liability. Firstly, the online disclosure of the data was not part of Mr Skelton's role, as it was an act which he was not authorised to do. Secondly, it was highly relevant that Mr Skelton was acting for purely personal reasons, as opposed to acting on behalf of his employer's business interests. The fact that Mr Skelton's employment gave him the opportunity to commit a wrongful act was not sufficient to warrant the imposition of vicarious liability. He was pursuing his own personal vendetta and so it would be unfair to hold Morrisons vicariously liable for this.

However, the Supreme Court rejected Morrisons' argument that the Data Protection Act excluded vicarious liability. In principle, employers can be held vicariously liable for an employee's breaches of data protection law. However, in this case, the employee's act was not an authorised one.

The *Chell* case

In this case, the High Court considered (on appeal from the County Court) whether Tarmac Cement and Lime Ltd (**Tarmac Cement**) was vicariously liable for the injury caused to an external contractor by one of its employees in the course of a practical joke which occurred in the workplace. The prank involved the Tarmac Cement employee placing pellet targets on the contractor's workbench and striking them with a hammer causing the pellets to explode. This resulted in a perforated eardrum, hearing loss and tinnitus for the contractor.

As in *Morrisons*, this case concerned the second strand of the vicarious liability test, ie whether Tarmac Cement's employee had performed the actions in the course of his employment. The *Morrisons* decision had not been handed down at the time judgment was given in *Chell* in the County Court. However, the County Court took a similar approach finding that on the facts there was insufficient connection between the employee's acts and his employment.

Spencer J in the High Court appeal agreed. He held that the employer was not vicariously liable for the employee's actions. Such actions were unconnected with any instruction given to the employee in the course of his work and did not advance the purpose of his employer in any way. While the incident happened in the workplace, the workplace merely provided the opportunity to carry out the prank; the prank was not part of the employee's work activities. Vicarious liability could not be established as there was insufficient connection between the employer-employee relationship and the employee's wrongful act to warrant the employer being held responsible.

Spencer J's approach is consistent with the Supreme Court's approach in *Morrisons*, which by then had been handed down. As Spencer J noted:

> "In my judgment, had Judge Rawlings had available to him the decision of the Supreme Court in *Morrisons v Various*, he would only have been fortified in the conclusions to which he had come and in his approach to this issue which, he would have found, and I find, was endorsed by the Supreme Court's judgment".

Comment

In the past few years, the courts have consistently expanded the scope of vicarious liability. This is partly in recognition of the fact that traditional models of employment are changing, but also because a number of the key cases involved victims of assault, and if the law hadn't adapted, then these victims would have been left without redress.

Following these three judgments, we can see that the courts are now reining in the scope of vicarious liability in both strands of the test. This means that the concept of an 'employee' for the purposes of this doctrine is now stricter and more in line with our gig economy, and what constitutes normal conduct in an employee's role has also been clarified, with thought given to the intention behind the employee's conduct.

This is good news for corporates and their liability insurers. If Barclays had lost their appeal, companies could have been on the hook for harm caused by a contractor. In a world where the number of companies operating on a model of self-employed staff is increasing, this would have had significant implications for companies. In light of these judgments, businesses are less likely to be held vicariously liable for the actions of their contractors, at least in respect of claims that would otherwise have been pushing the bounds of the doctrine. That said, the move to restrict the meaning of 'employee' in the context of vicarious liability may well be tested further in future decisions, and it remains to be seen how this will ultimately play out.

Likewise, employers and their liability insurers will also be relieved that the law of vicarious liability has not been extended to claims arising from the unauthorised actions of rogue employees. This would have represented a potentially troubling extension of the law, particularly in circumstances where the company had substantively complied with its legal obligations regarding the security of the data under the GDPR. It should be noted, however, that the *Morrisons* judgment does not wholly eliminate the risk of vicarious liability being imposed on companies. The Supreme Court acknowledged in principle that companies can have vicarious liability, although in these circumstances the employee's act was unauthorised and therefore vicarious liability did not attach. Put simply, there continues to be a very real risk for companies of liability and regulatory exposure–including class actions – related to authorised employee acts if they result in data privacy or security breaches.

In summary, the clarification around the scope of who a company may be vicariously liable for is helpful for insurers and policyholders alike. If corporates are less likely to be held liable for claims against their contractors, fewer claims will be

passed on to insurers under their liability programme, including public or employers' liability policies – and indeed cyber insurance policies. In theory, this should provide more certainty around the necessary scope of liability cover required by businesses. That said, there are still challenges around ensuring that the triggers in policy wordings align with and contemplate the scope of vicarious liability under the law as it now stands, and in identifying the level of liability cover required by companies with employees: put another way, the risk of vicarious liability exposure remains a very real one, and only partially offsets the enhanced risks faced by business of class actions and regulatory action in the UK.

As matter of good practice, therefore, companies should still make sure that they are covering their bases and not exposing themselves to any unnecessary risks including by ensuring:

- compliance with their legal obligations under the GDPR and more broadly;
- the terms of any contractual arrangements with third parties are appropriately drafted;
- they provide adequate training for employees and make sure they are aware of firm policies; and
- they review their liability insurance policy wordings carefully to determine whether they have cover for the vicarious liability of acts of employees.

It may take some time for these changes to bed-in, and there remains ample scope for future litigation over precisely how the newly drawn boundaries are to be applied in specific cases. But for the time being, it appears that the law has been placed on a footing that more closely reflects the equities and risks of the doing business in the twenty-first century.

Additional references

Armes v Nottinghamshire County Council [2017] UKSC 60

Cox v Ministry of Justice [2016] UKSC 10

The Catholic Child Welfare Society and Others v Various Claimants (FC) and The Institute of the Brothers of the Christian Schools and Others [2012] UKSC 56

High Court rejects claims on litigation privilege in advice from accountants on tax structure

The Financial Reporting Council Ltd v Frasers Group Plc (formerly Sports Direct International Plc) [2020] EWHC 2607 (Ch)

5 October 2020

The High Court has held that advice from accountants on a proposed new tax structure was not prepared for the dominant purpose of litigation, and was therefore not protected by litigation privilege, even if litigation over the relevant tax affairs was in reasonable contemplation at the time the advice was given.

Background

This is a further decision arising out of an application by the Financial Reporting Council (**FRC**) for an order requiring the respondent (**SDI**) to provide certain documents for the purposes of the FRC's investigation into the conduct of SDI's former auditors in relation to an audit of SDI's 2016 Financial Statements.

The FRC's investigation arose out of reports about SDI's subsidiary Sportsdirect.com Retail Ltd (**SDR**) engaging Barlin Delivery Ltd (**Barlin**) to provide delivery services to SDR's customers. This was part of a new or enhanced tax structure adopted by SDR in 2015 (the **2015 Structure**) on the advice of Deloitte LLP following enquiries from the French tax authorities. The FRC's investigation relates, among other things, to the non-disclosure of the relationship between SDR and Barlin (which was owned by the brother of SDI's founder and majority shareholder) in SDI's 2016 Financial Statements.

The documents sought by the FRC for the purposes of its investigation included documents which SDI disclosed to its auditors in 2015 recording the advice from Deloitte on the 2015 Structure (**the Deloitte Material**). SDI asserted that the Deloitte Material did not have to be provided because it was protected by litigation privilege. SDI's evidence asserted that the 2015 Structure was put in place "for the exclusive purpose of responding to the real and present threat of litigation that was anticipated from the French tax authority and other tax authorities".

Decision

The High Court (Nugee J) rejected the claim to litigation privilege over the Deloitte Material. He noted that there was little dispute between the parties on the applicable legal principles. As summarised in *Three Rivers DC v Bank of England (No 6)*, a successful claim to litigation privilege requires the following conditions to be satisfied:

> "...(a) litigation must be in progress or in contemplation; (b) the communications must have been made for the sole or dominant purpose of conducting that litigation; (c) the litigation must be adversarial, not investigative or inquisitorial."

