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An American Policyholder in London: English Choice of Law Clauses in United States Insurance Policies

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While certainly not the norm, it is not uncommon for insurance policies issued to companies based in the United States, particularly large commercial and excess policies brokered on the London Market, to contain choice of law and forum clauses specifying that the law of England and Wales governs and that any legal proceedings shall be brought in the English courts[1]. As one might expect from the birthplace of insurance and home to the best-known insurance market in the world, England does not have a reputation for law that is overtly favorable to policyholders and other insureds. Compounding the trepidation felt by some commercial insureds in these situations, many policies with English choice-of-law clauses also require that disputes be resolved via panels of typically-English insurance experts in confidential arbitration proceedings in London. On the other side, of course, there are many proponents of having complex insurance disputes resolved in London under English law, citing the certainty provided by even-handed rules of interpretation being applied by insurance experts in a confidential setting and the accordant ability of insurers to price risk more accurately.

[1] Some policies even refer to the laws and courts of the United Kingdom, although that is ambiguous since the United Kingdom is actually divided among several legal jurisdictions with separate laws and court systems. A 2012 decision of the High Court for England and Wales in *Faraday v. Howden North America* noted this but decided under the circumstances of that case to read this as akin to English law and courts. It might not always be so. Indeed, this would be much like deciding what a contract written subject to United States law and forum really means.

Without addressing which of these views is more appropriate, this article seeks to identify a few of the issues on which English law is notably different from prevailing law in the United States and which ought to be taken into account when considering an English law and forum clause.

Bad Faith Claims

The primary goal of "bad faith" law in the insurance arena is to provide insurance companies with an additional incentive to promptly pay meritorious claims. Although some states in the United States provide relatively mild if no practical incentives to insurers in this regard, the vast majority of states recognize some form of bad faith law. In those states with meaningful bad faith law, the incentive is provided through remedies such as attorneys' fees, prejudgment interest at higher-than-market rates and punitive damages that become available to an insured when its insurer unreasonably refuses to pay a justified claim. These laws do not prevent insurers from pursuing strategies insureds find nefarious, but they provide an additional tool when insurers engage in unreasonable claims handling practices.

Under the law of England and Wales there is no bad faith law as that is understood in the United States. While there is a legal principle requiring that the parties deal with each other in "utmost good faith" at the time of formation (discussed in greater detail below), this doctrine does not generally extend past formation to require the insurer to handle claims fairly. Whether the lack of an English bad faith law ultimately is significant is debatable, though, as in the commercial context one of the most valuable remedies provided under many states' bad faith laws is the ability to recover the attorneys' fees incurred pursuing coverage. But since England does not follow the "American Rule" under which each side pays its own attorneys, an insured which successfully pursues coverage can often recover its attorneys' fees under the law of England and Wales. Moreover, unlike many states in which attorneys' fees are recoverable only when the insurer is found to have denied coverage or acted unreasonably, fees can be recovered in England even when the insurer took a reasonable position which turned out to be erroneous. While that all may be positive, the counterpoint is that the insured, if unsuccessful, can end up paying the insurer's attorneys' fees.

In addition, an exemplary or punitive uplift in consequential damages as punishment for bad faith is also not generally available under English law. For example, in the case *Rookes v Barnard* [1964] the House of Lords held that, except in a few exceptional cases (generally involving torts), punitive damages against a defendant were not permissible however outrageous his conduct. In contrast to tort law, neither punitive nor aggravated damages are awarded in breach of contract claims, including insurance contracts. This is unlikely to change in future, as made clear in an assessment underpinned by a statement of the Law Commission (Paper 6, March 2010). The Commission clearly states that it does not propose that a breach of the duty of good faith should form a separate tort. Hence, exemplary damages are not awarded in connection with insurer bad faith. However, in a Consultation paper published at the end of 2011, the English and Scottish Law Commissions (ESLC), reviewing insurance contract law, suggested the implementation of post-contractual duties. Regarding such duties, there is a proposal on the table for insurers to be subject to damages claims in cases of delay or failure to pay a valid insurance claim. Changes in this area are thought to be more likely in the consumer rather than commercial market. Currently, any economic damage sustained as a result of an insurer's non-performance, other than interest, is not recoverable.

