Browne Jacobson

Warranties and indemnities update

Insurers prevail once more in construction of an exclusion clause in W&I policy

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Having reported only recently that it is unusual for W&I claims to proceed all the way to judgment, there has been another decision on the construction of an exclusion clause in a W&I policy following a preliminary issues hearing.

In Project Angel Bidco Ltd (in administration) v Axis Managing Agency Ltd (as representative of Syndicate 1686 at Lloyd's of London) and others [2023] EWHC 2649, the Commercial Court found in favour of the Defendant insurers in respect of a claim under a W&I policy, agreeing with the Defendant that the loss (had it been established) fell within the scope of an exclusion clause.

The Judge disagreed with the Claimant that there was an error in the policy wording that needed to be rectified finding that in order to justify a re-writing of a contract there needs to be an obvious error or an irrational outcome. The exclusion as worded did not render the clause contrary to common sense or absurd. This was a high threshold to overcome and it was not met in this case.

Background

The Claimant entered into an SPA to buy the entire issued share capital of a company trading as King Construction (the Target). The Claimant entered into a buyer side warranty and indemnity policy with the Defendant (the Policy). The Policy contained an exclusion which provided that there would be no lability for losses arising of *"any ABC Liability"*. 'ABC Liability' was defined as meaning *"any liability or actual or alleged non-compliance by any member of the Target Group or any agent, affiliate or other third party in respect of Anti-Bribery and Anti-Corruption Laws"*.

The Claimant alleged that the Target was in breach of several warranties under the SPA. The facts surrounding those allegations were kept confidential due to an ongoing police investigation, though it could be inferred from the rest of the judgment that they related to compliance with anti-bribery and anti-corruption legislation.

The Defendant denied that there had been any breach of warranty or that it caused the alleged loss. The Defendant also claimed that, even if the Claimant could establish a breach which caused the loss, the Defendant had no liability due to the exclusion clause. It was agreed that if the Defendant succeeded, the claim must be dismissed. The Judge ordered this to be tried as a preliminary issue.

The construction issues

The Claimant argued that there was a minor error in the definition of 'ABC Liability' which should have read *"any liability [f]or actual or alleged non-compliance…"* with the impact being that the exclusion would be limited to actual or third-party liabilities rather than those directly suffered by the Claimant. The Claimant also argued that there was a conflict between the cover spreadsheet which noted that 'Bribery and Corruption' was 'covered' and the Defendants' interpretation of the exclusion clause, which would have completely eradicated any cover for Bribery and Corruption.

The Defendants argued that there was no proper textual or contextual reason for construing the exclusion in the way contended for by the Claimant, which would require the clause to be re-written and made no literal sense.

The decision

The Judgment sets out a helpful reminder that the principles that apply to the construction of an insurance contract are the same as any other contract. Words should be given their natural and ordinary meaning, based on the facts that were known to the parties at the time and disregarding any subjective evidence of the party's intentions. If the language is unclear then the court can suggest an alternative meaning, preferring a construction consistent with business common sense. An exclusion should be read in the context of the policy as a whole and if there is an alleged error then it can be corrected if it is clear that:

1. a mistake has been made, and
2. what the provision intended to say.

The Judge considered the starting point was the insuring clause which provided that the obligation to indemnify was *"subject to the terms and conditions of this policy"*. The exclusion was one of the terms and conditions to which the Defendants' obligation to indemnify was expressly made. It was entirely unequivocal that the Defendants were not liable for any losses arising out of 'ABC Liability'.

As to the scope of the exclusion, the Judge rejected the Claimant's argument that there was an error. The clause as written was not inherently absurd or obvious nonsense and an ordinary policyholder with all the background knowledge would read the clause as having disjunctively different situations, each of which came within the scope of the exclusion. The Judge considered the construction of the clause without reliance on any of the witness evidence which was found to be subjective, did not establish a fact that was known to both parties and ultimately reached the conclusion that there were known issues in relation to ABC Liability which the Defendants would want excluded and for which the Claimant required cover; none of which assisted in construing the proper construction of the Policy.

Considering whether there was any conflict between the Cover Spreadsheet and the Policy, the Judge rejected the argument that a reasonable policyholder would not expect a single exclusion to entirely sweep away the cover granted under a particular section of the Cover Spreadsheet. The Judge concluded that a policyholder who is taken to have read through the policy conscientiously would not reach any conclusion from the Cover Spreadsheet without also considering the insuring clause and the exclusions.

Comment

As noted in the judgment itself, W&I policies are usually underwritten on a bespoke basis and negotiated in parallel with the negotiations between the vendors and the sellers. As such, disputes arising out of them tend to be fact specific. This case is a useful reminder that a court will consider the policy from the position of the reasonable policyholder and there is a high hurdle to overcome before a court will conclude that a mistake has been made in the policy drafting. Nothing short of an 'obvious nonsense' is going to be sufficient. If there are obvious issues during the negotiation stage then it is important that exclusions are clearly drafted and each side is aware of the scope of cover being provided.

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