PROFESSIONAL INDEMNITY CONFERENCE

Notification, Allocation and Aggregation

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The Problems

- When circumstances are notified under a "deeming" clause in a "claims made" wording and these are disputed by insurers
- When a claim is notified under a "claims made" policy what is the extent of the notification where subsequent losses are discovered
- Interpretation of the "nexus" clause – when a claim or claims are made the number involved for the purpose of limits and deductibles
  - "Event"
  - "Occurrence"
  - "Cause"
- Where insurance and reinsurance have different "nexus" clauses

A Variety of Circumstances

Usually a Condition Precedent – the implications

Might reasonably be expected

“circumstances which might reasonably be expected to produce a Claim against the Insured or loss irrespective of the Insured’s views as to the validity of such Claim or on receiving information of such a Claim for which there may be liability under this Insurance”

Likely

Circumstances “likely to give rise to a claim”

50% chance of a claim ensuing - *Layher Ltd v Lowe* (2000)

A Variety of Circumstances

May or might

“in the case of notification of a circumstance supply full particulars including all material facts, dates and persons involved and the reasons for anticipating that it is by definition a circumstance

Circumstance (shall mean) incident, occurrence, fact, matter, act or omission that may give rise to a claim”

“*the test for materiality for notice is a weak one*” - *Rothschild v Collyear (1988)*

“*fairly loose and undemanding” - Kidsons v Lloyd’s Underwriters (2008)*

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Circumstances – the major professions

SRA Minimum Terms and Conditions:

"*circumstances means an incident, occurrence, fact, matter, act or omission which may give rise to a claim in respect of civil liability*"

RICS Policy Wording:

"*Circumstance(s) Shall mean an incident …omission that might give rise to a Claim*"

ICAEW Minimum Approved Policy Wording - "*any circumstance which may give rise to a loss or Claim*"

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BNP Mortgages Ltd v Page & Wells and Sun Alliance & London (1994)

- Policy Period - 14 May 1991 to 13 May 1992 (later extended to 20 May 1992)
- 27 April 1992, Insured notified that Bass interviewed by Fraud Squad re fraudulent overvaluations
- Notified list of properties, including Bonbini, surveyed by Bass in accordance with the deeming clause
- Sun Alliance refused to accept the list as a valid notification – contended that there had to be notification of circumstances which might reasonably be expected to produce a particular claim
- Declined to renew
- Shortly after expiry of the policy period, a claim made against Insured in respect of Bass' valuation of Bonbini

BNP Mortgages Ltd v Page & Wells and Sun Alliance & London (1994)

- *The Insured shall give written notice to the company (regardless of the Insured's contribution) as soon as possible after becoming aware of* ***circumstances which might reasonably be expected to produce a claim*** *irrespective of the Insured's views as to the validity of the claim or on receiving information of a claim for which there may be a liability under this insurance. Any claim arising from such circumstances shall be deemed to have been made in the period of insurance in which such notice has been given.*

Rothschild v Collyear (1998)

- First Pensions mis-selling case
- Lautro (the Life Assurance and Unit Trust Regulatory Organisation) wrote to their members to say that a KPMG report disclosed a "problem which needs to be tackled" regarding non-compliance in the selling of pensions in cases, known as "transfers" and "opt-outs"
- 27 January 1994, a few days before the expiry of the policy year, Rothschild's solicitors gave notice by reference to the Lautro letter and the KPMG report of circumstances "which may give rise to a claim" against insured
- Insurers disputed that that was a valid notice on the basis that no criticism had been levelled against insured, and no cause for concern specific to any of their investors had been identified

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Rothschild v Collyear (1998)

- *Where a prediction based not only on objective evidence which has itself been under scrutiny by independent professionals, but also on the concern of regulatory authorities, turns out to have been entirely justified by events, it seems to me to be unrealistic to say that that prediction was invalid and unjustified merely because there was much other evidence which was not yet to hand, even though that evidence was of particular relevance to an important aspect of the prediction. This must be a fortiori the case where the prediction has to be not of what will be but only of what might be* (Rix J)

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Kidsons v Lloyd's Underwriters (2008)

- Torrance to Kidsons NEC
- *"recipe for disaster"…"DOS, SHEP Selling, the CRC Scheme and the Conditional Share Award scheme…all represent unacceptable tax avoidance…It represents an assault on the Treasury…"*

***Kidsons* - the notification**

"A tax manager in Edinburgh, Iain Torrance, has expressed the view that the Inland Revenue, if minded, could be critical of some procedures followed in certain cases. The Board of S@FI and the National Executive Committee of HLBK intend to investigate this view fully and have approached Ray Armstrong, who I gather has been a senior Inland Revenue official and has retired as a partner in PWC, to invite him to carry out the investigation and submit a report. The Board has taken the view that this might be regarded as material information for insurers. There is no sign of a claim arising at the present time but the Board feels that it is appropriate in the circumstances to advise what is happening and to take your instructions."

