PROFESSIONAL INDEMNITY CLAIMS AND THE SIB PENSIONS REVIEW - AGGREGATION REVISITED?

By Stuart Hill

One of the many remarkable aspects of the SIB Review of sales of personal pension contracts is how little litigation it has generated. It is yet to be seen whether the financial consequences of the Review will pass quietly through the insurance and reinsurance markets. So far, only one attempt to recover SIB Review compensation payments from insurers has produced a High Court decision; that of Mr Justice Rix in *J Rothschild Assurance v Collyear* [1999] 1 LRLR 6. However, some recent press articles have suggested that the "phoney war" is over and that the shooting is soon to start. The question of aggregation will lie at the heart of a large number of claims. It will operate as the prime "threshold" for recovery in many instances. How the courts will approach aggregation in the context of the SIB Review is an open question. In *Collyear* aggregation was identified as a potentially significant issue. However, it was not an issue which the parties invited Rix J to decide.

The last significant wave of cases to consider aggregation arose out of the problems of the Lloyd's market. The SIB Review has the potential to set off a new sequence of important decisions.

The purpose of this article is to explore the possibilities for approaching aggregation in the course of professional indemnity insurance claims arising out of the SIB Review. In preparing this article pains have been taken to avoid advocating any particular conclusion. Indeed, to the extent that this article has a central "thesis", it is that one should approach with caution any solution reached by reference only to the generality (even allowing for the fact that generalisations will hold a strong tactical appeal to those seeking to aggregate). In each claim, or case, the answer to the aggregation question will turn on a specific wording and a specific set of facts. The overarching scope of the Review can serve to conceal the latter point. Each individual insured may well have fallen foul of industry-wide standards, but each will have done so in its own particular way. That said, one must begin with an overview, both factual and legal.

The Review

The course of the SIB Review should be well known to product providers and to legal practitioners. It can be summarised swiftly. By 1993 the SIB had become concerned about certain aspects of personal pension sales as conducted in the wake of the financial services deregulation of the mid to late 1980s. In October 1994 the SIB published its document entitled "Review of Past Business" recommending that a review be undertaken regarding sales of personal pension plans to investors who had been eligible to participate in employers' occupational pension schemes. The review was to cover sales during the period 1988 to 1994. Initially, so-called "priority" cases were to be looked into. Personal pension providers were to set about investigating whether their sales during that period had complied with regulatory standards.

Where appropriate, they were to offer redress to those investors who were disadvantaged by taking out a personal pension plan at the expense of sacrificing potentially more valuable rights accrued or available under occupational schemes. As a result of the Review large sums have been paid to investors by many pension providers and intermediaries. In March 1998 it was announced that the Review would move into its second phase dealing with the "non-priority" cases.

The aggregation issue

At this stage of the analysis one turns to the dictionary. "Aggregation" is the grouping of what appears to be several claims into one claim by reference to a linking factor. A theme of this article is that aggregation is a practical exercise owing as much, if not more, to common sense than to judicial learning. Indeed, when the judicial learning is the product of almost abstract enquiries into the meaning of words, rather than the application of those words to facts, it can prove positively counter-productive.

The practical element of the aggregation exercise is evident as soon as one turns to consider whether aggregation is likely to be an issue in the course of a policy claim. Whether it will be necessary to try to aggregate in a claim derived from the SIB Review will depend on the result of a mathematical exercise. The insured first compares the quantum of each compensation payment made to individual investors with the level of the deductible, or excess, applying in the policy under which he seeks an indemnity for those payments. The deductible will usually apply to each and every "claim". It will often be the case that no individual compensation payment is, in itself, of sufficient size to overcome the deductible limit. If that is so then the insured will be looking to aggregate. Satisfying the terms of any aggregation provision will permit him to group seemingly disparate claims against himself into one "claim" for policy purposes (resulting in a single application of the deductible). When considering aggregation the focus tends to be upon the objectives of the insured. However, in certain circumstances, it may be to an insurer's benefit to aggregate; for instance, to avoid the "death of a thousand cuts" from numerous individual claims each of which exceed the uninsured limit.

