

London Market newsletter

December 2009

This edition includes a brief update on:

Commercial Court

- **Lockheed Martin Group v Willis Group Ltd** (error on claim form, substitution, intention to sue, identity of party)
- **Gard Marine & Energy Ltd (A Company Incorporated Under The Laws Of Bermuda) (1) Lloyd Tunncliffe (2) Glacier Reinsurance Ag (A Company Incorporated Under The Laws Of Switzerland) (3) Agnew Higgins Pickering & Co Ltd** ('close connection of claims', Lugano Convention Art.6(1))
- **Dunlop Haywards (Dhl) Ltd (Formerly Dunlop Heywood Lorenz Ltd) (In Liquidation) & Others v Barbon Insurance Group Ltd (Formerly Erinaceous Insurance Services Ltd) & Others** (professional indemnity insurance, rectification, change in terms of policy cover)

Technology & Construction Court ('TCC')

- **Seele Austria v Tokio Marine** (date cause of action accrued, constitution of a new claim, amendment of particulars of claim)

High Court

- **Corus UK Ltd v Cavendish (UK) Ltd** (contractor's agreement, asbestos, damage to property)

Court of Appeal

- **QBE Insurance Europe Ltd & Amalfi Underwriting Limited v Timothy Higgins** (conspiracy to defraud, mental illness)
- **A C Ward & Sons Ltd v Catlin (Five) Ltd** (interpretation of terms of policy, construction of terms, suspensive conditions)

House of Lords

- **Lexington v Wasa & AGF** (facultative policies, coverage period, back-to-back cover governing law)
- **Stone and Rolls v Moore Stephens** (professional negligence, knowledge of agent)

Guest article

- Cameron McNaught, Partner at Brodies in Edinburgh looks at **Pleural Plaques Compensation – The Scottish Challenge**

London Market Newsletter

Error on claim form, substitution, intention to sue, identity of party

In **Lockheed Martin Group v Willis Group Ltd** (9 June 2009) the applicants, Willis Group Limited and Willis Limited, applied to set aside an order which substituted them for the originally named defendant, Willis Group Holdings, on the claim form.

The respondent had entered into a US\$124 million settlement with London market insurance companies. US\$8.124 million was attributed to “unknown ship building London Market Insurers” and the sum paid to the claimant was reduced by this amount because the insurers remained unknown. Shortly before the limitation period expired proceedings were brought by Lockheed alleging that its brokers were negligent in failing to maintain proper records of those insurers subscribing to the policies. It was believed by Willis that service had not been properly effected as Willis Group Holdings, Berumuda, had been named instead of Willis Group Ltd, UK. By then the limitation period had expired.

Willis Group submitted that there was no mistake by Lockheed as to the name of the party sued. Rather insufficient thought had been given about who to name on the claim form and that it had misled the defendant. Lockheed submitted that it had at all times intended to issue proceedings against the senior United Kingdom company in the Willis group and not the Bermudian company and had made a mistake as to the name; that mistake had not misled the defendant.

Rule 19.5 of the CPR provides that a party can be substituted only if the original party was named “in mistake”. In the Court of Appeal decision of **Adelson v Associated Newspapers**, Lord Phillips laid down certain requirements before an amendment could be made, including:

1. “The mistake must not have been misleading... as to the identity of the person... intended to be sued.”
2. The mistake must be as to the name of the party and not as to the identity of the party. In other words the claimant must identify the correct person but merely misname them, rather than identifying the incorrect person.

Held

Mr Justice Beatson concluded “I allow the defendant's application to set aside Master Fontaine's order” which allowed substitution:

- Under **CPR r.19.5(3)** the mistake must be as to the name of the party, not the identity. “Mistake as to name” is broad. Given the generous test of mistake, it could be said that Lockheed made a mistake as to the name rather than identity when suing the holding company.
- However, the same did not apply to the trading and broking company. It was clear that there was no intention to sue this party when the claim form was issued. The second limb of the (**Adelson**) test was not satisfied, Willis Limited was not a holding company.
- The mistake was misleading to the other party, causing reasonable doubt as to the identity of the party who was intended to be sued.
- The failure to identify the correct entity to be sued was largely due to the inexplicable late actions of the claimant near to the expiry of the limitation period. As a matter of discretion the court would not have allowed the substitution.

