JUDGMENT : His Honour Judge David Wilcox : TCC. 23rd June 2003.

1. This matter comes before the court on the defendants' application to strike out the claim. On the 24th February 2003 the court ordered that any evidence in reply to the defendants be served by the 23rd May 2003 for the hearing on the 6th June 2003. The claimant failed to do so until 4 p.m. on the 30th May.

2. The parties agreed that this hearing be limited to one aspect of the strike out claim, namely the construction of the Professional Indemnity Insurance Policy for 1996/1997.

BACKGROUND

3. This is a professional negligence action arising out of the arbitration of a building dispute. The claimant, the successful party in the arbitration has taken an assignment of the rights of the unsuccessful defendant, Commissioning (South West) Limited (CSW) and sues on the basis of CSW's rights.

4. The defendants are and were at the material times CSW's solicitors.

5. The arbitration related to engineering works done for the Ministry of Defence by CSW as sub-contractors to the complainants under ACE Conditions of Engagement under clauses 18.1 and Condition 5 which required CSW to maintain professional indemnity cover of £1m for any one occurrence or series of occurrences under the engagement.

6. Initially the dispute related to CSW's claim against the claimant for unpaid fees. The claimant's present case is that on the 14th February 1997 at a meeting attended by CSW personnel and a partner in the defendants' firm, they were informed that the claimant had a substantial counterclaim against CSW in respect of outstanding works in the commissioning process, defects of work and the failures to provide satisfactory technical operation and maintenance manuals.

7. Seven days after, on the 21st February 1997 Mr Gary Povey a director of CSW filled in CSW's proposal form for insurance for the next policy year, 13th March 1997 to the 12th March 1998. He was asked in the form to give details of any claims made against CSW or circumstances which might give rise to a claim against CSW of which he was aware. He made no mention of the claimant's proposed counterclaim, stating that none of CSW's directors were, after enquiry, aware of any circumstances which might give rise to a claim against CSW, and declaring that that statement was true to the best of his knowledge and belief and that no material facts had been suppressed.

8. On the 13th March 1997 professional indemnity cover was extended by new underwriters on the basis of the information in the proposal form completed by Mr Povey. In July 1997 the claimant's claim was reported to the new underwriters. They declined to indemnify CSW in respect of the counterclaim except in relation to part of CSW's own costs of defending the counterclaim. On the 27th August 1998 the solicitor acting for the new underwriters wrote to the defendants saying they had decided to avoid the policy for the period 13th March 1997 to the 12th March 1998 *"on the grounds of non disclosure of material facts and misrepresentation"*. The arbitrator made two awards. The first on 15th March 1999 in the sum of £318,843 plus VAT. This award was made up of £136,642 in respect of overpayment, and £182,201 in respect of the claimant's counterclaim for defective work and failure to provide the appropriate technical manuals.

9. The second award made on the 6th January 2000 was in the sum of £1,457,678 plus VAT and was made up of £79,597 interest and £1,375,773 (net of VAT) costs. The balance of £2,307 was in respect of fees.

10. The amount of the second award attributable to the counterclaim namely 57% is £1,013,076. If one excludes the costs element associated with the counterclaim £784,191 (net of VAT) £228,886 represents fees and interest. It is accepted by both parties that the policy was subject to a limited indemnity of £1m for any one claim with an excess of £10,000 for each claim. According to the limit of indemnity the maximum payable under the policy was £990,000 in respect of any one claim.

11. The claimant recognises that the arbitration considered the defects in building number 11 only out of a total of 14 buildings. It contends however that it was a sample, and that it had intended to obtain an award in relation to each of the other buildings on site, but given CSW's insolvency they did not do so. Had it obtained such an award, CSW it is argued would have been liable to JMC for in excess of £2m (i.e. 14 times £182,000 equals £2.5m) and CSW's 1996/1997 professional indemnity insurance policy would have covered CSW's liability for the first million pounds of that liability. (see para. 17 below)

THE PRELIMINARY ISSUE

The assumed facts

12. The defendant knew that CSW had a professional negligence indemnity policy under the AME Conditions of Engagement, which was a claims made policy prior to the 13th March 1997, and was retained by CSW to advise in relation to the engineering/construction dispute with the claimant. Had it advised CSW to report the counterclaim to its insurers prior to the commencement of the new policy on the 13th March 1997 CSW would have followed that advice and reported the matters to its insurers for the policy 1996/1997 and in that event the counterclaim would have been covered under that policy and CSW would have been able to recover all sums payable under the 1996/1997 policy in respect of the claimants' counterclaim against CSW.

13. The question the court is asked to determine relates to the construction of terms in the professional indemnity policy.

14. The relevant terms of which are:-

INSURANCE CLAUSE

NOW THEREFORE, We, the Underwriters, hereby agree to indemnify the Assured up to but not exceeding in the aggregate the sum stated in the Schedule for any sum or sums which the Assured may become legally liable to pay arising from any such claim or claims made against them during the period stated in the Schedule as a direct result of any act of neglect, error or omission in the professional conduct of their business, as stated in the Schedule, by the Assured or any partner or previous partner or any person or party employed or engaged by the Assured including specialist designers or consultants acting on the Assureds behalf and for whom the Assured are responsible.