The dominant purpose of conducting litigation, for these purposes, means obtaining advice as to the litigation or evidence, or information which might lead to evidence, for use in the litigation (see eg *WH Holding Ltd v E20 Stadium LLP*).

Applying this test, Nugee J found that the Deloitte Material was not prepared for the dominant purpose of litigation, even assuming that litigation was in reasonable contemplation at the time. He noted that the expected litigation would be primarily over the tax arrangements which were in place before the 2015 Structure was implemented. The purpose of the Deloitte Material was to suggest a new arrangement which would have a better chance of withstanding challenge from the tax authorities, and to explain how tax was to be accounted for under that structure. It was not to assist in the litigation about the old structure. While it could be described, in a broad sense, as responding to a likely challenge from the French tax authority, it was not for the purpose of enabling SDR to take advice as to the merits of litigation about the previous tax structure, or how best to conduct or settle that litigation, nor was it for the purpose of obtaining evidence to defend the claim.

Even if, as SDI submitted, litigation challenging the effectiveness of the 2015 Structure was also in reasonable contemplation at the time, it could not be said that the Deloitte Material was prepared for the sole or dominant purpose of the conduct of that litigation. As the Court put it:

> "A taxpayer who takes advice as to how to structure his affairs does not do so for litigation purposes. He does so because he wants to achieve a particular result for tax purposes..."

The judge's conclusion with regard to the "dominant purpose" element of the test meant he did not have to decide if litigation was in fact in reasonable contemplation at the relevant time. He did however comment that, despite the "apparently bland nature" of the enquiry from the French tax authority, he was not persuaded that he could properly go behind SDI's witness evidence that the relevant individuals did anticipate a challenge from the relevant tax authorities. Nor did he see reason to doubt the evidence that it was anticipated that such a challenge was

likely to be followed by a claim, which would be defended by SDR and therefore lead to litigation.

Comment

The decision emphasises that, for litigation privilege to apply, a communication or document must have been prepared for the dominant purpose of obtaining advice or evidence in relation to litigation that is reasonably in contemplation. As the judge explained, even if it is contemplated that a particular tax structure will be subject to challenge, and eventual litigation, advice as to how to implement the new structure is not primarily advice as to the conduct of the potential litigation.

While not surprising, the decision illustrates the point that advice about a potential course of action may not be covered by litigation privilege, even if that course of action is expected to lead to litigation. Where the advice in question is legal advice given by lawyers, legal advice privilege (rather than litigation privilege) is likely to apply. However, legal advice privilege does not apply to advice from other professionals, as confirmed by the Supreme Court in *R (Prudential plc) v Special Commissioner of Income Tax*.

Additional references

WH Holding Ltd v E20 Stadium LLP [2018] EWCA Civ 2652

R (Prudential plc) v Special Commissioner of Income Tax [2013] UKSC 1

Three Rivers DC v Bank of England (No 6) [2004] UKHL 48

Supreme Court applies *Patel v Mirza* to reject illegality defence to solicitors' negligence claim where claimant had engaged in mortgage fraud

Stoffel & Co v Grondona [2020] UKSC 42

30 October 2020

The Supreme Court has held that a Claimant who had engaged in mortgage fraud was not barred from bringing a claim against her solicitors for negligently failing to register the forms transferring the property to her and releasing a prior mortgage.

Background

In March 2000 the Claimant, Ms Grondona, entered into an agreement with a Mr Mitchell under which she agreed to have in her name mortgage loans in relation to four rental properties, on the basis that Mr Mitchell would pay the mortgages and manage the properties and Ms Grondona would receive 50% of the net profit when any of the properties were sold.

One of these properties was 73b Beulah Road (**the property**). Mr Mitchell purchased a 125-year lease of the property for £30,000 in or about July 2002, and for that purpose took out a six-month loan of £45,000 secured by a legal charge over the property with BM Samuels. In October 2002 Ms Grondona purchased the leasehold interest in the property from Mr Mitchell for the sum of £90,000, taking out a mortgage of £76,475 from Birmingham Midshires.

Stoffel & Co solicitors (**the solicitors**) acted for Ms Grondona, Mr Mitchell and Birmingham Midshires in connection with the transaction. The solicitors failed to register at the Land Registry the forms transferring the property to Ms Grondona and releasing the BM Samuels charge. As a result, Mr Mitchell remained the registered proprietor of the property and BM Samuels remained the registered proprietor of the BM Samuels charge, and further advances were made to Mitchell under that charge.

In 2006 Ms Grondona defaulted on payments under the mortgage and Birmingham Midshires brought proceedings against her. She brought a Part 20 claim in negligence against the solicitors, who raised an illegality defence, ie that Ms Grondona could not recover damages because the purpose of putting the property into her name and obtaining a mortgage from Birmingham Midshires was illegal, in that it was a conspiracy to obtain finance for Mr Mitchell by misrepresentation, and the purpose of instructing the solicitors was to further that fraud.

In April 2014 the leasehold interest in the property was sold by BM Samuels for £110,000 in order to satisfy the sum owed by Mr Mitchell under the BM Samuels charge. In May 2014, Birmingham Midshires obtained summary judgment against Ms Grondona in the sum of £70,000.

The judge found that Ms Grondona had participated with Mr Mitchell in a mortgage fraud, the purpose of which was to obtain moneys from Birmingham Midshires for Mr Mitchell which he could not obtain himself. The fraud involved making dishonest misrepresentations in the mortgage application form that: the sale to Ms Grondona was not a private sale; the deposit moneys were from her own resources; and she was managing the property. However, she concluded that the solicitors could not rely on the illegality defence, applying *Tinsley v Milligan*, as the claim did not rely on the allegations of illegality. Ms Grondona was awarded damages of £78,000, the value of the property as at November 2009, plus interest.

The Court of Appeal dismissed the appeal, applying *Patel v Mirza* which had been handed down since the first instance decision. It considered that, although mortgage fraud was a canker on society, barring the claim would not enhance the fight against mortgage fraud, there was a public interest in ensuring that clients can pursue claims against solicitors for negligence or breach of contract, and to deny the claim would be disproportionate to the wrongdoing involved. The solicitors were granted permission to appeal on the ground that the Court of Appeal erred fundamentally in its application of the *Patel v Mirza* guidelines.

Decision

The Supreme Court dismissed the appeal, Lord Lloyd-Jones giving a judgment with which Lord Reed, Lord Hodge, Lady Black and Lady Arden agreed.

Lord Lloyd-Jones referred to the "trio of necessary considerations" described by Lord Toulson in *Patel v Mirza* to determine whether allowing a claim which is tainted by illegality would be contrary to the public interest, namely:

- the underlying purpose of the prohibition which has been transgressed, and whether that purpose will be enhanced by denying the claim;
- any other relevant public policies which may be affected;
- whether denial of the claim would be a proportionate response to the illegality.

In applying these considerations, the essential question is whether to allow the claim would damage the integrity of the legal system. The answer will depend on whether it would be inconsistent with the policies to which the legal system gives effect. The court is not concerned to evaluate those policies but to identify the policies engaged and ascertain whether allowing the claim would be inconsistent with those policies or, if the policies compete, where the overall balance lies. If, on examining the relevant policy considerations, the court clearly concludes that the defence should not be allowed, there will be no need to go on to consider proportionality.

Underlying purpose of the prohibition

As to the underlying purpose of the prohibition, Lord Lloyd-Jones said there clearly exists an important policy that the law should condemn mortgage frauds, which are serious criminal offences, and deter such conduct. He doubted, however, that allowing Ms Grondona's claim would undermine that policy to any significant extent, as the risk of being left without a remedy if their solicitor should prove negligent in registering the transaction was unlikely to feature in the thinking of those considering engaging in such a fraud.

