CONTRA PROFERENTEM AT A TIME OF A PANDEMIC

Introduction

The Latin phrase "contra proferentem" is an established contractual rule which states that any clause considered to be ambiguous should be interpreted against the interests of the party that created, introduced, or requested that a clause be included.

Such a rule is certainly recognised by the Financial Ombudsman Service, in circumstances where one of the parties is a consumer (e.g. the policyholder) and the other is a commercial concern (often their insurer). The FOS works on the principle of equity and fully identifies that the situation for consumers may be grossly unfair, as there is (invariably) an imbalance in the parties' negotiating positions.

However, where the contracting parties are both commercial businesses, then matters (as evidenced by the case law) are more complicated. Typically, there are two types of clauses where the contra proferentem rule could be pertinent- exclusion clauses (where an insurer attempts to limit it's exposure) and indemnity clauses (the basis for an insurer's requirement to meet valid claims).

Early history

The case of **R v Canada SS Lines Ltd [1952] AC 192 (Canada Steamship)** (Canada Steamship) established a number of key (sequential) guidelines for interpreting clauses that seek to exclude liability for negligence.

1) If the clause contains language which expressly exempts the party seeking to rely on the clause from the consequences of negligence, effect will be given to that provision.

2) If negligence is not expressly referred to, the court must consider whether the ordinary meaning of the words used is wide enough to cover negligence.

3) If the second rule is satisfied, the court must then consider whether or not the exclusion clause could cover forms of liability other than negligence. If this is the case, then the clause is generally not interpreted as applying to negligence.

Canada Steamship's main principle is that, where one party seeks to avoid liability for its own negligence, that position must be spelt out expressly (and not in general terms). There is a view that (in the UK) the guidelines are only that and do not create rules as such.

One of the earliest cases to consider contra proferentem is the case **Houghton v Trafalgar Insurance Co. Ltd [1954] 1 QB 247.** This revolved around an exemption which stipulated that the Defendant was not liable to pay out where the claimant's vehicle had an excess load at the time of an accident. The specific wording of the exemption clause was that coverage was excluded for

*"loss, damage and or liability caused or arising whilst the car is conveying any **load** in excess of that for which it was constructed".*

It was held that the wording was ambiguous – specifically, the decision hinged on the word "load" and it was decided that it did not apply to passengers. Consequently, the insurer was obliged to meet the claim.

The latest case law

If we jump to the most recent case law, we can see how the interpretation of the contra proferentem principle has evolved, both for exemption/exclusion and indemnity clauses.

With regard to the former, perhaps the most significant case decision has been the one in **Persimmon Homes Ltd v Ove Arup and Partners Ltd (2017),** where the Court of Appeal was asked to consider an exclusion. The claimants had formed a consortium that engaged Arup as consulting engineers.

A (2009) agreement included an exclusion that stated…

"…Liability for any claim in relation to asbestos is excluded."

The Court of Appeal held that the wording excluded all liability relating to asbestos, including liability arising from negligence. The language used by the parties and the general application of business common sense produced the same conclusion. Exclusion clauses were a common contractual tool in major construction contracts for allocating risks, and there was no need for the courts to approach these with a mindset determined to restrict their application.

The court also confirmed that the *contra proferentem* rule now had a very limited role in relation to commercial contracts negotiated between parties of "equal bargaining power".

Equal bargaining power?

The phrase "equal bargaining power" does not mean that the courts scrutinize the financial and other resources which the parties can each utilize to support their (contractual) negotiating position. It is merely a device to indicate that commercial contracting parties generally enter into contracts with their "eyes wide open", in that they have the opportunity to negotiate the final position. In other words, the courts are less than sympathetic to business concerns that fall foul of a contract, negotiated freely. However:

- Consumers entering into a contract with a commercial concern are disadvantaged financially and will lack resources and possibly knowledge to strike "the best deal".
- Unequal bargaining power is evident where inequality is structurally lodged in a transaction e.g. employment contracts, tenancy and consumer agreements.

The Court of Appeal in **Persimmon** also suggested that (Lord Morton's) three stage test for interpreting exclusion clauses in the **Canada Steamship** case was now more relevant to indemnity clauses than exclusion clauses, at least in relation to commercial contracts.

