IN THE HIGH COURT OF JUSTICE **Claim No. FL-2020-000018**

BUSINESS AND PROPERTY COURTS

COMMERCIAL COURT (QBD)

FINANCIAL LIST

FINANCIAL MARKETS TEST CASE SCHEME

BETWEEN:

THE FINANCIAL CONDUCT AUTHORITY

Claimant

-and-

(1) ARCH INSURANCE (UK) LIMITED
(2) ARGENTA SYNDICATE MANAGEMENT LIMITED
(3) ECCLESIASTICAL INSURANCE OFFICE PLC
(4) HISCOX INSURANCE COMPANY LIMITED
(5) MS AMLIN UNDERWRITING LIMITED
(6) QBE UK LIMITED
(7) ROYAL & SUN ALLIANCE INSURANCE PLC
(8) ZURICH INSURANCE PLC

Defendants

INSURERS' SUBMISSIONS

ON PRINCIPLES OF CONSTRUCTION OF CONTRACTS

These submissions comprise a stand-alone document setting out the general principles of contractual construction on which Insurers rely.

GENERAL PRINCIPLES

Ascertaining the Parties' Intentions

1 The Court's task in construing a contractual document, including an insurance contract, is to determine the intentions of the parties. This is not a reference to the subjective intentions of the actual parties. Rather, the task (as described by Lord Clarke in ***Rainy Sky v Kookmin*** [2011] 1 WLR 2900 at [14])[1] is:

> *"to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant".*

2 A number of tools are at the Court's disposal in ascertaining the meaning of the contract, as summarised by Lord Neuberger in ***Arnold v Britton*** [2015] AC 1619 at [15][2], in the context of a lease:

> *"That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions".*

3 A useful synthesis of the leading cases was set out by Popplewell J in his judgment in ***Lukoil Asia Pacific Pte Ltd v Ocean Tankers (Pte) Ltd*** [2018] 1 Lloyd's Rep 654, at [8][3].

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[1] **{J/109/7-8}**.

[2] **{J/127/9-10}**.

[3] **{K/176/7}**.

The Wording is the Starting Point

4 As set out by Lord Clarke in ***Rainy Sky*** ([23])[4], clear and unambiguous language in an agreement will be generally be binding on the parties:

> *"Where the parties have used unambiguous language, the court must apply it"….*

See also Lord Neuberger in ***Arnold v Britton*** at [17][5]:

> *"The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision".*

5 When analysing the wording itself, the Court is more concerned with what the drafting *does* include than what it *does not*. There are therefore limits to the utility of forensic arguments, that the draftsman could have made the matter clear (one way or the other) if he had chosen to do so[6]. Thus, the fact that an insurance policy might have included (but did not include) an exclusion, does not affect the proper construction of the words that have been used to articulate what cover is provided to the insured[7].

6 Any analysis of the commercial purpose of an agreement, or a presumptive notion of commercial common sense, may well be accorded lesser weight than a textual analysis of the language in the agreement:

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[4] **{J/109/9}**.

[5] **{J/127/10}**.

[6] ***Netherlands v Deutsche Bank*** [2019] EWCA Civ 771 at [59] (Sir Geoffrey Vos C) **{K/180/19}.**

[7] ***Burger v Indemnity Mutual Marine Assurance Co*** [1900] 2 QB 348 **{K/38}**.

> *"…the reliance placed in some cases on commercial common sense and surrounding circumstances…should not be invoked to undervalue the importance of the language of the provision which is to be construed"*[8]

7 However, the language may carry less weight in certain circumstances. This may well be where the agreement is informal, informally drafted or does not purport to be exhaustive. The issue was discussed by Lord Hodge in ***Wood v Capita*** [2017] AC 1173 at [13][9]:

> *"Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of contractual interpretation. … The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance".*

8 It is not just in informal or informally drafted contracts that the factual matrix or commercial purpose is relevant. It may well be so in professionally drafted contracts. As Lord Hodge further observed in ***Wood v Capita*** at [13][10]:

> *"… negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance spoke in Sigma Finance Corpn (above), assists the lawyer or judge to ascertain the objective meaning of disputed provisions."*

[8] ***Arnold v Britton*** at [17] **{J/127/10}**.

[9] **{J/134/8}**.

[10] **{J/134/8}**.

The Relevant Factual Matrix

9 As regards the factual matrix, it is important to identify the relevant one, being those facts reasonably available to both parties (***Arnold v Britton*** at [21])[11] or, if a wider class, the addressees of the document[12]. Where the policyholder entered into the policy upon the advice and through the agency of a broker, the broker can be taken to be reasonably aware of the operation of insurance law, and policy wordings available in the market. Decisions of the Court on earlier contracts using similar words are part of the context or background against which the particular contract falls to be construed: see ***The "Kleovoulos of Rhodes"*** [2003] 1 Lloyd's Rep 138 *per* Clarke LJ at [25] - [28][13].