***Kidsons* - Deeming Clause**

- "*the Assured shall give to the Underwriters notice in writing as soon as practicable of any circumstance of which they shall become aware during the [Policy period]…which may give rise to a claim or loss against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after the expiration of the [Policy period] shall be deemed for the purpose of this Insurance to have been made during the subsistence thereof.*"

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Kidsons v Lloyd's Underwriters (2008)

"*Are such circumstances such that they "may give rise to a loss or claim against them"? The latter question is an objective one; the insured may have his own views about the complaint, but the question has to be looked at objectively. In the present case, however, the problem which arose was internal, generated by the views of Mr Torrance. Normally the subjective personal views of an insured about the nature of a risk which he presents to underwriters for cover are irrelevant: provided, of course, that all material information is fairly presented, it is for the insurer to rate the risk, not for the assured. Mr Torrance, moreover, was only an employee: he was not a member of the firm.*

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McManus Seddon Runhams and others v European Risk Insurance (2013)

- McManus Seddon took over work and goodwill of Runhams in June 2011
- Runhams had taken over Sekhon Firth in October 2010
- MS were the successor practice as far as insuring risk of claims against Sekhon Firth
- April 2011 – 3 former members of SF subject to proceedings before the Solicitors Disciplinary Tribunal
- ERIC were insurers from 1st October 2011
- Nov 2011 – May 2012 17 claims were made relating to SF work
- Review carried out by MSR and independent regulatory consultancy – *"it is clear that the review has revealed to date a consistent pattern of breaches"*

Notification Clause

The insured will give notice in writing to the Insurer, as soon as reasonably practicable of any;

(a) claim first made against any Insured during the period of insurance; or

(b) circumstances of which any Insured first becomes aware during the period of insurance;

(c) investigation, inquiry or disciplinary proceeding during or after the period insurance arising from circumstances first notified to the Insurer during the period of insurance.

Circumstances means an incident, occurrence, fact, matter, act or omission which may give rise to a claim in respect of civil liability.

Notification and Rejection

"The conclusion my partners and I come to, which is the inevitable conclusion one must come to is that every file conducted by Sekhon & Firth and Runhams LLP … contains or is more likely than not to contain examples of malpractice negligence and breach of contract and so each and every file of the predecessor firms … should properly be notified to you as individually containing shortcomings …."

"The list of matters contained in the List and the Spreadsheet do not amount to valid Circumstances as you have not [identified] the specific incident, occurrence, fact, matter, act or omission which would give rise to a Claim on each individual file. Simply stating that Sekhon & Firth worked on the files in the List and Spreadsheet does not constitute a valid notification, and as such, the notifications are firmly rejected in their entirety and without question. "The files highlighted in the Corry (sic) report are specific and the problems on each have been highlighted. However, Insurers expressly reserve their rights in relation to those matters."

McManus Seddon Runhams and others v European Risk Insurance (2013)

- As regarding circumstances the judge followed the decisions in Rothschild and Kidsons
- The "blanket" notification could not be declined by the Insurer, although the insured did not obtain the declaratory relief they sought

Deeming Clause Conclusions

- The requirement to notify circumstances should be related to the duty to disclose material facts [1998] first instance
- Insurer should accept circumstances which would be excluded by renewal insurer - (*anything which would fall within the duty of disclosure on renewal constitutes a "circumstance*" - Rothschild Assurance plc v Collyear)
- Wording should be on a "may" or "might" basis
- Insureds should be required to notify and there should be a condition (precedent) to do so
- Subjective and objective circumstances should be notified and accepted
- Wording should make clear that no specific claim need be apparent
- Onus on insurer to show why circumstances should not be accepted

Growing Claims

- The original notification is (apparently) specific in the claim being made by the claimant or circumstances notified by Insured
- Subsequently the claim turns out to be more and the cause of the claim also applies to subsequent damage
- Investigation of the claim gives rise to the discovery of further damage

Thorman v New Hampshire Insurance Co. and Home Insurance Co. (1987).