A further underlying purpose of the prohibition against mortgage fraud is the protection of the public, and in particular mortgagees. Again it was difficult to see how refusing the claim would enhance that protection and, in fact, the registration of the transfer was in the interests of the mortgagee, as well as Ms Grondona.

Other relevant public policies

There were important countervailing public policies in play, namely that conveyancing solicitors should perform their duties to their clients diligently and that clients should be entitled to seek a civil remedy for loss suffered as a result of their negligence. To permit solicitors to escape liability for negligence in current circumstances would run counter to these policies.

A further countervailing public policy arose in this case relating to the effect of the transaction on property rights. Lord Lloyd-Jones noted that, unless a statute provides otherwise expressly or by necessary implication, where property is transferred for an illegal purpose the transferee nonetheless obtains good title both in law and in equity. In this case, no legal title passed to Ms Grondona but, as Mr Mitchell had done everything he could do to effect the legal transfer, she was entitled to an equitable right to be registered as proprietor of the registered legal title. It would be inconsistent to deprive her of the remedies provided by law for the protection of that interest.

Accordingly, Lord Lloyd-Jones concluded, permitting the claim in this case would not undermine the public policies underlying the criminalisation of mortgage fraud, and could help to protect the interests of the mortgagee as victim of the fraud. Furthermore, to deny the claim would run counter to other important public policies, eg that victims of solicitors' negligence should be compensated for their loss. It would be a disincentive to solicitors' diligent performance of their duties, and result in an incoherent contradiction given the law's acknowledgment that an equitable property right vested in Ms Grondona.

Proportionality

It was therefore unnecessary to go on to consider proportionality, but Lord Lloyd-Jones's comments suggest that in his view it may have been disproportionate to deny the claim against the solicitors because the fraudulent conduct merely provided the background to that claim and was not central to it. While the question of whether a claimant must rely on illegal conduct to establish a cause of action is no longer determinative of an illegality defence, following *Patel v Mirza*, it may still have a bearing on the issue of centrality. Here, the claim was conceptually entirely separate from the illegality and could be established without reference to it.

Profiting from one's own wrongdoing

Finally, Lord Lloyd-Jones considered the solicitors' submission that Ms Grondona's intention in committing the fraud was to make a profit, the loss resulted from her wrongdoing, and so the policy consideration that a person should not be allowed to profit from her own wrongdoing applied. Lord Lloyd-Jones agreed that (as for most illegal agreements) Ms Grondona's motive was to make a profit. He commented that, clearly, it would be objectionable for the court's processes to be used to recover the profits which would have been obtained had the illegal scheme succeeded. However, the claim in this case was not to recover a profit, but to recover compensation for property lost by the negligence of the appellants. So it was not a case of the Court assisting a wrongdoer to profit from her own wrongdoing.

In any event, even if allowing the claim could be said to allow Ms Grondona to profit from her own wrong, that was no longer the true focus of the inquiry in considering an illegality defence. As Lord Toulson explained in *Patel v Mirza*, the notion that persons should not be permitted to profit from their own wrongdoing is unsatisfactory as a rationale of the illegality defence.

Comment

The decision is of interest in illustrating the application of the (relatively) new test for the illegality defence, as established in *Patel v Mirza*. This replaced the test adopted by the House of Lords in *Tinsley v Milligan*, which turned on the formalistic question of whether the claimant had to rely on the illegality to bring the claim. The current test is described by the Supreme Court in the present case as "a more flexible approach which openly addresses the underlying policy considerations involved and reaches a balanced judgment in each case, and which also permits account to be taken of the proportionality of the outcome".

The decision suggests, however, that while the test is no longer one of reliance, this question may still have a bearing on whether the fraud is central to the claim, which may in turn be relevant in considering whether it is proportionate to deny the claimant relief. It also suggests that, in the ordinary course, a claimant is unlikely to succeed in a claim to recover the profits of the fraud – not because the claimant would have to rely on the fraud in order to establish the claim, but because this is likely to be the outcome when the court balances the competing policy considerations. As the Court commented in this case: "Clearly, it would be objectionable for the court to lend its processes to recovery of an award calculated by reference to the profits which would have been obtained had the illegal scheme succeeded."

Additional references

Patel v Mirza [2016] UKSC 42

Tinsley v Milligan [1994] 1 AC 340

Supreme Court judgment clarifies English law on arbitrator apparent bias

Halliburton Company (Appellant) v Chubb Bermuda Insurance Ltd [2020] UKSC 48

27 November 2020

This Supreme Court decision concerns arbitrator conflicts in the context of an insurance dispute and is the most significant decision on English arbitration law in nearly a decade.

The *Halliburton* judgment is now the leading English law case on arbitrator conflicts. Importantly, the decision has clarified how apparent arbitrator bias will be assessed by the English courts, refining the test in the context of arbitration. While the arbitrator challenge was not successful in this case, the judgment has re-emphasised the importance of arbitrator impartiality in English-seated arbitration.

Background

Claims arising out of the Deepwater Horizon incident were made against Halliburton, which had provided offshore services in relation to the project. Halliburton then sought to claim in turn under its Bermuda Form excess liability insurance policy with Chubb, governed by New York law and subject to London-seated ad hoc arbitration. Chubb rejected the claim and in January 2015 Halliburton commenced arbitration against Chubb.

The policy contained the standard Bermuda Form arbitration clause which provided for arbitration by a tribunal of three arbitrators, one appointed by each party and the third by the two arbitrators so chosen. As the parties were unable to agree on the selection of the presiding arbitrator, in accordance with the arbitration clause the English High Court appointed Kenneth Rokison QC in June 2015. Mr Rokison had been proposed by Chubb, but Halliburton had opposed his appointment on the grounds that Mr Rokison was an English lawyer, whereas the policy was governed by New York law.

Before he was appointed in June 2015, Mr Rokison disclosed that he had previously been an arbitrator in arbitrations involving Chubb, including some appointments on behalf of Chubb. The judgment does not set out the number of appointments involved, or the timescales. He also disclosed that he was acting as arbitrator in two current arbitrations involving Chubb.

After Mr Rokison took up his appointment in the arbitration between Halliburton and Chubb, he accepted two appointments in additional arbitrations relating to the Deepwater Horizon incident: (a) in December 2015, he was appointed by Chubb in an arbitration relating to a claim under the same excess liability cover, which Chubb had sold to another insured party, Transocean; and (b) in August 2016, he was appointed by Transocean, in an arbitration relating to a claim Transocean was bringing against a different insurer that related to the same layer of insurance. Mr Rokison did not disclose the December 2015 and August 2016 appointments to Halliburton, but Halliburton became aware of them in November 2016.

Halliburton then asked Mr Rokison to resign, but he stated that he did not feel he could do so, as he had been appointed by the Court. Mr Rokison noted that the issues under consideration were neither the same nor similar. He stated that he had been independent and impartial throughout and that this would continue to be the case. Halliburton then made an application to the English court for his removal under s24 of the Arbitration Act 1996. The application was unsuccessful and Halliburton then appealed to the Court of Appeal, which also rejected the challenge. Halliburton appealed to the Supreme Court.

The two main issues before the Supreme Court were:

- whether and to what extent an arbitrator is entitled to accept appointments in multiple arbitrations relating to the same or overlapping matters and where there is only one common party, without this resulting in an appearance of bias; and
- whether and to what extent the arbitrator could accept multiple appointments in this way without providing disclosure.

