Solicitors Entitled to Insurance Cover for Liability for Fees: Royal Sun Alliance Insurance Limited & Others v Tughans (a firm)

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In a recent judgment, Foxton J held that a claim for damages against a firm of solicitors for fees which it was contractually entitled to was covered under the firm's professional indemnity insurance. He held that it did not matter if the fees were obtained through the solicitor's fraudulent misrepresentation provided that the solicitor had done what was required under the contract to earn the fees. The decision will not be welcomed by insurers.

Background

RSA challenged the Final Award of an arbitrator which declared that Northern Irish law firm Tughans was entitled to indemnity for certain losses and liabilities under its Master Policy of Insurance.

The claim against Tughans arose out of its involvement in the sale of National Asset Management Agency's (NAMA) Northern Irish property loan book. Tughans was engaged by Brown Rudnick LLP to facilitate the deal. Brown Rudnick paid Tughans £7.5 million plus VAT representing 50% of the £15 million success fee following completion.

The client buyer sought confirmation that no part of the success fee would be paid to any current or former members of the Advisory Committee which assisted NAMA with its work. Both law firms provided the requested confirmation. That was despite it having been recorded earlier that one third of the success fee would be paid to a former member of the Advisory Committee (Mr Cushnahan).

The transaction was handled by Tughans' then managing partner Mr Coulter. He initially told his partners that he had generated a fee of £1.5 million through the deal. He arranged for the remaining £7.2 million fee to be transferred into an account in the name of a company which he had established. The true position was discovered by Tughans in November 2014 and the funds were returned to it.

Mr Coulter resigned from Tughans on 9 January 2015. Tughans notified a circumstance to RSA and reported Mr Coulter's conduct to the Law Society of Northern Ireland. Tughans ultimately undertook not to deal with the success fee funds without 14 days prior notice to the Law Society of Northern Ireland and the National Crime Agency save in relation to the payment of tax which was due.

Brown Rudnick LLP and its insurers issued claims against Tughans in March 2014. They claimed damages for loss and damage caused by: fraudulent and/or negligent misrepresentations, misstatement or deceit as Mr Coulter had intended to transfer part of the success fee to Mr Cushnahan, breach of fiduciary or contractual duties owed to Brown Rudnick, and negligence.

The Coverage Dispute and Arbitration

RSA declined to indemnify Tughans on the basis that the claim fell outside the scope of the insuring clause. It also asserted that Tughans could not suffer a loss should it be required to repay the success fee. That was because the success fee was only obtained through Mr Coulter's fraudulent misrepresentation and was money that the firm would not have been entitled to had Mr Coulter acted honestly.

Tughans was successful at arbitration. The Arbitrator held that the claim fell within the scope of the insuring clause as - "*Strategic advice, facilitation of necessary political contacts, intelligence gathering and oversight thereof, and deal structuring are all sufficiently solicitorial, and were all carried out here…*".

He also held that the fact that Mr Coulter had intended to share part of Tughans' success fee with Mr Cushnahan did not add much to RSA's case as "*either way this was a fee due and payable to Tughans for work done*". The Arbitrator held that RSA was liable to indemnify Tughans in respect of any award of damages in respect of its share of the success fee, but not in respect of any liability in restitution for the fee on the basis that a pure restitution claim would not fall within the obligation to indemnify.

Tughans first raised a request for an indemnity in relation to the entire £7.5 million success fee in their "Submissions on the Form of Relief & Costs". That was after the Arbitrator had issued a Partial Final Award following the merits hearing. This led RSA to challenge the Arbitrator's Final Award on the basis that they had acted in excess of their jurisdiction and that there had been a serious irregularity which had caused RSA substantial injustice. Mr Justice Foxton found the jurisdiction point in Tughans' favour but held that there had been a serious irregularity as RSA had no reasonable opportunity to put forward arguments on Tughans' newly formulated case. The court remitted the question of whether Tughans was entitled to pursue their indemnity claim in relation to the entire success fee on an unqualified basis back to the Arbitrator.

RSA also challenged the Final Award on the basis that the Arbitrator's decision involved an error of law. It argued that Tughans was not entitled to indemnity in relation to a success fee which it had no right to, as the fee had been procured through fraudulent misrepresentation. The court was therefore asked to rule on the general question of whether an insured is entitled to indemnity under a professional indemnity insurance policy for the loss of a sum to which they were never entitled.