A simple aggregation provision

This will identify the linking factor by which one may seek to group a number of apparently disparate claims. A simple clause might permit the insured to treat as one claim for policy purposes:

> "All claims resulting from the same act, error or omission or series of acts, errors or omissions arising out of the same cause"

This allows the insured two distinct potential bases for grouping claims:

(i) If they result from the same act, error or omission

(ii) If they result from numerous acts, errors or omissions arising out of the same cause.

The only additional observation which is necessary at this stage is that different standards of causation may be applied when drawing the link between claims, depending upon whether the insured seeks to aggregate under limb (i) or limb (ii) .

The law

The recent cases have been fought on a relatively narrow battle-field. They have, in the main, considered the effect of the use in aggregation clauses of the word "event" or, alternatively, "originating cause". The discussion of the law which follows is intended to answer a straightforward question: is it easier to link claims if a wording aggregates by reference to an "event", or by reference to an "originating cause" (or does it really not matter which is used)?

An appropriate starting point is the first instance decision in *Caudle v Sharp* [1995] LRLR 80. This construed "event" very widely, to the extent that even a "state of affairs" could amount to an "event" such that, in the case before the court, an underwriter's "blind spot" in relation to the Lloyd's market's underlying asbestosis problem could constitute an "event". It is worth noting in passing that this decision comments on one factor in the aggregation debate which is frequently overlooked but which has not assisted matters. The aggregation clauses which are frequently used in professional indemnity policies were drafted to deal with catastrophes involving physical loss or damage to property. A drafting approach intended to cater for the consequences of an earthquake is not necessarily ideally suited to resolving insurance issues arising out of the large-scale misselling of financial products. *Caudle* was followed by the first instance decision in *Cox v Bankside Members Agency* [1995] 2 Lloyd's Rep 437. Phillips J concluded that the concept of claims arising out of "one originating cause" was indistinguishable in meaning from "arising out of one event". He expressly relied on *Caudle v Sharp* to reach the conclusion that an individual underwriter's propensity to write negligently was sufficient to aggregate claims concerning contracts which that underwriter wrote.

The concepts of "event" and "originating cause" embarked upon a parting of the ways in *Caudle v Sharp* before the Court of Appeal ([1995] LRLR 433) when the court observed that, in order for there to be an "event", something must actually happen. They rejected the idea that a "state of affairs" could be an event. In order to produce an "event", a state of affairs had to manifest itself by something being done as a result of that state of affairs. Consequently, whilst an underwriter's "blind spot" could not be an "event", there was an individual event each and every time he negligently wrote a contract by reason of that blind spot.

The divergence was emphasised in the House of Lords in *Axa Re v Field* [1996] 3 All ER 517. In his judgment, Lord Mustill confirmed that something must actually

happen for there to be an "event". An "event" is something "which happens at a particular time, at a particular place, in a particular way". However, in looking for a "cause" one was not so constrained: "It can be a continuing state of affairs; it can be the absence of something happening". Furthermore, placing the word "originating" in front of the word "cause" opened up "the widest possible search for a unifying factor in the history of the losses which it is sought to aggregate".

At this stage in the law's development one could, in general terms, conclude that it would be far easier to aggregate claims by reference to a common originating cause, than by trying to identify a common event. However, these were not to be the final words on the topic.

In 1998 in *Brown v GIO Insurance* [1998] Lloyd's Rep IR 201, Waller LJ offered a gloss on what Lord Mustill had said in *Axa*. He rejected the idea that Lord Mustill's distinction between originating cause and event was as categoric as those reading the decision might otherwise have thought. In the view of Waller LJ, Lord Mustill had done no more than observe that an originating cause and an event might not necessarily be the same thing. Indeed, in some circumstances, Waller LJ believed that they might be precisely the same thing "or at least lead to no different conclusion so far as aggregation is concerned".

Within months of *Brown v GIO Insurance*, Hobhouse LJ, as part of a different panel of the Court of Appeal in *Municipal Mutual Insurance v Sea Insurance* [1998] Lloyd's Rep IR 421, continued to assert a very strong distinction between "originating cause" and "event". The wording actually under consideration was "original cause" but Hobhouse LJ regarded *Axa* as applicable notwithstanding this variation.

