Guidance on aggregation under the SRA Minimum Terms

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AIG Europe Limited v OC320301 LLP (formerly The International Law Partnership LLP) & The Law Society (Intervener) [2016] EWCA 367

In a much awaited judgment on 14 April 2016, the Court of Appeal has provided key guidance on the aggregation clause in the SRA's Minimum Terms and Conditions (MTC) required to be incorporated into all solicitors' professional indemnity policies. This is the first appellate court decision on the construction of the clause.

Aggregation permits two or more claims to be treated as a single claim where they are linked by a unifying factor of some kind. The choice of language used to express the unifying factor is of critical importance, with the appeal turning on the true construction of the words "a series of related matters or transactions" in clause 2.5 of the MTC.

The conclusion was that in order to aggregate the matters or transactions must have an intrinsic relationship with each other, not an extrinsic relationship with a third factor. The judge at first instance had been wrong to say that the matters or transactions had to be "dependent" on each other before aggregation could occur.

While the wider construction will be welcomed by insurers, the judgment does little to clarify how the aggregation clause is to be applied either to the specific facts before the court or more generally. The new test may prove difficult to apply in practice. The decision will apply generally to professional indemnity insurance, and possibly other classes which include aggregation clauses, and insurers who are not constrained by MTC will need to bear the test in mind.

First instance decision

This was an expedited appeal to address issues of principle only from the Commercial Court's judgment on 14 August 2015, as considered in our earlier alert. AIG had sought a declaration that some 214 claims ("the underlying claims") against its insured firm of solicitors by investors in overseas property developments that had failed, were to be aggregated as "*One Claim*". Clause 2.5 of the MTC, which was incorporated into the professional indemnity insurance policy issued by AIG, provides as follows:

"The insurance may provide that, when considering what may be regarded as one Claim for the purposes of the limits [of the policy]:

(a) All claims against any one or more insured arising from:

- (i) one act or omission;
- (ii) one series of related acts or omissions;
- (iii) the same act or omission in a series of related matters or transactions;
- (iv) similar acts or omissions in a series of related matters or transactions

(b) all Claims against one or more Insured arising from one matter or transaction will be regarded as One Claim."

AIG's case was that the underlying claims arose from similar acts or omissions in a series of related matters or transactions, with the result that AIG's limit of liability was £3m (being the policy limit per claim). The trustees who represented the investors in the underlying claims opposed the declaration. Their position was that the underlying claims did not aggregate, with the result that the losses estimated to exceed £10m could be recovered; alternatively that the underlying claims aggregated as two claims, so that potentially £6m was recoverable from AIG.

The judge concluded that the underlying claims should not be aggregated. He held that while the underlying claims did arise out of similar acts or omissions, they were not in a series of related transactions because the terms of the transactions were not conditional or dependent on each other. The judge said: "...the most natural meaning of the phrase "a series of related matters or transactions" in the context of a solicitors' insurance policy is, in my judgment, a series of matters or transactions that are in some way dependent on each other. It is difficult to talk of transactions being related unless their terms are in some way inter-connected." The judge strived to reach an outcome that provided a degree of certainty (having observed that "a reasonable man would expect an aggregation clause to be reasonably certain in its scope").

It was common ground between the parties that the individual transactions were not dependent on each other; it was therefore implicit that the judge considered there to be 214 claims. This outcome clearly favoured the investors.

Court of Appeal decision and guidance

The appeal turned on the true construction of the words “a series of related matters or transactions” in clause 2.5 of the MTC. The Court of Appeal concluded that this phrase required the matters or transactions to have an intrinsic relationship with each other, not an extrinsic relationship with a third factor.

“That means that there must be a relationship of some kind between the transactions relied on rather than a relationship with some outside connecting factor, even if that extrinsic relationship is common to the transactions. Thus transactions which all take place with reference to one large area of land in a particular country might be related transactions if they refer to or (perhaps) envisage one another, but if the relevant transaction is the payment of money out of an escrow account which should not have been paid out of that account, the fact of geography is too remote; what will be intrinsic will depend on the circumstances of that payment.”

The judge had been wrong to say that the matters or transactions had to be “dependent on each other” before aggregation could occur. There was a requirement for them to be inter-connected, but there were degrees of connection (or inter-connection) which are less than “dependence” and clause 2.5 did not require the degree of closeness contemplated by “dependence”. It was not the case that any degree of relatedness would do because that was an impossibly wide construction rendering the clause almost meaningless.

In finding that the connection between the matters or transactions had to be an intrinsic rather than a remote relationship, the Court of Appeal drew a distinction between how clause 2.5 had been drafted and a traditionally wide aggregation clause which used words such as “any claim or claims arising out of all occurrences...consequent on or attributable to one source or original cause” or “arising from one originating cause or series of events or occurrences attributable to one originating cause (or related causes)”.

It was held that it was because the language of the clause was “both itself imprecise and deliberately avoids the available wide formulations” that it was right to conclude that it was necessary to imply the unifying factor from the general context and the “intrinsic relationship” conclusion was reached. The Court of Appeal also referred to the history of the introduction of the clause, concluding that the history indicated that it was not intended that “any relation, however loose, will suffice.”

The appeal was therefore partially allowed and the entire case was remitted to the Commercial Court to determine the facts in accordance with the guidance given.

Comment

As most insurance coverage disputes for solicitors' policies are resolved by arbitration, it may not be surprising that this is the first case on the construction of the aggregation clause in the MTC. What is surprising is that the court has introduced a new test not previously adopted in wider case law. The fact that the judge and the Court of Appeal came up with very different meanings demonstrates the difficulty they faced in construing the clause in question.

Whilst the judge’s construction of the phrase “a series of related matters or transactions” had the advantage of being clear and comprehensible, the requirement of dependence gave a narrow construction of the aggregation clause. The judge's decision was regarded with circumspection within the insurance industry, particularly as few claims in practice would be capable of aggregation on that interpretation.

According to the Court of Appeal, for a series of matters or transactions to aggregate, they must have an intrinsic relationship with each other.

The Court of Appeal was clearly uncomfortable with both the judge's narrow construction, and what it regarded an “impossibly wide” construction that any degree of relatedness would do. Whilst the “intrinsic relationship” test has the benefit of adopting a middle ground, and insurers will no doubt be pleased that the narrow approach of the first instance judge has been rejected, the result is unlikely to assist insurers, insureds or their advisers, in determining whether aggregation applies in the circumstances. The difficulty is that the phrase “intrinsic relationship” has no established legal meaning and the judgment does little to clarify how the aggregation clause in solicitors' insurance policies should be applied. As a result, it appears that aggregation is likely to continue to raise difficulties. Ultimately, the manner in which clause 2.5 is applied will depend on the particular facts of a case. Here, it remains open to the 214 claimants to argue that there are multiple claims.

The decision demonstrates the importance of construing the aggregation clause against the background of other formulations of the clause, both wider and narrower. If the widest form of aggregation wording has not been chosen, the court will strive to respect the parties’ choice, and vice versa. Insurers should therefore exercise great care when drafting aggregation clauses where they are free to adopt language of their own selection. The history of the particular clause they select may be a legitimate aid to construction.

The decision also confirms that the construction of an aggregation clause has to be approached without any assumptions. It is

not helpful to consider the approach from a particular perspective, such as the interests of the insured or their clients who may be concerned that the solicitor should have adequate insurance cover. This reflects that aggregation applies also to deductibles, and in reinsurance contracts, and a strictly neutral position is appropriate.

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