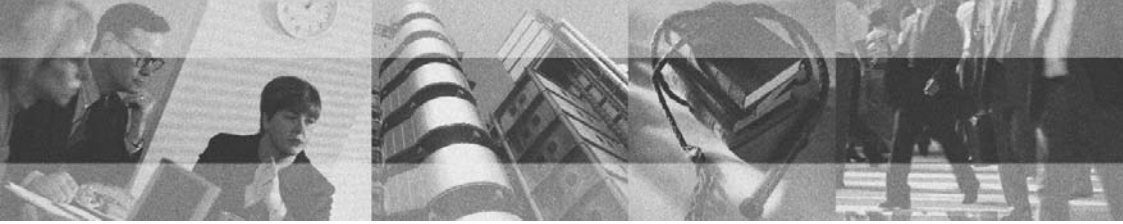

THE BILA/LAW COMMISION MOCK TRIAL 14 NOVEMBER 2007
LARKIN CAULFIELD LTD V REBEL UNDERWRITING LTD

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Introduction

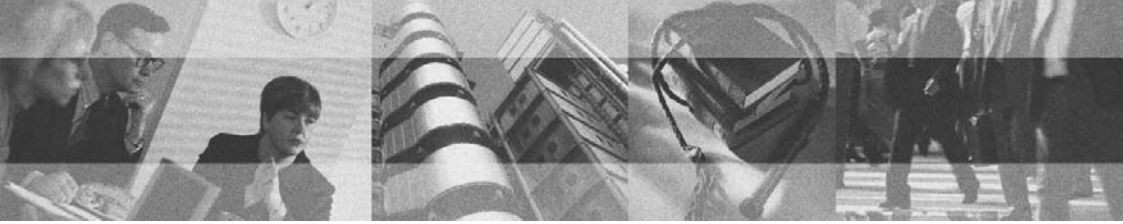
A unique event was staged in the court of the Lord Chief Justice on 14 November 2007, when the English and Scottish Law Commissions bravely road-tested their proposals for the reform of the law of utmost good faith, warranties and intermediaries, in the form of a mock trial presided over by Rix LJ. Jonathan Hirst QC and Stephen Midwinter appeared for the assured and, and Jeremy Stuart-Smith QC and Neil Hext appeared for the insurers. The Law Commissions' proposals, published in a Consultation Paper on July 2007, are to be found at http://www.lawcom.gov.uk/docs/cp182_web.pdf. The proposals were largely the work of the Law Commissioner then in charge of the insurance project, Professor Hugh Beale QC.

The scenario was introduced by the Law Commissioner now in charge of the insurance reform project, David Hertzell. The scenario was one devised by the Law Commission in order to draw out key elements of the law reform proposals, although alert members of the audience – namely, BILA members who were fortunate enough to have applied for tickets early, because the event was a sell-out – will have noted that the Law Commission may well have had in mind the decision of *Noblebright Ltd v Sirius International Corporation* [2007] Lloyd's Rep IR 584 in drafting its scenario. The key points which emerged from the mock trial were the test for disclosure, the incidence of a broker's agency and the meaning and effects of a fraudulent claim.

The facts

The assured, Larkin Caulfield, operated a textile manufacturing company in Manchester. Mr Walter Merricks has successfully combined careers as the assured's managing director and Chief Ombudsman under the Financial Ombudsman Scheme. In April 2004 the assured contacted its brokers, Moonstone, to review insurance arrangements. Moonstone also happened to be the insurers' sole preferred broker for the region. Moonstone, through one Ms Rachel Verrinder, arranged for a presentation to be made by the assured to that doyen underwriter in the London Market, Reg (Reasonable) Brown, underwriting on this occasion for Rebel Insurance. At the presentation it was truthfully stated that the assured had not made any claims in the preceding ten years.

The assured was duly presented with a proposal form. Amongst the various questions asked of the assured, two were of particular relevance: had the proposer made any claims in the last 5 years, and had the proposer made any claims in excess of £5,000? Both questions were truthfully answered in the negative. The assured did not, however, volunteer the information that there had been an attempted but unsuccessful robbery by three armed men in October 1999 and that Mr Merricks himself had been the subject of an attack by a former employee wielding a baseball bat in January 2004. The proposal form had been completed by Ms Verrinder and signed by Mr Merricks. Mr Merricks subsequently asserted, and his evidence was not contradicted, that he had earlier informed Ms Verrinder at a social event of these incidents, and accordingly that it must have been her decision or oversight not to include them in the proposal form.