So what about **indemnity** clauses? In the case of **Wood (Respondent) v Capita Insurance Services Limited (Appellant) [2017] UKSC 24**, the Supreme Court were asked to consider

such a clause, following an appeal from the Court of Appeal. The original court action pre-dates the change of the FSA to the FCA (and the FSO to the FOS).

The issue in dispute was the interpretation of an indemnity provision in a sale and purchase agreement (SPA) for the sale of shares in a motor insurance company to Capita. Under the SPA, the sellers had undertaken to indemnify the purchaser against losses and claims:

"…imposed on or required to be made by the Company, following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority..."

Capita later discovered that the company had possibly mis-sold insurance to customers. It was obliged to inform the Financial Services Authority and in due course agreed to put in place a remediation scheme to compensate customers who might have been affected. Capita sought to recover its losses under the indemnity provision in the SPA, claiming that this was triggered as a result of the following circumstances: the FSA considered the customers had been treated unfairly and to their detriment, and Capita, the company and the FSA agreed to conduct a remediation scheme to pay compensation to customers who were identified as potentially affected by the company's mis-selling.

There had not been any claims or complaints to the FSA. The FSA had only become involved, and required compensation be paid, as a result of an internal review undertaken by Capita which was reported to the FSA.

The Court preferred the seller's more limited construction of the clause, the balance being tipped in its favour by both the language used and, more importantly, the contractual context. The Supreme Court considered that the indemnity clause was imprecise and opaque (but there was no imbalance in the bargaining power of the parties).

In arriving at this decision, the court looked at the contractual context, and the wider factual matrix. The Supreme Court reiterated that the negotiations which led to the contract were not relevant.

Previous case precedents indicated that the approach to contract interpretation is a single exercise that requires striking the balance between the indications given by the language used, having regard to the contract as a whole and the implications of competing contractual constructions. This is analogous to a business common sense approach, in the context of the agreement as a whole.

It should be borne in mind that Capita had had another option to pursue Wood (the seller). Wood had provided warranties on regulatory compliance, but these had expired. Had Capita discovered the miss-selling earlier, when the warranties were still valid, then it may have been entitled to compensation.

It was held in Wood v Capita Insurance Services Ltd that the contract reflected the commercial intention between the parties. There are a few guidelines that can be taken from this decision:-

- *An interpretation of a word or phrase should start by considering the ordinary and natural meaning of the words in the clause.*
- *Does the ordinary/natural meaning of the clause reflect what the parties have intended to be agreed?*
- *The 'business common sense' approach prevails.*
- *It is not the intention or application of these principles to rescue a contracting party who has made a bad bargain.*

Insurers & the FCA approach

Another leap now, precipitated by the Covid 19 pandemic. This has resulted in the FCA seeking court guidance on the interpretation and application of pertinent business insurance policy wordings "……to resolve contractual uncertainty in business interruption (BI) insurance cover". The FCA has created a test case, to provide clarity of cover, having assessed a huge number of different policy wordings in the process.

The matter will initially be heard in the High Court, but an appeal/referral to the Supreme Court seems inevitable.

The test case is not intended to encompass all possible disputes, but to resolve some key contractual uncertainties and 'causation' issues to provide clarity for policyholders and insurers. It will not determine how much is payable under individual policies, but will provide the basis for doing so.

The following should be noted:

- The court has NOT been asked to provide definitive guidance on the contra proferentem rule. The terms of reference are confined to business interruption wordings in insurance policy wordings, "…..to resolve contractual uncertainty".
- The test case is being used as a basis for guidance (along with other key documents) and it applies to insurers, managing agents and insurance intermediaries (all as defined in the FCA Handbook) who were active in their respective roles prior to the 9th June 2020, plus where applicable, the Society of Lloyd's.
- It only applies to "….relevant non damage business interruption.." policies.
- It does not apply to insurers who have decided to accept claims, or decided that its non-damage business interruption policies do respond to the coronavirus pandemic. This is subject to the requirement that those same insurers continue to handle such claims, in accordance with their current approach.

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