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Bristol: 1, Redcliff Street, Bristol, BS1 6NP
Tel: 0117 9100 200

London: 18 Bedford Square, WC1B 3JA
Tel: 0207 323 4632

London: 77 Gracechurch Street, EC3V 0DL
Tel: 0207 220 7818

Manchester: 57 Spring Gardens, Manchester, M2 2BY
Tel: 0161 228 3622

Milton Keynes: 2 Eskan Court, Campbell Park, MK9 4AN
Tel: 01908 289200

Email:
crmsubscribe@greenwoods-solicitors.com

PICG News Issue 50

This has been another busy month in the Courts, with several decisions relevant to the work covered by PICG handed down, so once again this edition of PICG News is longer than usual.

There were no specific Bills of immediate concern to the insurance industry mentioned in the Queen’s speech on the opening of Parliament on 25 May 2010 and the focus was, perhaps unsurprisingly, primarily on reducing the deficit and ensuring economic recovery. That is not to say that the process of review and reform will not be ongoing throughout the year. We will keep you informed of progress on the Law Commissions’ draft Bill on Consumer Insurance.

For more information on any of the cases below please contact Marise Gellert on 020 7469 6249 or at msg@greenwoods-solicitors.com

“BUT FOR” CLAUSES IN BUSINESS INTERRUPTION INSURANCE POLICIES

In the case of *Orient-Express Hotels Limited V Assicurazioni Generali Spa (Uk) (T/A Generali Global Risk)* (2010) Orient-Express Hotels Limited (OEH) appealed against an arbitration award on questions of law concerning the correct interpretation of a combined property damage and business interruption insurance policy issued by its insurer (G).

OEH owned the Windsor Court Hotel in New Orleans, which was damaged by Hurricanes Katrina and Rita in the autumn of 2005. The hotel was closed for two months and H sustained substantial business interruption losses during that period.

The surrounding area of New Orleans was also devastated by the hurricanes and a mandatory evacuation of the city was ordered, meaning that the city itself was effectively "closed" for part of the time when the hotel was closed. The policy covered "loss due to interruption or interference with the business directly arising from damage".

A "trends clause" provided for revenue figures to be adjusted as necessary so as to "represent as nearly as may be reasonably practicable the results which but for the damage would have been obtained".

The policy also provided cover for prevention of access and loss of attraction. OEH had recovered an indemnity under the latter clauses but that was subject to significantly lower limits than would be the case under the main insuring clause.

OEH accepted that it had to establish and could only recover in respect of business interruption caused by physical damage to the hotel.

“BUT FOR” CLAUSES IN BUSINESS INTERRUPTION INSURANCE POLICIES (Cont’d)

The arbitral tribunal held that as a matter of construction the insuring clause provided cover only for losses caused by damage to the hotel itself but not (save for the prevention of access and loss of attraction extensions) losses caused by the damage to and devastation of the city. The policy wording required a "but for" approach to causation and it was, therefore, necessary to assess the business interruption loss on the hypothesis that the hotel was undamaged but the city was devastated, as in fact it was.

The issues on appeal were as follows:

- (1) whether on its true construction, the policy provided cover in respect of loss which was concurrently caused by physical damage to the property and damage to the surrounding area; and
- (2) whether the trends clause should be interpreted as permitting an adjustment for the consequences of the very same insured peril which caused the insured damage which gave rise to the relevant business interruption loss.

The Judge held, in dismissing the Appeal, that:

- (1) As a general rule the "but for" test was a necessary condition for establishing causation in fact. However, there might be cases in which fairness and reasonableness required that it should not be a necessary condition. Whether or not that was so would depend on all the circumstances of the particular case.