Insurability of Punitive Damages

Many states in the United States prohibit or limit coverage for punitive damages in some respect. For example, in California, obtaining coverage for punitive damage awards directly against the insured is

generally difficult, as there is a statute which is considered by some as precluding such coverage. A significant number of states (including California) do, however, recognize that insurance is available for punitive damages awarded vicariously. Moreover, other states (such as Delaware) permit insurance to cover punitive damages, whether assessed on account of the insured's own conduct or the conduct of others for whom the insured is liable.

Under English law, the insurability of exemplary damages was considered by the Court of Appeal in *Lancashire County Council v MMI* (1997). The Court held that such insurance was not per se contrary to public policy in English law. This could be perceived as a significant benefit to English law, given the number of jurisdictions in the United States where coverage for punitive damages is restricted in some fashion. It should be noted, however, that many of the situations under which punitive damages may be awarded in the United States can give rise to other arguments against coverage (e.g., insurers frequently argue that intentionally wrongful conduct is not insurable) whether under U.S. or English law.

Contract Interpretation/Resolution of Ambiguities

Like the law of most if not all states in the United States, English law concerning the interpretation of contracts has the goal of giving effect to the parties' mutual intent at the time of contracting. While one might be inclined to think, therefore, that there is no meaningful difference between English and American law concerning the interpretation of insurance policies, that would be a mistake.

There are many distinctions, but perhaps the most significant is the treatment of disputes involving a word or phrase that is subject to two or more interpretations, both of which are reasonable in some fashion. In most if not all U.S. jurisdictions, rules of contract interpretation require a court to adopt the meaning an insured ascribes to a word or phrase if the plain language is reasonably capable of being construed in the manner proposed. The insured's interpretation does not need to be better or more reasonable than the insurer's proffered meaning, just objectively reasonable. This often referred to as the "contra proferentem" rule since it construes the language against the insurance company who drafted the policy language for its own benefit.

By contrast, while *contra proferentem* may be still applied (See *Lexi Holdings Plc -v- Stainforth* [2006] EWCA Civ 988 and *Pratt –v- Aigaion Insurance Company* [2008] EWCA Civ 1314), insurers often argue that English rules of interpretation allow the arbiter to, in effect, make a judgment call about which interpretation is more reasonable under the circumstances. In making this determination, the arbiter is supposed to consider the meaning conveyed to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time they entered the contract. It does not matter, therefore, what information the parties actually had or what was actually said about the meaning the parties ascribed to words or phrases, just what would have been theoretically available to them, or at least so it is argued.

This was explained in *Sirius International Insurance Company (Publ) -v- FAI General Insurance Limited and others* [2004] UKHL 54, at paragraph 18 as follows:

> The aim of the inquiry is not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. The inquiry is objective: the question is what a reasonable person, circumstanced as the actual parties were, would have understood the parties to have meant by the use of specific language. The answer to that question is to be gathered from the text under consideration and its relevant contextual scene.

To provide a simple example of how these two approaches could lead to varied results, assume that a contract provided that notice must be delivered by midnight, but omitted the applicable time zone. Further assume that the insured delivered the notice at 11:00 P.M. PST/2:00 A.M. EST. Under the American approach, the court should construe “midnight” as meaning Pacific time if that would be reasonable under the circumstances, as it presumably would be if either the insured or insurer were based in California. Under the English approach, however, a court might decide that “midnight” referred to Eastern time, if the information reasonably available at the time of contracting indicated that insurance underwriters typically refer to Eastern time when stating notice deadlines.

As this simple example illustrates, there can be a certain circularity resulting from the English approach. That is, if the “market” (which consists primarily of insurance companies) generally considers ambiguous language to limit an insurer’s responsibility, there will be a tendency to apply that interpretation, even if the plain language suggests that there is an equally if not more reasonable interpretation of the language that would lead to a greater recovery by the insured.

