CONFIDENTIAL CLIENT BRIEFING
HLB KIDSONS v LLOYD'S UNDERWRITERS & OTHERS

Court of Appeal Judgment dated 5 November 2008

Background

In August 2001, following a meeting of the National Executive Committee of the accountancy firm HLB Kidsons, the Board of a subsidiary company S@FI which met the next day resolved that a notification should be made to the firm's professional indemnity insurers of circumstances which may give rise to a claim and so instructed the partnership secretary whose responsibility it was to make such notification. Both the Committee and the Board had heard that wide ranging concerns had been expressed by an employee of the firm about tax schemes the firm was offering through S@FI.

A letter was sent to Kidsons' brokers the next day. The following passages appear in that letter:

> *"The products marketed by S@FI have all been validated by virtue of Counsel's Opinion (in some cases two Opinions) but a tax manager in Edinburgh, Iain Torrance, has expressed the view that the Inland Revenue, if minded, could be critical of some procedures followed in certain cases. "*
>
> and
>
> *"The Board has taken the view that this might be regarded as material information for insurers. There is no sign of a claim arising at the present time but the Board feels that it is appropriate in the circumstances to advise what is happening and to take your instructions".*

The letter was followed by others and bordereaux were produced, and was later included in a broker's claim file.

First instance decision

At first instance before Mrs Justice Gloster it was held that the information provided to Underwriters was insufficient to trigger the deeming provision of the firm's PII policy save to the extent of a limited category of claims. Furthermore the Judge held that in respect of certain underwriters, the notice given to them of circumstances was too late because it was not made *"as soon as practicable"*. A general condition in the policy containing those words was held to be a condition precedent to indemnity.

In the course of her judgment, the Judge set down a series of important questions for determining whether or not a purported notification is valid and also whether claims that have arisen after the expiration of a policy fall within the scope of a particular notification made during the policy period. Those questions are:

1. What requirements must be satisfied for a notice to be valid and effective for the purposes of the relevant condition in the policy?

2. As a matter of fact, of what circumstance or circumstances was or were the insured aware during the policy period?

3. Does the particular communication/notification satisfy the relevant requirements of the condition in the policy?

4. If so, what, if any, circumstances does the particular communication notify?

5 If any one of the questions set out below cannot be answered in the affirmative, the communication is capable of being challenged as a valid notification:

   (a) Does the communication (including any attachments) include identification of any error, act or omission, or potentially negligent or otherwise wrongful conduct on the part of the insured?

   (b) Is the victim or possible claimant identified?

   (c) Is there any mention of the possibility that a client or any insured, or other individual, might suffer loss as a result of any identified error, act or omission, or potentially negligent or otherwise wrongful conduct on the part of the insured?

   (d) Is there a statement in the heading of the letter or any enclosure or in the body of the communications that the insured is in fact by the means of that letter and/or its enclosures notifying a circumstance which may give rise to a claim?

In their judgments in the Court of Appeal, Lords Justices Rix, Toulson and Buxton did not disagree with the premise for any of these questions.

The Appeal

The Court of Appeal handed down its judgment on the 5 November 2008. The lead judgment is that of Lord Justice Rix with important considerations also being dealt with by Lord Justice Toulson. Their judgments are important in the following areas:

1. the issue of awareness/knowledge and who at the insured is the knowledge-holder for the purpose of knowledge of circumstances which may give rise to a claim;

2. whether a subjective and/or objective awareness of the likelihood of a claim is required in order to trigger an obligation to notify;

3. the form in which notification is given;

4. the breadth of the particular wording of the notification;

5. timing, the meaning of the words *"as soon as practicable"* and the consequences of failure to give the notice in time.

Although the context in which the case was heard was that of a claims made policy, these judgments have wide application and relevance to all policies including, where appropriate, those of reinsurance.

The question of what is notified to an underwriter was for the purpose of the case answered by what the letter said and not what the letter did not say. Thus, an insured will be judged on the terms in which a circumstance is expressed and it is important to understand that those terms will be construed on the basis of a reasonable underwriter's interpretation of what the letter meant (which remains unchanged from the first instance decision) without there being any obligation on the underwriter to point out if a particular wording is unclear or for that matter to his mind amounts to (a notification of) nothing.

Whether a circumstance may give rise to a claim is not a matter of simple knowledge, a question of fact of which a person may or may not be "aware"; rather, it involves a degree of crystal ball gazing, an estimation of the likelihood of a claim.

It is interesting to note that in the process of determining the meaning and effect of the general condition, Rix LJ drew extensively on the professional (in this case ICA) guidance concerning the ICA terms. These, for example, contain the imperative : *"all members, whether sole practitioners, partners or directors, together with their employees, should be aware of the importance of notifying insurers promptly of claims or circumstances which may give rise to a claim. Everyone in the firm should know that failure to comply with underwriter's requirements in this regard could seriously prejudice the firm's rights and entitlement to indemnity under the policy"*. The ICA terms also mirrored the language of the general condition in that indemnity was said to be premised on *"such notice having been given"*, so that notification *"as soon as practicable"* was a condition precedent to liability. Professionals should take note of this fact that their professional guidance rules may be used as aides to interpretation of their professional indemnity policy.

HFW represented Kidsons at first instance and before the Court of Appeal. It is hoped that this short briefing note will be of assistance to you in highlighting the significance of the case to the insurance market; insurers, brokers, and those who purchase insurance.

5 November 2008

This briefing note has been provided for information purposes only. It should not be relied upon as a substitute for specific legal advice on any particular topic. Legal comment is from an English law perspective.

If you would like to discuss this briefing note or have any questions arising from it in respect of your business please contact:

David Robinson
(david.robinson@hfw.com)

Paul Wordley
(paul.wordley@hfw.com)

Andrew Bandurka
(andrew.bandurka@hfw.com)

Nigel Wick
(nigel.wick@hfw.com)

telephone: +44 (0) 207 264 8000.