



Claims notification/co-operation clauses back in the spotlight

AIG Europe (Ireland) Limited v Faraday Capital Limited

Court of Appeal (LJs Longmore, Dyson and Thomas) – 22 November 2007

On 22 November 2007 the Court of Appeal reversed a decision of the Commercial Court on the proper construction of a claims co-operation clause in the context of a D&O policy.

The facts

Insurers ('AIG') settled a number of claims on an underlying D&O policy arising from class actions against a company called Smartforce and several of its directors, after a re-statement of its accounts following a merger with a USA corporation in 2002.

AIG then sought to recover from its reinsurers ('Faraday'). The reinsurance agreement contained a Notification of Loss/Claims Co-operation clause, which provided that it was a condition precedent to liability that notice of "any loss or losses which may give rise to a claim" be given to reinsurers "as soon as reasonably practicable and in any event within 30 days".

Faraday declined to pay alleging, primarily, that the losses were notified to them too late. Faraday argued that AIG were obliged to notify them of circumstances that 'might' give rise to a claim against Smartforce, not only actual losses, and that this was not done "as soon as reasonably practicable" or "within 30 days".

First instance decision

At first instance, following the Court of Appeal's decision in *Royal & Sun Alliance plc v Dornoch* [2005], Mr Justice Morison held that the relevant loss or losses must be those of the purchasers of the shares who were the claimants in the class action against Smartforce. Further, the words "loss or losses" were essentially different from 'alleged' or 'claimed' or 'potential' losses. Had the parties intended to use such language they could have done so. It was not for the court to re-write the parties' bargain to remedy a 'mismatch' between the claims made by the nature of the underlying D&O policy and the notification of loss requirement in the reinsurance.

On the facts, the judge held that there was no (actual) loss known to AIG until 23 March 2004, when a Memorandum of Understanding had been agreed following a successful mediation in respect of the underlying class actions. Formal notification had been given to Faraday on 19 April 2004, and as such within the terms of the Notification of Loss/Claims Co-operation clause.

Faraday appealed.

The appeal

Faraday argued that although "loss" meant an 'actual' rather than an 'alleged' loss, there had in fact been a loss which "might give rise to a claim", within the meaning of the Claims Control Clause once the share price fell following the announcement by Smartforce that it intended to restate its accounts in

November 1992. Further, that loss was known to AIG in December 2002 when they received notice that a claim had been brought against Smartforce.

Giving the leading judgment, Lord Justice Longmore distinguished the decision in *Royal & Sun Alliance plc v Dornoch* on the basis that the loss under consideration in that case could not be attributed to any particular event. The fall in the share price in that case could easily have been the result of normal market fluctuation or market perception as much as anything else.

The position in the instant case, however, was not the same. There was a positive event which resulted in a substantive drop in the share price of Smartforce, namely the announcement to restate its accounts in November 2002. To suggest that the subsequent drop in the share price, of as much as one third, was normal market fluctuation was simply not credible. Further, the fact that the share price had recovered by June 2003 was irrelevant to the question of whether a loss had occurred in November 2002.

It was also important to note that the loss envisaged by the claims co-operation clause was not (or not necessarily) the loss which ultimately constituted the claim. On any view the loss that occurred upon the fall in the share price in November 2002 was a loss "which might give rise to a claim" within the meaning of the clause.

The loss was clearly known to AIG in December 2002, and indeed at that point was a loss known by them to have in fact given rise to a claim. Thus, it was notified to Faraday long outside the 30 days specified by the Notification of Loss/Claims Co-operation clause.

Faraday's appeal would therefore be allowed such that AIG's claims were not recoverable.

Comment

Given the clear circumstances of AIG's knowledge of the loss, it was unnecessary for the Court of Appeal to express any view on whether reinsurers under this form of claims co-operation clause have to prove subjective or objective knowledge of the loss in question.

At first instance in *Royal & Sun Alliance plc v Dornoch*, Aikens J was of the view that objective knowledge, ie what any reasonable reinsured would have known,

was enough. Lord Justice Longmore said that whilst he was far from saying that Aiken J's view was wrong, he preferred to express a view in a case where the point was actually in issue. He did however comment that it would be a rare case where an insurer did not know of a loss in any case when any knowledgeable (and therefore reasonable) insurer would have done.

In the opening paragraph of his judgment, Lord Justice Longmore noted that the court was again being asked to construe a standard form clause which was not apt for the type of business for which it had been deployed.

This decision further highlights the dangers of using standard form wordings in situations where they are not best suited, and the differing interpretations that can arise as a result.

If you require any further information in relation to the way in which these developments impact upon your business contact Nick Bradley, Colin Peck, David Breslin, William Sturge or Simon King on 020 7379 0000 at LG.

These notes are for general information only and are not intended to provide legal advice.

Lawrence Graham LLP.
All rights reserved.