JUDGMENT : The Hon. Mr Justice Langley : Commercial Court. 3rd March 2006

The Application

1. The second-named Defendant (GTI) seeks a summary judgment dismissing the claim by the Claimant insurers ("Brit"). Brit seeks a summary judgment against GTI for a declaration. The issues arise under a Professional Indemnity Policy for the period 15 December 2003 to 14 December 2004 ("the Policy"). GTI claims that the Policy entitles it to an indemnity in respect of a claim brought against GTI; Brit claims that it does not. The point is one of construction. In particular, the construction of "Extension 3" to the Policy.

The Policy

2. GTI is a not for profit corporation incorporated in Illinois, USA. It is the "*umbrella*" corporation which manages and maintains a worldwide organisation of member firms which practice under the Grant Thornton name. GTI has no practice or clients of its own. The first-named Defendant was, until 8 January 2004, when it was expelled, a member firm under the name, Grant Thornton S.p.A. I shall refer to it as "*GT Italy*".

3. GT Italy was, along with 93 others, a named member firm in a schedule to the Policy and so an "*Assured Firm*" as defined in the Policy. The insuring clause (clause 1) provided professional indemnity cover for two interests:
   i) *"to indemnify an Assured Firm against any claim or claims solely in respect of International Work"* ("*International Work*" was defined but can sufficiently be described as work done by one member firm for, or for a client of, another member firm);
   ii) "*to indemnify an Assured Firm should an Assured Firm by reason of its membership in Grant Thornton International be held legally liable for any negligent act, error, omission, breach of duty, whenever or wherever the same was or may have been committed or alleged to have been committed on the part of another member firm of Grant Thornton International … in or about the conduct of any Professional Services conducted by or on behalf of such other firms*".

4. GTI itself is not listed in the schedule of member firms to the Policy. Section III, clause 3 of the Policy ("Extension 3") provided that:
   "*Grant Thornton International is included as an Assured Firm but solely in respect of claims made against Grant Thornton International arising from claims made against a member firm of Grant Thornton International insured by the terms and conditions of this policy*."

5. It is the words I have emphasised, and in particular the last nine words, which give rise to the issues.

The claims under the Policy

6. At the end of March 2004, GTI gave notice to Brit of third party claims brought against GTI and GT Italy in the USA arising out of the audit by GT Italy of a subsidiary of Parmalat Finanziaria, S.p.A. ("Parmalat"). The claims were class action suits at the instance of investors complaining of violations of United States securities laws. GTI's liability was alleged to arise as an entity said to be in control of GT Italy. As Mr Guy Philipps QC, for GTI, put it it was "*precisely the type of claim against GTI to which the second limb of the insuring clause … and [Extension 3] are directed.*"

Avoidance

7. By letter dated 1 August 2005, Brit's solicitors wrote to GTI's General Counsel advising him of "*the avoidance … of the insurance of … GT Italy*" by a letter to GT Italy of the same date, which was enclosed. The letter to GT Italy referred to matters which had not but should have been disclosed prior to the inception of the Policy and the falsity of information provided by GT Italy in a Questionnaire which was agreed to "*form the basis*" of the Policy and continued:
   "Accordingly, and in view of GT Italy's failure to disclose such material information to insurers prior to 15th December 2003, insurers hereby give notice of their avoidance of the Policy ab initio, and tender the return to you of the relevant insurance premium in the sum of USD 3,731.35.
   Alternatively, and without prejudice to insurers' claim to have validly avoided the Policy, the declaration that was contained in the Questionnaire and that was signed by Mr Penca, consisted of an absolute and unqualified declaration by him that the statements and particulars given in the Questionnaire were true and that no material facts had been misstated or suppressed. The declaration, by virtue of the "basis of contract" provision contained within the declaration, constituted a warranty by Mr Penca on behalf of GT Italy as to the matters stated by him in the declaration.
   In the circumstances, and alternatively to insurers' claim to have validly avoided the Policy, the failure by GT Italy to disclose that one or more of its partners or principals knew of matters which "they [felt] could give rise to a claim(s)" against GT Italy, constituted a breach of warranty on the part of GT Italy, with the result that insurers are automatically discharged from any further obligations to GT Italy from the date of the breach, which was 15th December 2003, the date on which the declaration acquired contractual effect by virtue of the inception of the Policy."

