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Royal & Sun Alliance Limited v Tughans (a firm)

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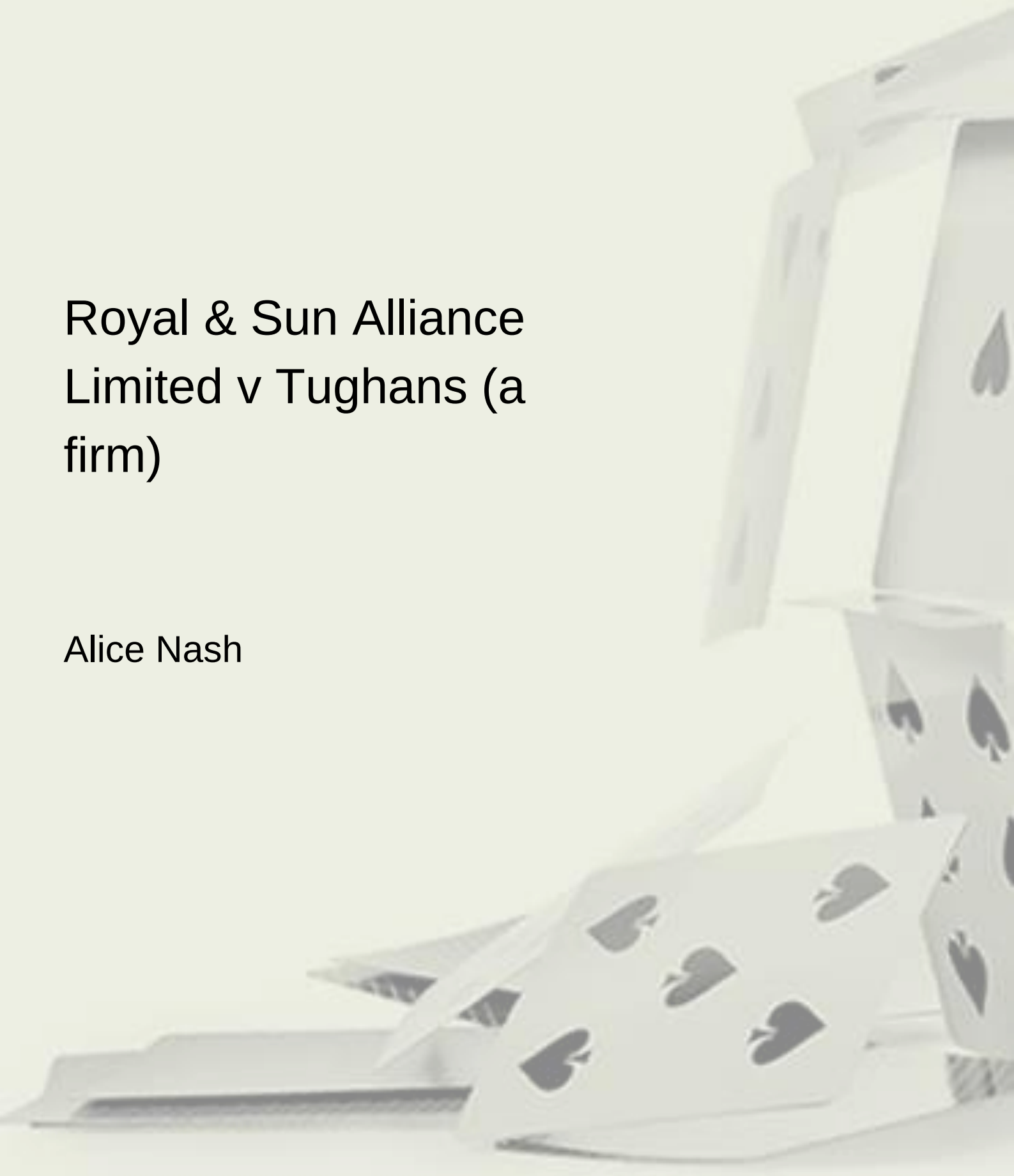

20th October 2022

Royal & Sun Alliance Ltd v Tughans (A Firm) [2022] EWHC 2589 (Comm)

When will a solicitor's professional indemnity policy respond to a loss which in effect comprises the solicitor's own fees? That was the question at the heart of this coverage dispute, which came before the High Court on a challenge under the Arbitration Act 1996.

