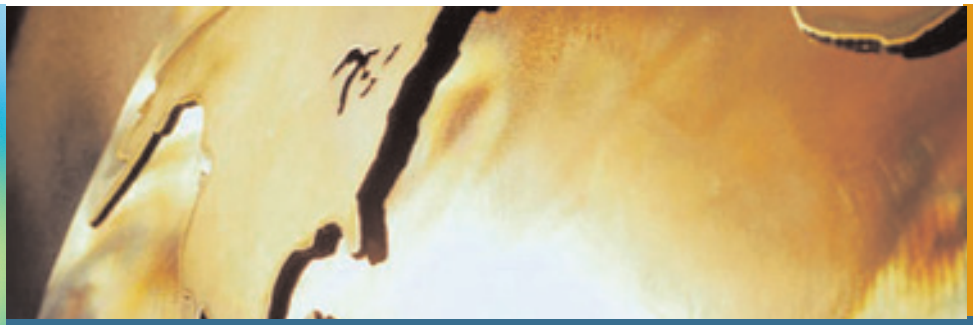

LAWYERS TO THE TRAVEL AND LEISURE INDUSTRY

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SUMMER 2007

Travellers' Checks

Introduction

We are often surprised by clients who have never read (or perhaps even seen!) their insurance policies and are unaware of the effect of exclusions and conditions. It is too late to discover these when a claim arises. Policy wordings differ significantly from insurer to insurer - lack of familiarity with them can lead to expensive gaps in cover. Insurers may seek to avoid liability where there has been a delay in notification of a claim. In this issue, we review the recent Court decision in Kosmar Villa Holidays plc v Trustees of Syndicate 1 2 3 4 [2007] EWHC 458 (Comm) which looked at this point.

Kosmar Villa Holidays plc v Trustees of Syndicate 1 2 3 4

Facts:

Kosmar Villa Holidays plc ("K") was insured by Euclidian ("E") under a combined liability policy. Cover extended to legal liability for damages payable consequent upon accidental injury to any person. It was a condition precedent to E's liability under the policy that K should, immediately after the occurrence of any injury or damage, give notice in writing to E with full particulars.

The policy provided that:

"*Insurers will indemnify the Insured against all sums which the Insured shall become legally liable to pay as damages consequent upon accidental injury to any person …occurring during the Period of Insurance, in connection with the Business….*".

The policy further provided as follows:

"*GENERAL CONDITIONS*

7. It is a condition precedent to insurers' liability under this insurance that:

[1] The Insured shall immediately after the occurrence of any Injury or Damage give notice in writing with full particulars thereof to insurers. Every letter, claim, writ, summons or

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Welcome to the Summer edition

One of our constant messages to clients is the vital importance of adequate insurance cover and our lead article is a salutory tale of the need to notify insurers promptly of a claim.

Competition law issues have been much in the news, with EC approval of the mergers of the big four operators, creating two significant vertically integrated businesses. On the airport front, the Office of Fair Trading (the "OFT") has referred BAA plc to the Competition Commission, whilst the ECJ dismissed British Airways' ("BA") appeal in the loyalty programmes case and, in addition, on 1 August 2007, BA receieved a record fine of £270m for anti-competitive practices. Neil Baylis, a partner at K&L Gates, who practices in competition law, reviews the final ruling on BA's loyalty programmes.

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K&L GATES

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process shall be notified or forwarded to insurers immediately on receipt. Notice shall also be given in writing to insurers immediately the Insured shall have knowledge of any impending prosecution or inquest in connection with any accident for which there may be liability under this insurance. So far as is reasonably practicable no alteration or repair shall without the consent of insurers be made to any works, machinery, plant, commodities or goods which are directly or indirectly connected with the occurrence until insurers shall have had the opportunity of examining the same.

[2] Upon receipt by or on behalf of the Insured of notice …of an intention by any person or body to make a claim against the Insured or of any allegation of negligence which might give rise to such a claim or on the discovery of any such act of negligence, the Insured shall notify insurers as soon as practicable and shall provide full information respecting it so far as such information is in the Insured's possession….. "

K received a claim from a holiday maker who had injured himself. However, K only gave notice to E of the holiday maker's accident over one year after it had occurred, when K received a claim from solicitors. On that basis, E denied liability under the policy. To understand K's claim under the policy and E's response, we set out a chronology of the main events.

