INSURANCE BULLETIN
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In this week's Insurance Bulletin:

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"The outcome on appeal demonstrates the importance of ensuring that your professional work product is compliant with the terms and conditions of your professional indemnity policy so that cover is not withheld for want of compliance. "

1. COURT CASES AND ARBITRATION

Australia: Have you dotted your i's and crossed your t's? The importance of compliance with the T&Cs of your PI insurance

The NSW Court of Appeal[1] recently held that an insurer was entitled to deny indemnity under a valuer's professional indemnity policy by relying upon an exclusion which operated to exclude liability in the event of a failure by the valuer to include a prudent lender clause in valuation reports prepared for certain categories of lenders. This was despite it being agreed that the loss which was the subject of the claim against the valuer was not caused by the absence of a prudent lender clause in the valuation reports.

In 2010, MMJ Real Estate (WA) Pty Ltd (MMJ) prepared three property valuations for BNY Trust Company of Australia Limited (BNY). BNY subsequently commenced proceedings against MMJ, Dennis Volk (a director of MMJ) and Bruce Hosking (an employee of MMJ) (collectively, the defendants) for professional negligence arising out of the three property valuations. The defendants cross-claimed against their insurer, XL Insurance SE (XL), after it denied indemnity under the policy and refused to pay their defence costs.

The policy was a claims-made policy which covered the period 30 June 2016 to 30 June 2017 and contained an unlimited "Retroactive Date". XL denied indemnity by relying upon exclusion clause (ix) which was contained in an endorsement to the policy. The clause excluded cover for liability arising from valuations undertaken for lenders who were not an Authorised Deposit-Taking Institution (ADI) supervised by the Australian Prudential Regulatory Authority, *unless* a prudent lender clause (in terms materially similar to that set out in the exclusion clause) was included in the relevant valuation report.

The Supreme Court was required to determine whether XL was entitled to decline to indemnify the defendants and to pay their defence costs by reason of the operation of the exclusion clause.

Importantly, the parties agreed, amongst other things, that BNY was not an ADI at the relevant time, and that the loss the subject of BNY's claim against the defendants was not caused by their failure to include a prudent lender clause in the valuation reports.

Supreme Court decision

Having applied the principles of construction to the endorsement in the policy, Schmidt J found that the introductory words of the endorsement:

a) being, *"directly or indirectly arising out of, based upon, attributable to or in consequence of"*, and the terms of the clauses which followed, of which clause (ix) was one, were ambiguous; and

b) were capable of being read as concerned with losses *caused* by the matters dealt with in the clauses which followed those words, in the case of clause (ix), the failure to include a prudent lender clause in the valuation report.

Accordingly, her Honour determined that the *"endorsement requires that there be a causal link between the absence of the prudent lender clause…in the valuation and the loss for which the indemnity is sought"*.

In support of her determination, her Honour reasoned that such construction *"avoids obvious consequences…which in the circumstances…it must be accepted, would be so irrational and unjust, that it is unlikely they were intended by these commercial parties."*

Her Honour concluded that XL were not entitled to deny indemnity under the policy by reason of the operation of the exclusion clause and ordered that the defendants be indemnified in accordance with the policy terms and conditions and that their defence costs be paid.

Outcome on appeal

All three judges of the Court of Appeal overturned the decision of Schmidt J.

Justice Gleeson (with whom Bell P and Emmett AJA agreed) undertook a similar exercise in construing the meaning of the exclusion clause by:

a) asking what a reasonable businessperson would have understood the clause to mean; and

b) considering the intention of the parties by reference to the terms of the clause in the light of their context and purpose.

His Honour did not agree that the introductory words required a direct or proximate relationship to be established, such as would have been required if the words "caused by" had instead been used. Accordingly, Gleeson J found that an indirect causal relationship between the subject matter of clause (ix) (the undertaking of valuations for lenders who were not an ADI) and BNY's loss was sufficient to engage the exclusion. Simply put, MMJ's valuations answered the specified description in clause (ix), having been prepared for a non-ADI lender without the inclusion of a prudent lender clause.

To adopt the construction proffered by Schmidt J would, according to Gleeson, have resulted in an alteration to clause (ix) rendering it effective only in circumstances where the absence of a prudent lender clause in a valuation prepared for a non-ADI is a cause of the loss. His Honour found that the commercial inconvenience which arises from the need for a *"causal inquiry as to the nexus between the absence of a prudent lender clause…and the loss suffered by the non-ADI lender"* is unlikely to have been intended by the parties.

On a proper construction of clause (ix), BNY's loss was excluded from cover and XL were entitled to decline to indemnify the defendants and to pay their defence costs.

Implications

The outcome on appeal demonstrates the importance of ensuring that your professional work product is compliant with the terms and conditions of your professional indemnity policy so that cover is not withheld for want of compliance. To otherwise rely upon the court's interpretation of the relevant terms and conditions could leave you with no cover in circumstances where such an outcome could have been avoided.

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Footnotes

1. In *XL Insurance Co SE v BNY Trust Company of Australia Limited* [2019] NSWCA 215

England & Wales: Privileged in perpetuity: *Lee Victor Addlesee & Ors v Dentons Europe LLP*[1]

The Court of Appeal has reiterated that legal advice privilege remains in existence unless and until it is waived. Such privilege attaches not to the client to whom the advice was provided, but to the communications/documents passing between the client and their legal advisor. Unless waived, that privilege is not lost, even if no one exists who is entitled to assert it.

