JUDGMENT : Mr Justice Colman : QBD. Commercial Court. 5th October 2004

Introduction

1. There are before the court four preliminary issues ordered to be tried by an order of Colman J. dated 7 May 2004. At least two of those issues raise matters of some importance in the field of liability insurance and in particular as to its application to the construction industry.

2. The defendants, "Bovis", were insured by the claimants, "the Insurers", under a construction, engineering and design professional liability policy and a commercial excess liability policy. The Insurers claim declarations that they are under no liability under either policy in relation to the design and construction by Bovis as contractor of the Braehead Retail and Leisure Centre in Glasgow between May 1996 and September 1999. The employer was Braehead Glasgow Ltd, a retail property developer. The works were carried out by Bovis under a building contract dated 18 December 1997.

3. Disputes arose under the building contract and Bovis commenced proceedings in the Technology and Construction Court in which it claimed £37,778, 266 allegedly due under that contract. This was a balance outstanding from a total of £254,153,124 after giving credit for amounts paid by Braehead totalling £216,374,898. The gross amount was made up of six elements, namely amounts due and payable in respect of common user, post novation design fees, an amount due in respect of preliminaries and loss and expense, a management fee and interest.

4. Braehead served a defence and counterclaim. The latter included a claim for mismanagement of the project by Bovis in the sum of £49,524,189 made up of £43,911,439 being the difference between Bovis' claim under the contract and the amount which the works would have cost if the project had been properly managed together with a number of additional items said to be caused by defective management. The claim for mismanagement was put in the alternative in the sum of £21,700,047. This was calculated by reference to the cost of eight specific instances of mismanagement plus further additional costs on nine sub-contract packages together with additional professional and management fees.

5. The counterclaim also included a claim for £46,685,178 in respect of defective and non-compliant work and a claim for liquidated damages in the sum of £7,385,000. The Insurers contend that some parts of the counterclaim were in respect of liabilities outside the scope of the cover.

6. Thus, whereas Bovis' total claim amounted to £37,778,226, Braehead's counterclaim totalled £103,594,367 or alternatively £75,770,225.

7. The trial having been fixed to commence in October 2002, the litigation was settled by an agreement, "the Settlement Agreement", dated 11 January 2002. Under that Settlement Agreement Braehead agreed to pay Bovis £15 million in full and final settlement of all disputes under the building contract. The method of calculation of that global sum was not identified in the agreement. In particular, there was no indication as to what extent if any Bovis's claim of £37,778,226 had been treated as validly in excess of £15 million or which if any of the many detailed elements of Braehead's counterclaim had been treated as valid. Indeed, the terms of the Settlement Agreement gave no indication as to whether the parties agreed that there was any substance in any of the elements of Braehead's counterclaim that is to say whether there was any common position that the claim by Bovis fell to be reduced because it was partly intrinsically defective or because part of Braehead's counterclaim could be set off against Bovis's claim. Nor does it contain any indication as to whether any particular amount was paid to settle such part of the counterclaims as the Insurers could not dispute fell within the scope of the indemnity.

8. In addition to the terms relating to payment of the settlement amount, the Settlement Agreement contained other terms, some of which varied the building contract, as well as additional indemnities from Braehead for the benefit of Bovis and from Bovis for the benefit of Braehead. There were other terms designed to facilitate the settlement and the continuation of the building contract.

9. So far as Bovis's perception is concerned there is evidence that it had received advice from its solicitors, Masons, in a report dated 18 August 2001 to the effect that it was likely to recover £12,741,625 from Braehead. This figure had been arrived at by reducing to £248,579,744 the gross amount Bovis was entitled to claim for the contract works and by very heavily discounting the three main elements of

Braehead's counterclaim which could be set off against the amount of above £32 million due to Bovis after giving credit for prior payments. However, this was a unilateral assessment of the value of the claim and counterclaim and there is no evidence that Braehead accepted it.

10. Bovis's policies with the Insurers included a primary policy for the period 28 October 1999 to 28 November 2000 (by subsequent extension). It was subject to a limit of £5 million per claim and a self-insured retention of £525,000 per claim. There was also an excess of loss policy for the same period which protected up to US $75 million per claim excess of the primary policy with an aggregate cover of US$75 million.

11. On 15 May 2003 Bovis sent to the Insurers a formal letter of claim for an indemnity under the policies. The total claim was for £19,222,722.40. It broadly replicated the assessment by Masons in their report of 24 August 2001, which had estimated the valid counterclaim by Braehead at £19,463,221. In other words, Bovis deployed their own solicitor's assessment of the substance of their own claim and of Braehead's counterclaim as the basis of their proof of an insured loss.

12. The Insurers issued their claim form for negative declaratory relief on 8 September 2003 and Bovis served its Defence and Counterclaim on 19 December 2003. The counterclaim was for the same figure as shown in the letter of 15 May 2003. It claimed that it had suffered insured losses in that amount caused by its liability to Braehead in relation to its breaches of duty under the building contract.

13. The preliminary issues now before this court are as follows:

"Issue 1

a. Has Bovis' liability to any third party been ascertained by judgment, award or settlement?

b. If the Answer to (a) above is 'No', can Bovis nevertheless establish that it has become legally liable to pay a sum to Braehead, within the meaning of insuring clause (a), so as to give rise to an entitlement to an indemnity from the claimant?

Issue 2

a. Whether Bovis' alleged loss in respect of Braehead's heads of counterclaim as identified in section 11 and schedules 1 to 4 of the Defence and Counterclaim is properly measured on a "subjective approach", as referred to in paragraph 11.5 of the Defence, or on any other basis and if so what?

Issue 3

a. Do the words ".. as a result of any neglect error or omission" in insuring clause 1 of the primary policy require Bovis to establish liability in negligence in order to trigger coverage under the policies?

b. Can coverage be triggered under the same insuring clause if it is proved that:

i there is a liability for breach of contract which is not deliberate (without more);

ii there is liability for breach of contract, a proximate cause of which was a negligent act, error or omission for which Bovis was responsible?