COSTS AND EXPENSES

FURTHER it is understood and agreed that the Underwriters will pay in addition to the sum stated in the Schedule the costs and expenses incurred with the Underwriters' written consent in the defence and/or settlement of any claim. However, if a payment in excess of the amount of indemnity available under this insurance has to be made to dispose of a claim made against the Assured the Underwriters' liability in respect of such costs and expenses shall be such proportion of the total costs and expenses incurred as the amount of the indemnity available under this insurance bears to the total amount paid to dispose of the claim. (emphasis supplied)

CONDITIONS

ASSUREDS DUTIES IN THE EVENT OF CLAIM: It is a condition precedent to Underwriters' liability under this insurance that,

(a) (i) Upon receipt by or on behalf of the Assured of notice whether written or oral of intention by any person or body to make a claim against the Assured or of any allegation of neglect, error or omission which might give rise to such a claim or on the discovery of any such act or neglect, error or omission the Assured shall notify the person(s) named for that purpose in the Schedule, for transmission to the Underwriters of such receipt, allegation or discovery as soon as practicable and shall provide full information respecting it so far as such information is in his/their possession.

(ii) If during the subsistence hereof the Assured shall become aware of any occurrence which may subsequently give rise to a claim against them by reason of any act or neglect, error or omission and shall during the subsistence hereof give written notice to the person(s) named for that purpose in the Schedule, for transmission to the Underwriters of such occurrence, any claim which may subsequently be made against the Assured arising out of that act of neglect, error or omission shall be deemed for the purpose of this Insurance to have been made during the subsistence hereof.

(b) The Assured shall not admit liability for or settle or make or promise any payment in respect of any claim which may be the subject of indemnity hereunder or incur any costs or expenses in connection therewith without the written consent of the Underwriters who if they so wish shall be entitled to take over and conduct in the name of the Assured the defence and/or settlement of any such claim for which purpose the Assured shall give all such information and assistance as the Underwriters may reasonably require.

THE ISSUE

15. The court is asked to determine whether on true construction of the policy *"The costs and expenses*" in the cost and expenses clause includes a claimants' costs in an arbitration award against the Assured, or whether such costs are *"…sums which the Assured may become legally liable to pay arising from any claim or claims made against them …"* within the Insuring Clause.

16. Clearly if the former they do not go to use up the limit imposed by the Insuring Clause and schedule 1. They may be payable in addition. It is of some materiality in this case on the basis of the assumed facts, subject to any breach and causation being proved.

17. The particulars of loss and damage claimed are as follows:-

"PARTICULARS OF LOSS AND DAMAGE

Under the 1996/97 policy the insurers would have been liable for:-

(a) £1 million – the insurers limit of liability on the 1996/97 policy (CSW would have been liable for £182,201 in respect of the Claimant's counterclaim on building 11, interest of £45,370 in respect of the counterclaim on building 11, and approximately "2.5 million in respect of the other 13 buildings on site).

(b) £784,191 plus VAT – the Claimant's costs associated with the counterclaim. (The total award by the arbitrator in Award Number 2 was £1,375,773.61 net of VAT and the Claimant seeks to recover 57% being the proportion that the insured element of the Claimant's counterclaim bears to the total amount awarded).

(c) CSW's costs and expenses incurred in the defence of the counterclaim (the Claimant seeks to recover the difference between CSW's actual costs which were approximately £350,000 and the payment made by the insurer in respect of costs of £303,911.65).

(d) £1,315 – the arbitrators fees and expenses associated with the counterclaim (The arbitrator's fees and expenses in Award Number 2 were £2,307.41 and the Claimant seeks to recover 57% being the proportion that the insured element of the Claimant's counterclaim bears to the total amount awarded)."

18. Mr Flenley counsel for the defendant contends that the underwriters draw a sharp and clear distinction between (a) costs incurred in the defence of the claim for which the assured was liable other than costs for which it was liable to the claimant against it, and (b) any costs for which the assured was liable to the claimant against it. The defendant contends that the underwriters assumed only the risk of having to pay for the costs incurred in the

defence of the claim for which the assured was liable (a) in addition to the £1m limit and not (b) costs which would come out of the £1m.

19. Mr Raymond Cox QC on behalf of the claimant submits that the costs and expenses clause does not in fact distinguish between any defence costs irrespective of the identity of the person to whom the assured owes the costs. Furthermore, costs for which an assured is liable to a third party are "*incurred*" by him just as much as any defence costs. He argues that if the costs and expenses clause was intended to restrict cover to type (a) costs it could easily have been done by defining "*the costs and expenses*" as those *"incurred by the assured but not sums for which the assured is liable to a third party"* and since they did not the defendants are now seeking to have read into the costs and expenses clause words such as these when they are not there. He referred to MacGillivray on Insurance Law 10th Edition at page 840 where at paragraph 28.36 a common clause is set out which observes the distinction between what has earlier been characterised as type (a) and (b) costs and expenses:

"In respect of a claim for damages to which the indemnity expressed in the policy applies the Company will also indemnify the Assured against -

(a) all costs and expenses of litigation recovered by any claimant from the insured,

(b) all costs and expenses of litigation incurred with the written consent of the company".

