

New ICAEW Minimum Terms - Farewell to (some) conditions precedent July 2010

Unlike the SRA, which recently announced very limited amendments, the ICAEW at least has shown itself prepared to substantially revisit their Minimum Terms in an attempt to bring them into the twenty first century. Apart from many superficial changes to remove redundant parts, there are several substantive changes that are disadvantageous to participating insurers but beneficial to policyholders. The most significant changes are as follows:

Preamble

The ICAEW have watered down the basis of contract wording, albeit the remedies for breach of warranty under their wording are clearly restricted. They have also amended the recital to make clear that any proposal is submitted by a representative of the Insured and this may be of assistance in cases for example involving fraudulent non-disclosure by an Insured's agent (emphasised by a change in clause D1.1).

Professional business – B13

A helpful change has been made to this to make clear that it is only professional business provided to a third party that is covered. We have seen a number of examples recently of Insured's themselves advancing claims and whilst these should anyway have been rejected under the insuring clause this does bring extra clarity.

Notification – C2

Of a claim

As warned in our previous bulletin in May 2009 (available at www.beale-law.com), the over-enthusiastic use of *Kidsons* by some participating insurers has led the Institute to amend the Minimum Terms. The obligation to notify a claim as soon as practicable is no longer a condition precedent, breach of which would have entitled underwriters to repudiate the claim. This clearly benefits policyholders. The new clause C2.1 still requires that notice be given as soon as practicable but adds a requirement that this be within 7 days of the expiry of the policy. However this requirement appears entirely toothless given that it is now clearly a mere condition.

There is conflicting Court of Appeal guidance on the extent of underwriters' remedy for breach of a mere condition. However the preferred view in absence of further guidance from the Courts is that *Sirius International Insurance -v- Friends Provident* is correct and that *BAI v Mcalpine* was wrong to hold that breach could in anyway entitle underwriters to reject a claim. Underwriters can still claim for damages from an Insured but this of course is dependent on establishing prejudice and this is already made clear in clause D2.1 and which remains.

The definition of a claim (B2) has been clarified to make clear that it includes both written and oral demands for compensation. In our view this simply reflects the previous position but to the extent it is now clearer it will make rejecting claims as made in a prior policy year somewhat easier.

Of a circumstance

Clause C2.2 now requires that notification of a circumstance must be provided within the period of insurance only. This benefits underwriters. There is no extension of the deeming clause given. Whatever one's view is of Lord Justice Rix's reasoning in *Kidsons*, despite the change above, it is still possible to argue that the late notification of a circumstance within the policy period (and especially a laundry list at year end) remains a breach of condition precedent, where the claim itself is then

received in a subsequent policy year. There is nothing in the notes produced by the ICAEW accompanying the changes to suggest otherwise.

Other conditions precedent

The conditions that an Insured must not admit liability nor settle any claims are also no longer conditions precedent.

Excess applies to defence costs – C3.2

This is the main benefit to underwriters. If a claim arises from professional business which required authorisation by the FSA then the excess will now apply to defence costs. It should be noted that the provision applies regardless of whether an Insured was as a matter of fact properly authorised.

At first blush this may not be terribly significant as many firms undertaking certain types of investment business are not authorised by the FSA directly but instead conduct it under a Designated Professional Body (“DPB”) license with the ICAEW. It does not appear intended that that should be caught.

However the Financial Services and Markets Act 2000 and associated Regulations are very complex as even a cursory glance at the DPB Handbook demonstrates and the question of whether a firm should have been directly authorised is not straightforward.

We are happy to provide further detailed guidance in this regard but the key point is that there will be substantial scope to argue that the excess will apply in wider circumstances on the basis that Insured’s have been carrying out work that did require FSA authorisation and/or that DPB work should otherwise be caught.

The provision generally will have a number of interesting consequences. It will no doubt concentrate the minds of panel firms as to the client care requirements that they should in any event be adhering to when acting in a joint retainer. It will also make swift decisions on coverage issues even more important.