Issue 4

a. What is the meaning and effect of insuring clause, paragraph 2, of the primary policy?

b. In particular, and with regard to Bovis' claim for liability in respect of defects, is there any coverage for breach of warranty, in particular for any claims in respect of an alleged breach of clause 2.5.2.5 of the contract which warrants that "... the Works comprise or will comprise only materials and goods which are new and of sound and satisfactory quality.." in light of the fact that the defendant failed to declare the contract to the claimant in accordance with memorandum 7(i) of the primary policy?"

14. With reference to Issue 2, it was pleaded by paragraph 11.4 of the Defence as follows:

11.4 It is Bovis' case that the appropriate breakdown of the aforesaid sum of £15 million is as follows, and as more fully detailed below and in schedules 1 to 4 hereof. The £15 million payment represented:

11.4.1 a payment by Braehead to Bovis of about £32,204,846.00 in respect of monies due under the Main Contract;

11.4.2 less a payment by Bovis of £19,463,221.00 in respect of Braehead's counterclaims;

11.4.3 The effect of the foregoing is a net payment of £12,741,625 by Braehead to Bovis;

11.4.4 The balance of £2,258,375 (ie £15m less £12,741,625) is attributable to Bovis' legal costs, ie this sum represents a reasonable recovery by Bovis of its legal costs, that is about 77% of Bovis' actual legal costs (which were £2,947,010.32 as described below)."

15. By paragraph 5 of the Defence it was pleaded:

11.5 In support of the aforesaid breakdown, Bovis relies upon the fact that:

11.5.1 Subjective attributability This breakdown reflects Bovis' own contemporaneous assessment of the value of the claim and counterclaims, on the basis of which assessment Bovis entered into the Settlement Agreement on 11 January 2002;

11.5.2 Objective attributability In any event, the breakdown referred to in the preceding paragraph is supported by a retrospective objective assessment of the appropriate allocation of the £15m to the various heads of claim and counterclaim, having regard to their relative merits."

16. As to Issue 4 it is agreed that the court should confine itself to answering 4(b) as to coverage in respect of claims for breach of clause 2.5.2.5 of the building contract.

17. The Insuring Clause in the policies was in the following form:

Insuring Clause

We the Insurers hereby agree to indemnify the Insured up to but not exceeding the Limit of Indemnity.

a) for any sum which the Insured may become legally liable to pay arising from any claim or claims first made against the Insured, and/or

b) for loss or expense necessarily incurred by the Insured with the consent of the Insurers in rectifying any part or parts of any building or engineering works prior to the issue of a certificate of final completion on such part or parts where the need for rectification first arises during the Period of Insurance as a result of

1. any neglect error or omission or breach of warranty of authority in the conduct of the Insured or of any party presently or previously employed or engaged by the Insured or for whom the Insured is responsible

2. breach of warranty or guarantee of the fitness or suitability for purpose or the reasonable fitness or suitability of any work or materials which are the subject of a contract (including any deed of collateral warranty or duty of care agreement) entered into by the Insured, or by any party on behalf of the Insured arising from the carrying out of the Activities and Duties anywhere within the Territorial Limits."

Issues 1 and 2: Submissions

18. The Insurers' case is very simple. It is submitted by Mr Gavin Kealey QC on their behalf that, these being liability policies, the assured can recover an indemnity only in respect of a legal liability which has been "ascertained" or, in the case of a settlement, proved, to exist and in an amount which has been ascertained by judgment or arbitration award or, in the case of a settlement, which does not exceed the true amount for which the assured would have been liable to the third party but for the settlement.

19. In support of this general submission Mr Kealey relies on the decision of the House of Lords in **Bradley v. Eagle Star Insurance Co Ltd** [1989] 1 AC 957, approving the reasoning of the Court of Appeal in **Post Office v. Norwich Union Fire Insurance Society Ltd** [1967] 2 QB 363. He also relies on the subsequent decision of the Court of Appeal in **Commercial Union Assurance Co v. NRG Victory Reinsurance Ltd** [1998] 2 Lloyd's Rep 600 and **McDonnell Information Systems v. Simback** [1999] Lloyd's Rep I&R 516 and on the decisions of Potter J. in **Colin Baker v. Black Sea and Baltic General Insurance Co Ltd** [1995] Lloyd's Rep I&R 261and of Moore-Bick J. in **Structural Polymer Systems Ltd v. Brown** [2000] Lloyd's Rep I&R 64. Mr Kealey submits that, given that in the present case there was ascertainment of liability and loss neither by a judgment nor by an arbitration award, the assured could recover only if it proved that it had become legally liable as a result of an eventuality insured under the policies and if the amount of its loss caused by that liability was ascertained by the settlement agreement and was reasonable in the sense of being no greater than the true amount of damages for which the assured would have been liable in respect of that liability but for the amount agreed under the settlement.

20. The Insurers contend that in the present case the global settlement agreement did not operate to identify any loss caused to the assured by any legal liability in respect of Braehead's counterclaim nor did it quantify any such loss. Accordingly, there was no ascertainment of such loss by the settlement agreement and, in the absence of such ascertainment, there was no basis for recovery as under the policy: there was simply no cause of action.

21. It is submitted on behalf of Bovis that there is no rule of law that it must be possible, in order for an entitlement to indemnity to be triggered, to discern the extent of an insured's liability for insured matters from the terms of the settlement itself. In particular, it is open to the insurer to challenge the existence or amount of the assured's liability to a third party and to assert that the settlement sum was unreasonable

or that the true basis of settlement differed from what was stated in the agreement. In such cases the court, having held that the settlement agreement does not ascertain the liability or the amount of the loss, does not go on to reject the claim for an indemnity but proceeds to determine if the assured was liable to the third party and, if so, in what amount.

22. In support of this proposition Mr Roger Stewart QC relies on the judgment of Mance J. in **McDonnell Information Systems v. Swinback** [1999] LRLR 98 which was affirmed by the Court of Appeal at [1999] Lloyd's Rep I&R 516.

23. Mr Stewart emphasised that it is rare for settlements to ascertain the amount of the loss. In particular, the settlement figure agreed may be for more than one claim, as with acceptance of a Part 36 offer or payment into court, or may also cover costs or may be in an amount which is not directly derived from a perceived amount of damages for which liability is alleged but with regard to other considerations, including claims which are merely feared but have never been advanced. Further, an agreement to break down the amount to be paid by reference to particular claims is not binding on insurers who may go behind the terms of the agreement and prove the amounts to be unreasonable. In such a case, there will have been no ascertainment of the amount of the liability. Reliance is placed on the judgment of H H Judge Bowsher QC in **P & O Developments Ltd v. Guy's & St Thomas' National Health Service Trust** [1999] BLR 3.

