Insurance Update

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Legal expenses insurance

Brown-Quinn v Equity Syndicate Management Ltd – insured’s right to choose a lawyer
(2011) EWHC 2661 (Comm)

For the second time this year, the High Court has considered the limits on an insurer’s right to control the insured’s choice of lawyer under a before the event (BTE) legal expenses insurance policy. On this occasion issues arose as to the relevance of the insurer’s prescribed rates for their panel solicitors where the insured wished to instruct a non-panel firm, and the entitlement of the insured to change solicitors.

Earlier this year in Pine v DAS Legal Expenses Insurance Co Ltd the court held that the claimant was entitled to an indemnity from her insurers in respect of costs incurred in instructing a barrister to act for her on a public access basis. DAS was not entitled to require her to instruct a solicitor to brief counsel.

In the present case, three claimants had all instructed a firm, Webster Dixon, to conduct their employment and discrimination claims. Webster Dixon was not on the defendant insurer’s approved panel of solicitors and charged higher rates than those paid to panel firms. One claimant instructed Webster Dixon from the outset whilst the other two wished to follow their case-handlers when they left the panel firm to join Webster Dixon during the course of the case. These were described respectively as “outset cases” and “transfer cases” in the judgment.
The arguments
Initially the insurers said that they would not cover Webster Dixon’s costs unless they agreed to act for the flat hourly rate of £125 (later increased in the transfer cases to £139) specified in their “Terms of Appointment for Non … Panel Solicitors” (the non-panel rate). They subsequently abandoned this argument in respect of outset cases, contending at the hearing that, in reliance on the policy terms which required fees to be kept “as low as possible”, the assessment of reasonable costs payable under a contract in accordance with CPR 48.3 should only depart from the non-panel rate if the rate could be shown to be unreasonable.

As for the transfer cases, the insurers contended that the insured is entitled effectively to only one “election” under the Insurance Companies (Legal Expenses Insurance) Regulations 1990 (the Regulations) and thereafter there is no longer the freedom of choice that there has to be at the outset to comply with the Regulations. There was no entitlement to change solicitors and to expect the fees of the new solicitor to be covered. Clause 5 of the policy provided that, unless the insurers agreed to the transfer, the cover would end.

The findings
Outset cases

- The claimant was entitled to choose a non-panel solicitor who would not act at the non-panel rate. Such a step could not of itself constitute the taking of an unreasonable step or a breach of any term of the policy.
- The fact that the chosen solicitor’s rates exceeded the insurer’s non-panel rate did not constitute “exceptional circumstances” within the meaning of the policy so as to entitle the insurer to refuse to accept the appointment.
- The claimant was entitled to recover fees in respect of that solicitor in accordance with the terms of the policy, not restricted by the non-panel rate but with reference to it.
- When assessing the claimant’s entitlement to recover costs under CPR 48.3, the court should take into account the non-panel rate, not as a starting point but as a comparator. It should consider the availability of suitable solicitors ready to act at the non-panel rate, with reference also to the factors identified in Wraith v Sheffield Forgemasters Ltd. This enables the court to take account of the policy term permitting the recovery of reasonable fees and the policy requirement that the insured keep the costs as low as possible.

Transfer cases

- The freedom to choose a lawyer is not limited to one choice. The Regulations (and the EC Directive they implement) cannot be interpreted so that the freedom of choice of the insured is limited to one selection or election at the outset.
- Clause 5 of the policy as it stands was in breach of the Regulations. An implied term should be read into it that the insurers’ agreement to a transfer will not be unreasonably refused.
- Examples of a reasonable transfer include where the initial firm has ceased to exist or has closed the relevant department, where there is a substantial and reasonable disagreement between client and solicitor, and where, as here, the case handler has moved to a new firm.
- An objection to a transfer simply on the basis that it would cost the insurer more clearly results in a conflict of interests entitling the insured to choose a lawyer under Regulation 6.
Comment

As predicted in the April 2011 Insurance Update, the courts are proving to be unsympathetic to attempts by legal expenses insurers to rely on exceptions in their policies in order to limit the insured’s right to choose a lawyer. The BTE insurers in this case (Equity Red Star at Lloyd’s and ULR Norwich) urged the judge to consider the potential wider consequences of his decision. They referred to the need not to discourage BTE insurance since access to justice is already restricted by the limited scope of legal aid, and the Jackson reforms are likely to make after the event (ATE) insurance and conditional fee agreements considerably more unattractive and therefore progressively more unavailable.

