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Can an ATE policy be good security in a claim where there are allegations of dishonesty or fraud?

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In this article, Matthew Amey of The Judge considers the questions the court will examine when deciding whether an after the event policy or an anti-avoidance endorsement can act as security in cases involving allegations of dishonesty or fraud, following the High Court's judgment in *Saxon Woods Investment Ltd v Francesco Costa and others [2023] EWHC 850 (Ch)*.

Saxon Woods Investment Ltd v Francesco Costa and others [2023] EWHC 850 (Ch)

The ability of claimants to rely on after the event (ATE) policies to provide adequate security for costs has been the subject matter of many cases in recent years, and latterly the courts have been examining anti-avoidance endorsements (AAEs). (The *Saxon* judgment refers to an "AA" endorsement but the ATE industry routinely adopts AAE when discussing these specific endorsements.)

An AAE is a contractual change to the insurer's usual policy which purports to disable the insurer's ability to avoid a claim for breach of the policy terms and conditions or the insured's obligations to provide a fair presentation of the risk at the time of application. At the same time, the insurer modifies the policy to give the opponent (defendant) a direct right of recourse to the policy. Those contractual amendments give the necessary protection to the opponents seeking security, because the insurer will pay their adverse costs even if the insured would not have been entitled to make a claim due to their breach of the policy terms or inadequate presentation of the risk.

Compounding the perceived risk that an insurer could avoid a claim are the public policy arguments that the law cannot restrict an insurer's right to avoid for fraud, nor can an insured benefit from its own fraud. The value of an AAE as security in cases involving dishonesty is therefore open to challenge.

The recent High Court judgment in *Saxon Woods Investment Ltd v Francesco Costa and others [2023] EWHC 850 (Ch)* examines the questions the court will weigh up when deciding whether a policy and its AAE can act as security in a case where the underlying factual matrix includes allegations of dishonesty.

How do insurers behave when considering cover for cases involving dishonesty or fraud?

Insurers can and will severely curtail their ability to deny a payment under a policy by issuing an AAE, albeit for an additional premium. Some insurers nevertheless refuse to remove their ability to deny a claim due to the insured's fraud or dishonesty. This is known as a keeping a 'carve out' for fraud and dishonesty within an AAE.

Those that insist on the carve out will say that it is a matter of public policy or general law because insurers cannot voluntarily expose themselves to a situation where the insured does not bear the consequences of their own dishonest behaviour.

The case law, helpfully summarised in the *Saxon* judgment, shows the type of circumstances in which insurers give AAEs (with or without a carve out), and the consequent judicial decisions on the value of the policy or AAE as security:

- The insured party themselves is not perceived to present any risk of behaving dishonestly. For example, in *UK Trucks Claim Ltd v Fiat Chrysler Automobiles NV and others [2019] CAT 26*, the Competition Appeal Tribunal (CAT) accepted that the claimant was a "responsible well-established body" seeking to act as a class representative in a follow-on cartel claim where there were no allegations of fraud. Indeed, in *Consumers' Association v Qualcomm Incorporated [2022] CAT 20*, the CAT used the same reasoning to decide there was not a need for an AAE at all, noting the additional premium costs it would impose on the consumer body bringing the claim.

- Professional or reputable claimants do not necessarily equate to less risk of dishonesty or recklessness (and policy avoidance). The Court of Appeal in *Premier Motorauctions Ltd (in liquidation) and another v Pricewaterhousecoopers LLP [2017] EWCA Civ 1872* felt there was still room for ATE insurers to rely on non-disclosures by professional insolvency office holders, for example over issues they were unaware of.
- Insurers may not insist on a carve out in a case where dishonesty and fraud are not central to the case. However, in *Lewis Thermal Ltd v Cleveland Cable Company Ltd [2018] EWHC 2654 (TCC)*, the question of dishonesty was central to the case so, following *Premier,* the ATE policy was not acceptable fortification.

Where does the *Saxon* case take us?

In *Saxon*, amendments to the defence contained allegations of dishonesty against a former director of the petitioning company. The petitioner already had an ATE policy in place but those allegations led to the insurers needing some time to decide whether they could offer an AAE in the circumstances, and how such an endorsement might be framed. The timings of the amended pleadings meant that in the initial hearing of the application for security, draft AAEs were not brought to the court's attention as the insurers were considering their position in the light of the new allegations. This was a later application to modify the security based on changed circumstances (the insurers having later agreed to an AAE). The respondents argued that the eventual AAE notwithstanding, there was a real risk relating to the insurer seeking to avoid the policy on grounds of fraud.