Halliburton took the position that there was apparent unconscious bias on the part of Mr Rokison. Halliburton's case was based on the suggestion that the situation "gave Chubb the unfair advantage of being a common party to two related arbitrations with a joint arbitrator while Halliburton was ignorant of the proceedings" in the later arbitrations and "thus unaware whether and to what extent he would be influenced in [the Halliburton/Chubb arbitration] by the arguments and evidence in [the Transocean/Chubb arbitration]". Halliburton contended that Chubb would be able to communicate with the arbitrator, for example via submissions and evidence submitted in the later proceedings, on questions that might be relevant to the arbitration between Halliburton and Chubb. Haliburton took the position that apparent bias was also made out by Mr Rokison's failure to disclose his later appointments to Halliburton. There was also a suggestion that Mr Rokison "did not pay proper regard to Halliburton's interest in the fairness of the procedure".

Decision

The Supreme Court emphasised the importance of impartiality in arbitration, highlighting that impartiality had always been a "cardinal duty" for arbitrators. Given that there was no

allegation that the arbitrator was actually biased, the Court was only concerned with whether there was an appearance of bias. It was well established that the correct legal test was "whether the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased."

The Supreme Court considered how the hypothetical observer is taken to be "informed". This meant, quoting an earlier case, that "before she takes a balanced approach to any information she is given, she will take the trouble to inform herself on all matters that are relevant...She is fair-minded, so she will appreciate that the context forms an important part of the material which she must consider before passing judgment." When the apparent bias test is applied to arbitrators, the distinctive features of arbitration must therefore be taken into account. This includes a consideration of the private nature of arbitration, and the very limited rights of appeal. The Supreme Court also referred to the appointment process for arbitrators, noting the potential for party nomination and that there may be a "financial interest in obtaining further appointments as arbitrator". It also observed that arbitrators may be non-lawyers with only limited experience of arbitration and may be from a variety of jurisdictions and legal traditions, with a range of views on arbitrator ethics.

The Supreme Court emphasised that, due to the private nature of arbitration, where an arbitrator is appointed in multiple overlapping arbitrations the non-common party cannot discover what evidence or submissions have been put before the tribunal, or the arbitrator's response. The Court also had regard to the range of understandings in relation to the role and duties of party-appointed arbitrators, recognising that some parties may expect party-nominated arbitrators to be pre-disposed towards their nominating parties, while the chair has a particular role to play in ensuring the tribunal acts fairly. While taking these differing perspectives into account, the duty of impartiality applied in the same way to every member of the tribunal and "the party-appointed arbitrator in English law is expected to come up to precisely the same high standards of fairness and impartiality as the person chairing the tribunal".

While the professional reputation and experience of an individual arbitrator was a relevant consideration in assessing whether there was apparent bias, the Court noted this was likely to be a factor accorded only limited weight.

Duty of disclosure

The Supreme Court confirmed that an arbitrator is under a duty to disclose facts and circumstances which would or might reasonably give rise to the appearance of bias. The Supreme Court held that compliance with this duty should be assessed with regard to the circumstances at the time the disclosure fell to be made.

The Court noted that several of the arbitral institutions and organisations which had been given permission by the Court to intervene in these proceedings, had argued in favour of the recognition of a legal duty of disclosure. The Court stated that this legal duty furthered transparency in arbitration and was in alignment with the best practice set out in the International Bar Association Guidelines on Conflicts of Interest in International Arbitration (**the IBA Guidelines**) and the approach taken by several arbitration institutions. The Court said that the IBA Guidelines "assist the court in identifying what is an unacceptable conflict of interest and what matters may require disclosure" but emphasised that they are non-binding.

The Supreme Court stated that an arbitrator may have to disclose acceptance of appointments in multiple overlapping arbitrations with only one common party, depending upon the customs and practice of the type of arbitration in question. The judgment explores in some detail the need to consider the duty of confidentiality in determining what information about potential conflicts may be disclosed.

The Court also explored the relationship between the duty to disclose and the duty of impartiality and concluded that failure to disclose will be one factor which the fair-minded and informed observer will take into account in considering whether there was a real possibility of bias. However, the Court held that questions of disclosure and apparent bias fell to be assessed at different times. Whereas the question of whether there was a failure to disclose was analysed as at the time the alleged duty of disclosure arose, the question of whether the relevant circumstances in any case amount to apparent bias must be assessed at the time of the hearing of the challenge to the arbitrator.

The Supreme Court held that failure to disclose appointment in overlapping arbitrations is capable of demonstrating "a lack of regard to the interests of the non-common party" and may in certain circumstances therefore constitute apparent bias.

Rejection of challenge

The Court held that, in the context of the Bermuda Form arbitration between Halliburton and Chubb, the Arbitrator was required to disclose the multiple appointments in question. This was because there was no established custom or practice in Bermuda Form arbitration of allowing an arbitrator to take on multiple and overlapping appointments without disclosure. Mr Rokison was therefore under a legal duty to disclose his appointment in the subsequent overlapping proceedings because, at the time of appointment in those arbitrations, those appointments might reasonably give rise to the real possibility of bias.

However, the Supreme Court concluded that the fair-minded and informed observer would not determine that there was a real possibility of bias. This was because:

- At the time the disclosure fell to be made there had been uncertainty under English law about the existence and scope of an arbitrator's duty of disclosure;
- The time sequence of the arbitrations may have been an explanation for the non-disclosure to Halliburton;
- Mr Rokison had explained that both the subsequent overlapping arbitrations would be resolved by way of preliminary issue, which meant there would in fact be no overlapping evidence or submissions. Mr Rokison had offered to resign from the subsequent arbitrations if that was not the case and it was therefore unlikely that Chubb would benefit as a result of the overlapping arbitrations;
- Mr Rokison had not received any secret financial benefit; and
- Mr Rokison's response to the challenge had been "courteous, temperate and fair...and there is no evidence that he bore any animus towards Halliburton as a result".

Comment

It is not uncommon in an insurance context for the same individual(s) to be appointed as arbitrators in separate but related arbitrations. First, a single event can impact any number of policyholders who may bring proceedings against their insurers and there may naturally be an overlap of arbitrators with particular expertise between different sets of proceedings. Secondly a single insured may be required to bring proceedings against a number of different insurers up an insurance tower in relation to the same event. Since arbitration clauses in insurance policies frequently do not provide for related proceedings to be joined or consolidated even when they relate to the same insurance programme, the appointment of the same arbitrator(s) across the different proceedings against different insurers may be the only route to mitigating the risk of inconsistent decisions.

Although the Supreme Court noted that challenges of this kind have "rarely succeeded" and also noted that the objective observer at the heart of the apparent bias test will be "alive to the possibility of opportunistic or tactical challenges", this judgment has emphasised the importance of arbitrator impartiality and has both clarified and refined the law on apparent bias in the context of arbitration.

Disclosure Pilot Scheme: report and proposals for reform

The Disclosure Pilot Scheme (**DPS**) was introduced to address widespread concerns at the perceived excessive costs, scale and complexity of disclosure. The aim of the DPS was to make the disclosure process simpler and cheaper. But it seems those aims are not being achieved.

The pilot has been operating in the Business and Property Courts since 1 January 2019 and is set to continue until the end of 2021 following an extension. As this is a primary forum for resolving insurance disputes, the pilot is relevant to all of those in the sector who handle disputes.

Third interim report

On 22 September 2020, the judiciary published an update on the operation of the DPS. The update includes publication of the Third Interim Report on the pilot by Professor Rachael Mulheron (of Queen Mary University of London), who has been monitoring the pilot since the outset. It analyses the 71 responses received to a questionnaire that practitioners were asked to complete in October/November 2019. The report presents a mix of positive and negative feedback regarding the detailed operation of the pilot, but respondents' views on the overall outcomes under the pilot, as set out in the report, are overwhelmingly negative:

- 85% say the pilot has not saved costs overall (4% say it has, 10% can't say/too early)
- 42% say it has made disclosure less accurate (16% say more accurate, 42% can't say/too early)
- 71% say it has increased burdens on the courts (2% say decreased burdens, 27% can't say/too early)
- 78% say it has not brought about a culture change (6% say it has, 16% can't say/too early)

Professor Mulheron's note accompanying publication of the report stated that there will be a further opportunity to give feedback on the pilot as it enters its third year of operation in 2021. In the interim, there will be a survey of the judiciary to ascertain their views and experiences of the pilot.

