EXCLUSION CLAUSES IN INSURANCE POLICIES REVISITED BY COURT OF APPEAL

In *Brian Leighton (Garages) Ltd v Allianz*, the Court of Appeal considered whether an exclusion for pollution or contamination excluded cover for damage which itself caused pollution and contamination. The result, in favour of the insured, might come as something of a surprise to insurers. Some of the Court's comments will also be of interest to brokers, particularly those advising SME insureds.

"The construction of exclusion clauses will, it seems, perpetually cause problems for the insurance market, no matter how clear the drafting appears to have been when put together."

The cover in issue related to a petrol station, but the operative part of the exclusion wording requiring loss to be "caused by" an excluded peril is common in many property, energy , CAR and other policies. The judgment will therefore be of interest to the wider insurance and reinsurance market, which may wish to revisit how some of its exclusions operate generally. Insurers may look to tighten up the wording of exclusions, leading to difficult negotiations with brokers, who have a duty to ensure that the cover offered is suitable for their clients.

The policy insured a petrol station in Yorkshire. A leak occurred from a pipe connecting the underground fuel tanks to the fuel pumps, caused by the pressure of an object such as a sharp stone under the pressure and movement of the concrete slab under the forecourt. The fuel leak contaminated the garage and adjacent property to such a degree the business had to be closed due to fire or explosion risk.[1]

The insured claimed under its Motor Trade policy, and the issue, in this summary judgment application, was whether the claim fell under the pollution and contamination exclusion from cover. At first instance the High Court found that claim was excluded, and summary judgment was granted to insurers. The insured appealed.

Policy wording

The policy provided cover for damage to property insured. It excluded:

"Pollution or Contamination

Damage caused by pollution or contamination, but

We will pay for Damage to the Property Insured not otherwise excluded, caused by:

(a) pollution or contamination which itself results from a Specified Event

(b) any Specified Event which itself results from pollution or contamination."

Specified Events were defined as "*Fire, lightning, explosion, aircraft or other aerial devices or articles dropped from them, riot, civil commotion, strikers, locked-out workers, persons taking part in labour disturbances, malicious persons other than thieves, earthquake, storm, flood, escape of water from any tank apparatus or pipe or impact by any road vehicle or animal.*"

It was common ground that no Specified Event occurred in this case. The matter proceeded on the basis of assumed facts.

Judgment

Lord Justice Popplewell gave the leading judgment, with which Lord Justice Nugee agreed. Lord Justice Males dissented.

All of the judges agreed on the following principles and points:

- As the Supreme Court said in the FCA test case[2], an insurance policy must be interpreted objectively and by asking what a reasonable person with all the background knowledge reasonably available to the parties, when they entered into the contract, would have intended the language to mean.
- The general principle is that an insurer is liable only for loses proximately caused by a peril covered by the policy, and the proximate cause is the dominant effective and efficient cause.[3] Likewise, there is a presumption that an insurer can only rely on an exclusion where the excluded peril was the proximate cause of the loss.
- That principle is based on the presumed intention of the parties, but is subject to contrary agreement.
- On these facts the assumed proximate cause of the damage was the puncturing of the pipe by the sharp stone.

1 The facts were not agreed, but the insurers agreed to proceed on this basis for the purpose of the summary judgment application.

2 *FCA v Arch* [2021] UKSC 1

3 S55 Marine Insurance Act 1906, *Leyland Shipping Co v Norwich Union* [1918] AC 350

- Therefore, the key issue in the case was whether the exclusion excluded cover only where pollution or contamination was a proximate cause of the damage, or also excluded cover where pollution/contamination was a process in the chain of causation.
- Contrary to submissions, the exclusion was not to be construed contra-proferentum to insurers, as it was clear the relevant clause formed part of the scope of cover.
- Some of the previous cases on pollution/contamination exclusions (*Legg v Sterte Garages*[4] and *Leeds Beckett University v Travelers*[5]) did not assist.

Popplewell LJ's judgment:

Popplewell LJ noted that it was common ground between the parties that the words pollution or contamination in the exclusion were not being used in the sense of a description of the damage, but rather as the process by which the damage was caused or the occurrence which gives rise to that process.

Taken alone, the Judge held that it was tolerably clear that the exclusion was concerned only with pollution/contamination as a proximate cause. This was reinforced by the fact that the drafter appeared to have in mind the distinction between proximate and indirect causation as there were other exclusions (although in optional parts of the cover that the insured may not always choose to take out) that did refer to loss or damage "*directly or indirectly caused by pollution or contamination*".

