INSURANCE AND CORPORATE FRAUD, WITH EMPHASIS ON ISSUES ARISING IN RELATION TO PROFESSIONAL INDEMNITY COVER

Nicholas Briggs, Guildhall Chambers
Simon Chandler, RPC

Applicable principles of construction in respect of an aggregation clause in a contract of insurance.

1. This paper accompanies the slides and talk that will be given at the Guildhall Chambers Commercial seminar. The focus of the talk will be on fraud and how dishonesty can risk the withdrawal of insurance cover. The first 15 minutes is to be viewed as an introduction to the subject, considers aggregation clauses and the principles of interpretation.

2. A definition of a contract of insurance is perhaps not too difficult a task, but to define it with accuracy is not easy. In the Centenary Edition of MacGillivray on Insurance the first page reads:

   "A satisfactory definition of "contract of insurance" is elusive.....the complex system of supervision and regulation created by the Financial Services Markets Act 2000 applies to specified 'regulated activities'. These include effecting and carrying out, as principal, a contract of insurance. Article 3 states that 'contract of insurance' where referred to in the Order means any contract of insurance which is either a contract of long-term insurance or a contract of general insurance falling inside the classes of actual or deemed insurance business listed in Schedule 1 to the Order, but does not provide criteria for determining whether a particular contract is one of insurance in the first place and so qualifying for inclusion in the Schedule." However some features of a contract of insurance are possible to ascertain.

3. The essential features of an insurance contract are as follows:

   a) that a sum of money will be paid by the insurers on the happening of a specified event;

   b) there must be uncertainty as to the happening of the event;

   c) the uncertainty may be as to whether it will happen or not, or, if it is bound to happen, like the death of a human being, as to the time at which it will happen.

4. There must also be an insurable interest in the insured, which is normally that the event is one which is on the face of it adverse to his interest.

5. The issue of what principles are applicable to the interpretation of a contract of insurance is now settled. In 1803 Lord Ellenborough CJ said in *Robertson v French* (1803) 4 East 135:

   > "The same rule of construction which applies to all other instruments applies equally to this instrument of a policy of insurance *viz*, that it is to be construed according to its sense and meaning, as collected from the terms used in it, which terms are themselves to be understood in their plain, ordinary and popular sense, unless they have generally in respect to the subject matter, as by the known usage of trade or the like, acquired a peculiar sense distinct from the popular sense of the same words; or unless the context evidently points out that they must...be understood in some other special and peculiar sense."

6. Accordingly an insurance contract is a private commercial contract which is subject to the same rules of construction as other commercial contracts. This was reinforced by the Court of Appeal in the 1970s. In September 1970 German sellers agreed to sell to Dutch buyers 12,000 tons of U.S. citrus pulp pellets c.i.f. for use as animal feed. The contracts incorporated the trade association term "shipment to be made in good condition." Following the buyers' payment of the price of some £100,000 and receipt of the shipping documents, a shipment on the *Hansa Nord*, with 1,260 tons of pellets in no. 1 hold and 2,053 tons in no. 2 hold, arrived in Rotterdam on May 21, 1970, by which time the market price of citrus pulp pellets had fallen. On May 22 discharge of the pellets into lighters commenced. Much of the cargo in no. 1 hold was found to be damaged while the goods in no. 2 hold were in substantially good condition. On May 24 the buyers rejected the whole

cargo from both holds and claimed repayment of the price on the ground that the shipment was not in good condition. The sellers rejected the claim. In arbitration proceedings in London the board of appeal of the trade association held that not all the goods in no. 1 hold were shipped in good condition, that though they were "merchantable" in a commercial sense on arrival in Rotterdam they were not of "merchantable quality" within the meaning of the Sale of Goods Act 1893 and that the buyers were entitled to reject the whole cargo. Mocatta J. on a case stated upheld the board's award in the buyers' favour holding that the term for "shipment to be made in good condition" was a condition of the contract, breach of which justified rejection and that the sellers were also in breach of the implied condition of "merchantable quality" in section 14 (2) of the Sale of Goods Act 1893.

7. The matter went to the Court of Appeal and is cited as *Cehave NV v Bremen Handelsgesellschaft mbH, The Hansa Nord* [1976] QB 44. It is the judgment of Roskill L.J that set down the marker as to the applicable principles of construction. He said at p71:

> "In principle it is not easy to see why the law relating to contracts for the sale of goods should be different from the law relating to the performance of other contractual obligations, whether charterparties or other types of contract. Sale of goods law is but one branch of the general law of contract. It is desirable that the same legal principles should apply to the law of contract as a whole and that different legal principles should not apply to different branches of that law."

8. As a result it was permissible, contrary to the judge's view, to apply the *Hongkong Fir Shipping Co. case* [1962] 2 Q.B. 26 principles to the construction of this contract. Having decided that the Court of Appeal went on to find that the term "shipment to be made in good condition" was not a "condition" any breach of which entitled the buyers to reject the goods but an intermediate stipulation which gave no right to reject unless the breach went to the root of the contract, and the court was not precluded from reaching this conclusion by section 11(1)(b) of the Sale of Goods Act 1893. Since the whole cargo was used for its intended purpose as animal feed, the breach did not go to the root of the contract. Damages could be awarded.

9. The reluctance of the courts to treat contractual situations differently in terms of construction principles is evident. However these principles are subject to the special principles of good faith which have a universal application to all insurance contracts.