Amendments to the DPS rules

The judiciary's update included a proposed revised version of the pilot rules at Practice Direction 51U, together with a revised version of the Disclosure Review Document, which were approved by the Civil Procedure Rule Committee in October 2020. Some of the main changes are as follows:

- Clarifying that the obligation to disclose "known adverse documents" does not bite until the stage at which the parties provide any Extended Disclosure.
- Providing that document preservation notices only need to be sent to employees or former employees where there are reasonable grounds to believe that the relevant person has disclosable documents that are not already in the possession of the party to the litigation.
- Providing that there is no need to disclose adverse documents at the Initial Disclosure stage, and that the parties can agree to dispense with the requirement for an Initial Disclosure List of Documents.
- Confining the obligation to complete the Disclosure Review Document (**DRD**) to cases where the parties propose one or more search-based Extended Disclosure models, and providing that some sections of the DRD may not have to be completed in some circumstances.
- Clarifying the scope of "Model C" request-based disclosure, and in particular that this is intended to relate to narrow categories of specific requests – ie not the wide-ranging requests that you might find in a "Redfern Schedule" in international arbitration.
- Simplifying section 2 of the DRD, which provides the court with information about the data held by each party, and allowing parties to tailor it more easily to their cases.

Given the relatively limited nature of the proposed amendments, it is not obvious that they will be sufficient to alleviate court users' concerns regarding overall outcomes under the pilot.

We understand there will be a further opportunity for practitioners and parties to give feedback on the pilot, as well as a survey of the judiciary to ascertain their views and experiences. It remains to be seen whether further changes will be proposed in light of further feedback.

Witness statements: significant changes proposed for Business and Property Courts

Proposals for a new Practice Direction and Appendix governing the preparation of witness statements for trials in the Business and Property Courts have been published by the Witness Evidence Working Group. The proposals include a new authoritative statement of best practice, as well as a beefed up statement of truth and a new certificate of compliance to be signed by the legal representative.

A witness evidence working group (**the group**) was set up in 2018 to consider potential reforms in light of concerns that witness statements often contain irrelevant or inadmissible material and do not always achieve best evidence.

The group's report was published in December 2019 and made various recommendations for witness evidence in the Business and Property Courts, including that an authoritative statement of best practice should be prepared. A draft of that statement has now been prepared by the group in the form of a new CPR draft Practice Direction 57AC and Appendix published in September 2020.

In broad terms, the aims of the draft Practice Direction and Appendix include improving witness evidence by reducing the potential for a witness's recollections to be influenced or overwritten by the process of taking the statement itself, as well as refocusing witness evidence on the areas where it is actually needed – rather than the detailed recitation of and commentary on the documents which is often found in witness statements at the moment. It is also hoped that, as well as improving witness evidence, this will increase cost efficiency and reduce the burdens on witnesses.

As well as the best practice statement itself, the draft includes a new enhanced statement of truth from the witness and a new certificate of compliance from the legal representative, both of which are aimed at focusing minds on the necessary change of practice.

Two other aspects are new:

- a new requirement that for important disputed matters of fact the statement should, if practicable, state how well the witness recalls the matter in question and indicate the extent to which that recollection has been affected by considering documents; and
- a new requirement to identify what documents, if any, the witness has referred to or been referred to for the purpose of providing the statement.

The group is divided on this latter proposal. Some members of the group believe this strikes the appropriate balance between transparency regarding the interactions with the witness, on the one hand, and party autonomy in presenting the evidence, on the other, and gives the judge important information to help him or her assess the weight to be attached to the witness's evidence. However, some members believe the requirement goes too far, particularly when considering large, complex commercial cases where the relevant events may have taken place some years before and it may be necessary to take the witness through the contemporaneous documents to put them back in the relevant context and see what evidence they can give. The concerns include: the possibility of judges drawing adverse inferences from a long list as to the quality of the witness's evidence, where that may not be justified; obvious difficulties regarding the witness who is also the client, and will therefore have to review documents in the course of giving instructions; and potential difficulties regarding the need to list privileged documents.

The draft Practice Direction and Appendix have been approved by the Business and Property Courts Board and have also been approved in principle by the Civil Procedure Rule Committee. There are some final points of drafting still being considered but subject to that, the final versions are likely to come into force on 6 April 2021. If they do, they will apply to all witness statements signed on or after that date.

Disputes after the end of the Brexit transition period: where are we now?

The UK left the EU on 31 December 2020. The post-Brexit trade deal reached between the UK and the EU on 24 December 2020 has no direct impact on commercial dispute resolution. However, the hope is that the deal will pave the way for a further agreement on the UK's accession to the 2007 Lugano Convention.

In this article, we consider the position for commercial litigation involving the English courts following the end of the Brexit transition period, whether or not the UK re-accedes to Lugano.

It is worth noting at the outset that arbitration with a seat in London will not be affected by Brexit, as arbitration is not regulated by EU law. The UK and all EU member states are signatories to the 1958 New York Convention. Accordingly, arbitration clauses will remain effective and arbitral awards will continue to be enforceable in the same circumstances as previously.

The Withdrawal Agreement

During the transition period established by the UK/EU Withdrawal Agreement up to 31 December, EU law continued to apply to and in the UK, and the UK continued to be treated as an EU member state for the purposes of international agreements to which the EU is a party, such as the Lugano Convention and the 2005 Hague Convention on Choice of Court Agreements. This is no longer the case after 31 December, though there are a number of respects in which transitional provisions under the Withdrawal Agreement continue to affect cross-border disputes and the enforcement of judgments between the UK and EU member states after that point. In particular:

- By Article 66, the rules on applicable law in contractual and non-contractual matters under the Rome I and Rome II Regulations (Regulations 593/2008 and 864/2007) apply to contracts concluded, or events giving rise to damage, before the end of the transition period (and in fact little will change even where these provisions do not apply – see below).
- By Article 67, the rules on both jurisdiction and enforcement of judgments under the recast Brussels Regulation apply where proceedings are commenced before the end of the transition period.
- By Article 68, the provisions under the EU Service Regulation and Taking of Evidence Regulation apply where the relevant document for service or request for the taking of evidence was received (by the relevant body in the state where service is to be effected or evidence to be taken) before the end of the transition period.
- By Article 86, the CJEU continues to have jurisdiction to give preliminary rulings on requests from UK courts and tribunals made before the end of the transition period and, by Article 89, those rulings will continue to be binding in the UK.

The Lugano Convention?

These transitional provisions do not apply in relation to Iceland, Norway and Switzerland. Questions of jurisdiction and the enforcement of judgments between the UK and these three EFTA countries were governed by the Lugano Convention, which as noted above, came to an end on 31 December 2020. The UK has applied to re-accede to Lugano but this requires the unanimous agreement of the contracting parties – namely the EU, and Denmark as an independent state (it has an "opt-out" of justice and home affairs matters under relevant EU treaties), as well as Iceland, Norway and Switzerland. While Iceland, Norway and Switzerland have indicated their support for the UK's accession, the EU's position is not yet clear.

