

Insurance & Reinsurance Law Update



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Inducement

A real and substantial cause

Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland Plc

Commercial Court Christopher Clarke J

In the course of giving judgment in a heavy banking dispute, Mr Justice Christopher Clarke paused to consider, in some detail, what is meant by inducement. Since inducement is a key element which an insurer must prove to justify an avoidance for breach of the duty of good faith at placement, that discussion, focussed on what the party alleging misrepresentation must actually show, makes this an important case.

It was, his Lordship found, already recognised in ordinary contract law that the misrepresentation need not be the sole reason for deciding to contract, but it had to play a real and substantial part in the decision taken; it was not enough to show that it merely supported a decision which would have been made anyway. What, then, did “a real and substantial part” actually mean? Clarke J considered the representation must be causative of the decision, and that involves the “but for” test. If the representee would have made the same contract for other reasons than that is not fulfilled. What, he next asked, does “but for” mean in the context of representations? Does one ask what would have happened if no representation was made? Or does one ask what would have happened had the truth been told? Clarke J indicated, “*The relevant test is what would have been done in the absence of the misstatement and a relevant question is what would the representee have done if given sufficient information to dispel its inaccuracy?*”

Of course, in an insurance contract law context, the duty to disclose may make the insurer’s reaction to the truth relevant in any event. If I claim an excellent loss record when the truth is that my record is very poor, I conceal the latter by representing the former. But for the purpose of proving inducement, the truth must still be that there is something unattractive about the risk. As the next case shows, the Courts are taking the view that the insurer still has to prove that being told the truth would have made a difference.

Focus on the facts

Synergy Health (UK) v CGU Insurance Plc

Commercial Court Flaux J

Here, Synergy claimed against CGU for material damage and business interruption losses following a fire. CGU avoided for material misrepresentation on the basis of a letter written by Synergy’s Operations Director on 8 December 2005 which stated, “*Intruder Alarm. This will be completed by end December.*” The letter, dated 13 December, was forwarded by brokers to the underwriting agent on 28 December. In fact, due to a “*comedy of errors*” on Synergy’s part, nothing had been done to put installation of the alarm in hand and it was still not installed by inception, many weeks later.

Synergy argued that the statement was not one of fact but a representation as to expectation and belief about the future. Section 20 of the Marine Insurance Act 1906 provides that such a representation is true if made in good faith. Here it was not alleged that the Director had acted in bad faith and his own evidence was that the statement reflected his honest expectation as to what would happen. However, Mr Justice Flaux rejected this analysis. The question of whether there was a misrepresentation was to be judged not at the date the letter was written but when the representation was made to CGU, 20 days later. It was impossible, he felt, to construe the words as a statement of future intention on that date; with only two working days left until the end of the month the implication was that the work was under way and about to be completed. Accordingly there was a misrepresentation on 28 December. In short, CGU was told, “*We are installing an alarm*” when what it should have been told was, “*We would be installing an alarm, except we are rather disorganised.*”

Proving the misrepresentation is only the first step; the second essential step is to prove the underwriter was induced to enter into the contract by the alleged misrepresentation(s). This is where CGU’s case came unstuck. If reliance is placed on a misstatement, one way to assess its effect is to ask what the underwriter would have done had the misstatement been corrected so that he had an accurate picture at placement. In his witness statement the underwriter focussed on the wrong factual assumptions. He certainly explained what his reaction would have been if told the non-installation was beyond Synergy’s control, which was to be reasonably understanding. He

also explained what his attitude would have been had the non-installation arisen from Synergy's unwillingness to spend what needed to be spent. There he would have been much firmer. But neither of those was relevant; what his statement did not deal with was how he would have reacted to the true explanation, namely that the failure to install was attributable to Synergy's disorganisation. His oral testimony to fill this gap was that he would have imposed a condition of installation before renewal. That, however, was not borne out when tested against his more lenient prior underwriting practice, when faced with similar issues. Therefore Flaux J found that there had been no inducement.