The Claimants had lost investments in a scheme marketed by a Cypriot company, Anabus Holdings Ltd, which has now gone insolvent. The Claimants issued proceedings against Anabus's lawyers, Dentons, in connection with misrepresentations allegedly made to the Claimants regarding the scheme. The Claimants wanted documents passing between Dentons and Anabus to be disclosed as part of those proceedings. Due to Anabus's insolvency, insofar as any rights in relation to the documents still exist, they have passed to the Crown as *bona vacantia*, which has disclaimed all interest in them without either asserting or waiving any legal professional privilege.

Relying upon the decision of the Upper Tribunal in *Garvin Trustees Ltd v The Pensions Regulator* [2014] 11 WLUK 469, the Claimants argued that the right to assert legal profession privilege has disappeared because Anabus no longer exists or, alternatively, because the Crown had disclaimed its interest in the relevant documents. However, that reasoning was rejected by the Court of Appeal.

In doing so, the Court highlighted the following key features of legal advice privilege:

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"Insurers are already facing a new normal in terms of the severity of wildfires. It seems likely they will soon be facing more aggressive regulation too."

- Such privilege extends beyond disclosure in proceedings: it is a fundamental human right.
- The doctrine exists because clients should be able to seek legal advice, secure in the knowledge that it will not ever be disclosed.
- Legal advice privilege attaches to the documents themselves, and at the time when they are made.
- The right to rely upon legal advice privilege can be "inherited", and is therefore not destroyed by virtue of the fact that the original client has become insolvent.
- Once privilege has attached to a communication/document, it will only cease if waived by the client (or someone otherwise entitled to waive it) or is overridden by statute.
- If the original client no longer exists, the key question is not whether anyone exists to assert the right, but whether anyone exists who is entitled to waive it.

Taking the above into account, the Court held that privilege still existed in Anabus's communications with Dentons: the right to rely upon it had not disappeared with Anabus's insolvency and had not been waived, either by the Crown or any other party. Accordingly, Dentons was entitled to withhold from inspection the documents sought by the Claimants.

In reaching this decision, the Court of Appeal explicitly overturned *Garvin*, in which, in very similar circumstances, the Upper Tribunal had held that the privilege in documents belonging to a now insolvent company had been lost. The Court of Appeal found that the Upper Tribunal had erred in focussing on who could assert privilege, rather than the pertinent question, namely, who can waive it.

The *Addlesee* decision is therefore a welcome development, which brings jurisprudence back into line with previous authorities

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Footnote

1 [2019] EWCA Civ 1600

2. MARKET DEVELOPMENTS

USA: Insurance issues in areas at high risk from California wildfires

It's peak wildfire season in California.

In recent weeks electricity companies in the Golden State shut off power to millions of people in an attempt to prevent sparks from overhead power lines lighting brush fires on ground that was tinder-box dry after the state's long, hot summer.

So far, 2019 has seen far fewer wildfires than the recent average. However, the years of 2015 to 2018 were particularly devastating, and this trend is only likely to worsen with climate change.

For residents struggling to rebuild their lives after having their homes destroyed, they must confront a further challenge: the state's fire insurance industry.

Following the 2017 fire season, the number of homeowner policies in ZIP codes affected by those fires that insurers refused to renew increased by 10% from 2016 to 2018.

Even for those homes that have not suffered a loss, carriers have either stopped writing altogether or demanded extraordinary premium increases. The LA Times quotes one homeowner in a high-risk area whose annual premium increased from US$4,200 to US$22,000.

Homeowners are having to resort in increasing numbers to finding coverage through the California FAIR Plan, the state's industry-funded fire insurer of last resort, and even surplus lines insurers including Lloyd's. New FAIR policies increased 177% between 2015 and 2018.

Surplus lines insurers are not permitted to sell residential insurance unless a customer has been rejected by at least three conventional insurers. Nonetheless, although such insurers still only account for a small proportion of homeowner business, they have seen a noticeable uptick in business to 2.3% of total premiums, after averaging 1.4 to 1.8% over the last five years.

It is difficult to disagree with insurers when they say climate change has affected the industry. However, critics argue that insurers' price setting mechanisms are opaque, and that it is too easy for insurers to drop customers. The United Policyholders consumer advocacy group has called the issue a crisis, and is calling on the Department of Insurance to step up its oversight. Insurers are already facing a new normal in terms of the severity of wildfires. It seems likely they will soon be facing more aggressive regulation too.

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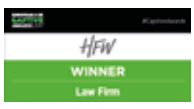
3. HFW PUBLICATIONS AND EVENTS

Briefing: Has Populism reached Part VIIs?

Carol-Ann Burton (Partner, London) and Rebecca Huggins (Professional Support Lawyer, London) assess the potential impact of the High Court's decision to block the Part VII transfer of Prudential Assurance Company's annuity book to Rothesay Life. For the full Briefing, go to: www.hfw.com/Prudential-and-Rothesay-Has-Populism-reached-Part-VIIs

Briefing: "BRILLANTE VIRTUOSO": a cautionary tale for co-assured banks and mortgagees' interest insurers

The High Court has dismissed a claim by the mortgagee bank of the "BRILLANTE VIRTUOSO" under the terms of the vessel's war risks policy on the basis that the constructive total loss of the vessel was caused by the wilful misconduct of the owner. For the analysis of the decision by Alex Kemp (Partner, London) and Kirsten Wright (Associate, London), go to: www.hfw.com/BRILLANTE-VIRTUOSO-a-cautionary-tale-for-co-assured-banks-and-mortgagees-interest-insurers



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