Rebel agreed to insure the Manchester warehouse and its contents against various risks, including fire and third party liability. The area of Manchester in question was one which was high risk in terms of losses, but remained "a poor and still just acceptable part of Manchester" as far as the London market was concerned.

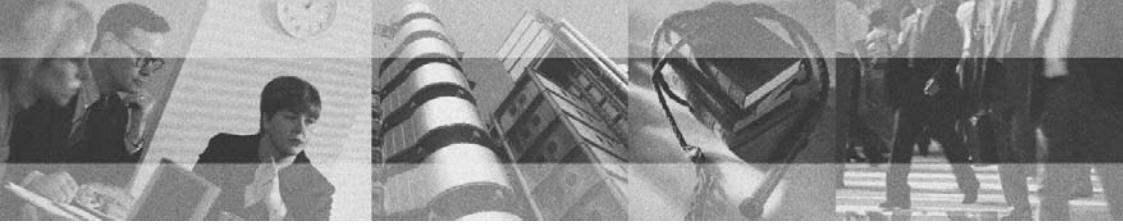
On 12 April 2006 the warehouse suffered a disastrous fire, apparently caused by a cigarette left by an employee of the assured. The fire spread to neighbouring premises. The total loss amounted to some £1.4 million. Included in the claim was an item for the cost of purchasing new computers. Investigations by the insurers showed that the computers actually lost in the fire were five years old and obsolete. A claim for stock in the sum of £200,000 was also made, subsequent investigation showing that the maximum value of the stock could have been only £175,000.

The insurers denied liability. They asserted that the policy was voidable for non-disclosure of the two incidents referred to above, and also that the claim had been forfeited by reason of the fraud. Each side produced their star witness: Mr Merricks gave evidence for the assured and Mr Brown gave evidence for the insurers. Neither side thought it necessary to call Ms Verrinder nor any other evidence from the broking profession.

Non-disclosure: the arguments and the evidence

The case proceeded on the basis that the Law Commissions' proposals were in force. Both parties sought to compare the old law with the new. Mr Hirst QC for the assured initially sought to appeal to Rix LJ's emotions by pointing out that the assured had paid large premiums for many years without making a claim. He then argued that even under the old law the two incidents were not material, and that even if that was wrong then there was no inducement because the insurers were aware that the area was not the best risk around or that the insurers had waived disclosure by confining their questions to losses. Under the new law, Mr Hirst QC pointed out that that even though the duty of disclosure had been maintained for business insurances the position was quite different for a number of reasons. First, under the Law Commissions' proposals the broker was the agent of the insurers and not the agent of the assured because the broker had not "searched the market" but rather was the preferred intermediary of the insurers. Secondly, the test for disclosure had become that of the "prudent assured", so that it was only necessary for the assured to disclose that which a reasonable assured would have regarded as of interest to the insurers. Thirdly, even if there had been non-disclosure, it was at best negligent, so that under the Law Commissions' proposals the assured would have been entitled to proportional recovery based upon the amount of risk that the premium had actually bought. The principles of inducement and waiver were unchanged.

Mr Stuart-Smith QC focused on the new law. His argument took the form of a series of points. First, the facts were known to Mr Merricks, so there was no excuse for non-disclosure. Secondly, under the old law the facts in question were plainly material because a prudent underwriter would have regarded them as such, and under the new law a prudent assured would have appreciated that the insurers would have wanted to be told about the incidents. Thirdly, had the insurers been given the true facts they would have refused to insure: the law on inducement was unaffected by the Law Commissions' proposals. Fourthly, under the old law the brokers were plainly the agents of the assured so that even if there had been disclosure to them the assured would not have been absolved from his duty. The position was unchanged under the new law,



because the brokers were fully independent and were in a position to search the market for the assured even if they had failed to do so. Even if that was wrong, disclosure by the assured to a broker at a social event did not suffice. Finally, there was no waiver of disclosure, as a reasonable person in the assured's position could not have assumed that the insurers had consented to non-disclosure given the difficulty facing insurers of asking express questions on all matters.