This is another example of the importance of inducement evidence and of the care with which the courts will approach it; material inaccuracy is not sufficient unless the impact of it can be shown to be significant and the evidence of that is capable of withstanding close scrutiny.

Employers' Liability

Trigger unhappy

Employers' Liability Insurance "Trigger" Litigation

Court of Appeal

The central issue in this litigation revolves around the fact that in cases of the asbestos-triggered and usually fatal disease of mesothelioma, the cause and the sustaining of injury are years apart. Certain run-off insurers raised the question of whether Employers' Liability (EL) policies which refer to "injury sustained" (by an employee) during the policy period are intended to cover the same group of victims as those which refer to "injury caused" (by the employer).

At first instance Burton J equated the wordings, thus a worker exposed to asbestos fibres was covered by the policy in force in the year of exposure (see Update Issue 23). The case has divided the Court of Appeal three ways. Lady Justice Smith endorsed the trial judge's approach. To her mind, the evidence was overwhelming that at the time these policies were purchased, (with one possible exception) the insurance industry saw no distinction between the two types of wording, which were in use throughout the period. The evidence in support of that conclusion seems striking – for example, nowhere is there any inkling that any of the many brokers placing this essential commercial

cover ever discerned a difference between the two formulations. The understanding that the wordings were synonymous was, Smith LJ held, not limited to mesothelioma but one applicable to all types of disease. She acknowledged that reading the policies in this way would distinguish EL insurance from Public Liability (PL) insurance – in the latter context, the Court of Appeal had already ruled in *Bolton v MMI* that a PL policy expressed to cover injury or illness which "occurs during the currency of the policy" had to respond to a mesothelioma injury which became actual in the policy period. In a postscript to his own judgment, Lord Justice Rix observed, commenting on Smith LJ's approach, "the fact that the [two types of policy] were treated the same does not mean that they had the same meaning". As a comment on the fallible use of language, that may be sound. However, if when these policies were in use science had not yet identified the key fact (the complete absence of initial harm) which gives the two formulations different meanings, is it not perhaps anachronistic to assume any difference was apparent at that time?

In contrast, Lord Justice Stanley Burnton rejected Burton J's approach as one "departing from the express provisions without any justification in law", recognising that the effect of his ruling will, in some cases, be to relieve insurers of liability for injuries only diagnosable post-policy. That is not to say that his views are entirely pro-insurer; on the contrary, he took a wider view of the scope of section 1(1) of the Employers Liability Compulsory Insurances Act 1969 so as, in Rix LJ's view, to make it "retrospective in a most serious way." With some hesitation, he also held that policies with "disease contracted" wording were triggered when the employee was exposed to the harmful fibres.

Occupying the middle ground was Rix LJ. In policies using the "disease contracted" wording, he also considered that the moment of inhalation is the "trigger" for coverage. However, he agreed with insurers that "sustain" must be read to mean "sustain [actual] injury", so that policies with that trigger will respond only to actual injury, consistent with *Bolton*. Like Stanley Burnton LJ, his judgment will therefore leave unprotected some mesothelioma sufferers whose employers' EL coverage is no longer in force when the injury first develops.

The 2-1 majority means the original judgment has been cut back, to some extent, by the insurers' appeal. But it is clear that Rix LJ's support for the restrictive view was heavily qualified –

had precedent permitted him, he would have preferred to take the route of respecting what he found to have been the commercial purpose of EL insurance all along – to respond to injury at the time it is caused, rather than on a much later basis. That is the clearest possible signal that he feels constrained by the *Bolton* decision and would, but for it, have upheld the original judgment. Only the Supreme Court can reverse *Bolton*. The saving grace is that its new premises may just be large enough to accommodate the cast of thousands which this litigation seems to require.

Warranties

What's cooking?

Sugar Hut & Ors v Great Lakes Reinsurance & Ors

Commercial Court

Burton J

The Claimants operated four nightclubs, insured against property risks by Great Lakes. Following a fire at one of these they sought indemnity. Great Lakes raised defences of, *inter alia*, breach of warranty and condition precedent.

