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Court of Appeal decision again demonstrates the need for reform of the Solicitors Minimum Terms

18 January 2024 Ed Anderson

The Court of Appeal decision in Axis Specialty Europe SE v Discovery Land Co LLC [2024] EWCA Civ 7 will come as further unwelcome reading to Participating Insurers and following the previous decision in Lord Bishop of Leeds v Dixon Coles & Gill [2021] EWCA Civ 1211.

Insurers will recall in that case the Court of Appeal held that the acts of a solicitor in stealing monies from clients were not "*one series of related acts or omissions*" for aggregation purposes under clause 2.5(a)(ii) of the Minimum Terms despite some evidence of teeming and lading (i.e. that some thefts were to cover up previous thefts).

The appeal in Discovery Land concerned aggregation under clause 2.5(a)(iv) of the Minimum Terms. In addition, it addressed findings at trial concerning the condoning requirement in the dishonesty exclusion found in clause 6.8 of the Minimum Terms.

The facts

Axis provided solicitors' professional indemnity insurance to Jirehouse LLP and two associated limited companies ("the Insured"). Mr Jones was previously the sole member and director but in June 2017 an employee Mr Prentice was also appointed. By that stage the Insured was in financial difficulties. In 2016 Prentice, then an employee, had given dishonest evidence to the court regarding his view of the Insured's solvency on a winding up petition against it.

Of note, in the preceding years a previous partner and two employees had all resigned due to their very serious concerns about Jones. The two employees both made reports to the SRA, who investigated but failed to take action.

In 2017 Prentice was asked to deal with an issue concerning a client, known as the Rheno matter. Jones had misappropriated the client's money but Prentice wrote to the client representing that the monies were still held on the Insured's client account, which was untrue. He had seen email chains suggesting that might not be correct. He also later saw Jones falsifying time records on the same matter to exercise a lien and further delay any repayment.

In April 2018 Jones was instructed to act for the Claimants, Discovery Land and their associated companies, on the acquisition of Taymouth Castle in Scotland. In April 2018 the Claimants, who are US property investors, transferred $14m to the Insured for the acquisition. Of this, $9.3m was misappropriated by Mr Jones. As the purchase could not be completed without it, he persuaded the Claimants to transmit another $9.3m in order to do so, falsely claiming that the original funds could not be used due to money laundering issues.

Following the acquisition in December 2018 the Claimants began to complain about the non-return of the original monies. The Insured's bank accounts were frozen at the beginning of January 2019, as were those of Mr Jones and Mr Prentice. Mr Prentice knew this was likely at the behest of the Claimants. On 25 January 2019, Prentice was copied into correspondence with the Claimants in which they stated that something "*dodgy*" was going on.

Shortly before that, on 21 January 2019 and unbeknown to the Claimants, Mr Jones had obtained a loan of £4.9m against the property. The charge was executed on that date but the monies not received until 10 or 11 February 2019. Jones stole those on 12 February 2019. He was subsequently jailed for 12 years.

Two claims were brought for the misappropriated money on the purchase ("the Surplus Funds") and the subsequent fraudulent loan secured against the property ("the Dragonfly Loan"). Insurers sought to decline cover under the dishonesty exclusion in the policy. In the case of LLP's and limited companies, the Minimum Terms require, for the exclusion to apply, that all members and directors must have committed or condoned the dishonest act. They argued that (i) Prentice was a sham member/director and (ii) if not, he had condoned the dishonesty of Jones. In the alternative, they sought to aggregate the two claims as "*one series of related acts or omissions*" under limb (ii) of the Minimum Terms or as "*similar acts or omissions, in a series of related matters or transactions*" under limb (iv).

The decision at trial

The Trial Judge Mr Justice Knowles rejected the sham member/director argument on the basis that the evidence presented by Axis was insufficient to discharge the burden of proof on them. Prentice was recorded at Companies House as being a member/director. Of interest, the Judge did not consider that of itself prevented the point from being taken and as is often argued in the case of de jure directors. He merely found that the Court should be cautious of going behind Companies House appointments.

On the condoning point, previous Court decisions have taken a broad view on the question of condoning (see for example Zurich Professional Ltd v Karim [2006] EWHC 3355 (QB)). For the exclusion to apply, the condoning in question does not have to be of the particular dishonest acts that gave rise to the claim. It is sufficient that there is a condoning of behaviour of the type of dishonest acts that gave rise to it.

There was no evidence here that Prentice was actually aware of the Surplus Funds theft when it happened (despite having later lied to the KC appointed by Axis as to whether he knew about the receipt of the money at all) nor that he was aware of the Dragonfly Loan. Axis however argued that he was guilty of turning a blind eye to Jones' conduct. For that to be condoning, it requires a suspicion of the existence of a state of affairs and a conscious decision to then refrain from confirming it. It is also a purely subjective requirement.

The Judge found Prentice to have been dishonest in many respects. On the key Rheno matter involving the previous theft, he lied in his evidence that he had not drafted the letter to the client and he also lied when he said he had not read emails that may have alerted him to the theft.