24. Secondly, Mr Stewart submits that it would be contrary to public policy, inconsistent with the proper construction of the insurance policy and contrary to commonsense to impose a requirement that the terms of the settlement themselves identify the amount of the insured indemnity. In particular, there was express provision in the policy (condition 7) under which Bovis was prevented from admitting liability or settling or making or promising any payment in respect of any claim which might be the subject of indemnity and the insurers were permitted to take over and conduct the insured's defence or settlement of any such claim and Bovis were required to give all information and assistance as the Insurers might reasonably require. In this case the Insurers had declined to take over Bovis's defence. Following a Part 36 payment by Braehead on 3 August 2001, which was reported to Insurers, at a meeting between Masons and Kendall Freeman the latter, while not admitting liability under the policies, requested a breakdown of the various heads of Braehead's counterclaim and were provided with a copy of Masons' August 2001 report to Bovis. In December 2001 Masons sent a draft form of the global Settlement Agreement to Kendall Freeman. Insurers raised no objection to this form of agreement. Nor did they raise the question of want of ascertainment. I interpose that it is not suggested that Insurers made any representation amounting to waiver of their strict legal rights or that they are estopped from relying on them.

25. In these circumstances it would be contrary to public policy if there were a general rule that, absent an ascertainment in the strict sense of express quantification of claims, an assured who had entered into a global settlement which took various claims into account and under which its position was worsened by making payment or giving credit could not recover an indemnity. Indeed, even if the settlement had included an apportionment of the total amount between claims, it is doubtful whether that would have improved the justice of the case for the parties could have agreed to divide the money in any way they chose and without reference to the true value of the claims.

26. Thirdly, the global settlement did in a general sense ascertain the losses in as much as it was clearly intended to settle all Braehead's counterclaims and they were all separately quantified so that it did establish the existence and amount of liability. In this connection Mr Stewart further relied on the approach of H H Judge Bowsher QC in **P & O Developments**, supra, for the proposition that it must have been in the mutual contemplation of Bovis and the Insurers when they entered into the policy that Bovis might enter into a global settlement with its employer on the basis of Bovis's subjective assessment of the value of each claim as exemplified by Masons' August 2001 report and that accordingly the global payment represented a foreseeable head of loss recoverable under the second rule in **Hadley v. Baxendale**.

27. Finally, Mr Stewart submits that, if the effect of the Settlement Agreement was not to ascertain the amount of the liability, Bovis is still entitled to a declaration that it was under an insured legal liability to

Braehead on particular heads of the counterclaim and that the amount paid was by way of settlement of such liability. That evaluation of liability and its quantification can be proved by evidence extrinsic to the Settlement Agreement, but the amount recoverable from insurers cannot exceed the lesser of the true amount of liability or the amount paid under the settlement.

28. Underlying the submissions of Bovis on this issue is the point that, where the ascertainment relied on is that by means of a settlement agreement, the assured still has to prove by extrinsic evidence that he was in truth liable and that the true amount of his liability is at least that of the amount paid in settlement. This process of establishing liability under the policy therefore in any event involves reliance on substantial extrinsic evidence, the only contribution of the policy being to cap what is recoverable from insurers.

29. As to the second issue on whether the Insured's loss should be measured subjectively by reference to Bovis's perception of the relevant amounts based on the August 2001 Report from Masons, as revised, or on an objective approach evidenced by a retrospective analysis of the value of the counterclaims following the making of the settlement agreement, Bovis submits that the correct approach is a subjective one. Reliance is placed on the judgment of H H Judge Bowsher QC in **P & O Developments v. Guy's & St Thomas**, already referred to. Alternatively, it is submitted that the judgment of H H Judge Hicks QC in **Royal Brompton Hospital v. Hammond** [1999] BLR 162 at page 166 supports this result.

Issues 1 and 2: Discussion

30. It is first necessary to investigate the juridical nature of "ascertainment" in the context of a liability policy. For this purpose the starting point is to ask what engages the insurer's obligation to indemnify the insured.

31. Firstly, there has to have occurred an eventuality which has rendered the insured liable to a third party. Secondly, the eventuality and the consequent liability has to be within the scope of the cover provided by the policy. Thirdly, it must be established that such liability has caused loss to the insured of an amount within the scope of the contractual indemnity. Each of these constituents of the obligation to indemnify the insured has to be established before it can be said that there is a cause of action. This is quite clearly established by the decision of the Court of Appeal in **Post Office v. Norwich Union Fire Insurance Society Ltd**, supra. Thus, at page 373, Lord Denning MR, with whom Salmon LJ. agreed (at page 378), observed: *"The policy says that "the company will indemnify the insured against all sums which the insured shall become legally liable to pay as compensation in respect of loss of or damage to property." It seems to me that the insured only acquires a right to sue for the money when his liability to the injured person has been established so as to give rise to a right of indemnity. His liability to the injured person must be ascertained and determined to exist, either by judgment of the court or by an award in arbitration or by agreement. Until that is done, the right to an indemnity does not arise. I agree with the statement by Devlin J. In* ***West Wake Price & Co v. Ching****. 'The assured cannot recover anything under the main indemnity clause or make any claim against the underwriters until they have been found liable and so sustained a loss' ".*

32. The full passage from the judgment of Devlin J. in **West Wake Price & Co v. Ching** is as follows: *"The essence of the main indemnity clause - as indeed of any indemnity clause - is that the assured must prove a loss. The assured cannot recover anything under the main indemnity clause or make any claim against the underwriters until they have been found liable and so sustained a loss. If judgment were given against them for the sum claimed, they would undoubtedly have sustained a loss and the question would then arise what was the cause of the loss. If the proximate cause (this seems to be the test;* ***Goddard and Smith v. Frew****) of the loss was the dishonesty of their servant, they could not recover under the policy; if on the other hand it was their own neglect, they could recover. If the action between the claimants and the assured did not settle the question of causation, it would in all probability settle the facts in the light of which the question could be answered. But all this would involve publicity which, where charges of professional negligence are made, might do considerable harm to an assured over and above the amount of any judgment obtained against him. For this reason professional men may prefer paying a bad claim to fighting it. Obviously, one of the main objects of the QC clause is to give the assured additional cover, not only against the costs of litigation but also as a protection against unwelcome publicity."*