Popplewell LJ held that it was reasonable to attribute to the parties the presumed intention that the wording was chosen to refer to proximate cause, as knowledge of the basic principles of causation and the language that reflects and modifies it formed a part of the background knowledge. He said:

"*I do not take what was said in [77] of FCA v Arch as suggesting that the reasonable person in an SME's shoes should not be taken to be familiar with the basic principles of insurance law and the meaning which has been put on phrases used in insurance contracts by consistent judicial authority. Many policies of insurance in many fields contain terms of art which have acquired their meaning by consistent use and judicial interpretation, which it is the duty of brokers to understand and, if necessary, advise on.*"

The Judge indicated that this conclusion could only be displaced if the write-back provision required something different, finding that it did not. This provision could be interpreted consistently as follows:

- Subsection (a) wrote back cover where pollution or contamination was the proximate cause of damage (so ie the loss would have otherwise fallen within the exclusion) but a Specified Event is a more remote cause;
- Subsection (b) could be construed as writing back cover where pollution/contamination and a Specified Event were concurrent causes of the loss (which would have otherwise been excluded following *Wayne Tank* which held that where a loss is caused concurrently by an insured and an excluded peril, the exclusion prevails). This meant that the words "result from" in the write-back must be given a meaning different to proximate cause, contrary to a previous decision in the House of Lords[6], but Popplewell indicated that this was permissible where here it referred to the relationship between insured/excepted perils in a chain.

Popplewell LJ regarded it as relevant that a reasonable reader of the clause would expect the exclusion to be determined by its words, not by what followed it. He also held that it was not surprising that the exclusion should have a narrow application in a policy covering all risks of material damage. Further, risk of fuel leaks is an obvious one for a petrol station in respect of which its operator is likely to require cover– a narrowly construed exception was consistent with this.

Lord Justice Nugee's judgment

Lord Justice Nugee agreed (not without difficulty) with the conclusions of Popplewell LJ.

Nugee LJ considered how the write-back operated by considering some specific examples:

- If there were an earthquake that damages a sewage pipe that contaminated the petrol station, then the earthquake would be at least a proximate cause, and it would be possible that the resulting sewage spill would also be a proximate cause. The effect of (a) would be to prevent an argument that cover may be denied.
- With regard to (b) if there were an escape of fuel that burned down the petrol station, a reasonable reader would regard the fire as the proximate cause, and (b) would prevent the argument that the pollution exclusion applied due to the escape of fuel.

As these reasonable interpretations of the write-back existed there was nothing to displace the presumption that the exclusion excluded only proximately caused loss.

Lord Justice Males' dissenting judgment

Males LJ concluded that, read as whole, the exclusion was not restricted to damage proximately caused by pollution/contamination. He found the presumption of proximate cause somewhat easier to displace than the majority.

In his view the provision (including the write-back) had to be construed as a whole. It was unlikely that Popplewell LJ's interpretation of the clause was what would reasonably be understood by the reasonable policyholder. In contrast, the reader would understand that (for example) escape of water is covered as a Specified Event due to the terms of the write-back, but in an apparent deliberate contrast the escape of fuel is not. Thus, loss arising from the former would be covered, even where it involved pollution or contamination, whereas loss arising from the latter would be excluded. The purpose of the write-back appeared to be that where a Specified Event occurred that causes or is caused by pollution/contamination, there would be cover regardless of which was the proximate cause.

4 [291] EWCA Civ 97

5 [2017] EWHC 588 (TCC)

6 *Lloyds TSB v Lloyd's Bank Group* [2001] EWCA Civ 1643

Males LJ found that it was not permissible to refer to contrasting indirect causation language in other sections of the policy that the insured may not have selected.

Comment

On one view, the outcome of the case might be seen as surprising. The policy excluded cover for pollution/contamination, and the loss that was suffered was due to the fuel contaminating the property, but the exclusion did not operate.

By a majority the Court of Appeal decided that in this case the words "caused by" in an exclusion clause should be ascribed a narrow interpretation. In other words that the presumption this means "proximately caused by" stood, despite some clear arguments to the contrary based on the exclusion clause as a whole. The Lord Justices noted that the matter was not straightforward, and indeed one of them dissented. Some may regard this as part of a shift in the judiciary towards policyholder friendly decisions.

The case suggests that the presumption that proximate causation is required is not readily displaced. The somewhat vague tests of commercial common sense and construction of the precise words in their plain and ordinary sense have, slightly surprisingly in this case, won the day over consideration of other "surrounding" words and context, although it was common ground that those surrounding words were irrelevant on the facts of this claim.

The construction of exclusion clauses will, it seems, perpetually cause problems for the insurance market, no matter how clear the drafting appears to have been when put together.

Finally, it appears to have caused the Lord Justices in this case some pause for thought that, whilst themselves considering the individual words within the policy in some detail, the Supreme Court in the FCA test case indicated that, where a policy is addressed principally to SMEs, the document should not be reviewed through the eyes of "*a pedantic lawyer who would subject the entire policy wording to a minute textual analysis*" but a nominal, reasonable SME.

Brokers will therefore need to take care to advise SME clients as to the meaning and implications of particular terms in the policy, including those that may appear innocuous such as "caused by". This may not always be straightforward, as shown in this case, where three Justices themselves did not agree on the correct interpretation of the policy wording.

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