Foxton J concluded, in short, that

(1) a payment of damages in respect of fees charged by a solicitor would ordinarily constitute a loss to the solicitor for which an indemnity should be payable where the solicitor had accrued a contractual right to the fees by doing that which had to be done under the contract of retainer to earn them; whereas,
(2) where solicitors had to return a sum of money to which they never had any legal entitlement then that would not be an indemnifiable loss in the absence of clear language to that effect.

However, notwithstanding that it was alleged that the solicitor's engagement had been procured by fraud, there had been a contractual entitlement to the fees in respect of which an indemnity under the policy was, in principle, available.

Background

The insured solicitors, a Northern Ireland firm, were involved in a dispute with another firm ("BR") over a deal to facilitate the sale of a portfolio of loans from a "bad bank" established by the Northern Irish government in 2009 to manage impaired loans during the financial crisis of that period. The two firms were engaged to "facilitate" the sale and had agreed to share a success fee payable on successful completion of the sale. It was alleged that, contrary to the warranties given by Tughans as a condition precedent to the contract of engagement, a managing partner at Tughans had always intended to divert part of Tughans' fees to a third party. The transaction completed and Tughans received a success fee of £7.5m plus VAT. The transaction was subsequently investigated and a claim was brought against Tughans claiming damages for misrepresentation including the success fee paid to Tughans, as well as costs incurred by BR in dealing with various civil and criminal investigations.

RSA purported to decline cover on the basis i) that the work done by Tughans had not been done "in connection with the practice of a solicitor", so that any liability was not a qualifying liability under the policy ("the Solicitor's Practice issue"), and ii) that in any event, insofar as Tughans was obliged to return the success fee, that would be because (on BR's case) it had never been entitled to it, and it was not therefore a "loss" within the meaning of the policy ("the Success Fee issue").
The matter proceeded to arbitration, where Tughans were largely successful.

Solicitor's Practice Issue

The arbitrator decided, despite what Foxton J described as "*the unusual nature of the transaction and the obscure nature of the services provided*" that "*strategic advice, facilitation of necessary political contacts, intelligence gathering and the oversight thereof, and deal structuring [were] all sufficiently solicitorial, and were all carried out*" so that the declinature on the basis of the Solicitor's Practice issue failed. RSA did not challenge that conclusion, "*understandably*" in the judge's view (para [137]). The judgment contains little detail of what Tughans in fact did, but the arbitrator's description suggests that the range of activities that may be construed as falling within the practice of a solicitor may be construed quite broadly.

Success Fee Issue

The Award also provided that RSA were obliged to indemnify Tughans, not only in respect of BRUK's claims for consequential losses and costs, but for the Success Fee, *"insofar as this is a part of the BR claim, as an element of loss which BR proves that it has suffered.*"

That was perhaps a surprising conclusion given that in correspondence preceding the arbitration, Tughans appeared, as the judge found, to accept that it was not entitled to an indemnity for the success fee and the Notice of Arbitration claimed a declaration that "*save for any liability on its part to return any fees which it has received from BR, [RSA] are obliged to indemnify it for (a) any liability arising from the claims made in the Proceedings, (b) its costs of defending the Proceedings, and (c) its costs of bringing any third party proceedings*." As Foxton J's judgment makes clear, it came about because following the handing down of a provisional award on the Solictor's Practice issue, a significant dispute developed in relation to the Success Fee issue. RSA challenged this aspect of the Award in the High Court under ss. 67, 68 and 69 of the Arbitration Act 1996.

The challenge in the High Court

The judgment of Foxton J contains (at paras. [48] to [96]) a detailed rehearsal of the rather unusual events that led, in effect, to the reopening of the issue of whether RSA was obliged to provide an indemnity in respect of the success fee. For reasons which are fairly specific to those facts he concluded, in short, that the Arbitrator had not acted in excess of jurisdiction for the purposes of s.67, but that the s.68 challenge succeeded on the basis that RSA had not had a proper opportunity to challenge Tughans' arguments.

On the s.69 challenge, however, the judge rejected the contention that the Arbitrator had made an error of law.

It was accepted on behalf of RSA – rightly, according to Foxton J – that *"where a solicitor who has performed work negligently is sued for damages which include wasted fees paid by the client, the solicitor's liability in respect of the wasted fees would ordinarily be capable of constituting loss for the purposes of a professional indemnity policy."*

Foxton J gave the further examples of a solicitor negligently advising that a particular (unsuccessful) application be made in the context of ultimately successful litigation, and then being sued by the client for the fees paid (including uplift) in respect of the application, and a case in which the solicitor's remuneration was entirely contingent in nature (for example, where it was conditional on obtaining judgment, but the solicitor had negligently advised the client as to the enforceability of a judgment in the only jurisdiction in which the defendant had assets.