33. In **Bradley v. Eagle Star Insurance Co Ltd** [1989] AC 957 these judgments were expressly approved by the majority. Lord Brandon at page 966 said this: *"In my opinion the reasoning of Lord Denning MR and*

*Salmon LJ contained in the passages from their respective judgments in the **Post Office** case set out above, on the basis of which they concluded that, under a policy of insurance against liability to third parties, the insured person cannot sue for an indemnity from the insurers unless and until the existence and amount of his liability to a third party has been established by action, arbitration or agreement, is unassailably correct. I would therefore, hold that the **Post Office** case was rightly decided, and that the principle laid down in it is applicable to the present one."*

34. These passages reflect the principle applicable to contracts of reinsurance as previously expressed by the Court of Appeal in **Versicherungs und Transport A/G Daugava v. Henderson** (1934) 39 Com Cas 312. Thus at pages 316 – 317 Scrutton LJ. observed: *"There is no privity between the original assured and the reinsurer. The liability of the latter is only to indemnify the insurer, the reassured, in respect of a loss for which he is liable to the assured by reason of his insurance policy. If the insurer is so liable, and the amount of his liability is ascertained, he can recover against the reinsurer though he has not paid the assured; for he is liable for an ascertained amount and the reinsurer must indemnify him. **Wolmerhausen v. Gullic; Re Eddystone, & C, Company, Re Law Guarantee Society**. But the insurer is not liable to pay the assured until the amount of his liability has been ascertained in accordance with the terms of his policy; so the reinsurer is not liable to pay the reassured until the amount of his liability is ascertained under the terms of his policy, which may or may not be the same as the terms of the original policy. In the present case they were the same, but the time for payment did not come till liability and amount were agreed or settled.*

The appeal must be dismissed with costs."

35. Maughan LJ. at page 317, in agreement with Scrutton LJ. added: *"A policy of reinsurance is an agreement by way of complete or partial indemnity to the insurer. That has long been settled, and has been stated in more than one case. Like every contract of indemnity it can only operate if the liability of the debtor, the insurer, is established, and it is necessarily contingent on that liability being established. It follows that the insurer has no cause of action against the reinsurer until the loss for which the former is liable (if any) has been ascertained."*

36. In **Colin Baker v. Black Sea and Baltic General Insurance Co Ltd** [1995] LRLR 261 Potter J. accepted as correct the proposition, conceded by counsel for the reinsurers, that under a contract of reinsurance, being a contract of indemnity, time began to run for the purposes of the Limitation Acts only when the liability of the re-assured had been ascertained by judgment, arbitration award or settlement agreement: *"A contact of reinsurance being a contract of indemnity for losses of the reinsured, the reinsurer's liability to indemnify the reinsured arises on the date on which the reinsured sustained a loss. In final submissions, it was common ground between the parties that the date on which a reinsured sustains a loss is the date on which his liability to his underlying assured is ascertained, whether by agreement, arbitration award or judgment. The amount then ascertained to be due from the reinsured is the measure of the reinsurer's obligation of indemnity."*

37. Finally, it is necessary to refer to certain observations which I made in the course of my judgment in **King v. Brandywine Reinsurance Co (UK) Ltd** [2004] EWHC 1033 (Comm) at paragraphs 199 to 202:

"199. It is not enough for the reassured to prove that there was liability to one of several primary insureds unless it is also proved that such liability was ascertained by judgment or settlement. If insurer X insures A and B against losses caused to either or both by a given peril and A claims, but B does not claim, that it alone has suffered loss caused by an insured peril and if there is then a judgment or arbitration award on a claim brought by A alone against or a settlement of A's claim, it is quite unarguable that X's liability to B has thereby been ascertained so as to establish that X is entitled to recover as a reinsured loss such amount as B may subsequently claim under the policy. The proposition only has to be stated to be seen to be wholly untenable.

200. Does it make any difference if A promises by the terms of the settlement agreement to indemnify X if in future B should bring a claim against X under the primary policy for loss caused by the same insured peril? Clearly the answer must be No.

201. Apart from express provisions to the contrary, that which triggers the obligation of a reinsurer to pay under his contract of reinsurance is not only the liability of the reassured to the primary assured but also the ascertainment of that liability by judgment or award against the reassured or by settlement by the reassured of a claim asserting such liability: Bradley v. Eagle Star Insurances Co Ltd [1989] 1 AC 957. In the absence of a judgment or award which concludes that a reinsured is liable to the primary insured, the process of ascertainment of such liability by settlement involves that an agreement has been made between the

reinsured and the primary insured who asserts a claim under the policy under which the primary insured withdraws his claim for the consideration of usually a promise of payment by the reassured. The substance of this requirement is that for such consideration the liability of the reassured has been discharged. It is the cost of the discharge of the reassured's liability which becomes the reinsured loss.

202. It follows that if in the settlement agreement between A and X there is nothing more than an indemnity by A to X in case B should in future claim against X, there is missing from such agreement the essential feature that the assured liability of X to B has been discharged in consideration of a payment by X. There has been no such discharge and there has been no agreement as to the cost of that discharge."

38. It is thus clear that the concept of ascertainment in the context of a contract of indemnity and specifically of liability insurance has two quite distinct facets.

39. First, it provides the essential link between the insured eventuality which has created the insured liability on the one hand and the actual loss sustained by the assured. It is the judgment, arbitration or settlement agreement which has imposed on the assured a judgment debt or a contractual obligation to satisfy an award or to perform a settlement agreement which constitutes the assured's loss caused by the assured's liability. It is thus an essential element of the assured's cause of action on the policy. In the case of a settlement agreement, that which must be distinctly ascertained is thus the cost of the insured liability.