'Close connection of claims', Lugano Convention Art.6(1)

In **Gard Marine & Energy Ltd v (1) Lloyd Tunncliffe (2) Glacier Reinsurance Ag (3) Agnew Higgins Pickering & Co Ltd** (9 October 2009) a reinsurance claim was made by Bermudian insurance company Gard Marine & Energy Ltd ("Gard Marine") against Swiss reinsurance company Glacier Reinsurance Ag ("Glacier"). The claim was deemed to be so closely linked to a claim against an English reinsurance company that it should be heard by the English courts. The court determined that it had jurisdiction to hear a reinsurance claim under the Lugano Convention Art. 6(1) as the claim was 'closely linked'.

Gard Marine had insured a US company in respect of property and business interruption. Gard Marine reinsured itself under two excess of loss reinsurance slips and two placements were made by the third defendant, one to London market underwriters, including the first defendant and also Glacier. Gard Marine subsequently settled a claim by the US company and made claims against its reinsurers. It calculated the reinsurance claim on the basis that the deductible in the sum insured clause was a deductible which was referable to 100 per cent property values, and where a claim was made in respect of property in which the US company had less than 100 per cent interest the deductible fell to be scaled down to reflect the lower interest.

Glacier disputed the basis of scaling the deductible and proceedings were issued. Gard Marine were subsequently given permission to add Agnew Higgins Pickering & Co Ltd ("Agnew") as third defendant. The claim was for damages in the event that Glacier's defences to the reinsurance claim were successful. Agnew contended that Swiss law applied, Gard Marine argued that English law was implied into Glacier's slip. Gard Marine submitted that the court had jurisdiction under the Lugano Convention 1988 Art.5(1) as the relevant contractual obligation was to be performed in London pursuant to an alleged custom and practice of the London market. Gard also contended that the court had jurisdiction under Art.6(1) as the claim against Glacier was intrinsically connected with the claim against the other defendants.

Held

- The applicable law was English law as the circumstances of the placement pointed towards this as the choice of law. The underlying policy was a London market policy. Glacier was invited to participate in a London Market placement. Further, a Lloyd's slip was used, significantly incorporating a number of London wordings.
- The claims were 'closely linked' as the general factual matrix of both cases were likely to be similar as the substance of the two contracts and the legal issues to be determined were the same.
- The contingent claim against Agnew was only likely to arise if Gard Marine's claims failed on the construction issue, therefore the implications of a differing judgment would be significant.
- The court determined that it was just and expedient that Gard Marine's claims should be dealt with in a single jurisdiction, thus avoiding conflicting decisions.

Professional indemnity insurance, rectification, change in terms of policy cover

In **1) Dunlop Haywards (Dhl) Ltd (Formerly Dunlop Heywood Lorenz Ltd) (In Liquidation) (2) Erinaceous Commercial Property Services Ltd (Formerly Dunlop Haywards Ltd) (In Administration) (3) Nationwide Building Society (Claimants) v Barbon Insurance Group Ltd (Formerly Erinaceous Insurance Services Ltd (Formerly Hanover Park Commercial Ltd)) & 6 Others (Defendants) & Lockton Companies International Ltd (Formerly Alexander Forbes Risk Services UK Ltd) (Third Party) (19/11/2009)** Hamblen J held that an excess layer policy of professional indemnity insurance for commercial property management did not include valuation services. Additionally, Hamblen J held that the policy could not be rectified include such services.

The claimant companies claimed against the producing broker in both contract and tort for their failure to obtain the necessary excess insurance cover. They additionally claimed against the defendant excess insurers on the basis that the excess policy provided cover in the circumstances or should be rectified so as to do so.

The claimant companies were commercial property consultants and additionally undertook property valuations for lenders. The companies received several claims from lenders in relation to valuations. The professional indemnity insurers were notified of the claims.

The insurance cover was in two layers: a primary layer of £10 million and an excess layer of £10 million excess of £10 million. The primary layer insurers accepted the claims up to the limit of indemnity. The defendant excess insurers rejected the claims on the basis that cover was limited by the policy wording to the group's commercial property management activities only. The claimants brought proceedings against the insurance broker on the basis that the broker had been instructed to obtain excess cover which protected the companies in respect of their valuation activities. The insurance broker argued that either as a matter of construction or by a process of rectification the policy did in fact cover the companies' valuation activities. The defendant excess insurers, who were joined to the proceedings, disputed this.