Scope of Discovery

Broadly speaking, there is no “discovery” in English legal proceedings as that is understood in the United States federal and state courts. Parties to English litigation are required to give "standard disclosure" under which they are to produce only those documents (including electronic documents such as emails) on which they rely as well as documents which may adversely affect their case or adversely affect or support another party's case. The rules also require that documents be preserved, a reasonable search must be made for such documents and specify factors relevant to the reasonableness of a search.

The English rules on disclosure define and limit the extent and nature of disclosure and are intended to avoid excesses of effort, resources and costs. In some cases, such as those involving fraud, broader, more specific, disclosure may be ordered by the court on application, but this is the exception rather than the rule and remains subject to the concept of proportionality. Indeed, all litigation in England is now conducted subject to the "overriding objective" of enabling the courts to deal with cases justly. The overriding objective incorporates the notions of dealing with cases expeditiously and fairly and proportionately, that is proportionate to the amount involved, the importance and complexity of the case and the respective financial positions of the parties to ensure a level playing field in so far as this is possible.

If a party wants to provide oral evidence at trial, then it must disclose this evidence in written format in a co-called witness statement. A witness statement sets out the facts to which the witness will testify at the trial and must be certified to be true by the witness. These statements are usually exchanged several weeks before the trial. Then, the witnesses may be cross-examined by the other party's lawyer at trial based on their witness statements. United States style discovery depositions are not normally allowed in English proceedings.

This more limited approach to “discovery” may be seen by some as inhibiting the search for truth but by others as a sensible, practical and economic way to avoid excessive expense and resulting injustice. In any event, it is a significant difference in approach that ought to be considered when analyzing an English law and forum clause.

Coverage When Underlying Case is Settled

The overwhelming majority of cases brought in the United States are settled before reaching a final judgment. One would expect, therefore, that a company's insurer would be willing to pay settlements that are reasonable in amount and involve payment on account of alleged liability coming within the scope of coverage. For example, when a life sciences company purchases large amounts of coverage to pay for bodily injury claims brought against it, it reasonably expects that coverage would be available in connection with settlements to resolve bodily injury claims.

This may not be the case under English law, as demonstrated by the decision in *AstraZeneca Ins. Co. Ltd. v. XL Insurance (Bermuda) Ltd. and ACE Bermuda Ins. Ltd.* [2013] EWHC 349 (Comm) (28 February 2013) *affirmed* [2013] EWCA Civ 1660 (20 December 2013). There, AstraZeneca's captive insurer had paid nearly $126 million in defense costs and settlements related to product liability suits. AstraZeneca took one case to trial, obtaining a complete defense verdict, and presumably driving down the settlement value for the balance of the cases. However, since there was no judicial determination that AstraZeneca had "actual legal liability" to the underlying claimants, the commercial excess layers insurer took the position that to obtain coverage AstraZeneca would have to, in effect, prove its own liability to the underlying claimants.

That bears repeating. The insurer claimed that since its policy allegedly provided coverage only when the insured had "actual legal liability" to the underlying plaintiffs, AstraZeneca would have to re-litigate the underlying cases, *but this time standing in the shoes of the underlying plaintiffs and trying to prove that its own product had in fact caused the alleged harm*. AstraZeneca declined to litigate plaintiffs' claims against itself, arguing instead that the settlements were reasonable in light of its "arguable liability" to the underlying plaintiffs. The English court sided with the insurer, holding that AstraZeneca could not recover defense costs or the settlements in the absence of a showing that it had "actual legal liability" to plaintiffs.

While insurers may sometimes assert the position outlined above under the law of certain U.S. jurisdictions, the vast majority of states which have considered the issue have rejected such arguments. For example, the courts in Illinois have repeatedly recognized that coverage is available when an insured settles "in reasonable anticipation of potential liability." *Federal Ins. Co. v. Binney & Smith, Inc.*, 393 Ill.App.3d 277, 288, 332 Ill.Dec. 448 (2009) (citations omitted). In so holding, the courts recognized that "requiring an insured . . . to establish actual liability in order to receive indemnification would place the insured in the difficult position of having to refute liability in the underlying lawsuit and then, after obtaining a settlement, turn around and prove its own liability in order to succeed in a subsequent insurance coverage action." Id. (Citations Omitted).