The Court's Analysis

Mr Justice Foxton began his analysis with reference to the well-established principle that a policy of indemnity insurance entitles the insured to recover its actual loss, but not more than its actual loss. He went on to comment that insuring clauses in professional indemnity policies may sometimes be qualified with a clause providing that "*Damages shall not include or mean future profits, restitution, disgorgement of unjust enrichment or profits by an Insured*". He then referred to authority which had invoked the indemnity principle as a reason why a professional indemnity policy will never provide cover for a restitutionary claim.

Mr Justice Foxton concluded that a claim against solicitors which includes the wasted fees paid by the client for the negligent work would ordinarily constitute loss indemnifiable under a professional indemnity policy. He noted that the solicitors will have spent the necessary time to earn those fees and lost the opportunity to spend the time earning fees on other work. He said that

> *" … if the solicitor has done what is necessary as a matter of contract to accrue a right to the fee, an award of damages in the amount of the fee payable will ordinarily constitute a loss for the purposes of a professional indemnity policy".*

He then addressed the situation in which the solicitor sought an indemnity for a sum of money which it had no contractual right to and whether the policy would cover liability to restore sums paid to it which it was not entitled to. He noted that there had been relatively little discussion of this issue in an English law context. He looked at the SRA's Minimum Terms and Conditions of Professional Indemnity Insurance in his analysis. They define the scope of cover under solicitors' policies by reference to the requirement for "*a claim in respect of such liability*" with "*claim*" defined as "*a demand for, or an assertion of a right to, civil compensation or civil damages or an intimation of an intention to seek such compensation or damages*". In other words, solicitors' professional indemnity policies must cover claims for compensation or damages; not claims for restitution or unjustified enrichment.

He then analysed the wording of the Tughans' policy. Although "Claim" was not defined, the definition of "Self Insured Amount" referred to "*all damages and claimants costs and expenses*" which suggested that the policy principally had liability for damages in mind. He concluded that

> *"Having to return a sum of money paid to the insured to which the insured never had any legal entitlement is not, in my view, an indemnifiable loss under a professional indemnity policy in the absence of clear language to that effect. Nor am I persuaded that the use to which the insured puts those funds between receipt and judgment alters my analysis. It is the ascertainment of the liability by settlement, judgment or award which creates the indemnifiable loss in third party insurance cover".*

He disagreed with Tughans' analysis that it was only entitled to indemnity to the extent that it had already paid away parts of the success fee (eg to HMRC) such that parts of the fee were no longer available to satisfy Brown Rudnick's claim. That approach would involve "*a series of fine judgments*" as to what steps were required following receipt of the funds in order to trigger indemnity under the professional indemnity policy which was unsatisfactory.

Ultimately therefore he had to decide whether the success fee was due to Tughans as a matter of contract. Under Tughans' engagement letter the following had to take place for the fee to fall due:

1. The transaction must have completed successfully.
2. Brown Rudnick needed to receive the £15 million success fee from the client in cleared funds.
3. Tughans had to "provid[e] the representations and warranties" set out in the engagement letter.
4. The client had to confirm to Brown Rudnick that the terms of Tughans' engagement letter were acceptable to it.

RSA's position was that the requirement to provide representations and warranties could not be satisfied if Tughans provided the representations but they were untrue, which would be the case if Brown Rudnick's claim against Tughans succeeded. Mr Justice Foxton disagreed. He concluded that the truth of the warranties and representations to be provided by Tughans was not a pre-condition to payment of the success fee under the engagement letter. Interestingly, as part of his analysis Mr Justice Foxton referred to the fact that Brown Rudnick "*has not purported to rescind the Tughans Letter of Engagement, with the result that the contractual rights arising thereunder remain*". The court's decision would therefore have been very different had Brown Rudnick asserted that Tughans had no right to the fees at all.

Commentary

This decision sets out principles to be applied in situations that insurers have had to address on a large number of occasions without the assistance of any direct authority. Different insurers have taken different stances – many not

as generous as that of Foxton J. This decision will now provide a degree of certainty for policyholders that was missing before.

The surprising elements of the underlying transaction will lead many insurers to query whether they should or want to insure a peril that includes the full array of entrepreneurial fee arrangements that firms are increasingly entering into. In many cases, the policyholder will have a good defence to the third party's claim for fees paid. In others, the claim simply won't arise on the facts.

However, there will continue to be proper claims for fees as damages and circumstances where the third party's claim against the policyholder is deliberately pursued in a way to avoid giving insurers a defence. Again, many insurers will now want to consider whether the insured peril should be so much in the control of the third party claimant. In each case, the considerations for insurers will turn in part on whether they are writing minimum terms policies.