The producing broker made a third party claim against the placing Lloyd's broker.

Held

Mr Justice Hamblen held:

- The producing broker was in breach of his duties in relation to the renewal of the excess professional indemnity insurance, in that he failed to:
 - review the terms of the cover and identify the limiting condition
 - draw the limiting condition to the attention of the Claimant companies
 - exercise reasonable care and skill in obtaining the right type of cover
- There is a clearly recognised distinction between property management and property valuation, especially in the area of professional indemnity insurance.
- As a matter of construction the excess insurance did not cover the valuation claims.
- The court rejected the producing broker's case on rectification that the excess policy had been preceded by an agreement specifically covering the additional valuation activities. There was simply a re-quote for commercial property management activities, not a change in the basis of

cover. The common intention at the time of signing the slip was that the commercial property management activities be covered. The claim for rectification failed.

- The claimants reasonably relied on the producing broker to obtain the required cover. The claimants were not contributory negligent for failing to review the terms of the cover in detail. The producing broker should have highlighted the limiting condition of the renewal terms.
- The placing broker was negligent in failing to query the change of cover from commercial property management to also include valuations. There was also a breach of the contractual term that cover would be obtained on no worse terms and conditions than the expiring cover. The placing broker's failures were causative but responsibility for the failure to obtain the necessary cover should be apportioned 80 per cent to the producing broker and only 20 per cent to the placing broker.
- The claimants' claim for £10 million failed as against the defendant excess insurers. The claim succeeded in full against the producing broker. The producing broker's claim against the placing broker for breach of duty succeeded but the damages were to be reduced by 80 per cent to reflect the contributory negligence.

Date cause of action accrued, constitution of a new claim, amendment of particulars of claim

Seele Austria v Tokio Marine (6 August 2009) follows on from our previous analysis in the April 2009 edition of our London Market team newsletter. The claimant originally sought to recover costs incurred in relation to the rectification of faulty windows and the resultant damage of the defects in a building project.

The Court had stopped the claimant from putting forward a new case as they had failed to seize numerous opportunities to do so previously and therefore an amendment of the Particulars of Claim would be an unreasonable abuse of process.

Following on from this, a 'new' claim came about as part of proceedings being transferred to the Technology and Construction Court and amended pleadings having been served. In response to the amended Defence, the claimant's admitted that contrary to their initial assessment, some costs related to a further 18 windows on the North East elevations, in addition to the 31 brick-clad windows on the South West elevation. The defendant argued that it appeared this was a new case being advanced. The claimants contended that the fundamentals of the case had not changed. However, references had been made to distinct windows. The claimants then filed a further standalone pleading limiting the claim to 26 windows, the remaining 5 not being brick clad.

Held

Mr Justice Clarke found for the defendant with the following reasoning:

- A claim for damages was a new claim, even if in the same amount as originally claimed, if the claimant sought, by amendment, to justify it on a different factual basis from that originally pleaded. It was highly material to know which windows were in question, since it was a necessary part of the cause of action that the costs in relation to each window for which there was a claim should exceed £10,000 and so there was a separate cause of action in respect of the damage relating to each window.
- The orthodox position was that suggested by the defendant that a cause of action accrued when the insured peril occurred (i.e. damage to the property) and not the date when the loss was manifested or the assured incurred expenditure. In the circumstances, the defendant had an arguable case that the limitation period in respect of the claim for 26 windows had expired. The claimant's reply could not be considered unless it arose out of the same or substantially the same facts as were already in issue in the existing claim.
- The claim in respect of 26 brick clad windows on the South and West elevations did not arise out of the same or substantially the same facts as a claim in respect of 18 windows. There were common facts as between the claim; however, a claim in respect of the 26 windows differed substantially from that of the 18 windows. The new claim was struck out.
- If that conclusion was wrong, the Judge was not persuaded that justice called for him to exercise his discretion in favour of allowing an amendment to the particulars of claim to plead a claim in respect of the 26 windows.