Strict Compliance with Covenants/Conditions

The typical insurance policy imposes upon an insured several obligations, most commonly the obligation to provide notice of claims, cooperate to some degree with the insurer at the time of the claim and not enter into settlements without the insurer's consent. Depending on the particular duty and state, many – but not all – of these obligations do not require strict compliance, and an insurer cannot deny coverage on grounds of purported non-compliance unless it demonstrates that it has suffered actual prejudice as a result of the non-compliance. In California, for example, insurer arguments based on alleged non-compliance notice provisions in occurrence-based or claims-made policies (but not claims-made-and-reported policies) are subject to an actual prejudice standard, which in the absence of an irreversible judgment against the insured makes it very difficult for an insurer to deny coverage based on late notice, even if the notice is given years after it was allegedly due. None of that is to suggest, however, that an insured should disregard or not take seriously their obligations under a policy, because sometimes strict compliance is

required and a lack of compliance certainly will be argued by the insurer as a reason the claim should be denied or its value reduced.

By contrast, compliance with claims notification provisions often requires strict compliance (if the provision in question is considered a "condition precedent," and not a "bare condition"), and an insurer can deny coverage even in the absence of any prejudice. Similar results can be found with respect to consent to settlement and cooperation clauses, i.e., that the insurer can deny coverage outright even in the absence of prejudice.

Two High Court cases, *HLB Kidsons (a firm) v Lloyd's Underwriters subscribing to Lloyd's Policy No 621/ PKID00101* [2007] EWHC 1951, [2008] 2 All ER 769, and *Kajima UK Engineering Ltd v Underwriter Insurance Co Ltd* [2008] EWHC 83, [2008] All ER (D) 194 (Jan), illustrate the English law approach.

In *HLB Kidsons*, a firm of accountants had received claims arising from tax avoidance schemes it had recommended to its clients. It claimed indemnification for the claims arguing that it had notified the underwriter of the circumstances giving rise to the claims in accordance with the provisions contained in its insurance policy. The Lloyds Underwriters challenged the validity and adequacy of the notifications.

The notification provision in *Kidsons* provided that "The [insured] shall give to the [insurer] notice in writing as soon as practicable of any circumstance of which they shall become aware during the [policy period] which may give rise to a loss or claim against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after the [policy period] shall be deemed for the purpose of this Insurance to have been made during the subsistence hereof." *Kidsons* gives the following guidance on the requirements for a valid notice under this type of notification provision:

- The notice must be given in writing not orally and be given by, or on behalf of, the insured to each underwriter or its duly authorized agent (unless agreed otherwise).

- The notice must be given as soon as reasonably possible after the insured has first become aware during the policy period of the relevant circumstance ("fact, event, happening or state of affairs").

- The communication, objectively evaluated, "should be sufficiently clear and unambiguous that it leaves the reasonable recipient in no reasonable doubt that the [insured] is by the communication purporting to give notice of a circumstance under [the notification provision] for the purposes of triggering coverage under the Policy".

- Notice must be given of any circumstance which the insured becomes aware of that may give rise to a loss or claim against it. The circumstance, objectively evaluated, should create "a reasonable and appreciable possibility that it will give rise to a loss or claim against the [insured]...a circumstance may give rise to a loss or claim when there is a possibility or perceived possibility that, at some stage in the future, it will do so. There need not be a certainty that it will do so; and there need not be a probability or likelihood that it will do so. All that need exist is a state of affairs from which the prospects of a claim (whether good or bad) or loss emerging in the future are 'real' as opposed to false, fanciful or imaginary."