Chronology:

- 22 August 2002 - James Evans ("Evans"), aged 17, dived into a swimming pool whilst on a holiday arranged by K, fracturing his spine and causing serious injury.
- 4 September 2003 - K received a letter, dated 14 August, 2003, from Evans' solicitors indicating that a claim for damages was to be made by Evans against K. K telephoned E to notify the claim.
- 5 September 2003 - K sent E various reports completed by its representatives on the day of the accident.
- 17 September 2003 - K e-mailed E providing further information about the swimming pool. E e-mailed K advising on tactics and saying that they "have taken the view, given the possible size of the claim, not to deny liability yet".
- 19 September 2003 - E wrote to Evans' solicitors asking them to note their interest. E also wrote to K with 25 questions about Evans' claim and discussed the usefulness of Evans' solicitor visiting the swimming pool in question.
- 22 September 2003 - E's letter to Evans' solicitors was copied to K. E also wrote to Evans' solicitors again.
- 30 September 2003 - E wrote to K formally reserving E's rights for the first time.
- 2 October 2003 - K replied to E's reservation of rights by saying that the claim was notified as soon as possible.

- 21 October 2003 - E's solicitors wrote to K repudiating K's claim under the policy.

- 15 December 2006 - Evans was awarded judgment against K. K's liability is £1 million.

Issues:

K argued that E had waived the condition precedent of immediate notification in view of:

(i) the history of dealings before the inception of the policy, meaning that E were estopped from relying on the clause;

(ii) the claims handling procedures agreed at a meeting between the parties in March 2002 which effectively did away with the reporting clause;

(iii) the fact that E had not rejected other claims by K on the grounds of late notification. In particular, between March 2002 and September 2003, E agreed to indemnify K in at least 16 cases where the reporting clause had not been complied with; and

(iv) the fact that in this case, E had dealt with the claim for a number of weeks without reserving its rights before deciding to repudiate the claim.

The Court's Decision:

The Court disagreed with K on all of its points except the last. On that point, K was successful. The Court held that there was no estoppel or any election arising out of either the history of dealings between the parties or the meeting to agree on claims handling procedures as there was no discussion of the notification of occurrences during that meeting; nor was there any trade custom or usage that the notification requirements should be ignored. There was no common assumption requirements that could be ignored, and so there was no estoppel by convention. In addition, the Court held that E's acceptance of other claims, notwithstanding non-compliance with the requirements, merely showed that E were taking a case by case approach. There was no common assumption or representation to the effect that in all cases in the future the clause could be ignored.

However, E tried to argue that K's breach of such an important clause - a condition precedent - meant that E was automatically absolved from any liability. If E was wrong on that, E then said that E should have a reasonable time to decide what to do and then unequivocally tell K about its decision.

The Court dismissed these later two points: it was common ground that on 4 September 2003 E had enough information to know that K had failed to report the occurrence and that that failure was a breach. E's communications throughout September 2003 indicated that E was not only dealing with the claim but also demonstrated "objectively or unequivocally the making of an informed choice by [E] to deal with the Evans' claim".

On the first point, E argued that a breach of a condition precedent led to an automatic discharge for the insurers. E sought to rely on the case of HIH v Axa [2002] EWCA Civ 1253. However, the Court found that that case was dealing with a breach of promissory warranty not a breach of a condition precedent. Therefore, it was readily distinguishable.

The Court went on to say that, although a breach of promissory warranty would lead to the cover as a whole ceasing to apply, that consequence should not extend to non-performance of obligations in the claims handling procedure contained in a condition precedent. The wording of the condition precedent did not imply that the insured's failure to comply with it would discharge the insurer from liability. The natural consequence of K's failure to comply with the clause was that their duty to pay a claim for which they otherwise would, or might be, liable under the policy had not arisen. E could still choose to accept or reject the claim, applying the doctrine of election. However, E's communications without reservation of rights disclosed an election to accept liability for the claim in issue. In the 26 days between 4 and 30 September 2003 E corresponded with K and Evans' solicitors. By then, they had had more than a reasonable time to consider their position. E's failure to insert a simple sentence into that correspondence reserving insurers' rights was fatal to its defence.

Conclusions:

In this case, the Court found that breach of a condition precedent allows insurers to repudiate a claim, but those insurers must elect to do so promptly. The Court may find that an insurer's conduct amounts to a waiver of its rights. In such a case, any later attempt to repudiate a claim is likely to fail unless insurers have expressly reserved their rights.

Comment:

This highlights the need to notify insurers immediately if any circumstance arises which may result in a claim. Failure to do so may mean that insurers will refuse to indemnify you.