40. The basis for this principle must be that there is an implied term to this effect in the contract of insurance. Certainly the applicability of this principle has been embedded in the analogous law of reinsurance for seventy years and in the law of liability insurance generally since the decision in **Post Office v. Norwich Union**, supra, for thirty-seven years. Since there is no express reference in the policy terms to ascertainment as an essential element in the cause of action, it must be an implied pre-condition to the right to recover. This was the explanation which underlay the reasoning of the Court of Appeal in **Commercial Union Assurance Co v. NRG Victory Reinsurance** [1998] 2 Lloyd's Rep 600. The issue which arose in the context of a reinsurance contract was whether ascertainment could be provided by the judgment of a foreign court as distinct from an English court. It was held that it could provided: *"That the foreign Court should in the eyes of the English Court be a Court of competent jurisdiction. (2) That judgment should not have been obtained in the foreign Court in breach of an exclusive jurisdiction clause or other clause by which the original insured was contractually excluded from proceeding in that Court. (3) That the reinsured took all proper defences. (4) That the judgment was not manifestly perverse."*

41. The passage in the judgment of Potter LJ. with which May LJ and Lord Woolf MR agreed is directly relevant: *"Mr Sumption has resisted that approach as one of convenience rather than logic. He has argued that, since the reinsured must establish that he was legally liable ie. liable on a proper application of the applicable law, the decision of a foreign court can be no more than evidence of such liability which ultimately falls to be decided by the court deciding the dispute as to the liability of the reinsurer to the reinsured. He concedes that, in many cases, the foreign decision is likely to be treated as conclusive evidence of liability, but says that should not affect the principle. In my view, the matter is better treated as a question of implication into the reinsurance contract, the implied term being that, absent any provision to contrary effect, the insurer will treat the decision of a foreign court of competent jurisdiction as to the liability of the reinsured to his original insured as binding, subject only to reversal on appeal and the limits which I have mentioned."*

42. Thus, the approach of the Court of Appeal to this issue was to deploy an implied term analysis and if that analysis was applicable in that case it must certainly be applicable in the case of liability policies generally. I would therefore hold that there is an implied term in a contract of indemnity in the form of a liability policy that it is an essential element of the assured's cause of action that his loss has been specifically ascertained by means of a judgment, arbitration award or settlement agreement.

43. The second and quite distinct facet of the concept of ascertainment in the context of a liability policy is that it is a source of evidence. As such it operates in different ways according to the nature of the ascertainment. Thus, a judgment that the assured is liable in a given amount of damages is normally conclusive evidence as to liability and quantum. This, of course, would not be true of all judgments – notably of a judgment in default or of a judgment arising from a trial where no proper defence had been raised by the assured. The same would be true if there was a pending appeal. An arbitration award

would give rise to a similar consequence. However, a settlement of a claim by a third party has a quite different effect. It is common ground that it evidences the amount which the assured has agreed to pay to discharge the claim in respect of the assured's liability but that it is not conclusive evidence as between assured and insurer either as to whether there was in truth liability or, if so, what the true amount of that liability was.

44. Thus as a matter of law an assured who relies on a settlement as a means of ascertainment has to prove by extrinsic evidence that he was in truth under a liability insured by the policy and secondly that what he paid by way of settlement of that liability was reasonable having regard to the amount of damages that he would have to pay if the matter had gone to trial. The latter requirement of reasonableness is normally satisfied by proof that such amount of damage would be at least as much as the amount paid under the settlement: see **Structural Polymer Systems v. Brown** [2000] Lloyd's Rep I & R 64, per Moore-Bick J. at page 72.

45. The requirement that he should prove that the eventuality the subject of the claim gave rise to a liability insured under the liability policy is strikingly illustrated by **McDonnell Information Systems Ltd v. Swinback** [1999] 1 Lloyd's Rep I&R 98, and 516 (CA). In that case there had been a settlement agreement in respect of claims by a third party put forward without allegations of dishonesty by the assured's employee which was known to the assured but not to the third party. Such dishonesty gave rise to an exclusion of liability under the policy. It was held by Mance J. and confirmed by the Court of Appeal that the insurers were entitled to prove the dishonesty and thereby the true nature of the assured's liability, that being the real basis on which so far as the assured was concerned the case had been compromised. Therefore the assured failed to establish an essential element of the cause of action, namely that the true ground of liability was covered by the policy.

46. Both **Structural Polymer Systems**, supra, and **McDonnell Information Systems**, supra, are concerned with the evidential function of the material means of ascertainment. They are not concerned with its primary function, namely whether the means of ascertainment specifically identifies and thereby represents the assured's loss attributable to the relevant liability. They are on analysis authority only for the proposition that, where the means of ascertainment relied upon is a settlement of claims, that agreement is not, as between the assured and the liability insurers conclusive evidence that the assured incurred insured liability or that the loss specifically identified in that agreement is reasonable in the sense of being no greater than the amount for which the assured would be legally liable if sued in respect of the insured liability.

47. It is important to appreciate that there appears to be no authority to suggest that if a settlement agreement has been entered into but it does not specifically identify the cost to the assured of discharging the insured liability, extrinsic evidence can be adduced to supply an ascertainment of that cost and therefore of the relevant loss. This is hardly surprising, for that proposition would be inconsistent with the contractual requirement for ascertainment of loss confirmed in **Bradley v. Eagle Star**, supra. Just as a judgment which went no further than a declaration of liability to the third party could not amount to a valid ascertainment of loss caused by such liability see **King v. Brandywine Reinsurance Co (UK) Ltd**, supra, so a settlement agreement deficient in the identification of the loss suffered specifically by reference to the insured liability could not amount to a valid ascertainment. No cause of action for an indemnity would arise and no amount of extrinsic evidence would cause it to do so. Consequently, on the basis of this analysis, the fact that a court could go behind the terms of the settlement agreement to investigate whether there was in truth liability to the third party and, if so, for what amount of damages the assured would be liable does not lead to the conclusion that the court can cure the deficiency in the validity of the ascertainment of loss by hearing evidence which goes behind that which is expressed by the settlement agreement.