Following a valid notice, coverage extends to "any loss or claim to which [the notified] circumstance has given rise". The guidance from *Kidsons* is that:

> The loss or claim should be sufficiently causally related to the fact, event, happening or condition which comprises the notified circumstance, that it can be fairly said to have arisen out of it.

Kajima involved a prime contractor employed to design and build a block of flats including certain so-called "accommodation pods". The notification provision in its insurance policy required Kajima to notify the insurer "as soon as practicable of any circumstances which might reasonably be expected to produce a claim". Kajima notified its insurer, during the policy period, that the accommodation pods were settling and moving excessively, causing adjoining roofing, balconies and walkways to pull out of shape. The notification also referred in general terms to other possible damage and that an investigation to identify cause and potential effects was being conducted. The Insurer did not contest that the notice given was a valid notification but challenged whether which circumstances and damage was covered by that notification. The judge in *Kajima* observed that "there must be some causal, as opposed to some coincidental, link between the notified circumstances and the later claim".

In the end, Kidsons failed to secure coverage from its insurer for the claims made against it. Several notices relied on by Kidsons were found not to be valid as their content and clarity were deemed insufficient, and one notice failed on timing as given almost three months after the policy period despite Kidsons having first become aware of the relevant circumstance some four months earlier. The valid notices were limited to notifications of certain procedural difficulties, but none of the claims had arisen from these notifications.

Kajima likewise failed to secure coverage because the notified circumstances were not attributable to, or did not give rise to, any of the later discovered defects or damage. The valid notice given by Kajima was found to be effective but only to the specific and limited circumstances which were notified and of which it was aware. It was not effective in relation to any other matters, loss, defects or damage that did not relate or contribute to the circumstances notified, or that were not caused by the notified circumstances. The notified circumstances could not be expanded by later discovery of unrelated defects or damage, even if there were an historical "continuum" of investigation that coincidentally revealed defects or deficiencies that did not, or may not, have been sufficiently related, in the eyes of the insurer and the court, with the notified circumstances.

A second area in which English law could be seen as being significantly less forgiving than law found in most U.S. jurisdictions is that surrounding pre-inception disclosures to the insurer. English law provides that the formation of contracts of insurance is governed by the doctrine of *uberrima fides* (sometimes stated as uberrimae fidei) a Latin phrase usually translated "utmost good faith". See: *Banque Keyser Ullmann SA v. Skandia (UK) Insurance Co Ltd.* [1990] 1 QB 665; *Banque Financiere de la Cite SA v. Westgate Insurance Co. Ltd.* [1991] 2 AC 249, 280; and *Sprung v. Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep. 111. This generally requires that all parties to an insurance contract must deal in good faith, making a full declaration of all material facts in the insurance proposal. Thus the insured must reveal the exact nature and potential of the risks to be transfered to the insurer, while at the same time the insurer must make sure that the potential contract offered fits the needs of, and benefits, the assured. While this might sound even handed, in many cases it imposes a higher duty only on the applicant for insurance to disclose all material facts so that the insurer may accurately assess and the contract price reflect the actual risk being undertaken, with the specter that any resulting policy may be found to be void *ab initio* for the insured's failure to have done so.. The principles underlying this rule were stated by Lord Mansfield in *Carter v Boehm* (1766) 97 ER 1162, 1164:

> Insurance is a contract of speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his

> representation, and proceeds upon confidence that he does not keep back any circumstances in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist... Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain from his ignorance of that fact, and his believing the contrary.

And, as one might expect, the failure to disclose all allegedly material facts leads to arguments from the insurer that it has no obligation to provide coverage, which is an argument likely to be stronger under English law that it might otherwise be under U.S. law.

Conclusion

Just as it is often remarked that the United States and Great Britain are two countries separated by a common language, the similarities and joint roots of their common law systems should not lull one into thinking that the choice of law and forum as between the two is mere "boilerplate" without meaningful significance. Indeed, the above comments are meant to be illustrative and do not cover all the differences. Rather than acquiescing, an astute insurance applicant would be well advised to seek knowledgeable counsel familiar with both systems to counsel and fully explain the particulars that may be applied to their circumstances.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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