Definition of Defence costs – B4

There is now also a very wide definition of defence costs at A3 and these are expressly said to be pro-rata to the limit of indemnity. B4 (d) includes the costs of any circumstance notified to underwriters “*in accordance with the terms of the policy*”. Combined with the new excess provision above it is therefore conceivable that underwriters could seek to argue that the costs of an attempted notification that is rejected and which relates to FSA authorised business, should be paid by an Insured up to the level of the excess.

Fraud and dishonesty – C4

These have been substantially tidied up to make clearer how the exclusions and reimbursement provisions should work. The only substantive point is that the balance of indemnity clause is now referenced to sums “recovered” and not “recoverable”.

Fraud defence costs – C5

This change will lead to greatly increased costs. It provides that where there is an allegation of dishonesty against an Insured, underwriters have to fund the defence costs until the earlier of (a) an admission of dishonesty by the Insured or (b) a finding by a Court or other judicial body that they have been dishonest.

In our view this may make sole practitioners a significantly worse risk. At present underwriters can rely on the judgment of experienced panel (or on occasion senior counsel following an indemnity conference) in order to exclude a claim for dishonest conduct. This will not be possible in future and

defence costs must be advanced pending a Court decision of a finding of a judicial body (such as an arbitrator or the Accountancy & Actuarial Discipline Board). The practical effect is that they may be forced to seek declaratory relief in all such claims.

Information on claims – C6.2

There is now a requirement that Insured's be entitled to "*any and all information or documentation regarding the defence, investigation or settlement of any claim and/or the investigation into any circumstances as they may reasonably request from Insurers*". In our view this adds nothing to the existing requirement that underwriters treat their policyholders fairly and/or pursuant to panel firms' professional obligations when acting under a joint retainer. However it does provide an additional weapon for policyholders seeking additional information.

Subrogation – C8

Underwriters are now prevented from exercising a right of subrogation to seek recovery from another Insured. This now includes any sub-contractors, save where their existence has not been disclosed. It also does not apply to subrogated rights against a dishonest individual. This is a very significant change as it is common practice for smaller firms to use sub-contractors, particularly for tax advice and it is common to seek recovery where the sub-contractor is insured separately.

Fraudulent claims – C9

This has been amended to specify that the entire policy cannot be avoided where one Insured advances a fraudulent claim, although it is not clear that this was anyway possible under a composite policy. The proper extent of the remedies for fraudulent claims generally remains uncertain (see for example *Manifest Shipping v Unipolaris Shipping* and *Axa v Gottlieb*).

Dispute as to insurers – C10.2

Where there is a coverage dispute, the current year insurer is now forced to conduct the defence of the claim pending its resolution. This is important and may lead the current insurer to incur significant costs, even where it may think it very clear that the claim falls to be dealt with in an earlier year.

Set-off – C13

Underwriters can no longer deduct from any settlement sums any unpaid premium or other amounts owing. It does not however oblige them to meet any unpaid excess.

Other insurance – C15

Underwriters can no longer exclude cover where there exists other insurance that covers a claim, in accountants' claims usually D&O insurance. This may be a very significant advantage for D&O insurers, who commonly also include such a provision in their policies.

Special conditions – D1 and D2

These have been tidied up considerably. Two changes have been made that may appear alarming at first but in fact are not. Firstly a clause on prejudice referenced to the amount of loss sustained by an Insured has been removed. However this relates to the fidelity clause removed some years ago and which was redundant. Secondly the clause relating to prejudice caused by failing to notify a circumstance prior to increasing a limit of indemnity has been removed. However this was also redundant as it is covered under Clause D2.1.

USA/Canada – E1

This tightens the exclusion to make clear that only work carried out from *an Insured's* office in the USA or Canada is excluded. This will provide less scope for excluding work in respect of both large and small firms alike.

Summary

The changes will apply from 1 September 2010. Whilst the Minimum Terms are now a much clearer document, most of the changes are not positive for the insurers of ICAEW firms. It could lead to some hardening on rates, which remain extremely low.

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