A “*Frying and Cooking Equipment Warranty*” required ducting to be (1) kept free from contact with combustible materials and (2) “*checked at least once every six months.*” As to the former Mr Justice Burton found this to be a “*true warranty*” with the “*drastic effect*” that breach terminated cover for all four clubs. He rejected the Claimants’ argument that the breach was *de minimis* because the area of contact was ‘only’ 114 square cm out of 15 sqm. There was no authority to show the *de minimis* concept was applicable to breach of warranty in the insurance field, and even if the concept was permitted it could not apply here since the experts accepted that contact area could be the source of a serious fire. As to the ‘checking’ obligation, Burton J was persuaded that it could be construed as a suspensive condition (as in the unsatisfactory *Kler Knitwear* case – see Update Issue 6) rather than as a warranty. It might be thought that splitting a single term into part warranty and part suspensive condition is rather odd when the two limbs are complementary obligations both aimed at the same fire risk. However, even if Burton J was wrong about that, that would not have assisted the Claimants since the inspection had not occurred by the time of the fire. If a loss occurs when a suspensive condition is not being complied with, the insurer is off risk anyway.

Separately, a “*Waste Condition Precedent*” required waste outside the buildings to be stored in (a) non-combustible containers or (b) metal skips. The evidence showed that only metal containers are in fact non-combustible. It was held that this condition precedent was not breached by the use of high density plastic wheelie bins which were susceptible to burning but “*not readily susceptible.*” Burton J reached this conclusion by holding that the clause was ambiguous. If metal was required for option (a) Great Lakes should have said so. Therefore, applying the *contra preferentem* rule, “*non-combustible*” was to be construed against Great Lakes, so as to permit combustible containers (albeit not readily combustible!).

Conditions

Time's up

Swindon Ltd & Anor v Quinn Insurance Ltd

TCC

Edwards-Stuart J

Quinn has been a regular visitor to the courts in recent years; this case, at least, will be one they remember more fondly than others. Lenihan, a building company, was insured by Quinn under a PL policy. In 2006 a fire broke out at premises it was refurbishing. In February 2009 Quinn told Lenihan it would not be offering indemnity due to various breaches of condition. The Claimants, companies affected by the fire, obtained quantified judgments against Lenihan in January 2010. Lenihan went into liquidation the following month and so the Claimants claimed directly against Quinn under the Third Parties (Rights against Insurers) Act 1930.

A General Condition in the policy provided that “*Any dispute between the Insured and the Company on our [Quinn's] liability in respect of a claim or the amount to be paid shall... be referred within nine calendar months of the dispute arising... [failing which] the claim shall be deemed to have been abandoned...*” Relying on the Court of Appeal's decision in *Post Office v Norwich Union*, the Claimants argued that a dispute could not have arisen until Lenihan's liability to them had been established, and that had not occurred until January 2010. Hence, they contended, the deadline had not expired.

Mr Justice Edwards-Stuart was not persuaded, however. He held that, whilst *Post Office* is authority for the proposition that the insured cannot sue the insurer until the insured's

liability has been established, and the amount ascertained, that decision does not prevent the insured from seeking declaratory relief once it can allege that the insurer is in breach of contract. Here Lenihan had made clear that it did consider it was entitled to be indemnified in respect of any liability that it might incur in respect of the fire and it had discovered in February 2009 that Quinn had no intention of paying up. So Lenihan had the right, at that point in time, to refer the dispute with Quinn to arbitration under the General Condition. But that reference had to have been made by November 2009 to comply with the condition. That had not happened and so Edwards-Stuart J held it was no longer open to the Claimants to pursue any claim against Quinn.

