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# Liability? What liability?

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Are the parties to a liability insurance policy bound by the terms of the judgment of a competent court in favour of a third party against the insured, when determining whether the liability is of a type that is covered by the policy?

Suppose a policy provides that no indemnity will be provided in respect of any liability arising under any contract unless such liability would have attached in the absence of such contract. The judgment of the court which established the liability of the insured to the third party was based solely upon a breach of contract. You might think that the court deciding any ensuing claim under the liability policy would be bound by the terms of that judgment.

According to Mr Justice Tomlinson, as he then was, in *London Borough of Redbridge v Municipal Mutual Insurance Ltd*[1], you would be right but, according to Mr Justice Christopher Clarke in *Omega Proteins Ltd v Aspen Insurance Ltd*[2], you would be wrong.

It is odd that such a simple and important point of insurance law and practice had not been judicially considered, until the beginning of the 21st century and, when addressed, has given rise to such a fundamental divergence of views between these two highly respected judges of the Commercial Court.

It may be that this disagreement is a reflection of each judge's views as to the merits of the respective insurance claim that each of them was considering. However, it is difficult to see how the underlying legal principle, to be applied, should differ.

In the *Redbridge* case, the insurer was facing claims under a liability policy, issued to the local authority, in respect of sums that it became legally liable to pay as compensation for loss or damage "occasioned by any negligent act or accidental error or omission committed by its employees". The policy expressly excluded any payment in respect of loss or damage arising from "fraud dishonesty or criminal offence" on the part of the employees. The Pensions Ombudsman made a series of determinations that obliged the local authority to pay compensation to some of its former employees who, relying upon misleading information, provided by the local authority, as to their pension entitlement, had taken early retirement. The Ombudsman determined that these employees were entitled to compensation representing the difference between the amount that they had been led to believe they were entitled to and the amount to which they were actually entitled. The compensation awards made by the Ombudsman were binding on the local authority and enforceable in the County Court as if they were judgments of that court. The Ombudsman concluded that the provision of misleading information was due to maladministration, on the part of the local authority, in failing to exercise proper supervision over its delegate officer.

The insurers refused indemnity, maintaining that the claim fell within the exception, as a loss arising from a criminal offence of misconduct in public office, committed by the

Chief Executive. The insurance claim went to trial upon a preliminary issue as to whether, if the Chief Executive was found guilty, at any subsequent trial, the insurer could rely upon the exception refuse an indemnity.

Mr Justice Tomlinson decided that the insurer must indemnify. He found that the determination by the Ombudsman was a finding that the local authority was liable, under statute, to compensate for its maladministration and that the Ombudsman had no jurisdiction to find the local authority liable on any other basis.

The ratio of the judgment was as follows[3]:

> "The policies are policies of liability insurance and in principle one would expect the enquiry whether insurers are liable to begin and end with the question on what basis had liability been established. … In my judgment it is normally neither permissible nor possible to look beyond or outside the four corners of the determination itself for the basis of the liability to which the insured has become subject. Impermissible, because if liability has been established by a court or tribunal of competent jurisdiction it is not open to another court in litigation between different parties to say that the basis of liability was in fact other than that which it was determined to be. Impossible, because if the liability is expressed by the primary judgment or determination to have been occasioned on one basis, it is simply not a logical possibility that the imposition of liability in fact arose from different facts and matters. It may of course be possible to say that liability should not have been found in the light of the facts relied upon, or even that the finding of liability could have been justified on different or additional grounds. Neither of these possibilities however detracts to my mind from the proposition that in liability insurance one is concerned, as between insured and insurers, with established liability and thus with the basis on which liability was in fact established. Just as it does not avail an insurer in a case where liability has been established by judgment to say that liability ought not to have been established so, also, in my view, it does not avail an insurer to say that liability might have been established on a different basis, or that the cause of the liability arising should be regarded as different from that stated."

Mr Justice Clarke, giving judgment in the *Omega* case, considered the above an incorrect statement of the law. Omega was seeking an indemnity under the Third Party (Rights Against Insurers) Act 1930 pursuant to which the rights of the Northern Counties Meat (in liquidation), under a liability policy, issued to it by Aspen, vested in Omega. Omega had obtained judgment, following a trial, against the insured for a breach of contract. No claim or allegation was made in the proceedings that the insured had been negligent or that it was liable to Omega by virtue of any non-contractual duty or obligation. Neither the insured nor the insurers played any part in the trial. The insurer had informed Omega, before the trial, that it was refusing an indemnity to its insured for a purely contractual

liability. The breach of contract was, in essence, supplying meat waste that had been mis-categorised under some newly introduced regulations.