Despite that, the Judge took an extraordinarily charitable view of Prentice's evidence that he had not actually appreciated that Jones had misappropriated the Rheno money. The Judge believed that he did not know and found that if he had had any suspicions, he would not have been prepared to lie in the letter. His later lies were, in his view, merely attempts to cover up his failings in not discovering the previous theft. He therefore rejected Axis's argument that he was guilty of condoning the dishonest conduct of Jones.

On aggregation under limb (ii), the Judge followed the *Bishop of Leeds* decision and held that the claims did not aggregate. The two acts did not together result in each of the claims and the thefts were brought about separately. The creation of a false charge in the Dragonfly Loan claim played no part in the Surplus Funds Claim. Conversely, at the time of the Surplus Funds Claim, there was no firm intent by the Claimants to later mortgage the property.

As far as limb (iv) was concerned, there are two limbs to satisfy in order to aggregate claims under that provision. Firstly, the acts or omissions must be "*similar*" and secondly, they must be in "*related*" transactions.

Surprisingly, the Judge took a very narrow view of what acts could be similar, despite accepting that the requisite degree of similarity must merely be real or substantial as opposed to fanciful. He held that the simple theft of the Surplus Funds for the property acquisition was not a similar act to the creation of the Dragonfly Loan documents and subsequent theft of that money.

In addition, he held that the transactions were not related. The test for that was laid down by the Supreme Court *in AIG v Woodman [2017] UKSC 18*. It is on the face of it a very loose and undemanding one, namely that there must simply be "some inter-connection" between the transactions in question and that "*they must in some way fit together*." Whilst acknowledging that purchase and loan transactions would very often be related, here they were not.

Court of Appeal

The appeal was against the Judge's findings of fact on condoning and his decision on whether the claims aggregated under limb (iv).

The Court of Appeal refused to overturn the findings of fact on whether Prentice was guilty of condoning Jones' dishonesty. There was clearly more than sufficient evidence for that finding to have been made and the Court of Appeal recognised that a different Judge may very well have done so. However, it is exceptionally difficult to appeal findings of fact as the Trial Judge is of course best placed to make

them, having had the benefit of actually hearing all the evidence which the Court of Appeal does not. They will only interfere if the findings were plainly wrong and no reasonable Judge could have reached them. In their view, that very high hurdle was not reached here; the Judge was entitled in particular to reach the conclusion that Prentice did not have sufficient suspicions at the time of the Rheno matter or at any time subsequently.

That is a surprising outcome on the face of the weight of evidence against Prentice. There may be an issue in particular regarding the extent to which the Court of Appeal considered sufficiently whether that was a finding that could have been made in January 2019. At that stage Prentice knew that the Claimants were alleging wrongdoing by Jones and that they were the ones that had frozen the bank accounts as a result. It is difficult to understand how Prentice could not have had the requisite suspicion at that stage and Jones did not steal the Dragonfly Loan monies until 2 weeks later.

On aggregation, the Court of Appeal recognised that the question of aggregation is always acutely fact sensitive but unfortunately for Axis agreed that these claims should not aggregate.

On the question of "*similar*" acts, they agreed the degree of similarity must be real and substantial and not fanciful. However, they approached it on a very granular basis rather than at, in their view, what was a superficial level. It was not sufficient to say that both acts were theft, as that was viewing it at too high a level. Drilling down, one involved the simple misappropriation of client funds entrusted to the solicitor. The other involved the fraudulent creation of loan documents, the drawing down of that loan and then the theft of that money. They were not sufficiently similar.

As far as the transactions being related was concerned, the Court of Appeal held on the facts that they were not related despite the seemingly low hurdle in AIG v Woodman. They found that there was no inter-connection or fitting together at all, as might have been the case if the purchase and subsequent loan had been planned as part of a sequence of events. The purchase had been completed by the time of the Dragonfly loan and the client had not intended it or known about it; they were therefore completely separate. The fact that the transactions involved the same property and the same clients did not suffice and nor did the fact that the purchase of the castle provided Jones the opportunity to steal money on both occasions.

Commentary

The decision is a stark reminder of the difficulties sometimes encountered in taking substantive coverage points under the Minimum Terms. The issues are very fact sensitive and outcomes can often depend heavily on the particular Judge or Arbitrator and the weight he gives to the fact that one purpose of the Minimum Terms is to protect the public. Insurers may be shocked to know that the Judge below felt that the Minimum Terms should be restricted further, commenting that he felt that the SRA should review whether to permit the exclusion of cover for the condoning of dishonest acts at all.

The protection of the public is however not the only function of the Minimum Terms. They exist also to protect the solicitor, but they must do so on reasonable terms that preserve the orderly functioning of the insurance market. That is also in the interests of the public and the primacy of public protection cannot be allowed to equate so often to a blank cheque from insurers. The Minimum Terms were previously amended in 2005 with the intent that the aggregation of claims would be easier with a higher minimum limit of indemnity in return. Recent decisions again make clear that this intent has not been met and the balance of risk between primary insurers, excess layer insurers, infill insurers and the Compensation Fund is not working in a fair or sustainable manner.

We hope that insurers will again press the SRA for fundamental reform, as was hoped for following the Charles Rivers review in 2010. Amongst other changes, it should not be remotely controversial that insurers and solicitors be free to instead agree an "*originating cause*" aggregation wording for the purpose of the limit of indemnity. Such freedom already exists in respect of the policy excess.

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