8. The letter to GTI itself stated:
   "We write to you, not simply as a courtesy, but also to advise you that since the insurance of GT Italy has been avoided ab initio, there is correspondingly no cover available to GT International under the Insurance. This is because the ab initio avoidance of GT Italy's insurance means that GT Italy is to be treated as never having been an Assured or Member Firm under the insurance.

Since GT International is only "included as an Assured Firm … in respect of claims made against [it] arising from claims made against a member firm of Grant Thornton International insured by the terms and conditions of [the] policy", it follows that the ab initio avoidance of GT Italy's insurance has the consequence that GT International is not to be "included as an Assured Firm" under the Insurance, since the claims made against GT Italy have not been made against "a member firm of Grant Thornton International insured by the terms and conditions of [the] policy".

There is thus no insurance cover available to GT International under the Insurance."

9. This letter states the issue, and Brit's case.

The Proceedings

10. Brit issued the present proceedings on 1 August 2005. The claim was for declarations that Brit had validly avoided the insurance of GT Italy by the Policy on the grounds of misrepresentation and/or non-disclosure by GT Italy, alternatively that Brit was discharged as from the date of the insurance or its inception from any obligation to GT Italy under the Policy by reason of breach of warranty by GT Italy, and that by reason of the avoidance and/or breach of warranty GTI "is not, pursuant to Extensions Condition 3 of the Insurance, *included as an Assured Firm … in respect of claims made against [it] arising from claims made against [GT Italy] and that [GT Italy],* by reason of the matters aforesaid, is not *a member firm of [GTI] insured by the terms and conditions of [the Insurance]* – and is thus not entitled to be indemnified by [Brit] in respect of the claims that have been brought against [GT Italy]".

11. The Particulars of Claim, whilst acknowledging (paragraph 2) that GT Italy was an Assured Firm under the Policy at its inception, alleged (paragraph 13) that the consequence of the avoidance or "*pre-inception breach of warranty"* was that GT Italy "*was not, at any time, a member firm of [GTI] insured by the terms and conditions of the Policy."*

The Applications

12. GTI issued its Application for summary judgment on 21 November 2005. The Application recorded that it was common ground that the claims in respect of which GTI sought an indemnity arose from claims made against GT Italy and averred that GT Italy was stated in the Policy to be a member firm of GTI insured by the Policy. It is Mr Philipps' submission that those two matters of fact are sufficient of themselves to entitle GTI to an indemnity.

13. Brit issued its application for summary judgment on 18 January 2006. It asserted that the effect of avoidance was that, as a matter of law, GT Italy was to be treated as never having been an insured under the Policy. The Application made no reference to the alternative claim of breach of warranty. Mr Edelman QC, for Brit, said that was a mistake. Mr Philipps did not oppose the matter being argued and adjudicated, albeit he submitted it was unsustainable.

The Default Judgment

14. On 21 February 2006, Brit entered judgment against GT Italy in default of any acknowledgement of service or defence being filed by GT Italy. The judgment was for a declaration that Brit had validly avoided the Policy for misrepresentation and/or non-disclosure "and/or that [Brit was] discharged, as from the date of the making of the contract of insurance, alternatively as from the date of its inception … from any obligation to [GT Italy] under the insurance" by reason of breach of warranty.

15. Mr Philipps submitted, and I agree, that the two declarations are inconsistent. A breach of warranty, even one said to bite at the date of the Policy, presupposes a contract in which the warranty is to be found. Non-disclosure, as is frequently stated and forms the basis of Brit's case, avoids a policy "ab initio".