Despite the policy excluding any indemnity for a purely contractual liability, in the terms set out at paragraph 2 above, Mr Justice Clarke held that he was entitled to go behind the legal basis for the underlying judgment and decide whether, upon the facts, as set out in the underlying the judgment, there being no other evidence put before him, he could, nonetheless, conclude that liability would have attached in the absence of a contract. Having reviewed various "factors" apparent in the underlying judgment, he concluded that he was both able to and would infer that the insured, had been negligent so that the exception did not bite. He accordingly declared that the insurer was liable to indemnify Omega under the policy.

The interesting question is how and why did Mr Justice Clarke decide that it was both permissible and possible for him to reopen the question of the legal basis upon which liability had already been established by the underlying judgment in the face of what appeared to be the sound reasoning of Mr Justice Tomlinson, cited above. He reviewed two earlier decisions[4] and then held:

a. The insured must establish that it has suffered a loss which is covered by one of the perils insured against.

b. This may be done by showing a judgment or arbitration award against the insured or an agreement to pay.

c. The loss must be within the scope of the cover provided by the policy.

Thus far his findings were uncontroversial. But then he went on to hold:

d. As a matter of practicality, the judgment or award or agreement may settle the question as to whether the loss is covered by the policy because the insurers will accept it as showing a basis of liability which is within the scope of the cover.

e. But neither the judgment not the agreement are determinative of whether or not the loss is covered by the policy.

f. It is therefore open to the insurers to dispute that the insured was in fact liable, or that it was liable on the basis specified in the judgment; or to show that the true basis of his liability fell within an exception.

g. Thus an insured against whom a claim is made in negligence, which is the subject of a judgment, may find that his insurers seek to show that in reality the claim was for fraud or something else that was not covered or excluded by the policy.

h. Similarly an insured who is held liable in fraud which is not covered by the policy, may be able to establish, in a dispute with his insurers that, whatever the judge found he was not fraudulent, but only negligent and thus entitled to cover under the policy, on that account.

Mr Justice Clarke held that Mr Justice Tomlinson was wrong to say that such an approach was impermissible because it ran counter to the well known principle that findings in an action by A against B are not binding, in action brought on the same facts, by B against C[5].

But, is it not the very nature of liability insurance that it is triggered by the happening of an event or events that may or may not result in a liability that is covered by the terms of the relevant policy? Why then is the question whether or not the insured is covered not determined, not, merely "as a matter of practicality" but, rather, as a matter of law, by the nature of the case that was proved by the third party claimant against the insured and was crystallised in the terms of the judgment. Is that not the intention and effect of liability insurance? That certainly seems to be the position adopted by the Court of Appeal in relation to reinsurance claims where the Court appeared willing to imply into a contract of reinsurance a term that the parties had agreed, absent special circumstances, that the re-insurer would be bound by the terms of the underlying judgment of a competent foreign court against the reinsured[6]. Is there any real distinction to be made, in terms of principle, between a re-insurance contract which is triggered when the primary insurer has an established liability to indemnify its own insured and a liability insurance contract that answers when the insured has an established liability to a third party? Equally, is there is any reason, in principle, why the decision of a competent foreign court should be binding on a re-insurer but the decision of a competent domestic court should not be binding upon a primary liability insurer or its insured?

Mr Justice Clarke went on to decide that Mr Justice Tomlinson was wrong to hold that it was impossible to go behind the terms of the primary judgment. Mr Justice Tomlinson was really saying no more than, once the liability had been established, on a particular basis, then, even if, at an earlier stage, it might have been possible, before that judgment, to establish liability on another basis, it was not possible to re-establish it, in a different way, after the judgment. Mr Justice Clarke's rationale was as follows: "As I have said, it is, of course, true that the liability imposed by the judgment necessarily arises from the facts and matters that the Court finds to be established. But the proposition that that renders it impossible to look outside the four corners of the judgment assumes that, as between the insured and the insurer, the court is not concerned with the true basis or bases of liability of the insured (i.e. the basis, if any, on which the assured ought to or could have been found liable, which may or may not be the same as the basis upon which he was in fact found liable) but only with whether or not the basis of liability specified in the original judgment fell within the cover of the policy."