Municipal Mutual deserves a little further exposition, not least because alone amongst this sequence of decisions, it is concerned with something other than the problems of the Lloyd's market. The case dealt with piecemeal acts of theft and vandalism committed in respect of two large excavating machines. The crimes were perpetrated across a period of some 18 months by various persons unknown and whilst the excavators were in the custody of the Port of Sunderland. Were these acts attributable to "one source or original cause"? Hobhouse LJ's exposition of the difference between an "original cause" and an "event" is worth noting. Of the latter he remarked:

> *"If this was a simple 'any one event' clause, the defendants would have a powerful argument. They could say that each act of pilferage or vandalism was a distinct event."*

However,

"one source or original cause ... are wide words. There is a clear unifying factor in the history of all the losses ... suffered as a result of the continuing pilferage and vandalising of their goods. The Port had no adequate regard to their responsibilities as the bailees of the goods; they had no adequate system to protect the goods from pilferage and vandalism; it was their want of care which was the consistent and necessary factor which allowed the pilferage and vandalism to occur. On an ordinary use of language, the acts of pilferage and vandalism were a series of occurrences attributable to a single source or original cause".

Some observations on the law in practice

There would appear to be a common-sense conceptual distinction between an "event" and an "originating cause" in that an event must be something which happens, whilst a cause is a reason why things happen. However, and this is where Waller LJ's views in *GIO* should be recognised as refreshingly pragmatic, one simply cannot dismiss the possibility that both concepts might, on occasion, be identifiable in one and the same thing. The necessity to identify an instant at which something specific takes place in order to have an "event" means that an "originating cause" wording offers the potential to cast the net wider in the search for a link between claims. As seems implicit in *Municipal Mutual*, the Port of Sunderland's lack of activity in protecting the excavators over 18 months is not an "event" in the way that the individual acts of thieves and vandals were. That said, a specific omission at a specific time and place is capable of being an "occurrence" (*Forney v Dominion Insurance Co* [1969] 1 Lloyd's Rep 502) and, in *Caudle*, Clarke J observed that if a negligent omission could be an "occurrence" then there was no reason why it could not also be an "event". Certainly, someone looking to limit the scope for aggregation may seek to fix each and every individual act in the history of the insured's losses with the status of an "event".

So much attention has been focused on the meaning of the specific phrases discussed in the above cases that one might be forgiven for forgetting that those phrases must be considered and construed in the context of a clause (and of a policy) as a whole. One may not need to look too far beyond the phrases themselves in order to identify a context which potentially alters their significance. For instance, the manner in which the word "event" is prefaced may be essential to the success of the proposed aggregation exercise. If it is permissible to link up matters "arising out of" an event, then a degree of cause and effect will need to be shown between the event and each of the consequences one is endeavouring to ascribe to it. It would still be necessary to demonstrate cause and effect, although arguably to a lesser degree, if one is looking to round up matters "attributable" to an event. However, there is, arguably at least, no need to establish any particular degree of cause and effect where the potential link is that the individual elements must be "related" to an event.

There is some authority which might be deployed in aid of interpreting phrases of this kind. In *Dunthorne v Bentley* [1999] Lloyd's Rep IR 560 the question arose as to whether injuries sustained by a motorist crossing the road from her vehicle (which had run out of petrol) were "caused by or arising out" of the use of the vehicle. The Court of Appeal found that "arising out of" contemplates more remote consequences than "caused by", however, both concepts involved an element of a causal relationship. The following statement of the Australian High Court (in *Government Insurance Office of New South Wales v Green Lloyd* 114 CLR 437) was cited in this regard:

> *" 'Caused by' connotes a 'direct' or 'proximate' relationship of cause and effect. 'Arising out of' extends this to a result that is less immediate; but it still carries a sense of consequence."*

By way of contrast, the decision in *R v MMC ex parte National House Building Council* [1994] 6 Admin LR 161 suggests that there may be no gradation of potential causal connections depending upon the use of particular words. In that case it was decided that the "natural meaning" of "attributable to" was "caused by" or "resulting from". This would suggest that there is no distinction to be made between the effect of the use of those phrases. However, this was a case involving the interpretation of these words in a statute, a task which has its own particular rules and conventions. Furthermore, if a clause in a contract used the phrase "caused by *or* attributable to" then the disjunctive "or" suggests an intention to distinguish between the effect of the phrases.