British Airways' loyalty programmes - The final ruling

In the early 1990s British Airways ("BA") introduced a variable additional commission which was applied where its travel agents increased their sales of BA tickets above a certain level over a specified period of time. The additional commission was structured so as to apply to all ticket sales made in that period and not only those above the threshold at which the additional commission kicked in.

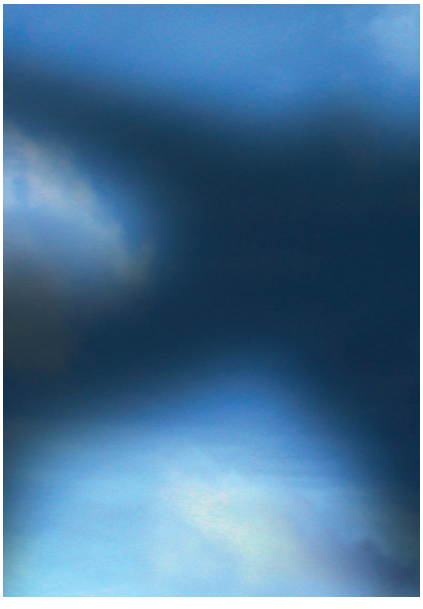
Virgin Atlantic Airways ("Virgin") made a complaint to the European Commission arguing that the commission structure employed by BA was an abuse of BA's dominant position in the market for UK air travel. Following a detailed investigation, the Commission ultimately found in favour of Virgin and decided that BA's additional commission arrangements were an unlawful abuse of its dominant position. BA subsequently appealed to the Court of First Instance ("CFI"). The CFI confirmed the Commission's Decision following which BA appealed to the European Court of Justice ("ECJ").

The Law

Article 82 of the EC Treaty prohibits the abuse of a dominant position by one or more undertakings, which has an effect on trade between Member States. Such conduct is unlawful and may result in fines of up to 10 per cent of worldwide turnover being imposed by the European Commission. (The EC law is reflected in Chapter II of the UK Competition Act 1998).
Article 82 has direct effect in Member States and is enforced in the UK by the Office of Fair Trading.

Judgment

The Commission had found in its Decision that BA was dominant in the market for the supply of air travel services from the UK. BA's strong market position allowed it to pay agents large sums by offering small discounts off ticket prices. BA's competitors meanwhile, whose sales were inevitably much lower than those of BA, were obliged to offer much larger discounts off their ticket prices in order to give their agents a similar level of revenue. Accordingly, the additional commission scheme had the effect of making it even less likely that agents would choose to sell non-BA air tickets in the knowledge that their income would be reduced as compared with seeking to sell as many BA tickets as possible.
The CFI confirmed the Commission's Decision and identified the additional commission as akin to a loyalty bonus - i.e. a discount based not on volume related cost savings but on ensuring the customer's loyalty.



The ECJ dismissed all BA's grounds of appeal. It confirmed that a system of discounts or bonuses will be abusive where it has an exclusionary effect which is harmful to competition. It was irrelevant whether there had been a direct consumer detriment arising from the commission arrangements. What mattered was that the arrangements were detrimental to competition and there were no objective justifications based on efficiency gains that would also benefit consumers.

Comment

This dispute began in 1993. The judgment is highly significant for the Commission which has sought to maintain that loyalty bonuses offered by companies in a dominant market position should be seen as abusive and hence unlawful, even where there was no direct detriment to customers. Loyalty bonuses are not of course unlawful when offered by non-dominant airlines.

Stop Press

On 1 August 2007, BA was fined more than £270m by the US Justice Department and the OFT over collusion with rival Virgin Atlantic on the imposition of fuel levies. The OFT fine of £121.5m followed an admission by BA that between August 2004 and January 2006 it colluded with Virgin Atlantic over the surcharges which rose from £5 to £60 per sector for trans-Atlantic flights over the period. Virgin Atlantic is not expected to pay any penalty because it qulaifies for immunity due to it advising the OFT of the conduct.

TOMS: The worst of both worlds

The recent VAT Tribunal case of Atlantic Holdings Limited (Case 20011) has considered whether charges for credit card transactions should be included in the TOMS calculation. Atlantic Holidays Limited supplies travel services and sets a surcharge of 2% for its customers who pay by credit card. This surcharge covers the charge of 1.51% or 1.775% (depending on the type of card used) which Atlantic incurs itself if it accepts payment for its travel services by credit card.