In this instance, the tribunal had not erred in law in applying a "but for" causation approach under the policy on the facts as found by it. As the tribunal held, under the policy it had been agreed that a "but for" approach to causation should be adopted to the assessment of loss of revenue. Even if that consideration was not in itself conclusive, it was difficult to see how the tribunal could be said to have erred in law in adopting the causal approach laid down in the policy itself. On any view it was highly relevant to what fairness and reasonableness required. It had not been shown that fairness and reasonableness required that the "but for" test should not be applied. None of the suggested alternatives appeared to be more fair and reasonable than the "but for" test adopted by the tribunal, still less so clearly so as to require the discarding of that test. Furthermore, the "but for" test did not have the consequence that there was no cause and no recoverable loss on the facts, but rather a more limited recoverable loss.

The answer to the question whether, on its true construction, the policy provided cover in respect of loss which was concurrently caused by physical damage to the property and damage to or consequent loss of attraction of the surrounding area was therefore "yes" unless the application of the "but for" test meant that the loss claimed was not caused in fact by physical damage to the insured property.

- (2) The tribunal was right to say that the trends clause was concerned only with the damage, not with the causes of the damage. What was covered were business interruption losses caused by damage, not business interruption losses caused by damage or "other damage which resulted from the same cause". Nowhere in the trends clause did it state that "variations or special circumstances affecting the business either before or after the damage or which would have affected the business had the damage not occurred" had to be something completely unconnected with the damage in the sense that it had an independent cause to the cause of the damage. The assumption required to be made under the trends clause was "*had the damage not occurred*", not "*had the damage and whatever event caused the damage not occurred*".

OEH's construction effectively required words to be read into the clause or for it to be re-drafted. Further, such a re-drafting of the trends clause, which would allow OEH to recover for the loss in gross operating profit suffered as a result of the occurrence of the hurricanes as opposed to the loss suffered as a result of the damage to the hotel, was inconsistent with the causation requirement of the main insuring clause which required proof that the losses claimed were caused by damage to the hotel. Therefore the tribunal's construction and application of the trends clause was correct.

OVERSTATED CLAIM FOR DAMAGE TO CONTENTS FATAL TO INSURANCE CLAIM

The recent case of *Farid Yeganeh v (1) Zurich Plc (2) Zurich Insurance Company* (2010) dealt with two important issues:

- the burden of proof where an insurer alleges that the insured, or a person acting on his behalf, had deliberately caused the fire; and
- the effect of the overstatement by the insured of his contents claim

The claimant (Y) was a property owner and developer, who sought to claim the benefit of a buildings and contents insurance policy as against the defendant insurers (Z) following damage to his home and its contents by fire.

The property was covered by a policy providing buildings and contents insurance, which covered damage to property and contents caused by fire. There was no dispute as to the building reinstatement cost, of in excess of £270,000, which fell within the limit of cover under the policy. The limit of cover under the policy for contents was £40,000.

It was a further term of the policy that Z would not make any payment under the policy if a claim was, in any way, found to be fraudulent or false.

Z refused to pay out on the policy, claiming that Y, or a person acting on his behalf, had deliberately caused the fire and that Y had overstated his contents claim.

The value of claims which Z accepted in respect of the damaged contents comprised some £38,788, just less than the limit of the policy cover. Nevertheless, Z disputed claims by Y that numerous and expensive articles of clothing had also been damaged or destroyed in the fire.

Y submitted that:

- (1) it was inherently improbable that he would have caused the fire and that where a court was presented with one or more possible causes of a fire, the law did not permit or require a court to simply choose the one which it considered to be more likely;
- (2) his schedule of contents said to have been damaged by the fire was prepared as an estimate from recollection and may have included errors, but that was not fraud.

The Judge held that:

- (1) There was no direct evidence that Y had caused the fire. There were, however, doubts about his honesty and the truthfulness and accuracy of his evidence. It was for Z to show that Y caused the fire and to do so clearly given the seriousness of the allegation. The Judge considered the cases of *National Justice Compania Naviera SA v Prudential Assurance Co Ltd (The Ikarian Reefer)* (No1) (1995) and *Continental Illinois National Bank & Trust Co of Chicago v Alliance Assurance Co Ltd (The Captain Panagos DP)* (1989)

The Judge accepted Y's Counsel's submissions that Y's reasons for not desiring to burn down his house were powerful and Y's Counsel submission that when presented with more than one possible cause of the fire the law does not permit or require the court simply to choose the one which it considers the most likely, following the guidance in *Rhesa Shipping Co SA v Edmunds (The Popi M)* (1985). On that basis the Judge held that in light of the absence of a motive by Y for committing arson Z had not proven that arson had occurred.