They went as far as to say that if the court allowed non-panel firms to be instructed and to have their fees covered by insurance, subject only to assessment under CPR 44, it would be bound to render it uneconomic for insurers to continue providing BTE insurance, at least without a considerable increase in premiums. They also warned against encouraging predatory solicitors, who would take steps to snap up claimants with BTE insurance, if the solicitors knew that they would be able to charge their usual rates and recover them from insurers.

This is somewhat reminiscent of the situation the courts found themselves in early in the life of the funding regime permitting the recovery of success fees and ATE premiums from the losing party. In Callery v Gray the Court of Appeal was assisted by representations from the Association of Personal Injury Lawyers, the Association of British Insurers, the ATE Insurers’ Group, Claims Direct Ltd, the Motor Accident Solicitors’ Society and the Law Society. Arguments as to the effect their decision would have upon the development and survival of the ATE insurance industry, and therefore the success of the new funding system, influenced the approach they took to the recovery of premiums and success fees. The House of Lords refused to interfere with their decision as a matter of principle, but it is clear from several of the opinions that there was disquiet about the role the courts were being required to play. Lord Hoffman stated (prophetically, as events have turned out):

“I must express some doubt as to whether the questions which arise in these appeals are capable of solution by the traditional method of adjudication by costs judges, subject to guidance from the Court of Appeal. It may be that they are not justiciable and require a legislative solution.”

And Lord Scott put his finger on the problem when he said:

“Your Lordships cannot know what will be the consequence for the ATE insurance market if premiums payable under ATE policies that have been taken out where there is no real risk of litigation, and therefore no real risk of the occurrence of the event insured against, are ruled to be irrecoverable from defendants.”

In the present case, the judge was similarly faced with arguments based on policy requiring him to predict the effect of his decision on the BTE market. However, there was an important distinction between his task and that facing the courts in Callery v Gray, namely the requirement to give effect to the Regulations. This meant that, while the judge said that he was taking the policy concerns into account when devising the approach to be taken to the assessment of reasonable fees under CPR 48.3, the outcome made few concessions to the defendant BTE insurers. They have lodged an appeal, with a hearing window before the Court of Appeal between April and October next year. The Law Society has said that it will continue to take an active interest in the case and would like to know of any occasion when an insurer has denied a client the right of freedom of choice of solicitor. The Society is seeking a test case to challenge the contention that an insured’s right to choose their solicitor only arises once proceedings have been issued.
Part 36 offers

**Epsom College v Pierse Contracting Southern Limited** – effect of withdrawn offers

The Court of Appeal reviewed the costs consequences of a withdrawn Part 36 offer. It also commented on the defence strategy of insurers when faced with a claim which becomes stronger at a stage in proceedings when considerable costs have already been incurred.

**The claim**

The claim arose out of a flooding incident in 2006 when a pipe burst under the floor of the dining hall at the claimant school. The hole in the pipe was plugged with a nail. The school blamed the defendant contractors who had been working in the hall in 2003. It alleged that the hole in the pipe had been caused by a negligently misplaced nail. The contractor denied any involvement and argued that the pipe had become corroded over its lifetime.

The claim for £25,537.72 was issued in 2006. In 2007 the school said that the pipe had been disposed of although they had photographs of it with the nail in situ (although this proved to be the replacement nail). Expert reports were exchanged at this stage. In October 2010 the pipe was discovered in a filing cabinet at the school. It was obvious that the pipe was not corroded and that the hole had been caused by a nail.

