Kidsons and *Kajima* reviewed

The Court of Appeal considers the notification of a "hornet's nest" in *Euro Pools Plc v Royal Sun Alliance Plc*

The scope of a notification of circumstance can be a contentious issue between insurer and insured and can have significant financial implications. In *Euro Pools Plc v Royal Sun Alliance Insurance Plc* the Court of Appeal considered these issues, and in particular considered the causal link between the scope of a notification and the subsequent claim, particularly in the context of a "hornet's nest" notification.

The Facts

Euro Pools specialised in the installation of swimming pools. Its pools contained a system of moveable "booms" or walls that enabled the pool to be divided into different configurations. Three different mechanisms were used to operate the booms during the relevant period. The first was an "air drive" system which utilised steel tanks in the booms into which air was pumped and released to raise and lower it. The second used inflatable bags in place of the steel tanks. The third was a hydraulic system which replaced the air drive system entirely.

During 2007 and 2008 Euro Pools had two materially identical professional indemnity policies. Both were written on a claims made basis with a standard circumstance attachment clause requiring the insured to notify "...circumstances...which might reasonably give rise to a Claim". The policy also contained a mitigation costs clause. This provided cover for costs incurred by Euro Pools in seeking to "....mitigate a loss or potential loss that would otherwise be the subject of a claim under the Policy...".

In early 2007 Euro Pools identified a problem with the booms in two of its pools. Air was leaking out of and water was entering the steel tanks causing them to fail to raise and lower properly. Euro Pools notified its insurer (RSA) of the circumstances at a meeting on 23 February 2007. It explained the problem with the steel tanks in the booms. It also indicated that the problem appeared to be a failure in the bracing of the steel tanks, and that a potential solution was the installation of inflatable bags in place of the tanks.

Later that year in June 2007, Euro Pools completed a proposal form to renew its insurance. In response to the question of whether it was aware of any circumstances which might give rise to a claim it noted: "tanks on booms but we are fixing these with inflatable bags". At the time of the proposal, Euro Pools' broker AON notified RSA that the remedial works were expected to fall within the policy excess but that the insured wanted "to ensure the matter [was] logged on a precautionary basis". The first policy expired on 29 June 2007 and the new policy incepted the following day.

Any comments or queries?

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Inflatable bags were inserted into the booms from February 2007 onwards. However, Euro Pools quickly identified that the solution was not satisfactory; the inflatable bags also started to fail. Euro Pools informed AON of this in May 2008 and proposed installing a hydraulic system instead. It sought RSA's approval to undertake the remedial work. AON forwarded on Euro Pools' email to RSA and indicated that "the original remedial works have now failed". RSA's loss adjuster confirmed that the only viable solution was to install a hydraulic system and accordingly RSA approved that it would cover the works. Euro Pools started to deploy the hydraulic system in its pools from late 2008 and RSA made regular interim payments to cover the costs.

In 2013 a dispute arose between Euro Pools and RSA as to which policy the remedial works attached to. Euro Pools contended that the steps taken to introduce air bags in place of the stainless steel tanks attached to the first policy and the introduction of the hydraulic system attached to the second policy. RSA contended that all of the works attached to the first policy. This was relevant because the limit of indemnity under the first policy was substantially eroded. As a result, the remaining cover was unlikely to be sufficient to cover all of the remedial works. In 2016 Euro Pools issued a claim against RSA seeking an indemnity for around £1.5 million under the second policy.

The decision at first instance

Moulder J gave judgment in favour of Euro Pools. She determined that the mitigation costs incurred in installing the hydraulic system attached to the notification of circumstance under the second policy. In particular, applying *Kajima UK Engineering Ltd v The Underwriter Insurance Company Ltd*[1], she made the following findings:

- There had been a valid notification of circumstances in May 2008 under the second policy relating to the hydraulic system.
- There had been a valid notification of circumstances in February 2007. That was limited to the problem affecting some but not all of the steel tanks. This was because, on the expert evidence, there was no sufficient causal link between the failures in the tanks and the decision to abandon to the air drive system in favour of the hydraulic system. In particular, the need to abandon the existing system had not been foreseeable.
- Even if there had been a sufficient causal link, Euro Pools could not notify something of which it was not aware. It was not aware of any fundamental problem with the air drive system in February 2007 and so could not have notified circumstances which led to the decision to adopt the hydraulic system.