- PI Cover under a scheme with New Hampshire up to 30th September 1983
- Transferred to Home insurance Co. from 1st October
- Development was completed in February 1977. In 1978 and 1979 the owners notified NH that remedial works to brickwork were required
- May 1982 further problems were notified and a writ was issued which in general terms alleged breaches of professional duty
- 29 June 1982 the solicitors for the building owners wrote to the Insured seeking arbitration. This read: "*Serious problems have arisen in this development, inter alia, with regard to cracking and defective brickwork, for which we hold you responsible.*"
- January 1984 - detailed statement of claim made up of 8 items - 3 related to defective brickwork, others to defective foundations, windows and roof
- NH claimed they were only on cover for the brickwork

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Claims Made – Extent of Notification

- *Thorman v New Hampshire Insurance Co.* (1987)
  - *"A single complaint that they suffered from a wide range of unrelated defects and a demand for compensation would, I think, be regarded as a single claim. But if the defects manifested themselves seriatim and each gave rise to a separate complaint, what then? They might be regarded as separate claims. Alternatively, later complaints could be regarded as enlargements of the original claim that the architect had been professionally negligent in his execution of the contract. It would, I think, very much depend upon the facts."* (Lord Donaldson)

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Claims Made – Extent of Notification

- *Hamptons Residential Limited v Field* (1998)
- Unqualified employee carried out valuations for two mortgage lenders and engaged in a mortgage fraud
- In 1989 one of the lenders notified a possible claim arising from the employee's activities – accepted by insurers
- The following year, the other lender brought claims against Hamptons
- The insurers contended that only the claims by the first lender were covered by the 1989 notification
- Insured entitled to cover in respect of all fraudulent acts of the employee

Kajima UK Engineering Limited v The Underwriter Insurance Co Ltd (2008)

- Notification 22nd Feb 2001
- *Accommodation pods settling and moving excessively; causing adjoining Roofing and Balconies and Walkways to distort under differential settlement. Service connections also under risk from movement; Potential Internal damage; Tennant [sic] Risk/Danger, and or Inconvenience*"
- This led to investigation which discovered further damage some related to notification, some not
- *not a "hornet's nest" or "can of worms" set of circumstances*
- *Notifications to be interpreted objectively having regard to factual context*
- Continuum argument not accepted

Claims Made Notifications

- Wordings are not clear as to what a notification of a claim should include and how specific it needs to be
- There needs to be a thorough understanding as to what is being claimed
- It is possible to notify (and to accept) a "can of worms"

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The Disputed Nexus - Number of Claims

- *Cox v Bankside*
- *Caudle v Sharp (1995)*
- *AXA v Field (1996)*
- *Lloyds TSB v Lloyds Bank Group Insurance and Abbey National plc v Lee (2003)*
- *Standard Life Assurance Company v Oak Dedicated Ltd & Others and Standard Life Assurance Company v Aon Limited (2008)*

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"Events, dear boy, events"

- A constant source of dispute in reinsurance treaties
- By using the word "event" property reinsurers and reinsured clearly mean the treaty to provide wider coverage than a "per policy" or " per claim" cover
- Not clear how "event" applies to liability business
- *Among players in the reinsurance market keen interest is shown … in the techniques of limits, layers and aggregations* (Lord Musthill – Axa v Field)
- *The choice of language by which the parties designate the unifying factor in an aggregation clause is thus of critical importance and can be expected to be the subject of careful negotiation* (Lord Hoffman – Lloyds TSB)
- What is an "event" and what is an "originating cause"?
- Litigation arising from Lloyd's losses 1988-92 "clarified" the meanings to the extent the same mistakes were made again

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Cox v Bankside (1995)

- In *Deeny v Gooda Walker* (1994) a managing and members' agents were liable for damages calculated as if underwriting had been competently performed – specifically if adequate reinsurance had been in place
- In *Cox v Bankside* the court decided there were three underwriters, therefore three "originating causes" for the purpose of claims against reinsurers.
- The three underwriters had been negligent in specifically different ways
  - "underwriting without rating the business properly"
  - "underwriting without monitoring aggregates, competently estimating his exposure, or having a proper appreciation of the excess of loss business
  - underwriting without calculating PML's or placing adequate reinsurance" and "on a basis that was bound to result in a loss to his names".

