Favourable approach for insurers to the construction of exclusion clauses

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In a recent decision the Commercial Court has followed the Supreme Court in the *Impact Funding* case. It declined to apply the *contra proferentem* rule to an exclusion clause in an insurance policy. Insurers will welcome the decision.

The *contra proferentem* rule is a rule relating to the construction of exclusion clauses in contracts. It applies where an exclusion clause purports to cut down liabilities that would otherwise be borne by a contract breaker. It operates where the drafting of the exclusion is ambiguous and it requires the clause to be construed narrowly against the party that is relying on it.

An attempt to apply to the rule to the construction of an exemption clause in a professional indemnity policy was rejected by the Supreme Court in Impact *Funding Solutions Ltd v AIG Europe Insurance Ltd* [2016] UKSC 57. There the Supreme Court held that the insurer could rely upon the trading debt exclusion in the policy and was not liable for loans that a funder had advanced to a law firm to pay disbursements under CFAs. It held that the extent of the insurer's liability was to be ascertained by reading the insuring clauses and exclusions together and that an exclusion clause had to read in the context of the policy as a whole and having regard to the purpose of the policy.

In *Crowden v QBE Insurance (Europe) Ltd* [2017] EWHC 2597 (Comm) the Commercial Court followed that approach. Mr Peter MacDonald Eggers QC (sitting as a High Court Judge) held that there was a clear difference between exemption clauses (which were designed to relieve a party of a liability that it would otherwise be liable for) and exclusion clauses in insurance policies which are designed to define the scope of cover.

There may be circumstances where there is a genuine ambiguity and the effect of the wider construction would be to denude the policy of a substantive part of the cover that it was intended to provide. In those circumstances, the court may construe the exclusion in its narrower construction and achieve that result either through the *contra proferentem* rule or simply by adopting the more commercially sensible meaning.

In *Crowden* the claimant suffered losses on investments as a result of negligent advice from a financial adviser. The investments included a bond from Keydata Investment Ltd and securities issued by Lehman Brothers Inc.

Any comments or queries?

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Keydata went into administration in June 2009 and Lehman entered Chapter 11 protection in September 2008.

The claimants made a partial recovery from the FSCS and sought to recover the balance from the adviser's insurer under the Third Parties (Rights Against Insurers) Act 1930. The insurer applied to strike out the claimant on two grounds. The first was that the claims against the insured adviser were excluded. The second was that part of the alleged liability had been assigned to the FSCS upon the claimants' settlement with the FSCS and that the claimants no longer had the right to sue the adviser in respect of it.

The exclusion clause excluded cover for claims "arising out of or relating directly or indirectly to the insolvency or bankruptcy of the Insured or of any insurance company ... or other business, firm or company with whom the Insured has arranged ... investments ...".

The claimants contended that the exclusion did not apply to any claims arising from negligent advice by the adviser. The court approached the policy without any pre-disposition to a narrow construction of the exclusion clause. Despite the potentially very wide effect of the exclusion there was no need to have regard to the commercial purpose and effect of the policy in construing it because there was no genuine ambiguity in its drafting. In addition, it was highly unlikely that the parties intended to limit its scope to non-negligent acts.

The claimants also argued that the exclusion only covered first party losses of the adviser. This was rejected having regard to the wording of the clause and the purpose of the policy affording predominantly third party liability cover. The court was also entitled to, and did, take into account changes in wording from an antecedent policy between the same parties that aided the interpretation. Where the relevant wording and alteration was contained in the body of the policy (rather than in attached standard terms and conditions) the court was entitled to assume that the parties had read them and would be aware of the difference.

The claimants also argued that the wide construction of the clause would operate to exclude wide tracts of "ubiquitous financial business" and that the purpose of the policy was to provide professional indemnity insurance to discharge the adviser's regulatory obligations under the FSA Handbook. The court held that although the clause was wide it did not have the effect of leaving the insured without substantial cover. The regulatory context was relevant but did not materially affect the construction where there was no indication in the policy itself, or otherwise, that it was intended to discharge the insured's regulatory obligations. In any event, it was not of sufficient materiality to override the plan meaning of the clause.

The court was not on this application able to determine whether the claimants' rights (in relation to part of the claim at least) had been assigned to the FSCS. The claimants relied in any event on a judgment that they had obtained against the insured adviser. The court held that the insurer remained entitled to question the insured's liability to the claimants. There were only two situations in which the insurer might be bound by a judgment between the insured and the claimant. The first was where the policy contained such an obligation. The second was where the insurer was a party or privy to the proceedings. Neither applied in this case.

Conclusion

This will be a welcome and instructive decision for insurers on the approach to the construction of exclusion clauses in insurances policies. It draws out the firm distinction between construing exclusion clauses in contracts where the exclusion is cutting down rights that would otherwise flow from a breach, and exclusion clauses which define the scope of the cover that is being provided in insurance policies.

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