Contractor's agreement, asbestos, damage to property

In **Corus UK Ltd v Cavendish (UK) Ltd & Others** (7 August 2009) the claimant claimed damages against the first defendant contractor and the third defendant sub-contractor in respect of the removal of asbestos at office premises owned by the claimant. The contract was for the removal of ceilings that had been sprayed with asbestos, although there was overspray on the concrete beams above the ceiling that was to be covered with a sealant rather than removed.

Removal of the ceilings proved impractical due to their construction. The contractor suggested a revised method involving leaving the old ceiling, scraping the asbestos from it and installing a suspended ceiling underneath the older one. Sub-contractors carried out the works under the original contractor's supervision.

Asbestos debris was found some ten years later in-between the old and new ceilings. It was agreed that the debris had probably been caused by the dragging of electrical cables over the old ceiling, which had resulted in the debris falling through the lighting wells onto the new ceiling.

The claimant sought to recover the cost of remedial works and argued that:

1. The advice from contractors had been inaccurate or misleading because under the revised method asbestos would be left on the underside of the old ceiling
2. Both contractor and sub-contractor were in breach of their duty of care in tort in failing to exercise reasonable skill and care in their removal of the asbestos coated materials by leaving them in situ in a loose and disturbed condition
3. The contractor owed a concurrent duty of care in tort to exercise reasonable skill and care in providing the services it had contracted to provide and was obliged to avoid causing economic loss and physical damage in doing so.

Held

The claimant's claims were discussed:

- It had been known that not all of the asbestos would be removed. The contractor would not have given a guarantee that every trace would be removed.
- The works had been carried out in a competent manner. The debris was not from the underside of the older ceiling, it had been caused by the dragging of cables causing debris to fall through fittings.
- Even if the work had not been carried out competently, it could not be said to have damaged the property.

Conspiracy to defraud, mental illness

In **QBE Insurance Europe Ltd & Amalfi Underwriting Limited v Timothy Higgins** (23 July 2009) the Court of Appeal found that mental illness is not an adequate defence in all cases. In the instant case there was overwhelming evidence of dishonesty on the part of the defendant, despite a defence based on Alzheimer's.

The defendant was found guilty of insurance fraud after two previous rulings in the case in June and December 2008. London Market insurers QBE, Amalfi Underwriting Ltd and Markel International Insurance Company Ltd had brought a joint action against Surety Guarantee Consultants Ltd, whose former directors and managers/associates had made secret profits by writing surety bonds above agreed limits.

Held

The Court of Appeal held that the High Court Judge was correct in his finding that the defendant, Mr Higgins, an underwriting agent who suffered from Alzheimer's disease, had either conspired with others to defraud Markel and QBE (his principals) or that he had given dishonest assistance to others in breach of his fiduciary duty to Markel/QBE.

The Court found that the components of the fraud/dishonest assistance case brought against Mr Higgins were overwhelming. Central to this was the fact that excess premiums should have been paid to Markel and QBE or, if there had been a silent co-surety arrangement, to Templeton. Instead, the unaccounted premiums were paid to a company effectively owned by the three co-conspirators in the case. There was a powerful inference that Higgins had acted dishonestly. Alleging intermittent forgetfulness caused by Alzheimer's was inadequate as he appeared to have known what he was doing. One transgression included writing bonds over the prescribed limits set by Markel and QBE on numerous occasions.

Interpretation of terms of policy, construction of terms, suspensive conditions

In **A C Ward & Sons Ltd v Catlin (Five) Ltd** (10 September 2009) the Court of Appeal found that a judge was correct to find that an insurance claim could not be summarily disposed of where the insurers had sought to rely on an interpretation of the terms of a outdated insurance policy. The construction and effects of those terms required that they be examined at a full trial.

The original hearing dates back to 19 November 2008 in the Commercial Court where applicant insurers, Catlin, applied for summary judgment against the insured, Ward. Ward owned a warehouse which was burgled. A contract of insurance covering theft from secure storage was in place with Catlin.

Catlin refused to pay, citing that:

1. The policy contained a burglar alarm maintenance warranty, in which the alarm specifications were to be detailed. These were never received by Catlin.
2. The policy contained a protection and maintenance warranty, security devices should be operational and all defects promptly remedied. Onsite CCTV was effective but offsite monitors were defective, there were also issues with an alarm.