The core practical issue seems to be the extent to which one needs to show a direct operative effect of the alleged unifying factor in producing each of its supposed consequences. In the search for an "originating cause" one is permitted to stray well beyond concepts of causation as they would be applied in assessing the consequences of a tort or breach of contract. Indeed, the approach to "causation" to be adopted in such circumstances is closer to that of the historian ("What were the origins of the First Crusade?") than that of the lawyer, and which may explain the number of analogies from history to be found in the cases cited above. However, it is worth remembering Lord Mustill's note of caution in *Axa* "that those engaged in the contract did not have in mind a philosopher's meaning of cause". It seems that common sense and context are key factors in the aggregation analysis.

Aggregation in the context of the SIB Review

In order to deal with aggregation one must go to the facts. Assumptions may lead to many misfortunes. It is important not to approach the facts with pre-conceived ideas of how the misselling has occurred. Each organisation has its own individual make-up both structurally and culturally. Each will have arrived at its misselling by its own individual route. Each will have exercised it own particular level of control over its

sales force. A thorough understanding of just what has gone wrong is essential to constructing or undermining any aggregation argument.

Despite this emphasis on the need for consideration of the specific facts of the case in hand, one can identify sufficient "facts" which should feature across the board. One is then able to explore the possibility of SIB Review claim aggregation in a little more detail.

The obvious starting point is with each and every sale of a personal pension contract. On the appropriate wording it might be possible to argue that each is an individual "event", just like the entry into each individual insurance contract in the Court of Appeal's interpretation of *Caudle v Sharp*. As noted above, the "event" wording gives the insurer wishing to challenge aggregation the potential to break the matter down into as many individual acts as possible.

Each individual salesman will have sold a number of contracts; is it possible to aggregate by reference to that individual? It is not easy to regard a propensity to sell in a non-compliant fashion as an "event". The existence of such a propensity is not self-evidently the kind of factual circumstance in which, as Waller LJ suggested in *GIO*, "cause" and "event" may be recognised in one and the same thing. A propensity fits more comfortably within the (wide) bracket of "originating cause". That said, in *GIO* Waller LJ specifically rejected the idea that *Axa* had decided "that negligent underwriting caused by some originating cause ie, a negligent approach, could not be an event."

The next stage may be to ask on what basis the insured organisation was found to have been in default. If it operated a policy of selling according to strict formulae, then can one identify a central failure in fixing those formulae from which every individual act of misselling flows? If the conclusion reached by the SIB Review investigation is that a specific aspect of the standardised approach to, say, pension transfers was defective then, as a matter of common sense, every sale in Newcastle will in that respect be non-compliant for the same reason as every sale in Canterbury. This seems an entirely appropriate result of Lord Mustill's "search" for a "unifying factor" in *Axa*. Aggregation on that basis is plausible on an "originating cause" wording, and it is not necessarily out of the question on an "event" wording. If the factor leading to non-compliance is to be found in the insured's manuals or training, then the moment at which those procedures were published (or at which the decision was taken that the company should sell in a particular way) may be no less an "event" than the point at which an individual pension was subsequently sold in accordance with those procedures. An attempt to aggregate on these lines was rejected in *Cox v Bankside*, however, that rejection was on the basis that the facts did not bear it out.

Another way of looking at the problem is to attempt to link by reference to similarities in the quality or nature of the acts rather than any causal relationship

between them. For instance, the example clause referred to above included the phrase "resulting from the same act, error or omission". The obvious application of this is to look for a point in time at which something happens from which multiple consequences flow. An alternative reading would be to look at "same" as relating to the description of the quality of the act, ie numerous salesmen making identical errors. Are all of the claims against those salesmen attributable to the "same" act? An argument of this kind was dismissed as "fallacious" in *Cox v Bankside.* Phillips J observed:

> *"A culpable misappreciation in an individual which leads him to commit a number of negligent acts can arguably be said to constitute the single event or originating cause responsible for all the negligent acts and their consequences. The same is not true when a number of individuals each act under an individual misappreciation, even if the nature of that misappreciation is the same."*

Conclusion

It would seem that the solution to the question of aggregation in the context of the SIB Review is very much "up for grabs". The decisions discussed above settle very little for that purpose. The wordings will need to be investigated in the light of the particular, and peculiar, facts of the Review. It remains to be seen if anyone will take up the challenge.

Stuart Hill is a member of Lovells' Insurance and Reinsurance Group.