If the UK re-accedes to Lugano, assuming no other agreement on jurisdiction and enforcement of judgments is concluded between the UK and the EU, Lugano will then apply as between the UK and the EU (as well as between the UK and other signatories). The result would be that there would be little change from the pre-Brexit regime in relation to jurisdiction and enforcement, so that English court judgments would continue to be readily enforceable throughout the EU and in EFTA countries, and English jurisdiction clauses would largely continue to be respected by those countries, and vice versa. (The Lugano Convention does have some disadvantages compared to the pre-Brexit regime, as it does not include the improvements made when the Brussels Regulation was "recast" for proceedings commenced on or after 10 January 2015.)

Even if the UK does not re-accede, it will continue to apply the current rules under Lugano in relation to questions of jurisdiction and enforcement where relevant where proceedings were commenced before the end of transition. It is not clear, however, whether Iceland, Norway and Switzerland will continue to apply Lugano where English proceedings were commenced before the end of transition, or whether now post-transition they will simply apply domestic rules in relation to jurisdiction and enforcement questions involving the UK regardless of when proceedings were commenced.

In any event, the UK and Norway have reached an agreement to continue to apply an old mutual enforcement treaty between the two countries dating back to 1961. Judgments will therefore continue to be enforceable between the UK and Norway under these provisions, even if the UK does not re-accede to Lugano.

If the UK does not re-accede to Lugano

If the UK does not re-accede to Lugano, and the transitional provisions under the Withdrawal Agreement do not apply, matters are somewhat more complicated, particularly as regards jurisdiction and the enforcement of judgments. The below sets out the position in some of the key areas affecting commercial dispute resolution.

Rules on applicable law

Very little will change in this area, even where the transitional provisions under the Withdrawal Agreement do not apply. The UK legislated to incorporate Rome I and Rome II into English law from the end of the transition period, and so the English court will apply the same rules as pre-Brexit to determine applicable law. EU courts will of course continue to apply Rome I and Rome II, so will continue to give effect to a choice of English law to the same extent, and the rules applied by non-EU courts and arbitration tribunals will not be affected by Brexit.

Jurisdiction clauses and enforcement of judgments

Where the transitional provisions under the Withdrawal Agreement do not apply, the recast Brussels Regulation will no longer be relevant to questions of jurisdiction and enforcement as between the UK and the EU. In those circumstances, a key question will be whether there is an exclusive jurisdiction clause which falls within the 2005 Hague Convention. Hague applies only if: (i) there is an exclusive jurisdiction clause (not a non-exclusive or unilateral clause) entered into after it came into force for the country whose courts are chosen; and (ii) proceedings are commenced after it came into force for the country whose courts are seised. (The clause must also fall within the scope of the Convention, which does not apply, for example, to employment and consumer contracts.)

The 2005 Hague Convention first came into force for the UK when the EU acceded on behalf of most EU member states on 1 October 2015. During the transition period, the UK continued to be treated as an EU member state for the purposes of international agreements including the 2005 Hague Convention. And the UK has re-acceded with effect from 1 January 2021.

However, there is some uncertainty as to whether EU member states will treat the Convention as having been in force for the UK since 1 October 2015, when it came into force for the EU generally, or only from when the UK re-joined on 1 January 2021. It is difficult to see why the earlier date should not be the relevant one. However, the European Commission takes the opposite view, although that is not binding on the courts that will decide this question in future. That means that, where an exclusive English jurisdiction clause was agreed before 1 January 2021 (and on or after 1 October 2015) there is some uncertainty as to whether EU member states will treat the clause as falling within the Convention.

For exclusive English jurisdiction clauses agreed on or after 1 January 2021, however, the position should be straightforward: EU member state courts will generally respect exclusive English jurisdiction clauses and enforce the resulting judgments under Hague (as will the other contracting states to the 2005 Hague Convention, currently Mexico, Singapore and Montenegro). Note however that, even where Hague applies, there is a slight wrinkle in relation to issues of jurisdiction where there is no party domiciled in the UK (or another non-EU Hague contracting state, ie Mexico, Singapore and Montenegro) – so for example if all parties are EU domiciled. In those circumstances, Article 26(6) of the Hague Convention provides that the Brussels regime takes precedence, and there is some uncertainty as to whether, under that regime, EU courts can stay proceedings or decline jurisdiction in favour of non-EU courts, as the English court will then be, except where the non-EU proceedings were commenced first in time. The authorities do not speak with one voice, but an English Court of Appeal decision from 2019 (*JSC Commercial Bank Privatbank v Kolomoisky and Bogolyubov & others*) lends support, somewhat indirectly, to an argument that there is in fact such a power. In any event, this uncertainty does not affect questions of enforcement, only questions of jurisdiction.

Where the 2005 Hague Convention does not apply (whether because of the risks outlined above, or because there is a jurisdiction clause which is non-exclusive or unilateral or which was agreed before 1 October 2015, or simply because there is no jurisdiction clause) the UK and EU courts will apply their own rules to questions of jurisdiction and enforcement.

As noted above, where an EU court has jurisdiction pursuant to the Recast Brussels Regulation, there is some uncertainty as to the circumstances in which it can stay proceedings or decline jurisdiction in favour of non-EU courts, as the English court will be, save where the English proceedings are commenced first (as there is an express power in those circumstances under Articles 33/34 of the recast Brussels Regulation).

So far as enforcement of judgments is concerned, most (but not necessarily all) EU countries will enforce foreign judgments even without a specific reciprocal regime, although the type of judgment enforced may be more limited and the procedures may be more cumbersome and more expensive.

Other issues relating to jurisdiction

Now that the transition period has ended, assuming the UK does not re-accede to the Lugano Convention:

- The English courts will no longer be restricted from applying national rules of jurisdiction to EU-domiciled defendants, eg based on temporary presence within England and Wales. This will, however, be subject to the court's discretion to refuse jurisdiction on the basis that England is not the convenient forum for the dispute. Similarly, English-domiciled defendants will be subject to national rules of jurisdiction in the various EU member states.
- The English courts should again be able to issue anti-suit injunctions in respect of proceedings in EU member state courts in appropriate circumstances, such as where an action has been brought in breach of an exclusive English jurisdiction clause.
- The English court's permission to serve proceedings out of the jurisdiction will be required in more cases. However, it will still be possible to serve out without permission if there is an exclusive English jurisdiction clause which falls within the 2005 Hague Convention. Also, as a result of an amendment to the rules on service under CPR Part 6 that is expected to take effect from 6 April 2021, it is also likely to be possible to serve out with permission if there is any other (exclusive or non-exclusive) English jurisdiction clause.

Service and taking of evidence

Now that the transition period has ended, the EU Service Regulation and Taking of Evidence Regulation will no longer apply to the UK (unless, under the transitional provisions referred to above, the relevant document for service or request for the taking of evidence was received before 31 December 2020).

Procedures for service of documents and taking of evidence between the UK and the EU will therefore largely depend on whether the relevant states are, like the UK, contracting states to:

- the Convention of 15 November 1965 on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (the Hague Service Convention); and/or
- the Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters (the Hague Evidence Convention).

All EU Member States are contracting states to the Hague Service Convention and all but Austria, Belgium and Ireland are contracting states to the Hague Evidence Convention. Where those conventions apply they will give alternative routes for service and/or the taking of evidence. Where they do not apply, there may be other methods available for both service and the taking of evidence. For example, in relation to service, it may be possible to serve through consular authorities, or by any method permitted by the law of the country in which service is to be effected. In relation to the taking of evidence, it may be possible to proceed via a letter of request.

EU law

Existing EU law as at the end of the transition period continues to apply in the UK, as retained EU law, pending any decision to amend or repeal it.

In interpreting this retained EU law, UK courts will apply decisions of the Court of Justice of the European Union ("CJEU") that pre-date the end of the transition period, save to the extent that particular courts are given power to depart from those decisions. The European Union (Withdrawal) Act 2018, as originally enacted, provided that the Supreme Court (as well as the ultimate court of appeal on Scottish criminal law) would have such power. Following a consultation by the Ministry of Justice, such power will now also be extended to other appellate courts, including the Court of Appeal. CJEU decisions post-dating the end of the transition period are not binding on UK courts but the courts may have regard to them so far as relevant.