The Submissions

16. The issue can be stated shortly and is apparent from the circumstances I have already set out.

17. Mr Philipps submits that Extension 3 is descriptive in stating the criteria upon which the cover for GTI is dependent. If (as it is) GTI is sued on a claim which arises from a claim made against a member firm named as such in the Schedule to the Policy then GTI is insured for the claim made against it.

18. Mr Edelman submits that the cover for GTI provided for by Extension 3 is only parasitic on effective cover for the claim made against the member firm.

What is not in issue

19. For the purposes of the present Application it is not in issue that:

    i) The claims made against GTI arise from claims made against GTItaly;

    ii) GTItaly was stated in the Schedule to the Policy to be a member firm of GTI;

    iii) Brit has validly avoided the cover of GTItaly; or GTItaly was in breach of warranty;

    iv) The Policy was a *"composite"* policy in the sense used in ***New Hampshire Insurance Co v MGN Ltd*** [1997] LRLR 24, namely that each member firm was an assured and insured separately, and thus avoidance against one insured does not discharge the insurer from liability to another innocent insurer. It is in issue whether or not GTI itself was separately insured in this sense;

    v) Not all member firms of GTI were insured by the Policy. No firm (other than GTI itself) based in the USA or the UK was covered: Exclusions 11. Mr Philipps pointed to that as a good reason why Exclusion 3 used the words "insured by the terms and conditions of this policy". Although Mr Edelman questioned this, and submitted by reference to other provisions of the Policy that the chosen criterion reflected a requirement for liability to the

"insured" member, I hope he will forgive me for saying that after discussion I think there was no substance to the point he sought to make.

Discussion

20. It is readily understandable that GTI, as an American corporation, would require cover for claims made against it arising from claims made against member firms. Extension 3 is the chosen mechanism of the parties to achieve that. In the event that such cover was lost to GTI as well as to the member firm through avoidance against the latter, Mr Edelman was able to suggest only very limited circumstances in which "*double cover*" for both GTI and the member would serve any commercial purpose. His suggestions were legal costs and possible exposure to double damages or the like. If Mr Philipps is right, the cover would be both "composite" and commercial. I agree with Mr Philipps that the fact that Extension 3 provides for GTI to be "*included as an Assured Firm*" in respect of the claims referred to points to GTI itself, like each member firm, being a separate assured in the ***New Hampshire*** sense in respect of such claims.

21. The authorities which emphasise the effect of avoidance to be that the policy is avoided from the outset give rise to or at least reflect the well-established law that when a policy is avoided the remedies are restitutionary. Mr Edelman referred the court to a number of authorities in which the courts have expressed the principle forcibly in those terms: see, for example, Lord Atkinson in ***Abram Steamship v Westville Shipping*** [1923] AC 773 at 781; ***Cornhill Insurance v Assenheim*** [1937] 58 Lloyd's LR 27 per Mackinnon J at page 31; and Lord Hobhouse in ***Manifest Shipping v Uni-Polaris Insurance Co (the "Star Sea")*** [2003] 1 AC 469 where Lord Hobhouse distinguished pre-contract from post-contract want of good faith stating (at paragraph 51) in respect of the former where it gave rise to a right to avoid:

"It applies retrospectively. It enables the aggrieved party to rescind the contract ab initio. Thus he totally nullifies the contract. Everything done under the contract is liable to be undone."

22. Mr Philipps countered by referring to ***Mackender v Feldia*** [1967] 2QB 590. The context was whether or not a Belgian jurisdiction clause in an insurance policy applied notwithstanding allegations of non-disclosure. The Court of Appeal held that it did. Lord Denning, at page 598, said non-disclosure made a contract voidable not void; "*the contract is not avoided from the beginning but only from the moment of avoidance*". Diplock LJ, at pages 601 to 604 drew the same distinction between a void contract ("not a contract at all") and a voidable contract. In the latter case, when the contract is avoided "*that does not mean that the contract never existed but that it ceases to exist from the moment of avoidance, and that upon it ceasing to exist there may arise consequential rights in respect of things done in performance of it while it did exist which may have the effect of undoing those things as far as practicable*". In McGillivray on Insurance Law, 10th Edn, para 17-31, these statements are questioned and the suggestion made that they can best be explained by the autonomy of the jurisdiction clause. In the same way an arbitration clause as a "collateral contract" is to be construed as such and so may apply notwithstanding allegations that the contract which contains it is illegal: **Harbour Assurance v Kansa General International Insurance** [1993] QB 701. Mr Edelman, understandably, relied upon this distinction.