48. Does the decision in **P & O Developments Ltd v. Guy's and St Thomas's**, supra, so heavily relied upon by Bovis, advance this issue? In that case Guy's and St Thomas National Health Service Trust were sued by P & O, their project managers, for money due under a management contract in respect of a new building development at Guy's Hospital. Guy's counterclaimed for damages for breach of the management contract alleging that delays to the works had been caused by P&O and their service

engineers, A&A. The damages counterclaimed were based on a global settlement under which Guy's had agreed to pay to their main contractor, Higgs & Hill, £83.9 million. Higgs & Hill had claimed against Guy's under the terms of the main contract to be indemnified against the claims of sub-contractors which in turn were based on claims that P&O and A&A had unjustifiably delayed the progress of the works. By the settlement agreement Higgs & Hill were to meet the claims of those sub-contractors without further recourse to Guy's. The global settlement agreement did not apportion the £83.9 million between the claims of the individual sub-contractors. Guy's sought to prove their losses as against P&O and A&A by asserting that the global settlement figure was in itself a reasonable sum at which to settle all Higgs & Hill's claims and that such figure was made up by aggregating separate evaluations of each claim which those advising Guy's had considered reasonable in a prior report to Guy's but not provided to Higgs & Hill.

49. There was a trial of preliminary issues in the Technology and Construction Court. Amongst the preliminary issues were the following.

"Question A:

If Guy's proves that the sum, £83,876,354, at which it reached a global settlement with HH was reasonable:

(1) does it follow that the sums in fact allocated by Guy's to individual works contractors' claims (as pleaded in Schedule H2 of the Amended Defence and Counterclaim) were also reasonable sums, such that if the reasonableness of the global settlement is established, the sums in fact allocated by Guy's to the individual works contractors represent Guy's actual loss with respect to those works contracts;

(2) is it necessary for Guy's to prove that the sums in fact allowed by Guy's to the individual works contractors claims were reasonable sums to allow? And

(3) is it material to investigate at what figure H & H themselves settled the individual works contracts claims?"

50. To this series of questions H H Judge Bowsher QC gave the following answers:

"Answer A:

I am not sure what is meant by the word "reasonable" applied to the global settlement here, but on any meaning of that word, my answers are:

(1) No.

(2) Yes.

(3) Yes, but only in the sense that evidence of the figures at which Higgs & Hill settled with individual works contractors might (or might not) be helpful evidence of reasonableness or unreasonableness."

51. In the course of his judgment Judge Bowsher relied heavily on the judgment of Singleton LJ. in **Biggin v. Permanite** [1951] 2 KB 314 at pages 321-324 for the proposition that in a case where a party claims as part of his damages the amount which he has paid by way of settlement of a claim on him by a third party it is not sufficient to establish his loss that he reasonably entered into the settlement agreement: he must go further and prove that the sum paid in settlement was in itself reasonable. In substance, that meant that it must be established that the amount recoverable had the arbitration proceeded would have been "somewhere around the figure at which the plaintiffs had settled". Whereas it was relevant that the settlement figure had been the subject of legal advice to the plaintiff, that in itself did not prove reasonableness. It was for the court to investigate what would have been recovered had the arbitration fought and damages been awarded against the plaintiff. Evidence of the terms of the settlement was thus held by Judge Bowsher to be relevant and admissible both as a rule of evidence and because under the second rule in **Hadley v. Baxendale** (1854) 9 Ex 341 the reasonable settlement of claims may be a matter which the parties may be held to have had in reasonable contemplation.

52. As to the reasonableness of the global settlement figure it is clear from page 14 of the judgment that, by reference to the approach of the Court of Appeal in **Biggin v. Permanite**, it was held that in determining whether a global settlement figure is reasonable it is necessary to consider what would be reasonable for each of the separate claims covered by the settlement. Hence, Judge Bowsher concluded that questions A(1) and A(2) should be answered No and Yes respectively.

53. In that case the court was confronted by a claim for damages for breach of contract and the issue was what evidence would be admissible for the purpose of proving the amount of damages recoverable in respect of the settlement agreement. The amount paid could only be shown to be reasonable by

determining whether what would have been payable as damages absent a settlement was somewhere close to what had been paid under the settlement for the cost of the individual claims. The court could thus investigate the comparative position and decide reasonableness, but reasonableness of any given amount allocated to a separate claim would not be proved by the reasonableness of the amount of the global settlement.

54. The deployment of this judgment in support of the proposition that the court can open up a global settlement and evaluate for reasonableness the assured's own assessments of the amounts allocated to each claim against the assured reflects the assumption underlying the submissions advanced on behalf of Bovis that the function of ascertainment of loss in the context of liability insurance is identical to the process of proving the amount of loss caused by breach of contract where the consequence of such breach is liability of the claimant to a third party with whom a settlement has been entered into. As appears from paragraphs (38) to (43) of this judgment, that assumption is fallacious. In the context of liability insurance the process of ascertainment is not merely the process of evidencing loss but represents that stage in the assured's relationship with the third party by which he sustains those compensatory liabilities to the third party specifically identified by the judgment, award or settlement agreement which, by the terms of the policy, is an essential element in the cause of action against insurers. There is no similar mechanism, which operates as a pre-condition to the cause of action for an ordinary breach of contract. The claimant has his cause of action regardless of whether there was a judgment, award or settlement of a third party's claim against him. His only concern is to establish the measure of damages and for this purpose the judgment, award or settlement are likely to provide the necessary evidence, although, as appears from **P&O Developments**, supra, this may not be of great weight in the case of the settlement agreement especially if it is a global settlement. Having regard to these considerations, the decision of H H Judge Hicks QC in **Royal Brompton Hospital National Health Service Trust v. F A Hammond**, supra, takes the matter no further.

55. For these reasons I have no doubt that a global settlement agreement of the nature of that found in the present case does not satisfy the requirement of ascertainment of loss under these liability insurance policies. It does not impose on the assured any identifiable loss in respect of any identifiable insured eventuality. It merely identifies the overall price paid by the assured as consideration for a contract which conferred on the assured various different benefits including the dropping by Braehead of all claims in respect of the project.

56. The argument advanced by Bovis that so to characterise the process of ascertainment would be contrary to public policy because it would be inconsistent with the policy of encouraging the settlement of claims cannot be correct. Once the purpose and scope of the implied term by which this pre-condition is imposed have been defined - as they have been in the cases leading up to Bradley v Eagle Star Insurance, supra, it is not for this court to superimpose a derogation from the effect of this term which would depart substantially from the conceptual basis underlying what has been firmly developed now in the field of liability insurance.