Post-transition, the English courts are no longer be able to refer questions to the CJEU for a preliminary ruling, though (as noted above) the Withdrawal Agreement provides that the UK courts will continue to be bound by preliminary rulings made in response to requests from UK courts and tribunals made before the end of the transition period.

Additional references

JSC Commercial Bank Privatbank v Kolomoisky and Bogolyubov & others [2019] EWCA Civ 1708

Post *Lomax v Lomax*: Two judgments relating to ADR and the courts

Telecom Centre (UK) Ltd v Thomas Sanderson Ltd [2020] EWHC 368 (QB)

McParland & Partners Ltd and Another v Whitehead [2020] EWHC 298 (Ch)

Two High Court decisions highlight a trend toward increased use of early neutral evaluation orders as well as adding to the broader debate on whether ADR should be compulsory.

Background

In *Lomax v Lomax*, the Court of Appeal held that it had the power to order an early neutral evaluation (**ENE**) even where one or more parties did not consent to that course. The *Lomax* decision had the potential to (i) prompt an increase in use of ENE by parties (either on their own initiative or further to directions from the judge); and (ii) be of wider significance in the context of the debate as to whether the courts' encouragement of ADR should extend into compulsion.

Two High Court decisions this year highlight the relevance of these observations. In a (brief) judgment in *Telecom Centre (UK) Ltd v Thomas Sanderson Ltd,* Master McCloud provided some guidance on how parties and judges could approach the ENE process in light of a lack of such guidance in the Queen's Bench Guide. In *McParland & Partners Ltd and another v Whitehead*, Sir Geoffrey Vos queried, in obiter comments, the relevance of the *Lomax* decision with respect to the power of the Court to require a party to try mediation.

Telecom Centre and the suggested approach to ENE by the Court

In *Telecom Centre*, Master McCloud in the Queen's Bench Division raised the option of using ENE – which the parties had also already considered on their own initiative – to assist the parties with settling the case. Commenting on the lack of specific information on the use of ENE in the Queen's Bench Guide, she used the judgment to share her approach to the process in order to inform other litigants and, potentially, the current author of the Queen's Bench Guide.

The judgment proceeds to explain the purpose of ENE and provides insight into how ENE procedures could be structured, when the process might be helpful, and how it may assist the parties and the court. The decision also appends a generic version of the order made in the case by Master McCloud, for guidance on what might be included in an ENE order.

The guidance offered in the judgment with respect to the ENE process might serve as a precedent for other judges who are considering to suggest (or order) that parties engage in ENE. The decision further appears to demonstrate an increasing level of interest in ENE following the Court of Appeal's endorsement of the process in the *Lomax* decision. Of course commercial parties will continue to think about whether they prefer ADR processes which are centred on party choice and control, such as mediation, or processes which enlist the assistance of a quasi decision-maker even where the neutral's evaluation is not binding.

McParland v Whitehead and the application of *Lomax* to other forms of ADR

From an ADR perspective, it is interesting that the Court records its encouragement to the parties to try mediation. In doing so, the Court notes that it mentioned the *Lomax* judgment to the parties and commented that *Lomax* "inevitably raised the question of whether the court might also require parties to engage in mediation despite the decision in *Halsey v Milton Keynes General NHS Trust*". The *Halsey* decision established the position that the courts do not have the power to compel unwilling parties to engage in ADR.

Even though the Court did not have to answer its question because the parties in *McParland* voluntarily agreed to attempt mediation, it is notable that the issue was raised in the judgment and Sir Geoffrey Vos' statement might indicate that the Court is open to reviewing the *Halsey* position in an appropriate case.

Additional references

Lomax v Lomax [2019] EWCA Civ 1467

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

Costs implications arising from a failure to engage in mediation

DSN v Blackpool Football Club Ltd [2020] EWHC 670 (QB)

BXB v Watch Tower and Bible Tract Society of Pennsylvannia & Others [2020] EWHC 656 (QB)

Wales (t/a Selective Investment Services) v CBRE Managed Services Ltd & Another [2020] EWHC 1050 (Comm)

The High Court has this year imposed indemnity costs orders and disallowed substantial parts of successful defendants' costs in cases where there has been a failure to engage in mediation.

In two cases (*DSN v Blackpool Football Club Ltd* and *BXB v Watch Tower and Bible Tract Society of Pennsylvannia & Others*), the High Court imposed indemnity costs as a result of a party's unreasonable failure to engage in ADR. In both cases, the party's belief in the strength of its case did not warrant a refusal to participate in settlement negotiations.

Similarly, in *Wales (t/a Selective Investment Services) v CBRE Managed Services Ltd & Anor*, the High Court disallowed a substantial part of a successful defendant's costs as a result of its failure to engage in mediation. The *Wales* ruling highlights that such a refusal may also have serious consequences for parties who prevail on the merits of a case.

Background

It is well-established that the unreasonable refusal to engage in ADR might result in cost sanctions. In *Halsey v Milton Keynes General NHS Trust*, the Court of Appeal set out a list of non-exclusive factors that are relevant to determining whether a refusal was unreasonable.

One of the factors listed in *Halsey* is the "merits of the case". The fact that a party reasonably believes that it has a strong case was considered relevant by the Court of Appeal because otherwise a claimant could potentially extract a settlement from a defendant for a meritless claim by using the threat of cost sanctions to its advantage. However, the Court set a high bar for when the strength of the case justifies a refusal to mediate. It noted that a party's reasonable belief that it has a "watertight" case may be reason for a refusal to mediate and that some cases are "clear-cut" in this respect (such as when a summary judgment application would have succeeded). However, even for "border-line" cases, the Court observed, "little or no weight" should be given to a party believing it would win as "border-line cases are likely to be suitable for ADR unless there are significant countervailing factors which tip the scales the other way".

This 'merits of the case' factor has been considered relevant in subsequent cases. In *Northrop Grumman Mission Systems Europe Ltd v BAE Systems Ltd*, for example, the High Court held that the respondent's reasonable view that it had a strong case provided "some but limited justification for not mediating".

The *DSN* and *BXB* decisions

Background

The *DSN* and *BXB* cases were similar in many respects. Both cases concerned successful claims for vicarious liability for sexual assault. In both cases, the Master had issued an order (in the standard form) that the parties were to consider settling the litigation by any means of ADR. In both cases, the Claimants sought an order for indemnity costs on the basis (amongst other reasons) that the Defendants had not been willing to engage in ADR. In both cases, the Defendants justified this refusal in part on account of their belief in the strength of their case. In both cases, the Court eventually ordered costs to be assessed (for set timeframes) on an indemnity basis.

Decisions

In its reasoning in *DSN*, the Court read restrictively the already limited relevance of the merits of a case on a refusal to engage in ADR. It observed that the repeated refusal by the Defendant to engage in settlement negotiations on the basis of a belief in a strong case was 'inadequate' and noted that:

> "No defence, however strong, by itself justifies a failure to engage in any kind of alternative dispute resolution. Experience has shown that disputes may often be resolved in a way satisfactory to all parties, including parties who find themselves able to resolve claims against them which they consider to be well founded".

In *BXB*, the Court further commented on the possible advantages of ADR even when a defendant believes in the strength of its case. The Court contended that the belief in a strong case does not:

> "...necessarily mean that there was nothing to discuss. One important purpose of a joint settlement meeting is to convey a defendant's view about the strength of its case. In any event, the possibility of agreeing quantum subject to liability provides a good reason to engage in discussions even in a case where the defendant is confident about its case on liability."