Catlin submitted that “warranties” were “suspensive conditions” limiting risk so that the insurer was effectively off cover during any period of non-compliance.

Ward submitted that the warranty only applied to protections notified to the insurers in writing prior to entering into the policy, that the warranty obligations were no more than obligations to promptly remedy defects and the absence of the specifications meant the alarm maintenance warranty did not apply.

Held

The application by Catlin was refused as:

- The summary judgment application failed as Ward had an arguable case on the issues and was entitled to a determination on them.
- The warranties were warranties in the technical sense, not “suspensive conditions” as the meaning of a warranty was a defined term in the policy and the definition clause said that a breach voided the contract from the date of breach.
- The protection and maintenance warranty did not apply only to protections notified to the insurers. There was no reason to exclude devices monitored by third parties or for which third parties had some responsibility or which were not physically on the premises from protection. These were risks and inclusions reasonably expected by insurers.
- The burglar alarm warranty should be best interpreted as extending to such system as the insured might from time to time install, regardless of whether it had been approved by the insurer.

Facultative policies, coverage period, back-to-back cover, governing law

Equitas v R & Q Reinsurance Company (UK) Limited

On 11 November 2009, the long awaited decision in **Equitas v R&Q Reinsurance** [2009] was handed down by Mr Justice Gross, provoking much speculation as to its effect on the London Market Excess of Loss spiral (“LMX spiral”).

Background

By way of background, the notorious LMX spiral arose because many syndicates at Lloyd’s which wrote excess of loss cover took out excess of loss cover themselves. Their reinsurers in turn took out their own excess of loss cover. As a result, there was a group of syndicates and companies which created a complex intertwining network of mutual reinsurance. In the event of a loss triggering the excess covers, claims were repeatedly made in respect of the loss as it circulated in the spiral, impacting on successive layers of reinsurances.

Two notorious losses which resulted in claims going through the LMX spiral was the Exxon Valdez disaster in 1989 and the invasion of Kuwait in 1990. Both incidents gave rise to claims which were presented to and paid by insurers and reinsurers within the LMX spiral on certain mistaken assumptions:

- (a) In the case of Exxon Valdez, claims were paid at the initial stages that included elements of cover which were later ruled irrecoverable in subsequent litigation (in particular, **King v Brandywine Reinsurance Co** [2005]).
- (b) In the Kuwait losses, losses were claimed and paid on the aggregation of a single event with no differentiation made between the losses arising from Kuwait Airways Corporation aircraft and British Airways aircraft stranded at Kuwait airport. **Scott v Copenhagen Re CO (UK) Ltd** [2003] subsequently ruled that the losses should not have been aggregated in this fashion because they did not arise out of the same event.

The dispute between Equitas and R & Q arose from claims by Equitas relating to these two losses under various excess of loss retrocessions underwritten by R&Q. The retrocessions were excess of an attachment point on an each and every loss basis and by reference to the reinsured’s Ultimate Net Loss. The contracts were either “back up” cover or with a significant element of such cover. As such, the wrong aggregation/payment of irrecoverable losses had an impact on (a) the true amount of Exxon Valdez/Kuwait losses that Equitas were entitled to recover under these retrocessions; and (b) the recovery of other separate reinsured losses where there was no question that they fell within the terms of the reinsurance but where questions arose as to whether the underlying layers were properly exhausted.

Issues

The question before the court was the burden of proof that Equitas had to discharge. In particular, whether Equitas could recover under the retrocessions without replicating the LMX spiral at each level to take into account the wrongly aggregated and irrecoverable elements in circumstances where it was accepted this would be impossible to do.

R & Q argued that Equitas need to show how properly aggregated and recoverable losses would flow through the spiral, irrespective of impossibility or impracticality. Equitas on the other hand took the position that they were entitled to prove their loss by using actuarial modelling.

Settlements wording

The relevant settlement clauses in the contracts were either:

“It is a condition precedent to liability under this contract that settlement by the reassured shall be in accordance with the terms and conditions of the original policies or contract” (the Joint Excess of Loss Committee (“JELC”) wording);

or

“All loss settlements by the Reassured including compromise settlements and the establishment of Funds for the settlement of losses shall be binding upon the Reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts ... and within the terms and conditions of this Reinsurance” (the “Settlements Clause”).

