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Legal Newsflash

Topical Update from Robin Simon LLP

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Drawing conclusions on the wall

The Court of Appeal's recent decision in *HLB Kidsons -v- Lloyd's Underwriters* [2008] EWCA Civ 1206 comes at a particularly interesting point in the market cycle.

Briefly, the case arose from the claimant accountants' attempt to notify circumstances to their various insurers under a professional indemnity policy. The claimants had developed a number of tax mitigation products but in August 2001 a tax manager in their Edinburgh office started to voice misgivings about the efficacy and implementation of these products.

These concerns led to four communications by the claimants to their insurers which they later relied upon as notification of circumstances:-

- 1 A letter dated 31 August 2001 from the claimants saying that the Inland Revenue might be critical of "procedures" followed in "certain cases". The letter went on to say that there was "no sign of a claim" but that it was regarded as "material information" of which the claimants felt it "appropriate" to inform their insurers. This was shown to the lead underwriters on 27 September 2001. The lead underwriter scratched the letter "WP – Please keep uwrs fully advised. Noted for information only."
- 2 A presentation to the lead insurers claims examiner in October 2001 accompanied by the letter of 31 August 2001 which the claimants were now describing as a "claim circumstance" and which the claims examiner scratched without comment.
- 3 A further letter from the claimants dated 28 March 2002 saying that there might be "procedural difficulties" implementing one type of product (only) which was presented to both the lead insurers' and the following companies' market's claims manager in April 2002 shortly before expiry of the claimants' policy on 30 April 2002.
- 4 A final presentation to the following Lloyd's market after expiry in July

2002 of the same material presented to the lead insurer and companies market in April 2002 (see 3 above).

The failure to address problems concerning the effectiveness (as well as implementation) of *all* the claimants' tax products with *all* of the lead and following insurers *before* expiry provides a paradigm example of "how not to do it". However, it is easy to draw such conclusions in circumstances where the insured undoubtedly found themselves in a difficult position. Remember there had indeed been no suggestion that they might be faced with claims and the only misgivings emanated from a "whistleblower" in their own organisation.

The judge at first instance, Gloster J, found that the first communication was ineffective as a notification of any circumstances, the second was also ineffective, the third was effective as a notification of the problems with the one type of product only and to the lead and company markets alone and the fourth would have been an effective presentation but it was not made (as the policy required) "as soon as practicable".

The Court of Appeal (where the lead judgment was handed down by Rix LJ) upheld Gloster J's conclusions on the first and fourth communications but reversed her decision holding that the second and third presentations were effective communication of circumstances relating to all the claimants' products to the lead and companies (but not to the following Lloyd's market).

So much for the (highly edited) factual background. What is more interesting is the discussion of the law relating to a reasonably standard and familiar notification provision which expressly made it a condition precedent that the claimants would notify claims made against them "as soon as practicable" and, as regards circumstances, that:-

"The [Claimants] shall give to Underwriters notice in writing as soon as practicable of any circumstances of which they shall become aware during the [policy period] which may give rise to a loss or claim against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after the expiry of the [policy period] shall be deemed for the purpose of this Insurance to have been made during the subsistence hereof."

The policy was to be read subject to the General Institute conditions (as required by the ICA) which provided that the claimants' "*breach of or non-compliance with any condition*" had resulted in prejudice to the insurers, the indemnity would be reduced to "*... such sum as in the Insurers' reasonable opinion would have been payable by them in the absence of such prejudice*".

Rix LJ's conclusions about these fairly conventional terms may cause problems in the future:-

- (a) Unsurprisingly, the requirement to notify circumstances "as soon as practicable" meant just that;
- (b) Surprisingly, although not expressed as such, the condition relating to the notification of circumstances was a condition precedent because the insured had to comply with it exactly (by giving notice as soon as practicable) as a condition precedent to it being deemed a claim made during the policy period in question;
- (c) Also surprisingly, the Institute conditions caught only conditions and not conditions precedent so that insurers were entitled to reject late notified circumstances on grounds of breach of a condition precedent; and
- (d) Following Gloster J's reasoning, the notification provisions were to be construed objectively (i.e. as a reasonable insured would) rather than subjectively (i.e. as the specific insured would).

The puzzling feature of Rix J's decision is that it implies that an insured who learns (or who ought objectively to have learnt) of circumstances in, say, month 1 of a 12 month policy and who fails to notify them (as so many insureds do) until month 12 is in breach of condition precedent and is not entitled to indemnity – at least on the ICA wording. What is entirely unsurprising is that an insured cannot notify circumstances after expiry.

It seems almost certain that this was not what the ICA intended and that, as Rix LJ suggested, their standard terms will "... need to be revisited" (para. 119). No doubt this exercise and the handling of many circumstances both before and after that exercise has been undertaken will be awaited with anticipation and concern by many insureds and, not least, their brokers (and *their* E&O insurers) . It also seems inevitable that other professional organisations such as the SRA will have to consider carefully their own minimum terms.

More immediate practical issues include:-

- The need to deal promptly with notifications of all circumstances
- The need to review carefully the scope of any such notifications
- And the need carefully to review the "laundry list" notifications that tend to emerge (in particular) during economic recessions.

Should you require any further information please contact

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We can put together a seminar/talk or panel discussion on the issue above, or any of the issues featured in our publications to be held at any of our offices, or yours.

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