The *Wales* decision

Background

The *Wales* decision concerned an order for costs in relation to an earlier judgment in which the Court had dismissed the Claimant's claims against the two Defendants.

The Claimant had indicated itself willing to engage in ADR in its July 2015 and June 2016 letters of claim, and had proposed a three-party mediation in a 2 November 2016 letter to the Defendants. The First Defendant replied on 11 November 2016 that it would not participate in the mediation. The Second Defendant initially indicated it was willing to engage in mediation, but changed its position after the refusal by the First Defendant as it questioned the utility of any mediation without the First Defendant taking part.

The Claimant eventually issued proceedings in July 2018. At the case management conference on 8 November 2018, the Court made an order that the parties should consider settlement by ADR at all stages of the litigation. On 28 November 2018, the First Defendant's solicitors filed a witness statement explaining that the First Defendant would not engage in mediation because it considered a mediation premature pending the conclusion of pleadings.

Pleadings concluded on 18 January 2019. The First Defendant sent the Claimant a without prejudice save as to cost letter on 14 February 2019. This letter contained a subject to contract settlement offer to the effect that the Claimant would withdraw the case and each party would bear its own costs. The Claimant did not respond to this letter.

In late May 2019, the Claimant proposed a mediation that was to take place in the week of 17 June 2019. The First Defendant refused to mediate on the basis that there was insufficient time to prepare for a mediation and that there were significant factual issues between the parties that had not yet been addressed by witness statements. The Second Defendant again indicated that it was willing to mediate but questioned the utility of a mediation without the First Defendant's participation.

The matter proceeded to a hearing on 1-3 July 2019, with closing submissions taking place on 27 August 2019. The Court dismissed the Claimant's claims in full in an 8 January 2020 judgment.

In its costs submissions, the Claimant argued that he should not be ordered to pay the First Defendant's costs – despite being unsuccessful on the merits of the case – as a result of the First Defendant's unreasonable refusal to engage in mediation. The Claimant also submitted that the Second Defendant should be deprived of some of its costs for failing to participate in a mediation.

Decision

The Court started by noting that the Claimant had clearly been unsuccessful in his claims and that CPR 44.2 prescribed that he should therefore be ordered to pay the costs of the Defendants unless there was a good reason to the contrary. It found, however, that such a good reason existed with respect to the First Defendant's costs in light of its conduct in the case.

The Court observed that the First Defendant had repeatedly – and at different stages of the proceedings – refused to participate in mediation and that its explanations for the failure to engage in ADR were unsatisfactory. The Court also noted that the First Defendant's conduct prior to the issue of proceedings had deprived the parties of the opportunity to fully canvas their cases and engage with the underlying issues. The Court then considered the *Halsey* criteria that guide whether a refusal to engage in ADR might be considered unreasonable and observed that the factors did not consistently point in the same direction. On the one hand, there was nothing in the dispute that made it unsuitable for mediation, the cost of ADR would not have been disproportionately high, and any delay in setting up the mediation would not have been prejudicial. On the other hand, however, the First Defendant did attempt other settlement methods by making the without prejudice offer. On balance, the Court decided that the refusal to mediate by the First Defendant had been unreasonable.

Accordingly, the Court contended that the First Defendant should be deprived of a substantial proportion of its cost, at least for the period until it made a settlement offer in February 2019. It therefore disallowed 50% of the First Defendant's costs for the period between the initial refusal to mediate on 11 November 2016 and the without prejudice offer by the First Defendant on 14 February 2019. However, because the Claimant had not responded to this without prejudice offer, the Claimant was liable for the whole of the First Defendant's costs between 14 February 2019 and 17 June 2019. As the First Defendant again refused to engage in mediation in the week commencing 17 June 2019, 20% of its costs were disallowed from that date onwards. This percentage was different from the initial 50% reduction to reflect that the Defendants had a stronger defence by that point in time and that the First Defendant had offered to settle the proceedings in February 2019.

With respect to the Second Defendant, the Court ruled that it had reasonably taken the view that the prospect of achieving a successful mediation would be unlikely without the participation of the First defendant. The Court therefore did not reduce the recoverable costs by the Second Defendant on this basis, though it did do so on other grounds.

Comment

These cases show that a party refusing to engage in ADR on the basis of a belief in the strength of its own case has to satisfy a high bar to succeed on this argument. Such refusal may carry with it considerable cost consequences.

In light of the current strain on judicial resources, it is expected that the courts will be even more robust in their exercise of the power to sanction parties who do not sufficiently explore settlement opportunities going forward. These decisions are further examples of a trend towards courts giving less weight to the 'merits of the case' as one of the factors taken into account when deciding whether a party was acting unreasonably in refusing to engage in ADR.

Additional references

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

Northrop Grumman Mission Systems Europe Ltd v BAE Systems Ltd [2014] EWHC 3148 (TCC)

The Singapore Convention on Mediated Settlement Agreements

12 September 2020

12 September 2020 was an important day for international dispute resolution as the Singapore Mediation Convention came into force, just over a year after its signing ceremony on 7 August 2019.

Background

More formally known as the United Nations Convention on International Settlement Agreements Resulting from Mediation, the new Convention aims to establish a global enforcement regime for settlement agreements resulting from mediation of international commercial disputes, broadly akin to the 1958 New York Convention for the enforcement of arbitral awards.

To date, a total of 53 states have signed the Convention and 5 states have either ratified (Singapore, Fiji, Qatar and Saudi Arabia) or approved (Belarus). However, a key feature of the Convention that has not been widely appreciated is that it will apply to mediations conducted anywhere in the world, not just within jurisdictions that have ratified it. Any jurisdiction that ratifies/approves the Convention agrees to enforce any mediated settlement agreement covered by the Convention, regardless of where the mediation was conducted. Accordingly, the fact that it has not yet been signed by the UK or the EU does not mean that it cannot be relied on to enforce settlements resulting from mediations held in those jurisdictions.

Of course, at this early stage, the Convention can only be relied on to facilitate enforcement in the current member states. However, given that 48 other countries have already taken the first step of signing the Convention, it seems likely that this list could soon increase substantially. And the fact that those countries include the world's three largest economies – China, the US and India – bodes well for the Convention becoming an important element of the global dispute resolution landscape.

The Convention stems from a concern that the use of mediation to resolve international disputes has been impeded by the fact that, unless a settlement reached via mediation is in the context of a pending arbitration and can be converted into an arbitral award, parties could only enforce it in the same way as any other contract. That would usually involve bringing fresh proceedings for breach of contract. In an international context, this could involve potentially difficult (and usually lengthy) processes to obtain a court judgment and then enforce it in a foreign jurisdiction.

Comment

It is important to note that, in practice, enforcement of mediated settlements is in fact rarely an issue (at least compared to litigation and arbitration), given that both the decision to mediate and the agreed resolution are voluntary, rather than imposed upon the parties. Having negotiated and documented a resolution through a formal process, commercial parties do for the most part tend to stick to it. Nevertheless, it had become clear in recent years that the lack of a formal enforcement process could account for at least some of the patchiness with which mediation has been embraced across different jurisdictions globally. This is supported by our own analysis of the data collected at the recent Global Pound Conference series. That project sought the views of thousands of dispute resolution stakeholders across the globe on various issues, including as to what would most improve commercial dispute resolution. Particularly in Asian jurisdictions, nearly two thirds of respondents said that what would be of most benefit would be legislation to aid enforcement of settlement agreements. In other regions, this was seen as less pressing than other factors but still received substantial support. The new Convention directly meets this call for regulation and certainty.

Mediation is a well-known form of alternative dispute resolution which is regularly used by policyholders and insurers in the London market and internationally. The Convention will provide an added layer of certainty regarding the enforcement of mediated settlement agreements around the world and we look forward to seeing more states sign and ratify these new arrangements.

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