**The judgment**

The judge accepted the school's case that the pipe had been punctured by a nail and that the contractor had replaced the original iron piping with copper piping in 2003. He concluded that the nail had probably been hammered into the pipe on the last occasion on which the duct covers had been lifted which was in 2003 when the contractor was working there. He rejected the contractor's argument that it was more likely that some rogue nail had been put through the carpet at a later date. He awarded the school £21,075.

**Part 36 offers**

The school made three offers, the first two of which were Part 36 offers and the third was a Calderbank offer because it was inclusive of costs. The first offering to accept £19,200 was on 13 March 2009, the second for £12,768.50 was on 16 April 2010 and the third for £62,000 including costs was on 26 July 2010. None of the offers was accepted by the contractor, which in turn made none of its own except a drop hands offer shortly before trial. The second and third offers were subsequently withdrawn by the school.

**Decision on costs**

The judge awarded the school its costs plus enhanced interest of 6 per cent and indemnity costs under CPR 36.14 from 7 May 2010, 21 days after the second offer. He was influenced by the school’s negligence in losing the pipe until October 2010 and the contractor’s failure to respond realistically to the second offer to settle for less than 50 per cent of the claim. He was not referred to CPR 36.14(6) which states that the consequences of CPR 36.14(3) do not apply to a withdrawn offer.

**The appeal on costs**

Although the judge had wrongly awarded enhanced interest and indemnity costs to the claimant under CPR 36.14 in reliance on the second Part 36 offer which had been withdrawn, the Court of Appeal upheld the judge’s decision on other grounds. The second offer could not be the basis of Part 36 costs consequences but it was possible to substitute reliance on the first Part 36 offer, which had not been withdrawn, to achieve the same outcome.

The school argued that the judge could have awarded indemnity costs under CPR 44.3. The court commented, although the point did not have to be decided, that indemnity costs could in principle be ordered against a party where there has been an unreasonable failure to accept offers. It referred to two cases this year where indemnity
costs have been awarded from a certain date in special circumstances where an offer which ought to have been accepted was not – Southwark LBC v IBM UK Ltd and Barr v Biffa Waste Services Ltd (Costs).

Defendant’s insurers’ strategy
Counsel for the contractor was frank with the Court of Appeal about the contractor’s insurers’ defence strategy once the pipe was disclosed and the school’s case became significantly stronger. They had decided that as capitulation would bring with it liability for all costs incurred to date, already many tens of thousands of pounds including a success fee, it would be better to soldier on to the bitter end in the hope that the school would fail to make good its case. The court described this as a “double or quits” approach and the attempt to rely on the difficulties of the insurers’ position to exculpate them was not well received. Once the pipe was found, the contractor could have accepted the first Part 36 offer and argued, relying on CPR 36.10(4), that it should not be liable for all of the school’s costs, let alone on an indemnity basis.

Comment
This decision goes to the heart of the dilemma faced by defendants and their insurers where a claim becomes stronger after considerable costs have been incurred. If they make an offer or accept the claimant’s offer, the automatic costs consequences under CPR 36.10 mean that they face liability for all the claimant’s costs. However, to plough on in such circumstances without at least making a Calderbank offer of some kind brings to mind Macbeth - “I am in blood stepp’d in so far that, should I wade no more, returning were as tedious as go o’er” – and we know how well that played out.

Although the point did not ultimately arise here, the Court of Appeal tacitly endorses orders for indemnity costs under CPR 44.3 against parties who fail to accept reasonable offers and continue to the bitter end in denial of the realities of their position. Both the recent cases referred to (see above) concerned claimants who had failed to accept a reasonable offer and will be helpful to defendants who have made sensible offers, whether Part 36 or Calderbank. Although the defendant’s offer which should have been accepted in Barr v Biffa was a Part 36 offer, the offer in the Southwark case was a drop hands offer. Another decision decided shortly before the present case also adopts this approach, awarding indemnity costs to the defendant for the period following its Part 36 offer, withdrawn on the fifth day of the trial, where the claimant should have realised that its case was fatally flawed (Community Gateway Association Ltd v Beha William Norman Ltd).