10. Having established that apart from the regulatory matters, and the overriding application of good faith principles, ordinary construction of contract principles apply to the interpretation of a contract of insurance, it would be natural to lead into a discussion of those principles. However this short paper does not intend to go into the complex world of construction of contracts in which there are at least two leading text books (see Gerard McMeel's 'The Construction of Contracts' and "The Interpretation of Contracts" by Lewison) but it is worth mentioning the leading case of *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 where Lord Hoffmann set out what is now the starting point for disputes about contractual interpretation:

    a) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

    b) The background was famously referred to by Lord Wilberforce as the 'matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

    c) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in

ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

d) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] 2 WLR 945.

e) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229 at 233, [1985] AC 191 at 201:

> '… if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'

11. To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties' intentions the court does not of course inquire into the parties' subjective states of mind but makes an objective judgment based on the materials already identified.

12. In his 5th edition of Interpretation of Contracts Lewison says that "the lazy reader may stop here." He says so as the above summarises the principles applicable to the construction of all contracts.

13. For completeness, however, recent cases of importance in this field include *Mannai* [1997] AC 749, BCCI v Ali [2002] 1AC 251; *Chartbrook* [2009] 1AC 1101; *Rainy Sky* [2012] BUS LR 313 and *Cherrytree Finance* [2012] EWCA Civ 736.

14. That said, where the meaning of words used previously has been settled by courts a degree of standardisation can take place so as to provide legal certainty in the industry. But this should not be overstated as context is always important.

Aggregation clauses

15. The above principles are essential when considering aggregation clauses. However in *Lloyds TSB General Insurance Holdings Limited and others v Lloyds Bank Group Insurance Co Ltd* [2003] UKHL 48 Lord Hobhouse thought that aggregation clauses require a 'construction which is not influenced by any need to protect the one party or the other." – see paragraph 30. It is doubtful whether this observation adds anything to the guiding principles set out above.

16. Most contracts of insurance contain an aggregation clause. The intention behind such a clause is to enable two or more separate losses to be treated as a single loss for the purpose of a deductible or limit. In order for aggregation to be effective the claims have to be linked by a contractually defined unifying factor.

17. In *Lloyds TSB General Insurance Holdings v Lloyds Bank Group Insurance Co Ltd* [2003] UK HL 48; [2004] 4 All ER 43 there had been a number of claims made against the Claimants for mis-selling personal pension schemes. There was a breach of the statutory code that gave rise to a

cause of action. There were 22,000 claims for mis-selling but none of the claims were for more than £35,000. Nevertheless the total paid out by the Claimants exceeded £125m. The Claimants held an insurance policy with the Defendant insurers which included an indemnity in respect of their legal liabilities to third parties for third party claims. The mis-selling claims fell within the terms of the policy but the policy covered only the part of each and every third party claim which exceeded the deductible amount of £1m. However an aggregation clause provided that if a series of third party claims resulted from 'any single act or omission (or related series of acts or omissions)' then all such claims were to be considered to be a single third party claim for the purposes of the application of the deductible. It was therefore critical to both parties to determine whether the mis-selling claims resulted from a 'single act or omission' by the Claimants, their officers or employees; and or a 'related series of acts or omissions' by the same persons. If the mis-selling claims were to be treated as such and therefore aggregated, then there would be a single claim which would be subject to a single deductible.

18. The House of Lords found that the scope of aggregation depended on the nature of the act or event treated as a unifying factor, so that the choice of language used was critical. It was held that a failure to train a sales force properly could not be the basis for aggregation. The language in the policy was too remote to have been intended as a unifying factor and the failure did not come within the term 'series of acts or omissions'. Lord Hoffmann said (paragraph 23):

> "The language of the aggregation clause, read with the definition of 'act or omission' shows that the insurers were not willing to accept as a unifying factor a common cause more remote than the act or omission which actually constituted the cause of action. An act or omission could qualify as a unifying factor in respect of more than one loss only if it gave rise to civil liability in respect of both losses. In the present case, the act or omission which gave rise to the civil liability in respect of each claim (failure to give best advice to that investor) was different from the acts or omissions giving rise to the other claims."

19. The nature of unifying events may be implied from the general context but express language may make such an implication unnecessary or even impermissible. Lord Hobhouse also observed (in the Lloyds case) that a 'single act or omission' must be the proximate cause of the financial loss caused to the third parties. He envisaged how a 'single act or omission' could arise on the facts of the pension mis-selling case: "One can visualise how this might happen when a 'consultant' to makes a single presentation to a room-full of people to persuade them to sign up to a pension scheme sold by his employer…".

20. A similar issue arose recently in *Standard Life Assurance Limited v ACE European Group* [2012] EWHC 104 Comm where Standard Life claimed under its professional insurance for about £100m spent to mitigate risk of anticipated claims arising from the mis-selling of one of its pension funds. The fund had been marketed as a temporary home for short term funds, with the suggestion in some literature that it was the equivalent of putting money on deposit. In fact the fund's assets included a substantial proportion of asset backed securities which became increasingly illiquid following the collapse of Lehman Brothers in 2008.

21. There was a deductible of £10m in respect of a single claim. A single claim was defined as:

> "all claims or series of claims (whether by one or more than one claimant) arising from or in connection with or attributable to any one act, error, omission or originating cause or source, or the dishonesty of any one person or group of persons acting together"

22. This is a very different aggregation clause to the clause in the Lloyds case. The term 'in connection with' meant that all that was required was a unifying factor and a connection between the claims. The word 'originating' is said to permit 'the widest possible search for a unifying factor in the history of the losses which it is sought to aggregate": see *Axa Reinsurance v Field* [1996] 3 All ER 517. The literature advertising or representing that the fund was a safe investment was a continuing state of affairs and constituted a unifying factor. Standard Life was therefore able to claim aggregation and as a result only had to bear one deductible. There is a lot at stake and permission to appeal has been given.

23. The talk will now turn to minimum terms of aggregation wording and the effect on different fraud models.

Nicholas Briggs, Guildhall Chambers
Simon Chandler, RPC
November 2012