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Caudle v Sharp (1995)

- Feb 1980 – October 1982 Outhwaite underwrote 32 separate run-off contracts unlimited in time or amount relating to asbestosis and pollution risks – a disaster referred to as his "blind spot"
- Names brought action against Outhwaite Managing Agency and Members Agencies who placed names on the syndicate
- Settlement was agreed at £116m - Sharpe paid £7,375,000
- There were claims notified by the managing agency in 1995 and by members agencies in 1997

Caudle v Sharp (1995)

- Sharp was reinsured under 4 excess of loss treaties
- *"For the purposes of this reinsurance the term "each and every loss" shall be understood to mean each and every loss and/or occurrence and/or catastrophe and/or disaster and/or calamity and/or series of losses and/or occurrences and/or catastrophes and/or disasters and/or calamities arising out of one event."*
- Sharp wanted to aggregate the losses from the Managing Agency and Members Agents for the purpose of his claim against reinsurers
- He argued the losses were due to one event - Outhwaite's Blind Spot

Caudle v Sharp (1995)

- The Court of Appeal held that there was no justification for reading the clause as extending the reinsurance cover to bring within its scope losses discovered by, or claims made against, different original insureds after the reinsurance had expired.
- Outhwaite incident was an event in the history of Lloyd's but for the purposes of the contract there were 32 events
- Defined "event" as having three requirements:-

  (1) a common factor which can properly be described as an event

  (2) that factor must satisfy the test of causation; the relevant clause required losses to "arise out of" a single event

  (3) that factor must not be too remote for the purposes of the clause

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Axa Reinsurance v Field (1996)

- *Clauses in such contracts should not be interpreted in the manner of a philologist or a pedant. Until the recent disasters, litigation under reinsurance contracts was very rare and it may be that in the absence of the rigorous scrutiny which has been given to many years to the terms of marine, fire and other forms of insurance, the wording of reinsurance contracts has continued to be more lax than was healthy. But it is quite another matter to equate poor drafting with poor thinking, ample enough as the latter may have been during the abnormal conditions of the past twenty years.*

(Lord Musthill)

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Axa Reinsurance v Field (1996)

- Reinsurers liability to E & O insurers of Gooda Walker
- Should "one event" in the reinsurance contract be interpreted in the same way as "one originating cause" in the original policy.
- *"In ordinary speech, an event is something which happens at a particular time, at a particular place, in a particular way"*
- *"A cause is to my mind something altogether less constricted. It can be a continuing state of affairs; it can be the absence of something happening. Equally the word "originating" was in my view consciously chosen to open up the widest possible search for a unifying factor in the history of the losses which it is sought to aggregate."*

Lloyds TSB General Insurance Holdings v Lloyds Bank (2003)

- Mis-selling of personal pensions in breach of LAUTRO Rules
- 22,000 Claims totalled £125 million
- Largest individual claim £35,000
- Deductible: £1million *"… each and every claim"*
- *"If a series of third party claims shall result from any single act or omission (or related series of acts or omissions) then, irrespective of the total number of claims, all such third party claims shall be considered to be a single third party claim for the purposes of the application of the deductible."*
- 1 claim for failure to train and monitor salesmen or 22,000 claims each time there was a breach

Lloyds TSB General Insurance Holdings v Lloyds Bank (2003)

"the absence of a training or monitoring system, even though an independent breach of the rules, was legally irrelevant to the civil liability of the TSB companies. Even without any such system, they would not have been liable unless their representatives actually contravened the Code. Likewise, any such contravention would have given rise to liability whether they had a training and monitoring system or not. It cannot therefore have been an act or omission from which liability resulted."

Lloyds TSB General Insurance Holdings v Lloyds Bank (2003)

- *(or related series of acts or omissions)*

It can only mean that the acts or events form a related series if they together resulted in each of the claims. In this way, the parenthesis plays a proper subordinate role of covering the case in which liability under each of the aggregated claims cannot be attributed to a single act or omission but can be attributed to the same acts or omissions acting in combination.

And so it goes on

- *Andrew Brown and others v InnovatorOne Plc and others (2012)*
- Inconsistent aggregation provisions in primary and excess layers of cover
- Action against insurers and brokers

Law Society Minimum Wording

(a) All claims against any one or more Insured arising from:
- *one act or omission*
- *one series of related acts or omissions*
- *the same act or omission in a series of related matters or transactions*
- *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."

Willmett Solicitors

- *Godiva Mortgage Limited v Travelers Insurance Company Limited*
- A partner involved in a number of fraudulent property transactions
- The firm is now in liquidation
- Over £50,000,000 claims
- Limit on PI policy £2,000,000 each claim
- Insurers argue that there is "one claim" - pursuant to the Minimum Terms and Conditions required by the Solicitors' Indemnity Rules 2008, all claims should be aggregated on the basis of the similarity of the acts or omissions involved in a series of transactions; or alternatively, that all claims with the same or related clients should be aggregated
- SRA and Law Society given right to intervene

Conclusion

- During the "careful negotiation" it might be a good idea to illustrate what the parties see as potential claims scenarios and establish how coverage applies