- (2) Y's approach to his contents claim was, at best, careless. In the course of giving evidence, Y did not hesitate to be untruthful where it was in his financial interests to do so. Thus, it was difficult to accept the truth of his assurances that he was innocent in regard to making a fraudulent or untrue insurance claim. On the evidence, it was apparent that Y had falsely claimed for damaged clothing so as to bolster his contents claim as a whole.

On that basis Y's claim fell in its entirety and judgment was given for the defendants.

“USUAL RESIDENCE” FOR SERVICE PURPOSES

In the case of *Bhimji Jadvu Velji Varsani V Relfo Limited (In Liquidation)* (2010) the Court of Appeal held that the critical test of whether an address was a defendant's usual residence for the purposes of CPR r.6.9 was his pattern of life and how he used the address, not merely a comparison of the duration of periods of occupation of the address and the defendant's other residences.

Mr Varsani appealed against a first instance decision that proceedings brought against him by the respondent Relfo Limited had been properly served.

V was a British citizen who had a business in Kenya. His family lived in a property owned by him and his wife in Edgware, London and he visited as work permitted, staying between 27 and 53 days in each of the previous few years. Relfo Limited had brought proceedings and served the claim form at the London address. V unsuccessfully applied for service to be set aside on the ground that the London address was not his usual or last known residence within CPR r.6.9.

V argued that:

- (1) The Judge at first instance had wrongly found that the property in London was his "usual" residence. The appropriate contrast was between "usual" and "occasional" use, and the Judge had failed to apply the proper test of comparative use based on frequency and duration of residence;
- (2) Only a last known *usual* residence could be a last known residence.

The Court of Appeal held that:

- (1) The Judge at first instance had been correct to hold that the property in London was V's usual residence for the purposes of CPR r.6.9. It was possible to have more than one usual residence. That was borne out by the distinction between "usual residence" and "principal" place of business and "principal" office in CPR r.6.9, which the Judge had rightly taken into account. The test to be applied was not one of merely comparing the duration of periods of occupation, taking little account of the nature or quality of use of the premises, and ignoring altogether the fact that the premises were occupied permanently by the defendant's family and that the premises could be described as his family home.

The critical test was the defendant's pattern of life, as applied in the case of *Levene v Inland Revenue Commissioners* (1928) which considered whether a taxpayer was “ordinarily resident” for the purposes of income tax. The settled pattern of V's life was to visit his family home in London regularly each year, albeit not at the same time each year, for reasonably extensive periods.

That was in marked contrast to the facts in *Cherney v Deripaska* (2007) and *OJSC Oil Co Yugraneft v Abramovich* (2008). Those were cases in which the court found that the defendant had not been resident in England at all for the purposes of jurisdiction, and so the question of "usual" residence had never arisen as a serious issue. The marked difference between the settled pattern of V's life and the facts of those cases provided a good illustration of what was and was not a "usual" residence.

- (2) It was unnecessary to consider the "last known residence" ground. However, where a defendant continued to reside at premises which were not his usual residence, there was doubt as to when, and if so, how the provisions of CPR r.6.9 paras (3)-(6) were engaged and operated. The Court of Appeal commented that it would be desirable for the CPR Committee to consider that matter.

On that basis the appeal was dismissed and service of the proceedings on V at the Edgware address was held to be effective service.

SET-OFF BY WAY OF COUNTERCLAIM UNDER DIFFERENT CONTRACT

In the case of *Geldof Metaalconstructie NV V Simon Carves Limited* (2010) the Court of Appeal held that a contractor was entitled to set-off its counterclaim for damages against a claim brought against it by a subcontractor because, although the claim and counterclaim concerned two separate contracts, events had brought them into a close and inseparable relationship with one another and it would be manifestly unjust to allow the claim under one contract without taking into account the counterclaim.