The Settlements Clause was considered previously in **Hill v Mercantile** [1996] where the court described it as containing a “dual proviso” with the first proviso being the requirement that “such settlements are within the terms and conditions of the original policies and/or contracts” and the second proviso that the settlements are “within the terms and conditions of this Reinsurance”. It was not in dispute that the JELC wording was the equivalent of the first proviso.

Judgment

The court decided that there was no requirement that Equitas must prove a loss at each underlying level of the LMX spiral.

The starting point taken by the court was the distinction between questions of law on the one hand and questions of fact or evidence on the other. It found that as a matter of *law*, Equitas must meet the requirements of the dual proviso to a standard of balance of probabilities. However, there was nothing in **Hill v Mercantile** that decided *how* Equitas must do so – that is a matter of fact or evidence.

In coming to this conclusion, the court decided that the reference to “original policies or contracts” in the first proviso was to the inwards policies or contracts and is not taken as referring to the/all of the intermediate or underlying contracts. Further, it was one thing to say that the loss must fall within the cover of the inwards policy but another to require proof of liability under each and every underlying contract. These are issues of fact and not law.

Having said that, the court recognised that there may be factual situations where it may be possible and appropriate to re-construct the layers of the LMX spiral, and that the above conclusions were subject to contractual provision or market practice to the contrary.

That aside, it was clear that a claimant was left to take its own decision on how to prove its claim and was not bound in all cases to prove a loss at each underlying level in the chain.

In considering market practice, Mr Justice Goss found that because the situation before him was unprecedented, there was only limited assistance that market practice can provide. However, what assistance there was favoured Equitas’ case and in particular, the use of collection notes by the market to recover losses rather than requiring strict proof of loss.

The court went on to assess the actuarial modelling put forward. Although Mr Justice Goss described actuarial modelling as “complex, expensive (and) imperfect”, he was persuaded that the models were

capable of establishing the properly recoverable minimum losses having regard to the applicable burden and standard of proof. This was subject to a discount factor applied of 25% for Exxon Valdez losses and 13.5% for the Kuwait losses.

Comment

This action was regarded very much as a test case with the court describing the LMX market as having reached a state of “lock down.” As such, the court was conscious of its obligation to find “an acceptable legal and sensible commercial solution” in circumstances where the market has failed to do so.

The expectation is that this judgment will now un-freeze claims caught in the LMX spiral. At the same time, as the court recognised, the facts behind the dispute between Equitas and R & Q are unprecedented and it is therefore difficult to say what practical impact it would have in reality.

Professional negligence, knowledge of agent

Stone & Rolls Ltd v Moore Stephens (30 July 2009), Stone and Rolls (S&R) had been used as a vehicle for defrauding banks by its sole director, Zvonko Stojevic. On discovery of the fraud, Komercni Bank SA, a main victim to his fraud, sued S&R and Mr Stojevic for deceit. This amounted to US\$100 million; S&R could not pay and went into liquidation.

The liquidators brought a professional negligence claim on behalf of S&R against Moore Stephens, the auditors of S&R. It was alleged that auditors should have detected Mr Stojevic's deceit. The auditors applied to strike-out the claim on the basis of *ex turpi causa non oritur actio*, that an action may not be founded on illegality.

The application failed at first instance, was reversed by the Court of Appeal and went to the House of Lords, where the auditors accepted they had breached their duty of care, which in turn enabled the fraudulent activity to continue. S&R's liquidators contended that S&R were merely vicariously liable for that fraudulent conduct and therefore the auditors could not plead *ex turpi causa* to defeat its claim, as in order to do this, S&R would need to be primarily liable.

Held

Lord Walker referred to the principle that knowledge of an agent would not be imputed to its principal where that knowledge related to the agent's own breach of duty to the principal (**re Hampshire Land Co** [1892]). This "adverse interest exception" was deemed to be a general principle of agency which could apply to any issue as to a company's notice, knowledge or complicity, whether arising as a matter of claim or defence. This principle was pleaded to insulate the company, for the purposes of the *ex turpi causa* rule, from Mr Stojevic's fraudulent conduct. However there was no doubt Mr Stojevic was the quintessence of the company.