I find it difficult to see how or why a competent court trying the underlying claim would not also be seeking to ascertain the "true basis or bases of liability of the insured". I quite

see that, where an underlying case has been settled by the parties, a court considering any subsequent insurance claim can and will go beyond merely looking at the way in which the original claim was framed and consider what were the true underlying facts in order to see whether the claim is one that falls within the terms of the policy. That was what the Court of Appeal decided in the *MDIS* case[7]. But surely the judgment of a competent court that determines both the facts and legal basis/bases of the relevant liability is just that; determinative as to what was the true nature of that liability. This seems to be the fundamental point where the two judges diverge.

Mr Justice Clarke went on to say: "This, itself, assumes that what the insurer has agreed to cover is only such liability as is found by another court in proceedings against the insured, whether those findings were correct or not, and whether or not the insured could also have been found liable on another basis as well. That is not, however, the nature of the cover which, in the present case is against "all sums which the Insured becomes legally liable to pay". Whether in truth there is such a liability begs the question as to who shall determine that question. As to that, in circumstances where no cause of action or issue estoppel arises the insured (and the insurer) are both, absent some special agreement, entitled, in my judgment, to have the matter determined by the judge who hears the suit to which they are both party."

In this passage, Mr Justice Clarke appeared to be saying that although the liability is determined by a competent court, as between the party liable and the party to whom he is liable, nonetheless, in a suit against the insurer, by the person thereby held liable[8], the whole issue as to whether and, if so, upon what basis he was thus found liable can effectively be re-tried. Mr Justice Clarke made the point that because the insurance claim involves different parties there can be no issue estoppel. This is presumably a reference back to his initial objection to the decision in the *Redbridge* case that I have identified above.

I pose the practical question who is best placed to determine the issue of whether and, if so, upon what basis, liability is established, the judge trying the issue of liability at the suit of the third party claimant against the insured or the judge trying the claim by the insured against the insurer?

Mr Justice Clarke sought to draw support for his conclusion from some obiter in the judgment of Mr Justice Aikens, as he then was, in *Enterprise Oil Ltd v Strand Insurance Co Ltd*.[9] However, my interpretation of that obiter is that Mr Justice Aikens was going no further than saying that a court, hearing the insurance claim, was entitled to consider what specific heads of damage fell within the type of loss encompassed within the scope of the indemnity provided by the policy[10]. It is, in my view, doubtful whether he was going so far as Mr Justice Clarke in saying that the whole issue of liability and upon what, if any, valid basis it could be established, could go back into the wash.

If the judgment of Mr Justice Clarke is correct, then it certainly opens up the scope for further litigation between an insured or a third party claimant, exercising the rights of the

insured, under the 1930 Act, and a liability insurer, if either side is not content with the judgment of the court that tried the original claim that is said to have given rise to the very liability that is said trigger the policy.

There was no appeal in Omega, so it remains to be seen whether the decision in that case will give rise to further ramifications or argument that results in its being considered in another case at an appellate level. Meanwhile, with two conflicting decisions, of equal weight, the simple question that I pose has, as yet, received no conclusive answer.



**Endnotes**

1 [2001] Lloyds Rep IR 545

2 [2010] EWHC 2280 (Comm),

3 See paragraph 12 at page 550

4 In particular Devlin J. in West *Wake Price v Ching* [1957] 1 WLR 45 and the Court of Appeal in *McDonnell Information Systems Ltd (MDIS) v Swinbank &Others* [1999] 1Lloyds Rep 98.

5 Referring to *Sun Life V Lincoln National* [2005] 1 Lloyds Rep 606 and *Hollington v Hewthorne* [1943] 1 KB 587.

6 See *Commercial Union Assurance Co Plc v NRG Victory Reinsurance* [1998] 2 Lloyds Rep 600

7 See footnote 4 above.

8 In the *Omega* case, the insurance action was in fact brought by the third party to whom the insured was held liable, in whom the insured's rights were vested under the 1930 Act

9 [2006] 1 Lloyds Rep 500

10 This follows the approach adopted by the Court of Appeal in *Rodan v Commercial Union Assurance* [1999] Lloyds Rep IR 495