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Solicitors' professional indemnity and exclusions clauses
Impact Funding Solutions Ltd v AIG Europe Insurance Ltd [2016] UKSC 57

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Introduction
The background to *Impact* was the withdrawal in England and Wales of legal aid for personal injury cases and the consequent appearance of conditional fee agreements (CFAs) and after the event insurance, combined with claims management companies (CMCs) and legal expenses insurance. The novel legal problem was the interpretation in solicitors' professional indemnity insurance of a term similar to all professional indemnity policies and also the business model by which many solicitors had funded litigation. The specific issue was whether the indemnity insurers were bound to indemnify solicitors liable to reimburse loans made to their clients to pay for disbursements made by those clients. *Impact* followed the familiar route of a first instance decision overturned by the appeal court and reinstated by the Supreme Court with a dissenting opinion.

The facts
Impact provided loans to personal injury claimants to cover the cost of disbursements such as expert reports or GP records which could not ordinarily be deferred. The claimant's solicitor would enter into a framework agreement called a Disbursements Funding Master Agreement (DFMA) with Impact under which Impact made the loan to the client (subject to a written agreement) in return for payment by the solicitor of an administration fee and a quarterly monitoring fee. The DFMA catered for the risk that a claim pursued under a conditional fee agreement failed by requiring the client to take out legal expenses insurance to cover the other side's legal costs, their own disbursements and the premium on the expenses policy. In successful claims the disbursements would normally be recovered from the defendants. If the claim failed or was settled on unfavourable terms, the loans plus interest might be covered by legal entity identifier or "after the event" (ATE) insurance but if the insurers did not pay for any reason, e.g. valid avoidance of the policy or denial of liability under the policy, the solicitors (rather than their clients) would be the secondary party to which Impact would look for recovery in terms of the DFMA which obliged the solicitor to indemnify Impact for any loss caused by the solicitor's breach of duty to its clients.

In breach of the DFMA Barrington Ltd (B Ltd) had failed to assess the merits of claims that were subsequently abandoned as time-barred or because they were intrinsically unmeritorious; further, monies drawn down from Impact under the loan agreements signed by B Ltd's clients were not used for genuine disbursements but to pay introduction (and other referral fees) to the CMCs who had found the claimants in the first place. The ATE insurers declined to pay the costs of the abandoned actions or to reimburse the loans made

by Impact to pay for genuine disbursements. Impact successfully sued B Ltd for breach of warranty but, as the latter was in liquidation, it then claimed against B Ltd's indemnity insurers, AIG, under the Third Parties (Rights Against Insurers) Act 1930. AIG was entitled in those proceedings to rely on any defence which it would have had if it had been sued by its insured, B Ltd.

The terms of AIG's insurance policy mirrored the insurance requirements of the Solicitors Indemnity Insurance Rules to be indemnified against civil liability arising from private legal practice. AIG accepted that B's liability to repay the loans to Impact fell within its cover, subject to an exclusion in cl.6.6 of the policy for claims arising out of breach by any insured of the terms of any contract or arrangement for the *supply to, or use by, any insured of goods or services* in the course of the insured firm's practice [author's emphasis].

Before the first instance judge AIG argued that, under the exclusion cl.6.6 of the policy, they were not liable to indemnify Barrington in respect of its liability to repay what AIG described as "commercial loans" since professional indemnity insurers were not in the business of helping Impact obtain repayment of loans to solicitors for the purpose of carrying on their practices. The judge agreed, holding that AIG was entitled to rely on this clause because Impact was providing a service to B Ltd in making the loans to cover the necessary disbursements which enabled B Ltd in turn to enter the potentially profitable CFAs. Barrington's liability to repay the disbursements arose from Barrington's breach of the contract pursuant to which this service was provided and therefore came within the exception in cl.6.6. of the insurance. Impact appealed and the subsequent decisions focused on this narrow issue.

The law

To construe the relevant terms of the indemnity policy and of the DFMA involved the "well-established approach" of looking to the meaning of the relevant words in their documentary, factual and commercial context (or "factual matrices") (*Arnold v Britton* [2015] A.C. 1619 at [15]). The extent of AIG's liability was a matter of contract ascertained by reading together the statement of cover and the exclusions in the policy. An exclusion clause is read in the context of the insurance contract as a whole. Professional indemnity policies protect not only clients but also third parties to whom solicitors owe duties of care (*White v Jones* [1995] 2 A.C. 207).