Liability Exclusions

A judicial rethink

Omega Proteins Ltd v Aspen Insurance UK Ltd

Commercial Court Christopher Clarke J

A case involving the sale of unsafe meat products has been the unlikely cause of a judicial rethink on quite an important liability policy exclusion. The Aspen policy in question covered a supplier, NC, against liability for damage caused by its products but excluded liability arising under any contract or agreement “*unless such liability would have attached in the absence of such contract or agreement*”. What did that mean, on these quite common facts?

The Claimant, Omega, had successfully sued NC for damage caused by a product supplied by NC, including claims Omega had met from on-purchasers. The only basis of liability which had been alleged by Omega was breach of the sale contract by NC, and judgment was given on that basis. NC went into liquidation without satisfying the judgment and so Omega brought a direct claim against Aspen under the Third Parties (Rights against Insurers) Act 1930.

Aspen argued that the basis of NC’s liability was conclusively determined by the earlier judgment as a liability which attached under the sale contract. Therefore it was not open, Aspen said, for Omega to show for policy claim purposes that NC had been negligent and was therefore liable in tort independently of its liability under contract. In support of this contention, Aspen relied on the decision of Mr Justice Tomlinson in *London Borough of Redbridge v Municipal Mutual*. In that case it was held, *inter alia*, that it would not normally be possible to “*look beyond*

or outside the four corners of the determination itself for the basis of liability to which the insured has become subject” (see Update Issue 8).

Omega argued that *Redbridge* was wrongly decided and should not be followed. Mr Justice Christopher Clarke agreed, noting that as a first instance decision *Redbridge* was not binding on him. He held that while a judgment against an insured establishes a loss, it is not determinative of coverage. It is therefore open to the insurers in a claim under the policy to dispute that the insured was in fact liable or that it was liable on the basis specified in the judgment or to show that the true basis of liability fell within an exception. It is similarly open to the insured to argue that it was liable on a different basis from that specified in the judgment.

As to the burden of proof, he held (*obiter*) that because this was an exclusion clause with a qualification, in order for Aspen to rely on the exclusion it must show that the liability in question arose under a contract and that the qualification was inapplicable. It seems the Court of Appeal concurs with this view as permission to appeal has been refused.

Premium

Risk-free premium? The answer is still No.

Clydesdale Financial Services & Ors v Smailes

Chancery Division David Richards J

Insurance lawyers are divided over the subject of William Murray, Lord Mansfield (1705 – 1793), father of modern English insurance law. Some, such as the Editor, regard him as a commercial judge *par excellence*. Others (including certain reformers) treat him as a dead hand, admiration for whom prevents the subject from evolving in accordance with their expectations. However one feels about Mansfield, his jurisprudence remains persuasive, even in the most unlikely situations. This action concerned a claim by an alleged creditor that the business with which it had been dealing had been sold at an undervalue. The business had been a legal practice and the creditor, Focus, was a litigation expenses insurer. When the former had been solvent, the parties had done business on the basis that Focus provided insurance against the risk that the legal practice could not, if a case it brought was unsuccessful, repay the ‘loan’ taken out for that case from a third party, CFS, to cover certain expenses.

Focus claimed premium was due on 839 such insurances, for which the practice had indeed applied and been granted cover. However, the administrator of the now-insolvent practice produced evidence to show that in 830 of those cases, although insurance had certainly been applied for, no loan had in fact been taken out. Was premium due? Lord Mansfield provided the answer. In *Stevenson v Snow* (1761) he held, “Equity implies a condition that the insurer shall not receive the price of running a risque, if he runs none...If the risque is not run, though it is by the neglect or even the fault of the party insuring, yet the insurer shall not retain the premium.” With no loan received on any of those 830 occasions, no risk was being run, so no premium was due. Will the reform lobby say that was the wrong answer?