20. As the commentary acknowledges such a clause would certainly cover all of the third party's reasonable costs of a successful claim because no limit is expressed, and the assured's costs if incurred with written consent. The requirement of written consent safeguards the underwriter's control as to the scale, manner and expense of the assured engaging in such litigation. Mr Flenley in support of his submission that the costs and expenses referred to in the "Costs and Expenses" clause are those incurred on behalf of the assured in the defence and or settlement of a claim against him cites the case of ***Aluminium Wire and Cable Company Limited v. Allstate Insurance Company Limited*** [1985] 2 Lloyds Reports at page 280. The construction of a similar costs and expenses clause was considered by the Deputy Judge who held that the plain words of a promise by the insurers to pay "all costs and expenses incurred with its written consent" covers only the costs and expenses of the insured himself. Mr Cox QC contends that the learned judge's construction of the costs and expenses clause was obiter and the issue decided in that part of the case related to the liability of the insurers under the Third Party's (Rights Against Insurers) Act 1930, to pay the costs of a third party in an earlier default action against the insolvent assured. At page 288 column one the Judge rejected the argument that such third party costs may be part of the compensation for – inter alia – accidental loss or damages to property or part of the promise to pay in addition *"all costs and expenses incurred with its written consent"*. He went on to refer to Special Condition 5 which provides: *"If in action at law, decree or judgment should be given against the Insured in respect of any claim or claims arising out of any one accident or number of accidents as a foresaid for a sum or sums (exclusive of costs) in excess of the amount of the Single Accident Indemnity Limit the Insured shall pay such excess and the liability of the Company to pay costs shall be limited to an amount of the total costs as to as the Single Accident Indemnity Limit bears to the total sum or sums decreed or adjudged as aforesaid".*

Then the learned judge says:- *"I am quite satisfied, on the proper construction of Section E of the policy, that the insured (sic) are liable to Mr Stephen in circumstances such as this and, by transfer allowable (sic) to the plaintiffs for a proportion of the plaintiffs' costs against Mr Stephen in those other proceedings. I am firmly of the view, however that that must be restricted to a proportion of five sixths; that being an appropriate fraction bearing in mind the ratio of £250,000 to £309,197 being the amount recovered by the plaintiffs against Mr Stephen in those set proceedings."*

21. In the passage above in line 2 *'insurers'* clearly should be substituted for *'insured'* and in the third line for the word *'allowable'* the words *'are liable'*. It is clear that the learned judge based his finding of liability on special condition five as warranting the plaintiffs' entitlement to recover a proportion of their costs in the earlier action. Whilst it is arguable that the construction of the costs and expense clause was not strictly part of the ratio, nonetheless I am persuaded as the correctness of the learned judge's construction of the plain words of the costs and expense provision.

22. In this policy since the costs and expensed clause relates to additional payment it is necessary to consider what it is additional to. The Insuring Clause gives indemnity of up to £1m less any excess *"for … any … sums which the Assured may be legally liable to pay arising from any claim or claims made against them …"* (emphasis provided).

23. These words are wide enough to include any damages or compensatory award or judgment and the legal liability to pay the reasonable costs of a successful claimant incurred in prosecuting the claim against the assured.

24. The payment obligation under the Costs and Expenses clause clearly relates to type (b) costs, since it specifically refers to the defence of any claim and is additional to the indemnity to pay the claimants costs as provided for in the Insuring Clause.

25. Clearly in the Insuring Clause and Costs and Expenses clause there is a distinction made between an assured's defence costs and a claimants' costs award arising out of their successful prosecution of a claim.

26. Mr Cox QC in his submissions adverted to the situation whereby a claimant might succeed on his claim and be awarded his costs. He might also incur costs as a result of successfully defending a counterclaim pursued by an assured. Such costs, of course whilst they can be characterised as defence costs could not fall within the costs and expense provision, because such costs incurred to be recoverable, must be with the written consent of the underwriters. It is inconceivable that the underwriters of professional indemnity policies should be asked to consent

to the costs and expenses incurred by the claimants' solicitors in defending a counterclaim brought as a result of a claimant's claim, this would be unworkable. In any event, such defence costs would become a legal liability arising from the claim or claims within the Insuring Clause. It would be an Alice in Wonderland situation otherwise and not contemplated by the clear words of each of these clauses.

CONCLUSION

27. 1. The costs and expenses clause covers only the costs and expenses incurred with the underwriters written consent incurred by the assured in the defence or settlement of a claim against him.

28. 2. Any liability for costs of a claimant prosecuting a claim or counterclaim against an assured fall within the limit of the insuring clause and the schedule.

Mr Raymond Cox QC (instructed by Masons) for the Claimant
Mr William Flenley (instructed by Barlow Lyde & Gilbert) for the Defendant