10 At paragraph 78 of its Skeleton Argument **{I/1/35}** the FCA contends these policies were addressed to "*SME businesses of limited expertise"*, with the implication that no particular knowledge can be attributed to them of "*insurance matters"*. This argument assumes what the FCA wishes to prove, and overstates the position:

(a) Many of the wordings in the Test Case relate to policies placed by a broker on the insured's behalf – see Agreed Facts 9 (Distribution Channels) **{C/15/2}**. The background knowledge "*reasonably available*" to each such insured

[11] **{J/127/11}**.

[12] See also the discussion of the spectrum of factual matrices available depending on the nature of the document, its addressee(s) and its circumstances, in ***Pathway Finance v Specified Defendants*** [2020] EWHC 1191 (Ch) at [25]-[37] **{K/186/5-8}**.

[13] **{K/111/7-8}**. See also ***Toomey v Eagle Star Insurance Co. Ltd*** [1994] 1 Lloyd's Rep. 516 at 520, per Hobhouse LJ ("*It is also necessary that the Court should have regard to previous decisions of the Courts upon the same or similar wording. Parties to a commercial contract are to be taken to have contracted against a background which includes the previous decisions upon the construction of similar contracts*") **{K/80/5}**.

includes any background knowledge known or reasonably available to its broker;

(b) The expression "SME" covers a very wide spectrum of businesses. The EU definition indicates that it covers everything from micro-enterprises to businesses with up to 250 employees, a turnover up to €50m, and a balance sheet total of €43m[14]. It cannot be assumed that businesses at the larger end of this spectrum have no knowledge of insurance matters.

(c) The policies were not exclusively taken out by SMEs. For example, Laddie Topco Ltd, referred to in paragraph 28 of the HIGA Interveners' Skeleton Argument **{I/2/9}**, employed almost 500 people.

Contract Construed as a Whole

11 Particular words and phrases are not to be construed in narrow isolation:

> *"It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole…"*. (***Wood v Capita****,* per Lord Hodge at [10])[15]

12 It is a corollary of this principle and a salutary warning that using dictionaries or case law to inform the meaning of individual words or expressions may lead the exercise

14 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32003H0361 **{K/216/4}**. This is the general EU standard. The FCA Handbook Glossary identifies firms which have an average market cap of less than €200,000,000 as SMEs.

15 **{J/134/7}**.

of interpretation into error[16]. Similarly, attributing to the draftsman of an insurance contract too precise a use of language risks falling into error[17].

Commercial Common Sense

13 When looking at the wider commercial context, care must be taken to identify the correct context, as observed by Lord Neuberger in ***Arnold v Britton*** at [19][18]:

> *"commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made".*

14 The fact that, with the benefit of hindsight, the natural meaning of the words leads to a result which is disadvantageous to one party, is unlikely to weigh heavily with the Court:

> *"a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed"* (***Arnold v Britton*** at [20])[19]

Resolving Ambiguity

15 Where there is no ambiguity, the Court will generally apply the wording used (see above). Where wording is ambiguous, resolving that ambiguity is an integral part of

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[16] Mance, ***Insurance Disputes***, at [6.69] **{J/152/12}** and [6.36] **{J/152/8}**. See also: ***Stratton v Dorintal*** [1987] 1 Lloyd's Rep 482 at 484 col.2 **{K/73/3}**; ***Mannai Investment v Eagle Star*** [1997] AC 749 at 755 **{K/84/7}**.

[17] ***Tektrol Limited v International Insurance Company of Hanover Limited*** [2005] EWCA Civ 845; [2005] 2 CLC 339, at [15] *per* Buxton LJ **{K/124/7}**.

[18] **{J/127/10}**.

[19] **{J/127/10}**.

the process of construction, and the Court must determine what the parties must be understood to have meant by applying the principles set out above. This was described by Lord Hodge in ***Wood v Capita*** (at [12])[20] as a:

> *"unitary exercise [which] involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated*".

16 As regards that exercise and iterative process, Lord Hodge went on to say ***Wood v Capita*** (at [12])[21]:

> *"To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each."*

17 In the event that, having considered what a reasonable person would have understood the parties to have meant, there remain two possible constructions of a clause in an agreement, then:

> *"…the court is entitled to prefer the construction which is consistent with business common sense and to reject the other"* (***Rainy Sky*** at [21])[22]

18 If the two meanings are both commercially sensible, the Court will be entitled to adopt, if there is one, the more commercially sensible[23].

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[20] **{J/134/7}**.

[21] **{J/134/7-8}**.

[22] **{J/109/9}**.

