

Professional Indemnity Wording in Spotlight

Shock decision puts professional indemnity policy wording in spotlight

In the recent case of *DA Constable Syndicate 386 v Auckland District Law Society Inc CA565/2008*, 8 June 2010, the Court of Appeal's decision has sent insurers scrambling to review the wording of their professional indemnity policies.

This reaction was due to the wide interpretation given to the wording of a professional indemnity policy and in particular the cover it provided. Naturally, insurers want to ensure that they are not caught out offering additional cover that is not intended.

Background facts

The Auckland District Law Society (ADLS) conducted an investigation into the conduct of law firm, Russell McVeagh (RM) in relation to bloodstock syndicates in the 1980s. During the course of the investigation privileged documents were provided to the ADLS. RM sought return of the privileged documents, which due to the ADLS's refusal, culminated in RM having to issue court proceedings.

The matter made it all the way to the Privy Council, where the Court found in favour of RM and the ADLS was ordered to return the documents. As part of the settlement the ADLS were to pay the litigation costs of RM which, together with its own costs, totalled \$1.5 million.

The ADLS then looked to its insurer, DA Constable Syndicate 386 (DA Constable), to recover costs under its professional indemnity policy. The policy wording



provided cover for:

*"all sums which the insured becomes legally liable to pay **as damages** [emphasis added] and claimant's costs and expenses... arising out of any negligent act, error or omission by the insured".*

DA Constable declined cover relying on the fact that there was no negligent act on the ADLS's part. The ADLS lodged proceedings against DA Constable seeking an order from the Court that its professional indemnity policy responded to litigation cost losses. The High Court held that the ADLS was entitled to indemnification under the policy.

DA Constable consequently appealed that decision.

The Court of Appeal had to determine the following issues:

1. Did the phrase "*damages and claimant's costs and expenses*" include circumstances where the claimant sought cover for costs and expenses where there was no damages claim?
2. Did the ADLS's liability for costs and expenses arise out of "*any negligent act, error or omission*" on its part?

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3. If there was cover, what was the effect (if any) of the ADLS breaching the terms of its policy in not seeking consent to the legal costs and settlement prior to its incurrence?

Court findings on issue 1

The Court of Appeal found that, based on its ordinary interpretation the phrase “damages and claimant’s costs and expenses” does not mean that only those costs and expenses associated with a claim for damages are covered. The Court stated that the phrase could be read either conjunctively or disjunctively. In this case the Court found that the “and” could be read as “and/or”.

Court findings on issue 2

The ADLS argued that the phrase “negligent act, error or omission” should cover non-negligent errors and omissions.

The Court of Appeal held that because of the ambiguity in the wording, the word “negligent” did not quantify the words “error or omission”. The Court stated that if following the insurer’s approach, there would be no cover for any breach of the ADLS’s fiduciary duty or breach of the Fair Trading Act or Consumer Guarantees Act.

The Court noted that given the business of the ADLS, it would be odd for the insuring clause to exclude liability for these matters.

This issue is under appeal at the Supreme Court.

Court findings on issue 3

The Court of Appeal considered the fact that the ADLS’s broker had notified the ADLS at an early stage that there was no policy response because of the lack of an allegation of negligence. Additionally, the lawyers for DA Constable advised the ADLS that DA Constable would not meet any costs relating to the investigation of the complaints.

The High Court decision, subsequently

supported by the Court of Appeal, reached the view that DA Constable had repudiated the contract of insurance. DA Constable had been faced with a valid claim and rejected it. As a result of the repudiation, both Courts held that the ADLS was not bound to comply with the policy condition seeking consent.

DA Constable argued that if the claim had been accepted, it would not have consented to the costs incurred by the ADLS. However, the Court of Appeal noted that as the ADLS had acted reasonably in settling the claim, the damages for such repudiation was the amounts incurred for settlement and costs, for which DA Constable would have been liable, had its consent been sought.

Lessons for us

There is one significant implication of this decision – professional indemnity policies may now provide cover for costs and expenses where there is no claim for damages.

Other lessons learnt include, if insurers want their professional indemnity policies to only cover acts, errors or omissions which arise through negligence, then the policy needs to carefully and expressly say so. This could be achieved by redrafting the wording to read “negligent act, negligent error or negligent omission”.

If an insurer seeks to decline a valid claim, and an insured continues to act prudently, then the insurer may ultimately still be liable to pay out. This would apply even if the insured may not have acted in strict compliance with the policy terms and conditions. Therefore, communication between the insurer and insured on indemnity needs to be clear.

Given this recent decision by the Court of Appeal, it is important that specific businesses and their activities are reviewed by Lumley underwriters and applicable

brokers to determine what cover may be required so that an insured is not caught short. The Lumley professional indemnity policy wording is very specific and does have wide ranging cover for a number of scenarios that are set out as extensions.

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