A term will only be implied into a detailed contract if, on an objective assessment of its terms, the term to be implied was necessary to give the contract business efficacy or was so obvious that it went without saying (*Marks and Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] A.C. 742 at [15]–[31]). The express terms must be interpreted before implication could be considered.

Court of Appeal

It was common ground that B Ltd's liability to Impact fell within the cover as "civil liability" arising from "private legal practice in connection with the insured firm's practice". However, Impact argued that the judge had been wrong to characterise the DFMA as a "contract or arrangement for the supply to … any insured of … services in the course of" B Ltd's practice because it was no more than a facility provided to, and for the benefit of, B Ltd's clients and that the DFMA was properly categorised as a contract designed to regulate the conduct of Impact's provision of loans to B's clients and B's provision of legal services to

those clients. AIG focused on the benefit to B Ltd of the disbursements being funded so that the litigation could proceed which was a service to B Ltd.

Longmore LJ (Patten and Gloster LJJ agreeing) analysed the rival arguments and said that, standing back from the detail, the essential purpose of the exclusion was to prevent insurers from being liable for liabilities of a solicitor in respect of those aspects of their practice that affect them personally (for example, cleaning services or payment for office premises) as opposed to liabilities arising from their professional obligations to their clients [19]. A loan that was made nominally to the solicitor's client but which was an inherent part of a set of interlocking agreements all intended to enable the solicitor to earn a professional livelihood was inherently part of their professional practice so cl.6.6 did not apply. AIG appealed.

Supreme Court

The appeal was allowed. Lord Hodge (Lords Mance, Sumption and Toulson agreeing) took the view that the disbursement loans were the provision of financial services to the client. In addition, the provision of the loans was also a service provided by Impact to B Ltd for four reasons: first B Ltd contracted with Impact as principal and not as the client's agent; secondly B Ltd clearly obtained a benefit from the funding of disbursements since the solicitors were personally liable for those disbursements; thirdly that benefit was not incidental or collateral to the service provided to the client but part of the wider contractual arrangement allowing claims to be run which the client would otherwise not be able to afford; and fourthly it was a service for which B Ltd paid the administration fee and contracted itself to repay Impact if the client breached the credit agreement and warranted it would perform its duty to the client. In summary Lord Hodge decided that the DFMA was a contract for the supply of services to Barrington and as Impact's claim against B Ltd arose out of the latter's breach of the DFMA it was excluded by cl.6.6 [30]. He rejected Impact's argument that a term restricting the scope of the exclusion in cl.6.6 should be implied since the policy did not otherwise lack commercial or practical coherence. He held that Impact's cause of action under the DFMA was an independent cause of action and that excluding the claim was simply the combination of the scope of the cover and the delimiting exclusions [32].

Lord Toulson added at [43] that the indemnity cover involved combining an insuring clause far broader than any ordinary understanding of a solicitor's professional liability with a list of exclusions. There was no requirement that the exceptions should be construed as narrowly as possible, only that the exclusion should be in clear terms and construed under the test set out in *Arnold v Britton*. Impact was not a client of B Ltd's but had made a commercial agreement as principals.

Lord Carnwath, dissenting, said that the essential service provided by the DFMA was the provision of loans to B Ltd's clients and not to B Ltd. Even though there were incidental benefits to B Ltd it was not a service comparable in any way to the supply of goods and services for use in the practice. The juxtaposition of "goods and services" with "supply" and "use" suggested a more restricted meaning [55]–[57].

Conclusion

It is difficult not to have sympathy for the views of the Court of Appeal and Lord Carnwath that, on a strict interpretation of the policy, the DFMA did not involve a "service" to B Ltd. However, when construed in its wider context, the DFMA clearly had little to do with

professional indemnity and much more to do with financing the solicitor's practice. Companies such as Impact will be reviewing their terms to see how they can avoid being left out of pocket as a result of undoubted negligence, perhaps by enforcing the loan against the client who would then sue the solicitor under the indemnity policy.