As for the costs consequences of withdrawn Part 36 offers, the fog is beginning to lift. Everyone accepts that a withdrawn claimant’s offer cannot give rise to an order for enhanced interest and indemnity costs under CPR 36.14 because of CPR 36.14(6). However, can the same consequences be ordered under CPR 44.3?

The Court of Appeal refused to deal with the problem in the present case because the judge had not been considering his Part 44 powers and because his decision could be upheld by relying on the first Part 36 offer which had not been withdrawn. It did refer to another recent Court of Appeal decision, French v Groupama Insurance Co Ltd, in which Rix LJ commented (obiter) on this point. He reviewed the changes to Part 36 in 2007 and concluded that:

“…there appears to be a new determination in the amended rules to specify carefully what does or does not count as a Part 36 offer with Part 36 consequences. All other admissible offers are relevant to the Part 44 discretion, but they do not carry with them the costs consequences of Part 36. It seems therefore rather harder to formulate a principled approach to the Part 44 discretion that some offers which are not Part 36 offers should nevertheless, in certain circumstances which are not the circumstances of the rules, be treated as though they were Part 36 offers for the purposes of applying Part 36 consequences under Part 44.”
Unfortunately the Court of Appeal in *French v Groupama* did not consider Teare J’s decision a few months earlier in *Owners of the Samco Europe v Owners of the MSC Prestige* which took a more generous approach to the cost protection afforded by withdrawn offers. There is, therefore, still some uncertainty about how this will work in practice. Nonetheless, the logic of Rix LJ’s analysis is hard to fault (the Court of Appeal took a similar view of the mechanics of Part 36 in *Shovelar v Lane*) and it does seem likely that attempts by claimants or defendants to claim the exact equivalent of Part 36 automatic costs consequences under CPR 44.3 where they wish to rely on a withdrawn Part 36 offer will fail. But presumably that does not mean that they will not be able to recover a little less than the automatic consequences in a deserving case.

**Vicarious liability**

*JGE v English Province of Our Lady of Charity & Trustees of Portsmouth Roman Catholic Diocesan Trust* – child abuse claims

The Bishop of Portsmouth could in principle be held vicariously liable for the torts of a priest of his diocese even though the relationship differed in significant respects from a relationship of employer and employee.

The claimant alleges that she was sexually abused by Father Baldwin (who is now dead) when she was resident at a children’s home run by the first defendants, a religious order of nuns, between 1970 and 1972. The second defendants, standing in the shoes of the Bishop of Portsmouth, appointed Father Baldwin to his office as a Roman Catholic priest within the Diocese of Portsmouth.

The preliminary issue of law determined by Macduff J concerned whether the second defendants could in principle be vicariously liable for the acts of Father Baldwin. This issue has not previously been considered by the courts because in other cases, such as *Maga v Birmingham Roman Catholic Archdiocese Trustees*, the Roman Catholic church has accepted that the priest should be treated as its employee, whilst reserving its position on the point.

A finding of vicarious liability involves a two-stage test:

- Was the relationship between the defendant and the tortfeasor one to which vicarious liability may attach?
- Was the act or omission of the defendant within the scope of the employment or other relationship?

The judge was concerned only with stage one of the test. He considered the following factors to be particularly relevant to stage one (although there is an overlapping of factors applying to both stages):

- The nature and purpose of the relationship.
- Whether tools, equipment, uniform or premises were provided to assist the performance of the role.
- The extent to which the tortfeasor has been authorised or empowered to act on behalf of the authoriser.
- The extent to which the tortfeasor may reasonably be perceived as acting on behalf of the authoriser.

He noted that the extent to which there is control, supervision, advice and support will be of relevance but not determinative. The following characteristics of the relationship between Father Baldwin and the Diocese were material:

- Priests are appointed verbally and the appointment is announced in a letter sent to the clergy. The appointment is subject only to the provisions of canon law.
There is effectively no control over priests once appointed to a parish. The bishop must exercise episcopal vigilance but his role is advisory not supervisory. He has no power to dismiss a priest and can only move him to another parish if he consents. This can only be done through the church in Rome.