HMRC took the view that this 2% surcharge was additional consideration paid for the travel services supplied by Atlantic and so had to be included in its TOMS calculation. The Tribunal agreed. The Tribunal also agreed with HMRC that the 1.51% or 1.775% charges incurred by Atlantic were not part of the cost of the services bought in by Atlantic and so were not costs that could be included in the TOMS calculation.

This decision is not particularly surprising, given the guidance in HMRC's manuals that surcharges made to customers and only those expenses specifically attributable to the TOMS supply should be included in the TOMS calculation.

Agent or Operator - does it matter?

It is fundamentally important to know whether you are agent or operator, but it is not always easy to work out. The widespread use of the internet has radically changed life and the way we do business. The distinctions between organisers or operators on the one hand and agents or intermediaries on the other, have become blurred. Consumers and agents alike can shop on the net for a whole range of services. Where these are put together to form a holiday and are sold to a consumer, these may or may not constitute a "package" within the meaning of the Package Travel Regulations 1992 (the "PTRs"), depending upon the way in which they are priced and offered for sale. Whether they constitute a package is important as it will determine the requirements for financial security, your potential liability to the consumer and insurance position.

Regrettably, the Court of Appeal judgment in the case brought by ABTA against the CAA has not ended these arguments. Confusion partly remains because of the unfortunate phrase "dynamic packaging" which seems to mean all things to all people. You need to start by looking at how your company does business, identify your potential liabilities and take action to minimise the risks materialising.

Case study

Mr and Mrs Smith buy a cheap flight to Barbados on-line through Opodo. They do a Google search for accommodation in Barbados and find Barbados Travel (an English company). Barbados Travel offer villa rental, car hire, insurance and cruise holidays. The Smiths book all of these elements via Barbados Travel at an inclusive price. After they pay, they read Barbados Travel's website terms. When they receive confirmation of purchase and their e-ticket confirmation and itinerary from Barbados Travel it says that Barbados Travel acts as agent for the accommodation owner but the owner is not named.

The holiday is a disaster and they assume it is a package so they sue under regulation 15 of the PTRs and they also claim damages for breach of contract and negligence. Barbados Travel denies liability. It says it is not responsible as it was only acting as an agent or intermediary. But what is the true position? Let us look at each of the elements in turn, starting with the villa:

First of all, there was nothing on the website specifying that Barbados Travel acted only as agent. That statement was not made until after the booking which formed the contract.

In addition:

- The documentation failed to name the supplier of the villa with whom Barbados Travel say Mr and Mrs Smith entered into a contract.
- The supplier of the villa did not know what his (supposed) selling price was - Barbados Travel had marked up the net price with its profit.

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Barbados Travel offered the travel arrangements at an inclusive price which makes them squarely a principal and therefore subject to the PTRs. Accordingly, Barbados Travel is liable as principal or organiser.

The key point here is that even though Barbados Travel describe themselves as agent, the Courts will look behind the terminology in order to determine a company's true status. To quote Halsbury:

"*Agency is determined on the true nature of the agreement or the exact circumstances of the relationship between the alleged principal and agent. If an agreement in substance contemplates the alleged agent acting on his own behalf, and not on behalf of a principal, then, although he may be described in the agreement as an agent, the relationship of agency will not have arisen.*"

What about the cruise from Barbados? That was a disaster. The only terms which the Smiths saw were Barbados Travel's website terms - no booking conditions for the cruise operator were drawn to their attention or made available. The e-ticket was little more than a reference number. The cruise was operated by an independent cruise line and Barbados Travel denies that it is liable to compensate the Smiths for the distress and injury.

Lee & Another v Airtours Holidays Limited & Another

These issues were considered by His Honour Judge Hallgarten QC in 2002. The facts were the same: the claimants booked a cruise through a travel agent but no terms and conditions were mentioned. The ship sank and the claimants sought damages for personal injury, including psychiatric damage, loss of possessions and valuables, loss of their holiday and disappointment. The claim was brought under reg. 15 of the PTRs. Subsection 3 says:

(3) *In the case of damage arising from the non-performance or improper performance of the services involved in the package, the contract may provide for compensation to be limited in accordance with the international conventions which govern such services.*

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Subsection 4 says:

(4) *In the case of damage other than personal injury resulting from the non-performance or improper performance of the services involved in the package, the contract may include a term limiting the amount of compensation which will be paid to the consumer, provided that the limitation is not unreasonable.*

The defendants admitted that there was a failure to perform the contract made with the claimants or that there was improper performance but tried to argue the damages were limited according to international conventions and, in particular, the Athens Convention which governs carriage by sea.

