Browne Jacobson

Court of Appeal upholds decision on professional indemnity policy exclusions in insurer's appeal

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In Axis Specialty Europe SE v Discovery Land Co LLC [2024] EWCA Civ 7, the Court of Appeal dismissed an insurer's appeal against the decision to indemnify the respondent clients.

The insurer sought to rely on an exclusion for dishonest or fraudulent acts and, failing this, to rely on the aggregation clause to treat two claims as a single claim.

The claims

The insured (Jirehouse Entities) was made up of an LLP and two private companies which were controlled by Mr Jones (J). Mr Prentice (P) was the only other member and director of the entities, appointed by J. As the insured was insolvent, the case was brought against AXIS (the insurer). The case involved two claims:

Surplus funds claim

The insured had agreed to act for a client on the purchase of a castle. The client transferred the purchase monies to the insured to hold on trust in its client account. However, J paid it into a bank account of another of his companies. Apart from the deposit, J misappropriated the remainder of the funds, together with additional funds that had been requested from the client. J had given the client dishonest excuses as to why they should transfer further funds (surplus funds) to complete the transaction, which the insured would repay. The final payment was made in December 2018 by the client to complete the purchase. The insured never accounted to the client for these surplus funds and the client became suspicious.

P was aware that the client had paid the money into the client account, but he was not directly involved in the purchase, nor was there evidence that he knew it was paid out of the account. P left J to handle the matter.

Dragonfly loan claim

Separately J dishonestly and without authority arranged a loan from Dragonfly Finance in January 2019, using the castle as security. J then removed the loan from the firm's client account and paid it into a bank account of another of his companies.

P gave evidence that he was unaware of the loan until March 2019. Upon learning that the proceeds of the loan had been paid away, P resigned.

The policy

As the claims fell within insuring clause, the insurer sought to rely on policy exclusions to decline the claim. Firstly, insurers argued that P had condoned the dishonest acts by J and that they could therefore rely on the following exclusion:

"*dishonest or fraudulent acts, errors or omissions committed or condoned by the insured, provided that ... no dishonest or fraudulent act ... 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.*"

Secondly, if it was not found that P had condoned J's acts, insurers argued that the aggregation clause allowed for both the surplus funds and Dragonfly loan claims to be treated as a single claim. Insurers argued that there was a substantial similarity between the acts, as they both involved taking money from a client account and that the clients were connected entities. In seeking to aggregate the claims, insurers relied on the following series clause:

"*similar acts or omissions in a series of related matters or transactions will be regarded as one claim ".*

Insurers' position on coverage was challenged and ultimately fell to be considered by the Court of Appeal.

Appeal

Fraud or dishonesty

The court agreed with the first instance judgment, namely that P had not condoned the pattern of dishonest behaviour leading to the claim. They held that condonation requires some knowledge, awareness or approval of other acts in the same pattern as the claim. Although the judge had reservations about P's subjective state of mind, they were unable to find a pattern of dishonesty as there was no evidence that J had a habit of making unauthorised borrowings against client assets.

The court therefore held that P did not have 'blind-eye' knowledge of the misappropriation of client monies, as that would require actual suspicion and an active decision not to take steps to confirm that suspicion. As this had been rejected by the first instance judge on the facts, and factual findings can only be disturbed on appeal where plainly wrong, the court found that the decision was not plainly wrong and the condonation appeal was dismissed.

Aggregation

As fraud or condonation on the part of P had not been found, there was cover under the policy and the aggregation issue was therefore also addressed. The court upheld that the acts were not similar for the purposes of the aggregation clause.

For the claims to be aggregated, the court held that the acts must be related, meaning that they must 'fit together'. This requires real or substantial similarity. The straightforward misappropriation of money from client account was different in nature from that of the wrongful arrangement of a loan and release of such money, despite both occasions involving J's dishonest behaviour in respect of the theft of client monies.

The surplus funds claim arose in relation to the purchase of the castle, which had completed before the Dragonfly loan acts occurred and was not, therefore, part of a sequence for which the purchase of the castle was the first step. The involvement of the same property or related clients was not, in itself, sufficient to demonstrate a substantial similarity between the acts that gave rise to the claims. The court held the first instance judge had reached a 'plainly correct' conclusion.

The appeal on aggregation was therefore dismissed and the insurer was unable to aggregate the claims.

Considerations for insurers

This case highlights the impact of the solicitors minimum terms policy wording, and the difficulties faced by insurers when seeking to apply the dishonesty exclusion and series clause. The courts are seemingly adopting an interpretation of both clauses.

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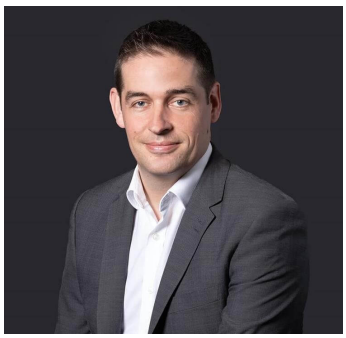

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