In each of these cases, if the solicitor had done what was necessary as a matter of contract to accrue a right to the fee, an award of damages in the amount of the fee payable would ordinarily constitute a loss for the purposes of a professional indemnity policy (at [107]-[109] of the judgment).

The position is different, however, in relation to actions to recover amounts paid which were never due. Foxton J started his discussion by quoting the blunt observation of the US Judge Richard Posner, sitting in the Seventh Circuit Court of Appeals in *Level 3 Communications Inc v Federal Ins Co* 272 F3d 908, 910-911 (7th Cir 2001): "*An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than 'stolen' is used to characterize the claim for the property's return*".

He went on to consider the distinction between a claim for damages or compensation on the one hand, and on the other a claim for the return of money such as a claim for restitution or debt (not ordinarily recoverable under a professional indemnity policy, and specifically excluded in England and Wales under the SRA's Minimum Terms). He concluded that "*Having to return a sum of money paid to the insured to which the insured never had any legal entitlement is not, in my view, an indemnifiable loss under a professional indemnity policy in the absence of clear language to that effect*." (at [113].

He rejected Tughans' argument that such a payment became a "loss" if events following the solicitor's receipt of the money meant that the solicitor was rendered unable to pay it:

> *"Tughans' approach would involve a series of fine judgments more suited to the law of unjust enrichment than the law of insurance as to what steps subsequent to the receipt of the unearned payment were sufficient to generate an indemnifiable loss. It is possible to conceive of circumstances in which partnership profits are declared, distributed and disbursed on holidays, fine wines, tasteless art or charitable donations, or used to make investments whose value fluctuated over time. The need, on this approach, to address issues such as subjective devaluation, subjective revaluation and surviving value in an insurance law contract is a strong sign that the argument has ventured down the wrong path."* (at [114].)

Neither could the insurance position be affected by the way in which the complainant in the underlying dispute characterised their claim, for example by choosing not to allege that the amount paid had never in fact been due.

However, the question of whether the money had or had not ever been due turned on the construction of Tughans' engagement letter. After careful consideration, the judge concluded that a contract had come into existence when certain warranties were given, regardless of whether or not they were true. The truth of the representation was not a condition precedent to the validity of the contract (at 133]). BR had not purported to rescind it on the grounds of misrepresentation, so there was a contractual entitlement to the Success Fee.

According to Foxton J (at [135], *"taking the example of a solicitor who (negligently or fraudulently) misrepresents the firm's expertise, leading the client to embark on unsuccessful litigation which it would otherwise have refrained from. If the firm was subsequently ordered to pay the client damages in the amount of the fees paid to the firm, I do not believe the misrepresentation would have the effect of depriving the firm (and, in the event that it sought to recover on a derivative basis, the client) of a right to indemnity under the firm's professional indemnity policy."*

Accordingly "a claim for damages against Tughans in the amount of the Tughans Fee to which it had acquired a contractual right under a subsisting contract constitutes a loss to Tughans for which they are entitled, if the other pre-requisites to cover are established, to an indemnity under the Policy."

The judge remitted the Award back to the Arbitrator to determine whether Tughans should be restricted to the "Qualified Claim", advanced in the written submissions that followed his partial Award, that it would only be entitled to an indemnity in relation to the Success Fee insofar as Tughans was no longer in possession of the funds. Absent that feature, it would seem that Tughans would have been entitled to an indemnity in relation to the whole fee.

Conclusion

No claim for an indemnity in respect of a solicitor's own fees can attach to a PII policy where the essence of the claim is that the solicitor was never legally entitled to the funds, and this is so regardless of any subsequent change of position and regardless of the way the underlying claim is put.

It seems, however, that – at least in English and Welsh law – there are limits to the scope of activity which is considered equivalent to "stealing": absent clear words, a contract is not void *ab initio* because it is made in reliance upon statements – even warranties – which prove to be untrue. Accordingly, the mere fact that the underlying claim involves an allegation that the solicitor's contract of engagement – and hence entitlement to fees – was procured fraudulently does not prevent it from being a claim for damages in relation to the fees paid, rather than a demand for restitution or repayment.

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20 October 2022