Priests receive no financial support from the Diocese. They are supported by their parishioners and take from the collection plate what they consider necessary for basic living expenses. They are considered to be office holders and not employees for tax purposes.

The judge concluded that, although the relationship differed from employment in several ways, it was one which could give rise to vicarious liability. Father Baldwin was handed immense power by the second defendants who appointed him to a position of trust with free rein to act as a representative of the church and provided him with the premises, the pulpit and the clerical robes. By appointing him as a priest and clothing him with all the moral authority and powers involved, the defendants created a risk of harm to others, namely the risk that he could abuse or misuse those powers for his own purposes.

Comment

Vicarious liability claims for acts of abuse have proliferated following two important milestones in the last decade. First, in 2001 the House of Lords held that an employer could be vicariously liable for an employee’s acts of sexual abuse where the latter’s misconduct was so closely connected with his employment that it would be fair to impose liability (Lister v Hesley Hall). Second, the House of Lords decided in 2008 that the jurisdiction to extend the limitation period for personal injury claims under section 33 of the Limitation Act 1980 should be extended to include deliberate assault or trespass to the person, reversing its earlier decision in Stubbings v Webb (A v Hoare).

Claims against the Roman Catholic church have received the most media attention in recent months but the principles involved in determining when vicarious liability should be imposed are of general application. Cases such as this one may well affect the liability of local authorities, schools, charities and others concerned with services for the young. The problem to date has been the lack of an accepted rationale for the doctrine, which creates a form of strict liability where one party who bears no fault is made responsible for the wrongful act of another. Longmore LJ noted this problem in Maga v Birmingham Roman Catholic Archdiocese Trustees (2010):

“Is it that the law should impose liability on someone who can pay rather than someone who cannot? Or is it to encourage employers to be even more vigilant than they would be pursuant to a duty of care? Or is it just a weapon of distributive justice. Academic writers disagree and the House of Lords in Lister did not give any definitive guidance to lower courts.”

Macduff J in the present case found the reasoning of the Canadian Supreme Court in Doe v Bennett the most helpful. This was decided after Lister but was not considered in MAGA, although he considered it to fit very comfortably with the reasoning in MAGA. It is not surprising in the circumstances that the Court of Appeal will be hearing the defendant’s appeal between April and June next year.

The question of whether these claims are covered by insurance and the issues which arise in that regard have not been considered by the courts. Problems with the wording of employers’ liability (EL) and public liability (PL) policies have been considered in the context of asbestos-related claims. In Durham v BAI (Run Off) Ltd (known as the Trigger Litigation) the Court of Appeal considered test cases concerning asbestos-related mesothelioma claims and the liability of insurers under EL policies written many decades ago. Where the policy offered cover in respect of injuries “caused” during the period of the insurance, the trigger in mesothelioma cases is agreed to be the exposure to or inhalation of asbestos fibres. Problems arise, however, with other EL policy wordings which refer either to the date on which the injury is “sustained” or the date when the disease is “contracted”.

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Up until the Court of Appeal's decision in *Bolton Metropolitan Borough Council v MMI Ltd* concerning the meaning of similar terms in PL insurance, it had been the universal practice within the EL insurance industry during the relevant period to treat the date of exposure as the indemnity trigger and claims were paid out in accordance with this common understanding. In *Durham v BAI*, a majority of the Court of Appeal considered that the court was bound by the decision in *Bolton*. The court held accordingly that policies with a "sustained" wording responded at the date when the injury was "suffered", meaning that the injury occurred at the earliest at the date of onset of malignancy. Rix LJ was not happy about this conclusion and questioned the correctness of *Bolton*. By contrast, the "contracted" wordings were capable of referring to the disease’s origins and the trigger for indemnity was therefore the date of exposure or inhalation.

The Supreme Court heard the appeal in *Durham v BAI* earlier this month. The Court of Appeal took almost a year to deliver their judgment in November 2010, and when it arrived it was more than 100 pages long and far from unanimous. We - particularly those who have been waiting for years to find out whether they can recover compensation and those insurers and employers who do not know whether they are liable to pay it – can only hope that the Supreme Court's decision is prompt and clear.