The appellant contractor Simon Carves Limited (SCL) appealed against a decision that it was not entitled to set-off its unliquidated but provisionally quantified counterclaim for damages against a claim brought by the respondent subcontractor Geldof Metaalconstructie NV (GM). SCL had contracted to carry out the construction of a bioethanol plant in Teeside and had entered into two subcontracts with G, one relating to the supply of items and the other relating to the installation of other items.

Clause 24 of the supply contract provided that SCL was entitled to set-off against the purchase order price, any amounts lawfully due from GM to SCL, whether under that purchase order or otherwise. SCL alleged that GM had breached the installation contract and it issued notice of default and failed to pay GM's invoice for items supplied. GM stated that it would not continue with the installation work unless SCL paid GM the amounts set out in invoices relating to the installation contract and invoices relating to the supply contract. SCL issued a notice of termination under the installation contract. GM commenced proceedings to claim the price of the equipment SCL had purchased under the supply contract and SCL counterclaimed for damages for repudiation of the installation contract. S accepted that the supply and installation contracts were separate contracts but submitted that the counterclaim was inseparably connected with the dealings and transactions which gave rise to the claim and so should be set-off against the claim.

The Court of Appeal held that:

- (1) The principle that only cross-claims that impeached the title of legal demand could be set-off should no longer be used. The Court of Appeal considered the cases of *Rawson v Samuel* (1839), *Bank of Boston Connecticut (formerly Colonial Bank) v European Grain & Shipping Ltd (The Dominique)* (1989) and *Bim Kemi AB v Blackburn Chemicals Ltd (No1)* (2001).

There was a formal requirement of close connection. The test of there being an inseparable connection was one formulation of that test but it was not the only one. The Privy Council case of *Newfoundland v Newfoundland Railway Co* (1888) was also considered. There was also a functional requirement that it needed to be unjust to enforce the claim without taking into account the cross-claim. The test for equitable set-off therefore involved considerations of both the closeness of the connection between the claim and cross-claim and of the justice of the case but it was not appropriate to speak in terms of a two-stage test. Instead, there was a formal element and a functional element in the test. The best restatement of the test, freed of any reference to the concept of impeachment, was therefore whether the cross-claims were so closely connected with a claimant's demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim, as held in *Federal Commerce & Navigation Co Ltd v Molena Alpha Inc (The Nanfri)* (1978).

GM, by insisting on the payment of the supply contract invoices as a pre-condition of returning to work on the installation contract, brought the two contracts into intimate relationship with one another and that relationship became inseparable and irrevocable when SCL brought the installation contract to an end, as it arguably did, in reliance upon GM's poor performance under the installation contract coupled with its insistence of prior payment. It then became manifestly unjust to enforce payment under the supply contract without taking into account the cross-claim for repudiation of the installation contract. The cross-claim arose from the use to which GM had sought to put its supply contract claim and that sufficed on any formulation of the test for equitable set-off.

- (2) Business sense and the intended width of clause 24 suggested that the clause referred to amounts which were claimed to be due and which were recognised or recognisable at law. SCL was therefore also entitled to set-off its counterclaim under that clause.

On that basis, the appeal was allowed

DRAINAGE – LOCAL AUTHORITY DUTY

In the case of *Lambert & Ors V (1) Barratt Homes Ltd (2) Rochdale Metropolitan Borough Council* (2010) the Court of Appeal held that it was not fair, just or reasonable to impose on a local authority a duty to carry out and pay for relief work to an existing drainage system which had been blocked by a developer and caused water to accumulate on the local authority's land and subsequently damaged nearby properties.

The appellant local authority (R) appealed against a first instance decision that it was liable in relation to damage to property occupied by the respondents (L). L's properties were situated near to land which had been owned by the local authority. R sold part of that land to Barratt Homes Limited (B) and retained the remaining part. B developed the land but in doing so blocked a drainage ditch and culvert on its land. As a result, surface water from R's land accumulated in a corner of the retained land and on occasions flooded into L's properties and caused damage. It was later decided that to prevent flooding, a catch pit should be constructed on R's land and drainage should be laid. L commenced proceedings against B and R. The Judge held that B was primarily responsible but R was found to have breached its measured duty of care in failing to abate the nuisance, in failing actively to co-operate in solving the problem and in failing to construct the necessary drainage ditches and catch pit. R submitted that the Judge failed properly to address the scope of any measured duty of care which it had.