The House of Lords therefore held by a majority, Lord Scott and Lord Mance dissenting, that the appeal should be dismissed.

S&R was a one-man vehicle used by an individual, Mr Stojevic, to defraud. S&R was therefore primarily liable for Mr Stojevic's frauds. Accordingly, the auditors could rely on *ex turpi causa*. If the auditors were held liable, this would basically amount to allowing S&R to benefit from its own illegal activity as "a company, exclusively controlled by a single director so as to be primarily liable for frauds committed against third parties, could not bring a claim for damages against its auditors ...since any such claim would be based on the company's own illegal conduct and was accordingly debarred by the defence of *ex turpi causa non oritur actio*."

Lord Walker stated that:

- 1) The illegality defence, that no one could found a cause of action on his own criminal conduct, was a fundamental principle of public policy (**Holman v Johnson** [1775]).
- 2) The test for its application is whether the claimant had to rely on or plead his own illegality (**Tinsley v Milligan** [1994]).
- 3) If Mr Stojevic had carried out his frauds on his own, rather than through the company, neither he nor his trustee in bankruptcy would have had a claim against the auditors, since the illegality defence would have been unanswerable.

Guest article

We are delighted to have a guest article in this edition from Cameron McNaught who is a Partner at Brodies LLP in Edinburgh.

For further information about the pleural plaques compensation in Scotland, please contact Cameron at Cameron.mcnaught@brodies.co.uk or +44(0)131 228 3777.

Please note that there are no formal ties between Weightmans and any other law firm and the views expressed in this article are those of the authors.

Pleural Plaques Compensation – The Scottish Challenge

Any insurers who are called on to deal with occupational disease claims will be familiar with the House of Lords decision in **Rothwell** and its effect on asbestos litigation. The response to the decision in Scotland raises the prospect that individuals with pleural plaques will again be able to receive compensation for their condition.

The Scottish reaction

Rothwell finally brought an end to the longstanding practice of insurers settling claims for damages for the mere existence of pleural plaques. The court held that pleural plaques did not constitute actionable damage and, as a result claimants in England & Wales lost their ability to bring claims for the condition.

A surprising twist is that House of Lords decisions in English cases, based on common law, are not binding on Scottish courts. Such decisions are “highly persuasive” but in theory it would have been possible for the courts north of the border to refuse to follow the reasoning in **Rothwell**. In reality, it was accepted that the decision would almost certainly be followed and any doubts were dispelled by comments in the Scottish case of **Wright v Stoddard International plc**.

There was intense political pressure on the Scottish Government to reverse the effect of the decision from a variety of groups committed to securing compensation for those exposed to asbestos at work. The Government supported a return to compensation for plaques, but in the absence of support from other political parties, the issue could have faded away. As it turned out, there was wide cross party support for government intervention.

Just over a month after **Rothwell** the Scottish Government indicated that it intended to introduce a bill in the Scottish Parliament to reverse the decision. Moreover, the legislation would be retrospective. In the words eventually used in the Act, the critical sections were to be treated as “as having always had effect.” Following a brief consultation period, the bill itself was published in June 2008. The Act was eventually passed in March 2009 and was brought into force on June 17 of this year.

It provides that asbestos related pleural plaques, and pleural thickening/asbestosis which have caused no impairment of an individual’s physical condition are personal injuries which constitute actionable harm for the purpose of an action for personal injuries. Any rule of law which states otherwise ceases to apply.

Some potential difficulties

It is unusual in the personal injury field for there to be divergence between English and Scots law. The law has developed along very similar lines with Scottish decisions being influential in England and vice versa. Increased statutory liability, along with European legislation has meant that for many years there have been

few differences in substantive law. The 2009 Act threatens to give rise to practical difficulties for the first time. In particular, there is a risk of “forum shopping”. Brodies has already seen claimants raising an action against an employer for exposure to asbestos in Scotland, but at the same time involving other defendants based south of the border in respect of whom the Scottish courts would ordinarily have no jurisdiction. It is argued that that existence of the first claim is so closely related to the other claims that the Scottish courts should deal with them in a single action. It will certainly be interesting to see how the Courts deal with this type of problem.

