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WHAT DOES IT MEAN TO CONDONE?

In *Discovery Land v Axis* the Court of Appeal has given some guidance as to the meaning of the word “condone” within the context of a fraud or dishonesty exclusion in a solicitors’ professional indemnity policy. It also considered issues relating to aggregation under the SRA solicitors' minimum terms ("MTC").

Introduction

This claim arose from several fraudulent and dishonest acts committed by a solicitor, Mr Jones, a partner in a law firm and director of two related companies, (the "Jirehouse entities"). There was one other partner / director in the Jirehouse entities, Mr Prentice.

On one occasion, he removed very large sums from the client accounts held on behalf of the claimants, in connection with the purchase of a castle, taking them for his own benefit ("the Surplus Funds" claim). On another, he fraudulently arranged a loan to one of the claimant companies without client knowledge, using the castle as security and misappropriated the proceeds (" the Dragonfly claim"). The claimants obtained judgment against the Jirehouse entities, which had become insolvent.

Accordingly, the claimants sought to obtain payment of the judgment amount from the defendant, the professional indemnity insurer of the Jirehouse entities, under the Third Party (Rights Against Insurers) Act 2010.

The policy was written in accordance with the MTC and the question was whether the claim was excluded under the fraud or dishonesty exclusion which read:

“*Any claims directly or indirectly arising out of or in any way involving dishonest or fraudulent acts, errors or omissions committed or condoned by the insured, provided that:*

(a) the policy shall nonetheless cover the civil liability of any innocent insured; and

(b) no dishonest or fraudulent act, error or omission shall be imputed to a body corporate unless it was committed or condoned by, in the case of a company, all directors of that company or, in the case of a Limited Liability Partnership, all members of that Limited Liability Partnership.”

This exclusion applies only where all of the partners (Mr Jones and Mr Prentice in this case) committed or cordoned fraud. At first instance it was held, amongst other things, that Mr Prentice had not condoned the fraud by turning a blind eye to it. This was despite the fact that Mr Prentice was himself dishonest and lacked integrity and, for example, had been prepared to artificially raise bills to extinguish an amount to be paid to a client and lie in the witness box.

Issues

The key issues in the appeal were:

- whether the only other member and director of the Jirehouse entites, Mr Prentice, had condoned the behaviour of Mr Jones – so that the exclusion from cover would be engaged and;
- whether the two frauds outlined above aggregated as one claim.

Judgment

The Court of Appeal judgment was given by Lady Justice Andrews, with which the other judges agreed.

The condonation issue

This was an appeal of the judge's finding of fact. In order to succeed on such an appeal on factual matters, the appellant must establish that the judge was plainly wrong and the decision was one no reasonable judge could have

reached. In this case, insurers said the judge's decision could not be reasonably explained or justified in light of the adverse findings he had made about Mr Prentice's honesty.

Andrews LJ said that the clause requires a causal nexus between the dishonest behaviour said to have been condoned and the claim against the insured for which indemnity it sought. It is the condonation of that particular dishonest behaviour that leads to it being attributed to the insured entity, not the condonation of dishonestly generally.

Nevertheless, Andrews LJ agreed with the first instance judgment that the language of the clause is wide enough to embrace a situation in which someone condones a pattern of dishonest behaviour which is of the same type as the dishonest behaviour that directly gives rise to the claim, and of which the latter forms part (e.g. if a member condoned the regular use by another of client funds for their own purposes it could not be said he was unaware of a specific instance because he was on holiday). The question is whether the knowledge and acceptance and approval of other acts in the same pattern amounted to condonation of the acts which give rise to the claim.

The primary finding at first instance was that, whilst Mr Prentice had not complied with his responsibilities as a solicitor, he had not suspected client monies were being misappropriated by Mr Jones. Alternatively, the judge said that if Mr Prentice had suspected something, then it was that client monies were being used to address temporary exigencies and pressures on the firm and that large scale theft by Mr Jones did not form a pattern with such use of client monies. Andrews LJ had some reservations about this alternative finding, and doubted an individual could escape the consequences of his condonation by arguing that he was only condoning small thefts not large, or "borrowing" not theft.

The Court also found that it was possible to condone dishonest behaviour after the event, by doing something such as covering it up, or not taking the action it would be expected that an honest person would take (especially if there was a duty to act, as there is in the case of a solicitor).

Applying this to the case, Andrews LJ noted that the first instance judge rejected the case that Mr Prentice had "blind eye" knowledge of the dishonesty i.e., that he had a firm focussed suspicion that Mr Jones was deliberately misappropriating funds and failed to follow up because he feared it would be confirmed.

Although the judge had found that Mr Prentice was dishonest, deeply unprofessional and unsuitable to be a solicitor, the evaluation was that Mr Prentice had told lies to try to distance himself from events and circumstances and the personal risk that entailed. The Judge found that Mr Prentice knew the Jirehouse Entites were struggling to pay salaries and were taking money from the client account as well as artificially raising bills, but there was insufficient to conclude Mr Prentice was closing his eyes to the obvious (although he should have looked into what was happening as a question of professional responsibility).

Andrews LJ found that although another judge might have drawn less benign conclusions on the basis of the factual findings, nonetheless the conclusions that Mr Prentice might lie about certain issues to protect himself, but would draw the line at telling clients monies were in the client account when they were not, were perfectly reasonable.

The appeal on this issue was therefore dismissed.

Aggregation

The question was whether the Surplus Funds and the Dragonfly claim aggregated.

This depended on whether they arose from *"similar acts or omissions in a series of related matters or transactions"* (under clause 2.5(a)(iv) of the MTC). The Court held that (considering the first instance decision in *Woodman v AIG*) that the degree of similarity between the acts and omissions must be real or substantial and to determine that it was necessary to consider the substance of each claim. In this case the Surplus Funds claim was a straightforward misappropriation of the monies the clients had transferred for a specific purpose that should have been held on trust. The Dragonfly Loan claim was the wrongful arrangement of a loan and charge over a client's property, whilst keeping the client in the dark, and release of the monies from the client account. These were in substance two very different things. However, even if this was incorrect the claims were not *"acts or omissions in a series of transactions which were related"* as the Dragonfly claim was not in any sense a part of the first set of frauds.

The appeal on aggregation was therefore also dismissed.

Conclusion

The case gives some useful guidance on the meaning of condone within a solicitors' professional indemnity policy. It provides an illustration of circumstances where, despite some fairly extensive dishonesty on the part of a second partner and poor behaviour generally, this will not be enough.

As to aggregation, the case highlights that the circumstances in which claims will aggregate under the MTC are fairly limited. The position would, of course, have been different if the aggregation clause had aggregated by reference to an "originating cause" (although that would not have complied with the MTC) where Mr Jones's dishonesty may have been enough to aggregate the claims, as was the case in Spire v Healthcare.

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