The Court of Appeal held that:

The Judge found by inference that the scope of R's duty extended to carrying out and paying for the relief scheme, or substantial parts of it. A measured duty of care in nuisance or negligence was a duty which was owed by one occupier of land to another. It was therefore necessary to consider what steps it was reasonable to expect the person on whose land the hazard had arisen to take to prevent damage to other land liable to be affected by it. Any such duty to act arose as soon as the landowner became, or should have become, aware that the hazard had come into existence. In this instance, when it became apparent that the flooding of L's properties was likely to be a regular occurrence, the fact that the hazard was, and was known to have been, created by B having blocked the ditch on land which it then occupied was one of the factors to be taken into account in deciding the scope of the local authority's duty, but unless it was also clear that L had a good cause of action against B to recover the cost of any relief works, it was not possible to take that fact into account as being established when assessing the scope of the local authority's duty at that time.

The Court of Appeal considered the cases of *Goldman v Hargrave* (1967) and *Leakey v National Trust for Places of Historic Interest or Natural Beauty* (1980) and held that the scope of the duty of care depended on the particular circumstances of the case.

Here, R was not at all responsible for the cause of the flooding but as a result of B's actions the only way of removing the hazard which resulted from the natural accumulation of rainwater on part of its retained land was to carry out work, the cost of which was likely to be considerable. The case of *Sedleigh-Denfield v O'Callaghan (Trustees for St Joseph's Society for Foreign Missions)* (1940) was distinguished, as this was not a case where a simple and inexpensive act on the part of the occupier of the land where the hazard arose could have abated the nuisance. Given the nature of the retained land, R could reasonably have been expected to allow L access to it free of charge to enable the catch pit to be constructed and could also have been expected to provide reasonable assistance in providing, or assisting L to obtain, any consents necessary to enable the drainage to be laid.

While the nuisance continued R was under a continuing duty of care. By the time the Judge had to decide on the scope of R's duty he was also in a position to determine that B was liable to L in respect of the nuisance. The fact that L had a right to recover from B the whole of the cost of the work was a powerful factor to take into account when determining the current scope of R's duty of care. It was therefore not fair, just or reasonable to impose on R a duty to carry out and pay for any part of the necessary relief works. It was under a duty to cooperate in a solution which involved the construction of suitable drainage and a catch pit on its retained land but that did not extend to obliging it to meet the whole cost of the relief works.

On that basis the appeal was allowed.

THE THIRD PARTIES (RIGHTS AGAINST INSURERS) ACT 2010 – UPDATE

No commencement date has yet been fixed.

SEMINARS

Throughout 2010, Greenwoods will be holding a series of seminars for both Greenwoods lawyers and interested clients. Each month, we will publicise the seminars to be held over the forthcoming months.

If you would like to attend any of the seminars shown below, please e-mail crm@greenwoods-solicitors.com We will then notify you as soon as we can regarding availability as space is limited.

Please note that events are held in Central London and occasionally Milton Keynes or Manchester

Case Law Update on Novus Actus Interveniens

Date	Time	Location	Speaker(s)
14th July 2010	08.30 - 09.30	77 Gracechurch Street London EC3V	Shail Patel & Daniel Saoul 4 New Square

Party Wall Act 1996 & Common Law Rights of Support

Date	Time	Location	Speaker(s)
22nd July 2010	08.30 - 09.30	77 Gracechurch Street London EC3V	Andrew Deakin 39 Essex Street

New Third Party Rights against Insurers Act

Date	Time	Location	Speaker(s)
30th September 2010	08.30 - 09.30	77 Gracechurch Street London EC3V	James Todd 39 Essex Street

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