**In brief**

**Breach of undertaking**
The court refused to grant a summary judgment application based on a solicitor’s breach of undertaking because the transaction was unusual and the complex facts required full examination with oral evidence (*Global Marine Drillships Ltd v Landmark Solicitors LLP*).

**Late notification**
The insured engineer’s delay of 18 months in notifying his liability insurer about 2 fires at a recycling centre had prejudiced the insurer’s ability to contest liability for the fires. Whilst the insurer remained liable to indemnify the insured, it had a claim for damages which could be set off against the latter’s claim for indemnity. The valuation of the loss of the insurer’s opportunity to defend successfully the claim against the insured was 15 per cent. The insured was therefore entitled to be indemnified to the extent of 85 per cent of his liability (*Milton Keynes Borough Council v Nulty* (2011) EWHC 2847 (TCC)).

**Legal aid reforms**
The government has announced a delay in implementing the legal aid cuts contained in the Legal Aid, Sentencing and Punishment of Offenders Bill which is currently being debated in the House of Lords. Originally, the government hoped to bring in the cuts in civil categories next October but the Bill will now not be enacted before March 2012.

**Privilege and accountants**
The appeal in *R (Prudential plc) v Special Commissioner of Income Tax* will be heard by the Supreme Court on 6 November 2012, two years after it was heard in the Court of Appeal. The Court of Appeal confirmed that legal advice privilege applies only to legal advice given by a lawyer and not to legal advice given by a non-lawyer such as an accountant.

**Regulation of benefits in kind insurance**
Extended warranty contracts providing for the repair or replacement of satellite television equipment were contracts of general insurance within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 Article 3(1). The risk was the breakdown of the equipment which would lead to expense on the part of the insured and the risk was therefore one of financial loss attributable to their incurring unforeseen expense. The...
provision of the contracts was therefore a regulated activity under the Financial Services and Markets Act 2000, for which the defendants had required to be authorised, but were not. The Court of Appeal rejected the defendants’ appeal (Digital Satellite Warranty Cover v The Financial Services Authority).

Reinsurance contracts
The judge had correctly determined a preliminary issue that a tower of insurance contracts was to be regarded as exhausted once claims amounting to US$60 million were settled. This gave effect to the commercial sense of the “top and drop” policy. The insurer’s appeal was dismissed (Teal Assurance Co Ltd v W.R. Berkley (Europe) Ltd).

Summary determination of professional negligence claims
The judge held that the defendant solicitors and counsel were entitled to summary determination of the claim against them despite its apparent complexity. This arose principally from the background facts, but there was little real dispute about the primary facts. The determination of the claimants’ pleaded case was also relatively straightforward but complexity arose from the claimants' unpleaded and loosely formulated argument. The judge held that it would be unfair to the defendants if their applications were refused because of deficiencies in the claimants' pleading and so examined the unpleaded allegations in some detail, finding that the claimants stood no real prospect of succeeding (Asiansky Television plc v Khanzada – Mills & Reeve acted for the successful applicant solicitors).

Valuation claim
Applying a valuation margin of error of eight per cent, the defendant surveyors’ valuation was not negligent. This margin was appropriate because of the lack of consistency and clarity in relation to comparables and the difficulties presented in valuing in July 2004, when the market was volatile. Had the valuation been negligent, the judge would have made a finding of 60 per cent contributory negligence against the lender (Paratus AMC Ltd v Countrywide Surveyors Ltd. Click here to see our briefing).

Waiver of rights
In the absence of special circumstances, silence and inaction were, when objectively considered, equivocal and could not, of themselves, constitute an unequivocal representation as to whether a person would or would not rely on a particular legal right in the future. There were no special circumstances capable of turning the silence and inaction of the insurer into an unequivocal representation to the insured that it did not intend to enforce its strict legal rights based on a breach of the hold harmless warranty in the marine insurance policy. It followed that there was no waiver or estoppel and the insurer’s appeal was allowed (Liberty Insurance PTE Ltd v Argo Systems FZE).