Also, the Act gives no guidance as to how a court is meant to assess the level of damages for non-symptomatic conditions. Cases of pleural plaques in Scotland were previously settled by insurers at around £8–10,000. It seems unlikely that a court would now be willing to make such a high award, given the current level of medical knowledge about these conditions, but who knows?

The challenge

The speed with which the Act was introduced is in marked contrast to the approach in England and N. Ireland. At the time of writing, the result of the UK government’s deliberations following consultation have not yet been revealed although judging from statements in the House of Commons, there appears to be a reluctance to intervene. A Private Members Bill was introduced in the Commons due to lack of Parliamentary time. A fresh bill has been introduced in the House of Lords but without government support it is unlikely to make any impact. It was only in June of this year that a former minister, Nigel Dodds, indicated his intention to recommend to the N. Ireland Executive that they look at legislating to reverse the effect of **Rothwell**.

The potential financial impact of the Act and the spectre of compensation for other symptomless conditions presented serious concerns for insurers. There was particular anxiety about abandoning a longstanding principle that the law does not compensate the “worried well.” As a result, Brodies were instructed by AXA, Norwich Union, RSA and Zurich to act on their behalf in mounting a challenge to the Scottish legislation.

A Judicial Review of the Act was launched in the Court of Session in Edinburgh with the hearing ending before Christmas. The challenge is being defended by the Scottish Government and, interestingly, a number of individuals with plaques, who are potential claimants, have been allowed to join the proceedings. Attempts to persuade the court to grant an injunction to prevent the Act being brought into force were unsuccessful but by a combination of judicial decision and agreement, all new cases raised in the courts in Scotland have been sisted (stayed) pending the outcome of the review.

Irrespective of the outcome, it seems inevitable that the matter will go further. Any appeal would be heard initially by the Inner House of the Court of Session with a further right of appeal to the Privy Council.

The main grounds of challenge are straightforward even if the supporting arguments are far from simple:

1. The Act is incompatible with the insurers’ rights under Article 6 of and Article 1 of the First Protocol to the European Convention for the Protection of Human Rights. It denies insurers the right to a fair trial by, amongst other things, imposing a retrospective financial burden that the courts decided they should have to bear. It deprives them of their funds without any reasonable basis for doing so and runs contrary to established medical opinion that plaques are not harmful.
2. The Act is the result of an unreasonable, irrational and arbitrary exercise of the legislative authority conferred on the Scottish Parliament by the Scotland Act 1998.

And what's it all going to cost?

During the Act's passage through Parliament one of the most controversial issues was the cost implications of future claims. The ABI estimates that the cost of Scottish claims may be anywhere between £1.1 and £8.6 billion pounds. The Scottish Government suggests a very much lower figure.

Whatever the actual figure, there is no doubt that the legislation has a price and that the costs will have to be met by someone. The majority of the burden will fall on insurers with knock on effects for the industry, policyholders and premiums.

Cameron McNaught, Partner
Brodies LLP

Seasons Greetings and catch up

Our London Market team would like to wish all of our clients and contacts a very merry Christmas and a happy and prosperous 2010.

Members of the London team can be found in early 2010 at the following:

- At the British Insurance Law Association ("BILA") seminar at Lloyd's on 8 February 2010
- At the Association of Run-Off Companies ("ARC") Congress on 23 February 2010
- At the BILA Half-Day Conference on 8 March 2010
- Our next London Market Team seminar at the The Old Library in Lloyd's on 24 March 2010 (invites to follow)



Colin Peck
Partner
+44(0) 20 7822 1984
colin.peck@weightmans.com



Ling Ong
Partner
+44(0) 20 7822 1985
ling.ong@weightmans.com



Dan Cutts
Partner
+44(0) 116 242 8923
dan.cutts@weightmans.com



Mike Grant
Partner
+44(0) 151 242 7956
mike.grant@weightmans.com



This update does not attempt to provide a full analysis of those matters with which it deals and is provided for general information purposes only and is not intended to constitute legal advice and should not be treated as a substitute for legal advice.

Weightmans LLP accepts no responsibility for any loss that may arise from reliance on the information in this update. The copyright for this update is owned by Weightmans LLP 2007.