[23] ***Rainy Sky*** at [29]-[30] **{J/109/12}**.

SPECIFIC ISSUES ON CONSTRUCTION

Contra Proferentem

19 Whatever the historical roots and utility of this doctrine of so called 'restrictive' interpretation, it is out of step with the principles of contractual construction described above. It is, perhaps, instructive that the principle is not mentioned in any of the three recent leading Supreme Court decisions on construction of contracts referred to above (*Rainy Sky, Arnold* and *Wood*).

20 In business contracts, the utility of the principle has been the subject of significant judicial doubt; for example, in ***K/S Victoria Street v House of Fraser*** [2012] Ch 497 at [68] per Lord Neuberger MR as he was[24]:

> *'... such rules are rarely if ever of any assistance when it comes to construing commercial contracts. Quite apart from raising abstruse issues as to who is proferens (and, in particular, whether the issue turns on the precise facts of the case or hypothetical analysis), "rules" of interpretation such as contra proferentem are rarely decisive as to the meaning of any provisions of a commercial contract. The words used in a commercial sense, and the documentary and actual context, are, and should be, normally enough to determine the meaning of a factual provision".*

21 The principle is at most, a port of last resort, available only where all other attempts to determine the intentions of the parties have failed[25]. Moreover, as Auld LJ said in ***McGeown v Direct Travel Insurance*** [2004] Lloyd's Rep IR 599 at [13][26]:

> *"A court should be wary of starting its analysis by finding an ambiguity by reference to the words in question looked at on their own. And it should not, in*

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[24] **{K/147/22}**.

[25] "*[T]he contra proferentem rule is very much a last refuge, almost an admission of defeat, when it comes to construing a document*"; ***BNY Mellon v LBG Capital*** [2016] Bus LR 725 at [53], per Lord Neuberger with whom Lords Mance and Toulson agreed **{K/163/14}**.

[26] **{K/118/5}**.

any event, on such a finding, move straight to the contra proferentem rule without first looking at the context and, where appropriate, permissible aids to identifying the purpose of the commercial document of which the words form part. Too early recourse to the contra proferentem rule runs the danger of "creating" an ambiguity where there is none…"

22 Even if the rule does have some residual role in some cases, for example where one party has sufficient bargaining power than it can deal with the other on a 'take it or leave it basis,'[27] that provides no assistance here. Even if the court admitted defeat and concluded that sufficient ambiguity exists in the wording so that the principle is potentially available[28]:

(a) The policyholders were commercial parties;

(b) They largely entered the policies on the advice of brokers;

(c) They did so in a competitive insurance market with several or indeed a multitude of insurers and policies to choose from (as the range of test wordings alone demonstrates).

23 Contrary to the suggestion made by the FCA in its Skeleton Argument at [92]-[99] **{I/1/39-42}**, insurers do not suggest that policyholders should be treated as the *proferens*. Rather, they contend that the doctrine of *contra proferentem* is unlikely to provide any assistance to the Court in this case, for the reasons set out above.

[27] This sphere of potential application being identified by Gloster J as she was in ***CDV v Gamecock*** [2009] EWHC 2965 at [56] **{K/135/21}**.

[28] As to this requirement, in ***Impact Funding v Barrington*** [2017] 2 AC 73 the Supreme Court rejected the application of the *contra proferentem* doctrine completely on the grounds that the clause in question was not ambiguous [6] **{J/132/7}**. But even where ambiguity is identified, there is no presumption in favour of a narrow interpretation, per Briggs LJ in ***Nobahar-Cookson v The Hut Group Ltd*** [2016] 1 CLC 573 at [19] **{K/167/7}**, described as an important point by Lewison LJ in ***Rees v Windsor-Clive*** [2020] EWCA Civ 816 at [38] **{K/188/11}**.

The Construction of Exclusion Clauses in Insurance Contracts

24 The fact that a provision is expressed as an exception to cover does not mean that it must be approached with a pre-disposition to construe it narrowly. Such provisions must be read – as with any others – in the context of the policy as a whole: see ***Impact Funding Solutions v AIG Europe Insurance*** [2017] AC 73 *per* Lord Hodge at [32][29] and Lord Toulson at [35][30].

25 The court should not adopt principles of construction which are appropriate to exemption clauses when interpreting insurance exclusions, because insurance exclusions are designed to define the scope of cover which the insurance policy is intended to afford: ***Crowden v QBE Insurance (Europe) Ltd*** [2018] Lloyd's Rep IR 83 at [65].[31]

Errors in the Contract

26 In ***Chartbrook v Persimmon Homes*** [2009] 1 AC 1101 the House of Lords considered the consequences of manifest errors in a contract[32]. Lord Hoffmann confirmed (at [25]) that as part of the unitary exercise of construction the Court is able to disregard manifest errors where it is clear what the parties intended to say[33]:

> *"…there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant".*

[29] **{J/132/12-13}**.

