

4 December 2014

Practice Group(s):
Insurance Coverage

Insurance for Professional Fiduciaries

UK Insurance Coverage Case Update

By Sarah Turpin and Frank Thompson

English Court of Appeal clarifies the inter-relationship between insurance and indemnities in *Rathbone Bros v Novae Corporate Underwriting*

In an important decision for professionals operating in the trust and asset management sector - and their employers - the English Court of Appeal has recently provided guidance in the case of *Rathbone Bros Plc and Paul Egerton Vernon v Novae Corporate Underwriting Limited and Others* [2014] EWCA Civ 1464 on the inter-relationship between insurance and indemnities in responding to third party claims, as well as other aspects of coverage available under professional indemnity insurance policies.

The Background

Rathbone is well known for its trust business which includes the management of family trusts for private clients. Mr Vernon ("PEV") was a consultant of a Rathbone subsidiary having ceased to be an employee of the company upon giving up full time employment. PEV was a solicitor and professional trustee. He acted as a personal trustee - and was also director of a corporate trustee - of the 'Walker Trust', a discretionary trust established in Jersey by the late Mr Jack Walker, a well-known industrialist and former chairman of Blackburn Rovers FC. The fees due for the services provided by PEV were accounted to Rathbone, although no formal agreement was in place between Rathbone and the Trust for the provision of such services. Claims were made by beneficiaries of the Trust to the effect that the trustees had acted in breach of duty by making poor investment decisions.

Rathbone had purchased £50 million of professional indemnity insurance ("PII") for the relevant year of account which was arranged into various layers of coverage. The PII policy covered group entities as well as insured persons operating within such entities. Rathbone (and its subsidiary) had also granted an indemnity to PEV in respect of his services as a trustee and as a director of corporate trustees which was capped at £40 million.

The Issues

Various excess layer insurers disputed that there was coverage under the PII policy in respect of the claims made against PEV. The excess insurers disputed liability under the policy on several grounds including that:

- PEV was not covered by the policy as an insured person as he was a consultant and no longer an employee
- as there was no agreement in place between Rathbone and the Trust, the excess insurers challenged whether professional services to the Trust had been provided by or on behalf of Rathbone
- the PII policy featured an 'Other Insurance' clause which provided that the PII policy operated in excess of any "*other insurance and indemnification available from other*

Insurance for Professional Fiduciaries

sources” - the excess insurers said that the Rathbone indemnity triggered this clause with the effect that the indemnity applied first and in priority to the PII policy in responding to the claims

- the excess insurers argued that D&O insurance obtained by Rathbone - which covered PEV as an outside entity director - also triggered the Other Insurance clause such that the D&O policy responded before the PII policy, in particular as the D&O policy also included coverage for legal defence costs for third party claims
- the excess insurers argued that in any event they would be entitled to recover any payment made under the PII policy from Rathbone as insurers had the right to subrogate against the £40 million indemnity provided by Rathbone to PEV.

The Decision

The Court of Appeal decided that

1. ***PEV was an insured person entitled to coverage under the PII policy.*** As is common with many forms of liability insurance, the PII policy contained a definition of insured person which specified groups of individuals entitled to coverage. The question before the Court was whether PEV was a 'paid employee' of Rathbone as it was accepted that this was the only limb of the policy definition of 'insured person' which could apply. Although the Court of Appeal accepted that, as a consultant, PEV would not be categorised as an employee at common law, it was held that the PII policy intended to cover a more expansive category of persons as 'employees'. In the particular the Court of Appeal took note of the relevant regulations in Jersey (pursuant to the Trust Company Business (Registration) Jersey Order 2003) which described a trust business employee as someone employed either under a contract of service or for service by a regulated trust business, which the Court accepted was consistent with a wider commercial meaning of an employee in the context of the provision of professional trustees. The Court also noted that the fees arising from the provision of services by PEV to the Trust were accounted to Rathbone (with PEV then remunerated by Rathbone under his consultancy agreement). It was also accepted that PEV was acting under the direct control and supervision of Rathbone who had issued a Code of Practice to PEV and took an active role in the supervision of trustees activities.
2. ***PEV was plainly providing professional services on behalf of Rathbone and therefore coverage under the PII policy was engaged.*** The PII policy described the professional services covered thereunder as “*financial services as declared in the proposal form which were performed by or on behalf of an insured company pursuant to an agreement with a third party for compensation or in conjunction with services for compensation*”. The excess insurers pointed to the absence of an agreement between Rathbone and the Trust in relation to the provision of services by PEV, arguing that coverage only applied where the company itself had agreed to provide the services given the express requirement for there to be an agreement in place with a third party. The Court of Appeal dismissed this argument. The Court said a professional such as PEV performing services at the request of an 'employer' is plainly doing so on behalf of the employer, adding that it would have implied an agreement between Rathbone and the Trust if required to satisfy the requirements under the language which had been used in the PII policy.