The Court of Appeal decision

The leading judgment was given by Dame Elizabeth Gloster DBE with whom Males LJ and Hamblen LJ both agreed. She first summarised the key legal principles relevant to the scope of a notification of circumstances:

- A deeming provision, such as the one written by RSA, was to be construed and applied with a view to its commercial purpose. That was to provide an extension of cover for all claims in the future which flowed from the notified circumstances (*Kidsons*[2] (first instance) at paragraph 21).
- A provision which referred to circumstances which "may" give rise to a claim had a low materiality threshold (*Rothschild*[3] at paragraph 22). The addition of the word "reasonably" (as per RSA's policy) did not affect that low materiality.
- A notification did not need to be limited to particular events. An insured could notify a "hornet's nest", meaning that it could notify a problem where the scale and consequences are not known (*Kidsons* (first instance) at 76).
- Whilst the insured had to be "aware of circumstances" this did not mean that

1. [2008] EWHC 83 (TCC).
2. *HLB Kidsons (A Firm) v Lloyds Underwriters Subscribing to Lloyds Policy No 621/ PKID00101 & Ors* [2007] EWHC 1951 (Comm) (the decision at first instance).
3. *J Rothschild Assurance Plc v Collyear* [1991] 1 Lloyd's Rep IR 6.

an insured had to know or appreciate the cause, or all of the causes, of the problem that has arisen, or the details of the consequences that flow from it (citing with approval paragraphs 39 to 43 of *McManus*[4]).

- Any claim which arises subsequently would attach to the notified circumstance provided that there was a sufficient causal link between them (*Kajima* at paragraph 99(f)).

The substantive part of Dame Gloster DBE's judgment dealt with the trial judge's analysis of the causal connection between the notified circumstances in 2007 and the potential third party claims. She found that the judge had erred in her legal analysis, in particular, in finding that there was no causal connection between the circumstances notified to the first policy and the relevant loss.

First, she considered the scope of the 2007 notification. She concluded that the circumstance that had been notified to the first policy was that the booms, which were powered by an air drive system, were not rising and falling properly. The fact that Euro Pools did not know what the fundamental problem with the air drive system was did not matter. Euro Pools knew that it had a real problem with the failure of the booms, that the problem might not be capable of being resolved with the inflatable bags, and that it might face third party claims as a result. In this instance, it was not appropriate to over-analyse the problem by dissecting every potential cause as a different notifiable circumstance.

She then looked at what the potential third party claims were in respect of which Euro Pools had undertaken the remedial steps. She noted that it was necessary for the potential third party claims to "arise from" notified circumstances. This required an objective assessment. On the facts, Euro Pools' claim on the policy was for the costs of works to mitigate the risk of potential third party claims based on booms failing to rise and fall correctly. It did not matter what the technical reasons for that failure was ie whether it was failure of the steel tanks or the inflatable bags.

Finally, she considered whether there was a sufficient causal connection between the circumstances notified in 2007 and the remedial works that were undertaken. It was clear that, when the notification was made, there was the possibility that the inflatable bags would not resolve the problem. There needed to be something more than pure coincidence between the problems notified in 2007 and any potential third party claims made for boom failures after mid-2008. It was plain that, but for the repeated failures in the booms, there would not have been a need to install the inflatable bags, and there would not have been a need to replace the bags with a hydraulic system. Accordingly this test was met.

Given these findings, it was not necessary to consider the insurer's other grounds of appeal. However, Dame Gloster DBE did *obiter* address whether it was necessary for an insured to know or foresee the problems which eventually transpired and which would trigger the later claims. She disagreed with the trial judge's finding in this respect. She indicated that there was no requirement for an insured to be aware of the full causal origins and implications of the circumstances notified.

Commentary

A "hornet's nest" notification often arises out of a wide scale systemic problem where the extent of the problem and the precise cause is not known.

The application of this decision will sometimes favour the policyholder and other times the insurer. It depends on the circumstances of the case and, in particular, the policy limits

4. *McManus v European Risk Insurance Co* [2013] Lloyd's Re IR 533.

under the first policy, pre-inception disclosure under the second policy, and the terms of both policies including the excesses.

In this case, the notification under the first policy was given a wide construction because of the language used in the notification and, in particular, the acknowledgement that the cause of the problem was not known. Ultimately this worked in the insurer's favour; the attachment to the earlier policy capped the insurer's liability at the policy limit rather than engaging a further limit under the second policy. However, the decision will favour the policyholder in cases where there is no issue as to the available cover under the first policy.

On balance, the decision will be viewed as favouring the insured. It permits effective notification of circumstances where the cause of the problem is not known at the time of the notification. Insureds are likely to take advantage of this by taking care not to unnecessarily limit the scope of the notification in the language used. Insurers may see an increase in notifications which are intentionally drafted in this manner. Of course, in situations where notifications are made to different successive insurers the decision will favour the second insurer.

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