Mr Merricks' evidence, given both in his capacity as the assured and also in his capacity as a reasonable assured, was that he did not inform the insurers of the two incidents because he was not asked about them, and that he left everything to Ms Verrinder. He insisted that in his view insurers were expected to ask questions, that he could not possibly know what facts the insurers were interested in unless he was asked and that had he been asked he would have disclosed the incidents.

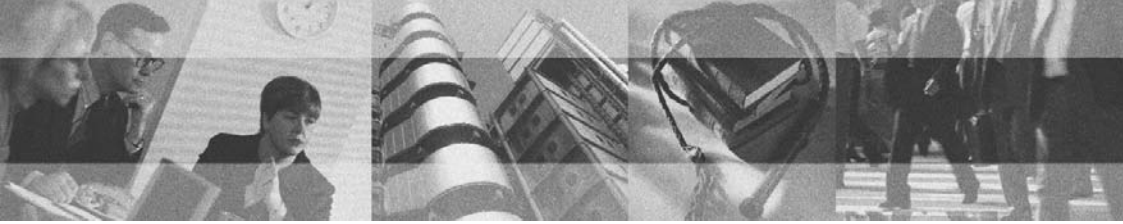
Mr Brown's evidence was given in his capacity as underwriter. Under the Law Commissions' proposals the test of prudent underwriter no longer applies to determine whether or not a fact was material, so Mr Brown's evidence was for the most part confined to inducement. He insisted that he would not have issued the policy had the incidents been disclosed, and that it was not practicable for him to have asked questions about the incidents. The point was made that the Manchester market was a marginal one and was not particularly profitable, and that underwriters should not be penalised for trying to offer insurance wherever possible.

The excessive claim

The assured's case on this point was that the claim was not fraudulent but simply excessive. Mr Hirst QC referred to previous authority which had indicated that excess was not evidence of fraud, and that there was a distinction between attempting to defraud insurers and attempting to establish a sensible starting point for bargaining. Accordingly, there was no fraud in the present circumstances. Mr Merricks, in his evidence, emphasised that his expertise was in textiles and not in computers, and resented any attempt to "cast nasturtiums" on his integrity. Mr Brown denied that insurers always made low offers on principle. Mr Stuart-Smith QC accepted the distinction drawn by Mr Hirst QC, but argued that on the present facts the assured had crossed the line into fraud.

The judgment

Rix LJ gave judgment for the assured. The judgment focused on the new law and rejected the significance of earlier authority: the Law Commissions' proposals were "new fruit of an old tree". Rix LJ was satisfied that under the old law the insurers would have succeeded on materiality, in that the facts not disclosed would have been of interest to a prudent underwriter (and it is of interest to note that in *Noblebright* that very concession had been made by the assured) and in that any disclosure to the brokers would not have amounted to disclosure to the insurers themselves. In his words, "cometh the claim, cometh the avoidance". Under the new law, however, Rix LJ held that the position would have been different on each of these points. As regards materiality, the new test focused on the views of a prudent assured, and Rix LJ pointed out that a reasonable assured does not have the insights of an underwriter: it would not have been possible for the assured to appreciate that disclosure of the incidents was required. As regards agency, Rix LJ was also satisfied that the brokers were on the facts not to have been treated as having searched the market for the assured and accordingly the knowledge of the



brokers was to be imputed to the insurers. In the event that he was wrong on these points, Rix LJ went on to decide that the assured had been at worst negligent, so that the proportionality approach to the sum recoverable was applicable. On that basis Rix LJ was not satisfied that the insurers would have refused to write the risk but preferred the view that they would have charged an additional 5% premium, so the assured was entitled to recover the vast proportion of its loss.

At this point Rix LJ chose to comment that the existing law had fallen into error in treating the broker as the agent of the assured for disclosure purposes. A better approach would be to treat the broker as the agent of the underwriters, so that information proven to have been disclosed to the broker would be deemed to have been disclosed to the underwriters. The benefit of such an approach would be to remove the need for the assured to sue the underwriters and then the brokers in the event that the claim against the underwriters failed, but rather to impose liability upon the underwriters and then to leave it to them and the broker to sort out the problem between themselves.