Insurance for Professional Fiduciaries

3. ***The Other Insurance clause did not apply to the Rathbone indemnity and therefore the PII policy applied in priority to the Rathbone indemnity.*** While the Court of Appeal recognised that the wording of the Other Insurance clause could have expressly provided that it did not apply to any indemnification provided by a co-insured under the policy such as Rathbone, nevertheless the Court of Appeal held that the clause was not triggered by the Rathbone indemnity. It was decided that the parties would have reasonably intended that such a clause could only apply to another source of indemnity where that had been provided by an independent third party. For this type of clause to apply to an indemnity from a co-insured under the same policy (in particular a co-insured such as Rathbone which had purchased the insurance policy to insulate against claims), specific language to this effect would need to be included in the policy which was not the case here.
4. ***The D&O policy did not respond to the claim and also did not trigger the 'Other Insurance' clause.*** The D&O policy was subject to a 'professional services' exclusion which the Court of Appeal said clearly applied in this case. The Court also followed the orthodox view under English law that there is no free-standing coverage for defence costs under liability insurance if the liability itself is not insured by the policy unless clear words to the contrary are included in the policy - which again was not the case. As the D&O policy did not respond due to the professional services exclusion, there was no D&O coverage for the defence costs and so no double insurance in respect of those costs which was necessary to trigger the Other Insurance Clause in the PII policy.
5. ***In reversing the decision of the Court below, the Court of Appeal decided that the insurers did not have rights of subrogation against Rathbone and could not recover amounts paid under the PII policy pursuant to PEV's rights to an indemnity from Rathbone.*** Following a comprehensive review of relevant authorities, the Court of Appeal decided (by a majority of 2:1) that it was appropriate to imply a term into the PII policy that insurers were not entitled to subrogate against a co-insured under the same policy. In doing so, the Court of Appeal looked at the commercial reality in that, in purchasing PII coverage, Rathbone and the excess insurers must reasonably have intended that the insurance would apply first in the event of claims with the indemnity granted by Rathbone to operate in excess of the insurance. This was consistent with the commercial purpose of the PII policy which was to cover both Rathbone and those it insured against third party claims. Moreover, Rathbone was not at fault for the claim and the indemnity given by Rathbone provided the same protection as the insurance - for these reasons, the Court of Appeal said it would have also implied a term into the indemnity contract that PEV's right to an indemnity from Rathbone would be extinguished if the claim was covered by insurance.

Comments

The Court of Appeal's decision is a positive one for policyholders particularly those who provide professional fiduciary services to clients in the trust and asset management sector.

It is a particularly important decision for policyholders as the Court of Appeal looked to give effect to the commercial reality and purpose behind purchasing insurance and also providing indemnities in respect of the risk of third party claims professional indemnity. This was despite a lack of clarity in the actual wording used in the insurance policy and other relevant contractual documents. In practice, it is not uncommon for insurers to contend that it is simply not possible to look beyond the wording of the policy and related

Insurance for Professional Fiduciaries

documents to establish the scope of coverage they have agreed to provide. This decision should assist policyholders in addressing that type of argument where insurers' position would lead to commercially absurd results.

Nevertheless, the number of points taken by the excess insurers in this case illustrates the potential pitfalls for policyholders if care is not taken in ensuring the wording of insurance policies is fit for purpose. Although the Court of Appeal was prepared in this case to 'fill in the gaps' in the contractual relationships between the parties, the case also serves to demonstrate the importance of having contractual documentation which clearly sets out the rights and responsibilities of the parties, and the order in which different forms of financial protection will apply, to avoid disputes arising once problems occur. This is particularly important in the insurance context where the standard policy wordings offered by some insurers do not always provide sufficient clarity.

Authors:

Sarah Turpin

sarah.turpin@klgates.com
+44.(0)20.7360.8285

Frank Thompson

frank.thompson@klgates.com
+44.(0)20.7360.8183

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises more than 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2014 K&L Gates LLP. All Rights Reserved.