57. It follows that issues 1(a) & (b) must be answered No.

58. It further follows that issue 2 must also be answered No. An insured loss can only be quantified by reference to the mode of ascertainment in question, which in this case is the Settlement Agreement. If that agreement does not specifically identify the cost to the assured of discharge of the claim or claims said to be within the scope of the cover, the ascertainment of the relevant loss to the assured cannot be supplied by extrinsic evidence, whether of objective or subjective evaluation.

Issue 3

Submissions

59. It is submitted on behalf of Bovis that the words "***as a result of any neglect error or omission***" in insuring clause 1 of the primary policy cover non-negligent errors or omissions and further do not require Bovis to establish that it committed the tort of negligence and that it is enough that Bovis's liability resulted from a negligent act or omission. The words "error or omission" are wide enough to include non-negligent errors or omissions provided they were not deliberate. The overall purpose of the policy was to protect the assured against liability incurred in the course of carrying out the activities and duties

involved in the projects save in so far as the policy expressly reduced the scope of the cover by means of specific exclusions. Since there is no exclusion in respect of non-negligent breaches of contract, the mutual intention must have been that the words "***error or omission***" were wide enough to cover the non-negligent activities or inactivities of the assured. In support of this submission Bovis rely on the decision and reasoning of Webster J in **George Wimpey & Co Ltd v D.V.Poole** 27 BLR 58.

60. On behalf of the Insurers Mr Kealey submits that, although there is no direct authority on the point, the sense of the Insuring Clause requires that those words connote negligence in general, negligent but non-deliberate error and negligent but non-deliberate omission. He refers to authorities, which, while not directly referable to identical wording or the identical issue of construction suggest that negligent conduct is essential. In particular, he relies on a passage from the judgment of Clarke L.J. in the Court of Appeal in **McDonnell Information Systems v Swinback** (1999) Lloyds Rep I&R 516 at p.520, a passage from the judgment of Goddard L.J. in **Goddard & Smith v Frew** (1939) 4 All ER 358, a comment made by Porter J. in **Davies v Hosken** (1937) 3 All ER 192 at p.193 and a reference by Devlin J. in **West Wake Price & Co v Ching** (1957) 1 WLR 45 at p.47.

61. Further, as to Issue 3(b)(ii) there is no cover for non-deliberate breach of contract which does not result from neglect, error or omission.

Issue 3: Discussion

62. Analysis of those judgments to which I have referred relied upon by the Insurers shows that in none of the passages did the Court take a concluded view on whether the words "***error or omission***" imported proof of negligence. None of those cases go any further than supporting the proposition that the error or omission must be non-deliberate and that it must be such as to give rise to liability on the part of the assured: as to the latter, see **Haseldine v. Hosken** (1933) 1 KB 822, where the words were "***neglect, omission or error***" at page 837 per Greer L.J: *"What it [the policy] was intended to do was to cover the case of a solicitor who, in conducting the business of his client, either in conveyancing or when representing him in litigation, made a mistake about the facts or a mistake about the law, or did something while acting on behalf of his client which rendered him, the solicitor, liable to a third party."*

63. In **McDonnell Information Systems v Swinback** at first instance at (1999) Lloyds Rep I&R 98, where the relevant words were "any neglect or omission including breach of contract occasioned by same", insurers conceded that "the words extend beyond negligence alone but do not embrace deliberate neglect or error or deliberate omission to do that which the insured knows he must do" (at p.100L). There was an exclusion in the insuring clause as follows: *"The Assured will not be indemnified against any claim or loss, resulting from the dishonest, fraudulent, criminal or malicious act(s) or omission(s) perpetrated after the assured could reasonably have discovered or suspected the improper conduct of the employee(s)."*

64. The issue in that case was the effect on the right to indemnity of the inclusion of dishonesty where none was relied upon by the third party in its claim. It was thus not necessary to consider the impact of non-negligent omission or error, which did not involve dishonesty. In the Court of Appeal Clarke L.J. at p.520L, having referred to the common ground as to the meaning of the clause observed: *"In short clause 2(a) is a neglect or negligence clause, whereas clause 2(b) may be described as a dishonesty clause."*

65. At p.523L of his Judgment Clarke L.J further concluded as to the meaning of the clause: *"In my judgment, when clause 2(a) is read in the context of clause 2 as a whole and when it is borne in mind that this is an indemnity policy, the correct construction of it is clear. It is that underwriters will be liable where the proximate cause of the loss ascertained by judgment award or compromise was one of the perils set out in clause 2. In this way underwriters are not liable, not only if the proximate cause of the loss is the dishonesty of the insured itself, but also if the proximate cause of the loss was not neglect but dishonesty of an employee perpetrated after MDIS could reasonably have discovered or suspected the improper conduct of the employee concerned."*

66. It is thus clear that in commenting on the meaning of the clause he was concerned to distinguish between events which fell within the insured perils in clause 2(a) on the one hand or the dishonesty of the insured or an employee on the other. He was not concerned to distinguish for the purposes of the issues in that case between negligence and non-negligent error or omission. This judgment is not authority which goes to the issue now before the court.

67. In **George Wimpey & Co Ltd v D.V.Poole**, supra, the relevant words in the policy were expressed in two ways: "***any negligent act, error or omission***" and "***any error, omission or negligent act***". Clearly the former word order could be constrained as referring to negligent error or negligent omission. However, Webster J held that, properly construed, the words referred to non-negligent error or omission: see pages 92-93

68. In the present case the words in clause 1 are *"1. any neglect error or omission or breach of warranty of authority in the conduct of the Insured or of any party presently or previously employed or engaged by the Insured or for whom the Insured is responsible."*

69. Obviously, a breach of warranty of authority can be negligent or non-negligent on the part of the person giving it. So, as a matter of commonsense, there can be no question of the clause singling out negligent breaches of warranty of authority. It is obviously designed to protect against liability for all such breaches save those deliberately and knowingly caused. If this peril does not necessarily require negligence, it is hard to see why "***error or omission***" should incorporate such a qualification. "***Neglect***" clearly involves negligent conduct, specifically a negligent omission. If so, there is no need to re-iterate negligent omission by using "***omission***". Similarly with error.