Ironically, however, and all of this apart, the change in law made no difference because the case turned on waiver. Rix LJ, relying upon his own dissenting views (albeit in a judgment which was part of the majority) in *WISE v Grupo* [2004] Lloyd's Rep IR 764, held that the insurers had, by asking specific questions about actual losses, waived disclosure of attacks which had not given rise to losses. Rix LJ was not referred to the contrary view which had been reached in *Noblebright*.

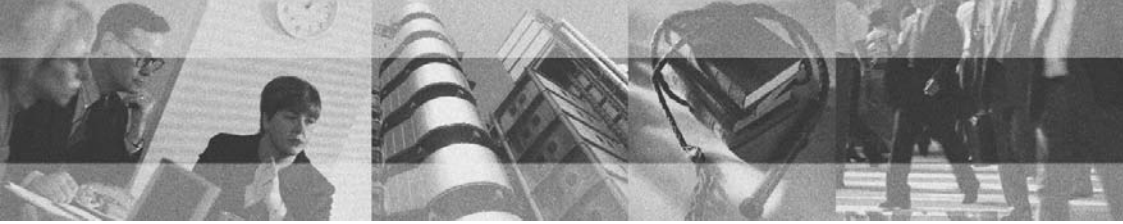
As far as the alleged fraudulent claim was concerned, Rix LJ noted that no one knew quite what the remedy was for a fraudulent claim, and what was meant by forfeiture of benefit under the policy. That said, if the insurers were found to have fraudulently made a low offer there was no forfeit payable by them, so it was difficult to see why the assured should have to bear a forfeit for a high claim. Rix LJ also commented that the meaning of "substantial fraud" was unclear. Nevertheless, on the facts, the assured was found not to have been fraudulent at all, and that the assured was perfectly entitled to claim for lost property on a replacement cost basis. The claim was "optimistic" but not "dishonest". Judgment was thus given for the assured.

An appeal?

Your reporters are strongly of the view that the insurers should apply to Rix LJ for permission to appeal immediately. There are at least three grounds upon which an appeal would have strong prospects of success.

First, the ruling on waiver is "Denning-esque" in its approach to the doctrine of precedent. Rix LJ relied heavily upon his own dissenting opinion in *WISE v Grupo*. Admittedly that dissenting opinion was embodied in a majority judgment which determined the case in favour of the claimant reinsured, but the wide view of waiver espoused by Rix LJ in *WISE v Grupo* was rejected by both Peter Gibson and Longmore LJJ. The outcome is also inconsistent with that, on remarkably similar facts, in *Noblebright*.

Secondly, the judgment does not give proper weight to the Law Commissions' proposals on the role of brokers. The Law Commissions specifically recommended that if the assured used a broker in placing the risk, the test of whether a prudent assured would have regarded facts as



relevant to the insurers is replaced with the test of whether a prudent broker would have regarded those facts as relevant. However, there was no evidence as to what a prudent broker would have thought of the relevance to the insurers of the two attacks. The point underlines a weakness in the Law Commissions' proposals, in that the assured – even if he has made full disclosure to the broker – will not be able to argue that the facts were not relevant if a prudent broker would have disclosed them. The arguments also highlight a further problem with the Law Commissions' proposals, namely, exactly when is a broker to be taken as having searched the market on behalf of the assured so that his knowledge is not imputed to the insurers? The arguments emphasised that this test is not an easy one to apply, but there is a strong likelihood that an independent broker – even one who is favoured by insurers – is not to be regarded as "tied" in a fashion which requires his knowledge to be imputed to the insurers. Applied to the facts of the present case, there are respectable arguments that: (a) the broker was independent and her knowledge was not imputed to the insurers; and (b) a prudent broker would have realised that the facts not disclosed would have been relevant to the insurers – indeed, if she actually realised that, then the assured would not be able to recover anything at all on the basis that fraud would have been made out. The solution may be that suggested by Rix LJ in his *obiter* comments, namely that even an independent broker should be the agent of the underwriters for the purpose of receiving information, although this represents neither the present law nor the Law Commissions' proposals.

Thirdly, and most tellingly, however, Rix LJ unashamedly revealed after he had delivered his judgment that he had been at Oxford with the claimant. Indeed, the claimant was fulsome in his praise for his Lordship's perceptive judgment in the claimant's favour and noted that Rix LJ could anticipate a most promising career in the law.