The court in *Saxon* summarised the exercise which is required in order to decide whether a policy and AAE can stand as security. It must:

- Form a view as to the meaning of the wording of the policy (and its AAE).
- Assess how readily it might be avoided (both contractually and legitimately for policy reasons).
- Consider the likelihood factual circumstances which could arise that might enable avoidance.

(*Paragraph 33, judgment*.)

This means there can be no hard and fast rule – in each case the court will need to consider and weigh up these various factors. But the case demonstrates that where the insurers are well aware of the "extraordinary bargain" they are making in contracting out of the ability to avoid for fraud, and do so clearly in their wording, there is a strong argument, notwithstanding the public policy issues, that the AAE should stand as valid security from which defendants can ultimately benefit.

Wording

The judgment is well worth reviewing for the clear analysis of the wording of the policy and the AAE. Whilst the terms need to be "really clear" it is not essential to use the words "dishonesty" or "fraud" in an AAE when the insurer is contracting out of the ability to avoid for such behaviour, as long as the wording will "alert a commercial party to the extraordinary bargain he is being invited to make" (*paragraphs 41 and 42, judgment*). In the *Saxon* case, it was obvious - not least because the dishonesty allegations were added to the defence shortly before the first security application hearing- that the insurers and the insured all had those allegations "squarely in [their] minds" when deciding to make the bargain of contracting out of fraud in the AAE, and when choosing the appropriate wording to do so (*paragraph 48, judgment*).

Moreover, the court felt that the AAE was clear in its effect. There was no ambiguity over what the insurer was agreeing to.

Public policy

The defendants argued that the ATE insurer could still rely on dishonesty as a means to avoid the policy, despite the existence of AAE. Like some insurers reluctant to offer AAEs without a carve out, they argued that even if the proper construction of the specific AAE did not exclude avoidance for fraud, they doubted that such a clause is possible (*paragraph 31, judgment*).

The court here was able to take a narrower view on the principle that "a party should not be able to contract that he will not be liable for his own fraud". Whilst the law since *Patel v Mirza [2016] UKSC 42* shows that no one can claim an indemnity for their own wilful crime, the court decided that public policy here militated towards enabling an innocent third party (that is the respondent seeking the security) to benefit, despite any fraud by the insured (*paragraphs 43 and 44, judgment*).

> "In the current case, the First Respondent is clearly the person in the position of the innocent third party who has been given extensive rights under the terms of the AA endorsement. He is not the person seeking to benefit from his own fraud." (*Paragraph 69, judgment*.)

Factual matrix

Amongst other things, the judge in *Saxon* had to consider whether the particular AAE was adequate fortification in a circumstance where the prospect of fraud or dishonesty as pleaded was not fanciful or illusory. The dishonesty allegations in this case were made against the director of the petitioner, Mr Loy, who was alleged to be its controlling mind. Whilst a live issue, a finding of fraud against him would not necessarily equate to the failure of the petitioner's case, distinguishing it from the circumstances, and the assessment of risk, in *Holyoake v Candy [2017] EWCA Civ 92* and *Lewis Thermal* (*paragraph 70, judgment*).

Another key part of the factual matrix appears to be the fact that the allegations of dishonesty were, given their timing, "front and centre" for the insurers when deciding whether or not to give an AAE (*paragraph 70, judgment*). In that sense it would be very difficult for the insurers to maintain that they were entitled to avoid should the allegations themselves be proven.

What are the key considerations for insurers and litigants?

This case represents a positive step forward in the evolution of AAEs as a form of fortification. It addresses the effect of the insured's potential fraud and dishonesty. Moreover, it highlights the conditions and factual circumstances which favour the policy advantage of allowing third parties (defendants) to benefit from the AAE as security for costs over the policy reticence to permit "contracting out" of fraud.

In reality, insurers who perceive a high risk of cases failing due to fraud or dishonesty will not issue ATE policies at all, let alone AAEs, without a carve out. But if the court can be satisfied that the insurer must have been comfortable with the known risks in order to issue a clearly worded AAE, then defendants cannot then seek to undermine that AAE by pointing to dishonesty as some sort of silver bullet.