[30] **{J/132/13-14}**.

[31] **{J/135/13}**.

[32] **{J/103}**.

[33] **{J/103/14}**.

27 Where something has gone wrong with the language of the contract, the function of the Court is *"to see if [it] can divine what the parties intended to say"* (see ***Gan v Tai Ping (Nos. 2 & 3)*** [2001] Lloyd's Rep IR 667 *per* Sir Christopher Staughton at [83] (p.700 col. 2))[34], rather than *"to punish insurers guilty of unclear and inaccurate wording"* (see ***Doheny v New India Assurance*** [2005] Lloyd's Rep IR 251 *per* Longmore LJ at [12])[35].

28 It is therefore permissible to overlook obvious grammatical or linguistic errors, or even disregard redundant words or phrases as surplusage.[36]

Inconsistent Contract Terms

29 A contract term is only inconsistent with another if effect cannot fairly be given to both terms. As stated in ***Pagnan S.P.A. v Tradax Ocean Transportation S.A***. [1987] 3 All E.R 565 by Bingham LJ[37]:

> *"It is not enough if one term qualifies or modifies the effect of another; to be inconsistent a term must contradict another term or be in conflict with it, such that effect cannot fairly be given to both clauses".*

30 The role of the court is to attempt to reconcile the terms in an agreement, where that can be done, rather than adopting a construction which has the opposite effect:[38]

> *"…the court's duty, when confronted with two provisions in a contract that seem to be inconsistent with each other, is plain. It must do its best to reconcile them if that can conscientiously and fairly be done".*

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[34] **{J/82/30}**.

[35] **{K/120/5}**.

[36] See generally ***MacGillivray on Insurance Law*** (14th Edition) at 11-007 **{J/151/4-5}**.

[37] **{K/72/9}**.

[38] ***Geys v Société Générale*** [2013] 1 AC 523 at [24], per Lord Hope **{K/151/16-17}**.

31 It is rare that this will not be achievable, because the parties will be taken to have intended consistency rather than conflict: [39]

> *"The court must start from the premise that the parties intended that effect should be given to each of the clauses in their agreement; so that "to reject one clause in a contract as inconsistent with another involves a rewriting of the contract which can only be justified in circumstances where the two clauses are in truth inconsistent" — Yien Yieh Commercial Bank Ltd v Kwai Chung Cold Storage Co. Ltd [1989] 2 HKLR 639 , 645G–H. And, as Lord Goff of Chieveley pointed out, in delivering the advice of the Privy Council in that case:*
>
> > *"In point of fact, this is likely to occur only where there has been some defect of draftsmanship .... But where the document has been drafted as a coherent whole, repugnancy is extremely unlikely to occur. The contract has, after all, to be read as a whole; and the overwhelming probability is that, on examination, an apparent inconsistency will be resolved by the ordinary processes of construction."*

Ejusdem Generis & Noscitur a Sociis

32 The *ejusdem generis* principle and its effects are summarised in ***Chitty on Contracts*** (33rd ed.) at 13-100[40]:

> *"The so-called "rule" which is laid down with reference to the construction of statutes, namely, that where several words preceding a general word point to a confined meaning the general word shall not extend in its effect beyond subjects ejusdem generis (of the same class), applies in principle to the construction of contracts. The principle depends on the assumed intention of the framer of the instrument, i.e. that the general words were only intended to guard against some accidental omission in the objects of the kind mentioned and were not intended to extend to objects of a wholly different kind".*

33 For example, the words "*all the perils"* in the ordinary form of marine insurance policy include only the perils of the sea or perils 'ejusdem generis *therewith*', because the meaning of the words is restricted by the subject matter of the contract.[41]

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[39] ***Taylor v Rive Droite Music Ltd*** [2005] EWCA Civ 1300 at [27] per Chadwick LJ **{K/123/14}**, citing Lord Goff in ***Yien Yieh Commercial Bank Ltd v Kwai Chung Cold Storage Co Ltd*** [1989] 2 HKLR 639 PC **{K/37/7}**.

[40] **{J/145/45}**.

34 The *ejusdem generis* principle is closely related to that of *noscitur a sociis*. This provides that where words in a contract share common characteristic, other words in the same contract (whether or not general words), ought to be accorded that same characteristic. ***Tektrol v International Insurance Company of Hanover*** [2005] EWCA Civ 845 provides an example in the context of an exclusion to BI cover, where "*malicious persons"* was construed to mean malicious persons whose actions were directed to the insured's computer systems rather than generally[42].

All Counsel for the Defendants

14th July 2020

[41] ***Stott (Baltic) Steamers v Marten*** [1916] 1 AC 304 {**K/43**}.

[42] {**K/124**}.