Footnotes for Brokers

A more limited retainer

Kam Hing Trading v PICC & MST Hong Kong (MV Worldwide Shanghai)

High Court of Hong Kong

Hon Stone J

Brokers have a duty to advise their clients and can incur liability when steps are not taken to ensure that the client properly understands the effect of particular matters, especially the niceties of insurance (see Updates *passim*). In *Wm Jackson & Sons v Oughtred & Harrison* (see Update Issue 9), Morison J held in robust terms that the broker’s duty to advise was lower where his client had attained a certain level of sophistication. In an equally colourful judgment, the High Court of Hong Kong has now concluded that a broker operating under a limited retainer did not owe a general advisory duty to its client.

Kim Hing Trading, acting through its broker MST Hong Kong, purchased an open cover from PICC, under which PICC issued a cargo insurance incorporating the Institute Classification Clause (ICC/01). The insured cargo was lost with its carrying vessel in the Taiwan Straits and Kam Hing claimed. PICC repudiated liability on the basis that the vessel was not an ‘approved vessel’ within the ICC/01 requirements. Kam Hing then sued both PICC and MST, who retained our Hong Kong office.

Kam Hing argued that MST had a contractual duty to ensure that Kam Hing had a proper understanding of the insurance terms and that this duty had been breached. It was said that the breach caused the loss since, if Kam Hing had been advised that using vessels not classed in accordance with ICC/01 could jeopardize its cover, Kam Hing would not have chartered the vessel in question. This view of the parties’ relationship did not appeal to Judge Stone. He found that MST had been engaged purely as a convenient ‘sourcing agent’, when Kam Hing’s prior insurer’s cancellation necessitated an urgent replacement. He found nothing to suggest that MST was engaged to give general advice nor that Kam Hing had retained MST on the basis of any purported specialist broking expertise. Indeed, Kam Hing’s claim that it needed such advice looked thin since it had made 51 shipments on precisely the same terms under its cancelled insurance. Those findings disposed of the case against MST in contract.

Environcom revisited

Synergy Health (UK) v CGU Insurance Plc

Commercial Court

Flaux J

In Update Issue 26, we reported on the decision of Mr Justice Steel in *Jones v Environcom*. The issue was whether a broker had been negligent in failing to advise its client adequately as to its duty of disclosure. The judge held that it was not sufficient to rely on written standard form warnings attached to proposal documents; the broker must satisfy himself that the position is in fact understood by the client and this will usually require a specific oral or written exchange. The broking community will be pleased to hear that Mr Justice Flaux has now softened the *Environcom* sting, albeit on an *obiter* basis. In the *Synergy* case, discussed in another context above, Flaux J endorsed the duties set out in *Environcom*. However, he agreed with the submission made by Counsel for the broker that there must be a limit to the broker’s duty to make enquiries of the insured for the purposes of enabling it to comply with its disclosure duties. He did not read the *Environcom* judgment as laying down an immutable requirement for brokers to give oral advice concerning the effect of any non-disclosure or misrepresentation. Whether it is necessary to do so, whether a failure to do so is a breach of duty, and whether that breach is causative of the loss, will depend on the circumstances.

Judgewatch

September brought the sad news of the death of **Lord Bingham**, the UK's former senior Law Lord. His short spell in the Commercial Court was followed by what seasoned insurance market readers may best remember him for – a series of appeals driven by the difficulties at Lloyd's, all handled under huge pressure of time. Then subsumed by the BCCI affair, he emerged from that Augean stable and entered the Lords, sitting on insurance cases ranging from subrogation through film finance to after-the-event insurance. Although retired from the bench, he had lost neither his interest in the law nor his readiness to write about it with great lucidity. The legal profession will be much the poorer for his premature passing.

On a much happier note, **Bernard Eder QC**, possibly best known to the insurance market for his impressive pedigree in heavy disputes ranging from Lloyd's Names Actions to the darker recesses of the PA spiral, has been appointed a High Court judge.

Ince News

Tim Schommer and **Georg Lehmann** of our Hamburg office have been promoted to the partnership with effect from 1 January. Tim specialises in insurance, shipping and general commercial litigation work and will be focussing on the development of Ince's insurance and reinsurance practice in Germany. Georg is a ship finance and corporate law specialist. We wish them both every success.

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