70. In the result I have no doubt that "***error or omission***" are intended to refer to non-negligent conduct giving rise to liability, for example the liability under **Reynolds v Fletcher** or in conversion.

71. Accordingly I would answer issue 3(a): No.

72. As to issue 3(b), the question arises whether clause 1 has any application to liability for breaches of contract if not proximately caused by negligence. The Insurers concede that liability in respect of a breach of contract proximately caused by negligence would be an insured peril. That would be because the word "***neglect***" in clause 1 would provide for such cover whether or not the facts also gave rise to a breach of contract. Clause 1, in contrast to clause 2 is clearly directed, albeit not exclusively, to liability arising independently of contract. Clause 2 is a provision as to cover, which is exclusively concerned with cover in respect of those breaches of contract described. Consequently clause 1 must be directed to those liabilities which may arise independently of constituting a breach of contract. Thus, if the assured can be sued in tort for non-deliberate neglect or error or omission or for non-deliberate breach of warranty of authority without formulating the claim as one for breach of any contract between the assured and a third party, there will be cover under clause 1, subject to the other provisions of the policy.

73. Accordingly, issue 3(b) is to be answered to the effect that there will be cover under clause 1 in respect of liability caused by facts amounting to a breach of contract but not giving rise to an independent claim for negligence where those facts give rise to liability for non-negligent and non-deliberate error or omission which would arise even if there were no parallel contractual liability.

ISSUE 4

74. It is agreed that Issue 4(a) should not be considered at this hearing.

75. As to Issue 4(b), it was provided by clause 2.5.2 of the building contract as follows. *"Insofar as the design of the Works is comprised in the Contractor's Proposals and in what the Contractor is to complete under clause 2 and in accordance with the Employer's Requirements and the Conditions (including any further design which the Contractor is to carry out as a result of a Change in the Employer's Requirements), the Contractor warrants and undertakes to the Employer that:*

2.5. Works comprise or will comprise only materials and goods which are new and of sound and satisfactory quality, and all workmanship, manufacture and fabrication will be to standards appropriate to the nature of the project of which the Works form part."

76. Policy memorandum 7(i) provided as follows: *"the indemnity in respect of breach of any express warranty or guarantee will apply only to such contracts as are disclosed to the Insurers by means of an annual declaration to be made by the Insured prior to the expiry of the Period of Insurance."*

77. It is argued on behalf of Bovis as follows:

i) The indemnity referred to in memorandum 7(1) is that set out in Clause 2, namely: *"breach of warranty or guarantee of the fitness or suitability for purpose or the reasonable fitness or suitability of any work or*

materials which are the subject of a contract (including any deed of collateral warranty or duty of care agreement) entered into by the Insured, or by any party on behalf of the Insured

ii) the warranty given at clause 2.5.2.5 of the Building Contract did not go to the fitness or the suitability of any work or materials used for the works: it related only to the quality of the materials and goods and to the standard of workmanship, manufacture and fabrication. The requirement in memorandum 7(i) had no application to mere quality warranties unless the fitness or suitability for a particular purpose was expressly warranted.

iii) Consequently, memorandum 7(i) did not have the effect of excluding from for the scope of the indemnity liability for breach of clause 2.5.25 even although the contract in this case had not been disclosed to the insurers in an annual declaration by Bovis.

78. On behalf of the Insurers it is submitted that the reference in clause 2.5.2.5 to the materials and goods being new and of sound and satisfactory quality could only be understood as referring to the goods and materials being satisfactory or suitable for the purpose of the works into which they were incorporated. Further, the warranty that workmanship manufacture and fabrication would be to "***standards appropriate to the nature of the project***" of which the works formed part was also in substance a warranty of the fitness or suitability for purpose of the work carried out. Accordingly, since there had been no declaration of the contract, there was no cover in respect of liabilities defined by writing clause 2.

79. Attention was focused in the course of argument on the distinction between the conditions implied by law into a contract for the supply of goods and services under section 4(3),(2a),(4) and (5) of the Supply of Goods and Services Act 1982. On the one hand there is the condition that the goods should be of *"**satisfactory quality***" (the same phraseology as in clause 2.5.2.5) in the sense that they should meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances and on the other hand there is the condition implied in section 2 (5) of reasonable fitness for a purpose for which it has been expressly or implicitly made known to the supplier that they are required.

80. It is reasonably clear that Insuring Clause 2 is at least intended to cover express as distinct from implied warranties of fitness for purpose analogous to the condition implied in Section 2 (5) of the 1982 Act. However, it is to be observed that Clause 2 applies not only to goods (materials) supplied under a construction contract but also to "***any work***" which is subject to the contract. Further, it clearly has a wider application than the fitness or suitability for purpose of the materials or work. This is apparent from "***or the reasonable fitness or suitability of any work or materials***." These are to be contrasted with the preceding "***fitness or suitability for purpose***" and accordingly they must refer to fitness or suitability in the broader sense analogously to that contemplated by Section 4 (2A) of the 1982 Act – by the words "***satisfactory quality***", but not related to any particular design or management purpose. Thus, both with regard to materials and to work carried out the scope of the insuring clause extends to intrinsically satisfactory quality.

81. Clause 2.5.2.5 is an express warranty which, in as much as it relates to materials and goods, relates to the intrinsic quality of what is to be supplied, as distinct from its fitness for a particular purpose, and in as much as it relates to workmanship, manufacture and fabrication, relates to the intrinsic quality of such work and arguably the suitability for purpose. It follows that obligations assumed under that clause fall within the scope of the indemnity of insuring Clause 2. Accordingly, if there is failure to comply with the registration requirement under Memorandum 7(i), there is no cover in respect of loss exclusively attributable to breach of Clause 2.5.2.5. If, however, the liability will arise, for example in the tort of negligence, independently of contract, insuring Clause 1 would in principle provide cover.

82. It follows that Issue 4 must be answered No, but the same facts could give rise to coverage under Insuring Clause 1.

Mr Gavin Kealey QC and Mr David Allen (instructed by Messrs Kendall Freeman) for the Claimants
Mr Roger Stewart QC and Mr Paul Sutherland (instructed by Messrs Masons) for the Defendants