23. For my part, I do not derive any real assistance in deciding the issue in this case from these authorities. Their application must depend on the question being asked. The question here is what does Extension 3 mean. If the words "insured by the terms and conditions of this policy" are descriptive of the member firms in the Schedule it is nothing to the point that the Policy has been avoided. If, on the other hand, they mean "entitled to an indemnity" or "validly insured" then there is no issue that such was not the case. What I do derive from the authorities, as might be expected, is that the court is not required to ignore reality, namely that, until it was avoided, GT Italy was not only a member firm but one which was in fact and in normal language "insured" under the Policy.

24. As Giles CJ succinctly put it in the Commercial Division of New South Wales, in ***FAI General Insurance v Ocean Marine Mutual*** [1998] LRIR 24 at page 28, addressing the use of words to the effect that a contract avoided ab initio is taken never to have existed:

"*The words are sufficient for most purposes, but they should not be taken literally. Neither rescission by a party nor a judges say so can turn the clock back to have that literal effect, and a contract avoided ab initio is not, in Newspeak, an uncontract.*"

25. The submissions in relation to breach of warranty can be addressed shortly. A warranty predicates a contract; in this case a contract of insurance, the Policy. The basis of the warranty, the letter of avoidance, paragraph 12 of the Particulars of Claim, and the wording of the default judgment each acknowledge as much. Nor do I think, despite Mr Edelman's submissions, that it makes any difference that the warranty in question bites at the time of the contract rather than during its term. The leading authority is ***Bank of Nova Scotia v Hellenic Mutual (the "Good Luck")*** [1992] 1 AC 233. Lord Goff, at pages 262-3, stated that:

"*subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty …. for the simple reason that fulfilment of the warranty is a condition precedent to the liability of the insurer …. Here, where we are concerned with a promissory warranty, i.e. a promissory condition precedent, contained in an existing contract of insurance, non-fulfilment of the condition does not prevent the contract from coming into existence. What it does … is to discharge the insurer from liability as from the date of the breach. Certainly it does not have the effect of avoiding the contract ab initio.*"

26. In my judgment, for this reason, Brit's case must be made on the principles of non-disclosure, if it is to be made at all.

Conclusion

27. I think the terms of Extension 3 are descriptive, as Mr Philipps submits, and not to be read as referable to liability to indemnify GTItaly, as Mr Edelman submits.

28. My reasons are:

i) The conclusion gives substance to the provision rather than the very limited effect for which Brit contends;

ii) I see no reason why the composite nature of the insurance should not extend to GTI as an *"Assured Firm"* when it fulfils the stated criteria. That is the language used. On principle, GTI should not then be affected by the conduct of other assureds, relative to their insurance, of which GTI was ignorant;

iii) The conclusion avoids the uncertainty which would arise if cover for GTI was dependent on the conduct of a member firm and whether the Policy responded to that member firm, which might, and often would, be in issue.

iv) I see no good reason to apply the principles of avoidance to a question of the construction of ordinary words and to the exclusion of the real factual position.

v) I do not think it material, despite Mr Edelman's submission, whether or not the word *"insured"* qualifies only the *"member firm*" or the "*claims made against a member firm*" or both. The question is whether or not, in any of those cases, they are merely descriptive of the type of claim or firm to which the criterion applies.

29. It follows that GTI is entitled to the judgment it seeks and the Application of Brit must be dismissed.

30. I will hear the parties on ancillary matters, if they cannot be agreed, when this judgment is handed down.

Mr C Edelman QC and Mr C. Wynter (instructed by Mills & Reeve) for the Claimants
Mr G. Philipps QC (instructed by Ashurst) for the Second Defendant