The claimants said that no contract was ever issued, let alone a contract which purported to refer to compensation being limited in accordance with any international convention. They denied that the defendants could rely on arts. 5, 7 or 8 of the Athens Convention, because the defendants had failed to incorporate their booking conditions into their contract with the Claimants. As no contract terms were issued, the Court refused to allow the convention limits to apply.

What does this tell us? The way in which you advertise and sell holidays and travel services is hugely important. Whether you are acting as principal or agent will affect:

- Your liability to consumers;
- Your obligations for health and safety;
- Your insurance requirements;
- Your liability under the Tour Operators' Margin Scheme for VAT; and
- Your obligations to provide security in the form of a bond, insurance or trust account for consumers' pre-payments.

In a worst case scenario, a company which thinks it is acting only as an agent or intermediary, but is found liable as principal, could face huge uninsured losses.

What are the key features of a true agency?

- The agent undertakes to exercise due diligence on behalf of his principal.
- The agent is subject to fiduciary duties and is remunerated by commission rather than by way of profit.
- The making of an undisclosed profit is inconsistent with the existence of a fiduciary relationship.
- The principal must have the right to exercise control over the agent.

In essence, this means that an agent must act openly and honestly and in the best interests of the company or individual on whose behalf he is acting. This is true regardless of the type of agency. It is, for example, possible to act as:

- Agent for a disclosed principal, or
- Agent for an undisclosed or unidentified principal.

The duties of good faith are the same but the consequences for the agent, in terms of liability, are quite different. Where you act as agent for a disclosed principal, you tell consumers at the outset the identity of the company with whom they will be contracting. For example, a customer booking a Thomas Cook holiday through an independent travel agent will know that they are entering into a contract with Thomas Cook subject to Thomas Cook's booking conditions. If something goes wrong, they will look to Thomas Cook to put it right.

However, a consumer who accesses a website to book car hire may not realise that the car will not, in fact, be supplied by the company who owns the site. In other words the website is agent for an undisclosed principal. The identity of the actual supplier is not disclosed until after the car rental has been booked. In this case, the consumer could sue the agent if something goes wrong but it is fair to say that in many cases, the actual nature of the legal relationship is fairly grey. In 2001, this prompted the Office of Fair Trading to write to a number of car rental brokers criticising the standard terms of business for not making its status clear. The danger is, of course, the OFT's power to injunct against what they identify as an unfair commercial practice.

Usually, adding a mark up to a supplier's price will mean that you are acting as principal and not as agent. Even if you are not selling a package within the meaning of the PTRs, that could still mean that you assume primary contractual liability to the consumer. Let us assume for example, that you are just selling two week's accommodation in a cottage in France. There is no pre-arranged combination of two or more components sold at an inclusive price, so the PTRs do not apply. However, there is liability in contract.

As we saw in the case of International

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Life Leisure Limited v The Commissioner's for HM Revenue & Customs, calling yourself an agent for the accommodation owner but adding a mark up to his price by way of profit may mean that, in reality, you are selling as principal. If the cottage proves to be a death trap and consumers are killed or injured, you could be liable to pay significant damages. You might also be liable to a criminal prosecution for gross negligence manslaughter either here or in France.

Conclusions

First, know whether you are agent or principal and look at:

- your contracts with your suppliers
- your contracts with consumers - usually the terms are set out in booking conditions which must be drawn to consumers' attention before they book and be properly incorporated in the contract
- your websites, brochures, offers and all forms of advertising.

You need to ensure that your contracts are consistent and reflect your

company's true position. If you are genuinely acting as an agent, then say so. Make it clear that the consumer's contract is with the supplier and is subject to the supplier's terms of business. Beware of the trap of creating packages by combining the services of two or more suppliers and offering them for sale at an inclusive price, because that makes you a principal.

If, however, you decide you want to sell as a principal:

- make sure that your own terms deal with all the obligations contained in the PTR's. These should incorporate the limitations on liability of the international conventions covering international carriage by air, sea or rail. Check that the invoices which you issue are correct.
- your contracts with suppliers should contain clauses indemnifying you for any breach or negligence by the supplier or its employees. The supplier should warrant that its services will, as a minimum, comply with local standards of health and safety.
- check your bonding position. Remember that it is a criminal offence to fail to provide protection for consumers' pre-payments where you are selling packages.

Whether you are principal or agent, look carefully at your insurance policies. These should provide cover for public liability and professional indemnity claims. It is also worth checking that you have proper cover for claims against directors and officers for both civil claims and the defence costs of a prosecution.

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