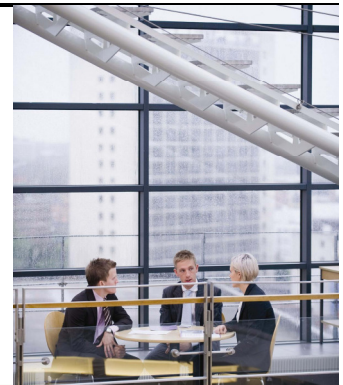


# Review

## Commercial & Dispute Resolution

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### Pulling cover : Lenders' claims under the Third Party (Rights Against Insurers) Act 1930

*Goldsmith Williams (a firm) v Travelers Insurance Company Limited* [2010] EWHC 26 QB reminds us of the problems faced by lenders bringing negligence claims where the Defendant's professional indemnity insurance cover has been withdrawn. Lenders must then make the difficult decision whether to make a claim under the Third Party (Rights Against Insurers) Act 1930 (the "Act"), a process which can be complicated, uncertain and expensive.

#### The facts

Mr Atikpakpa, a director of Joshua & Usman Legal Services Limited ("JULS") applied to Mortgages 5 for a loan of £541,579.70 to purchase a property in Poplar, East London. At around the same time, Mr Atikpakpa's wife applied to Mortgages 5 for a loan of £152,880 to purchase a property in Tulse Hill, South London from her husband. There was one other director of JULS: a Ms Usman.

Mortgages 5 instructed Goldsmith Williams to act on its behalf in both transactions, and Goldsmith Williams forwarded both advances to JULS. Neither transaction completed. It was not disputed in Court that Mr Atikpakpa stole the money advanced by Mortgages 5.

Mortgages 5 made a claim against Goldsmith Williams for the amount advanced and Goldsmith Williams paid Mortgages 5 £671,623.89 in settlement. In return, Mortgages 5 assigned its claim against JULS to Goldsmith Williams, who then obtained judgment against JULS (who made no attempt to defend themselves). JULS had in the meantime been the subject of a Law Society intervention and had entered into insolvency proceedings.

Travelers Insurance Company Limited ("Travelers") provided professional indemnity insurance to JULS. As JULS had entered into insolvency proceedings, under section 1 of the Act, Goldsmith Williams acquired the right to pursue the insurer, and therefore claimed the judgment debt from Travelers.

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**The Third Party (Rights Against Insurers) Act: expensive, uncertain but ultimately avoidable?**

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Travelers accepted that if it was bound to indemnify JULS in respect of the claim brought by Goldsmith Williams it was also liable to Goldsmith Williams, but declined to indemnify JULS, on the basis that the insurance policy contained an exclusion relating to claims arising from "*dishonesty or a fraudulent act*" "*committed or condoned*" by "*all directors of the company*".

Travelers' position was that the frauds committed by Mr Atikpakpa were facilitated by Ms Usman, and that the exclusion applied. Goldsmith Williams' position was that Ms Usman's actions in relation to the transactions were minimal and not fraudulent (she witnessed a signature and certified a copy of a passport on one transaction, and did not appear to have received a direct financial benefit) and therefore, as all directors of the company were not involved, the exclusion should not apply.

## The decision

Wyn Williams J considered that the appropriate test to be applied in judging whether there had been dishonest or fraudulent conduct was that in *Twinsectra v Yardley* [2002] 2 AC 164: "*before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised by those standards his conduct was dishonest*".

Having considered evidence gleaned from investigations into other transactions, Wyn Williams J found that Ms Usman:

- had engaged in mortgage fraud in her own right in relation to separate transactions;
- must have known that Mr Atikpakpa was also engaged in mortgage frauds; and
- was therefore undoubtedly aware of the Poplar transaction and, having helped to facilitate it (albeit without actively participating in the fraud or benefitting from it financially), it was "inconceivable" that she did not know that the transaction was fraudulent.

The Court then considered and applied the case of *Zurich Professional Ltd v Karim and Others* [2006] EWHC 3355 (QB) and concluded that if an insured condoned a course of conduct which was dishonest or fraudulent and that course of conduct leads to or permits the specific acts or omissions upon which the claim is founded the insurer is entitled to repudiate liability. The exclusion was therefore held to apply and the claim failed.

## Comment

This case highlights one of the key problems for lenders (or those who take an assignment of a lender's right to claim) in making a claim against negligent conveyancers with only two or three partners or directors. If the insurance company suspects that one partner has acted fraudulently, it is likely to investigate whether it should withdraw cover on the basis that all partners are implicated. If an insurer decides to withdraw cover it is not obliged to provide reasons to a lender. The lender is then faced with a choice:

- Do nothing and drop the claim; or
- Pursue the conveyancing firm, which will probably be unable to pay; or
- Put the conveyancing firm into insolvency proceedings (if they are not already in such a situation), and pursue the claim against the insurer using the Act.

Under the Act, a lender acquires the right to pursue the insurer upon the insured entering into insolvency proceedings but, to exercise this right, the lender must first obtain judgment against (or agree liability with) the insured. The insured cannot simply

consent to judgment or agree liability without the insurer's knowledge or agreement because this is likely to entitle the insurer to withdraw cover. The third option therefore progresses in one of two ways:

- If the insured is already in insolvency proceedings, the lender will need to either obtain consent to bring proceedings against a firm in administration, or apply to have the company reinstated to the Register. It will then need to obtain judgment or an admission of liability against the insured. Once it has this, it can finally make a claim against the insurer under the Act; or
- If the insured is not already in insolvency proceedings, the lender must obtain the judgment or admission of liability, put the insured into insolvency (for non-payment of the judgment debt) and then step into the insured's shoes and bring the claim against the insurer under the Act.

What sort of shoes will the lender be stepping into? Whilst lenders will have some idea of the content of the insurance policy from the minimum terms for professional indemnity insurance for solicitors set out at Appendix 1 of the Solicitors' Indemnity Insurance Rules 2009, the problem is that it is only at this stage that the insurer must explain and justify the grounds on which it withdrew cover, and only now that the full picture about the insured's activities may emerge.

The *Goldsmith* case is a good example: whilst one partner in a firm may have apparently acted innocently in the claim in question, her conduct on other files (which the lender would be unaware of) brought her innocence into question. Furthermore, lenders are unlikely to be able to count on the availability of witness evidence to help their case (in *Goldsmith*, one partner moved to Nigeria, and the other to Egypt).

Pursuing a claim under the Act is therefore risky and potentially expensive, and the Act has come in for extensive criticism through the years and was subject to a review in 2001 by the Law Commission.

### There is another way...

For lenders, the *Goldsmith* case is a pertinent reminder that a claim under the Act can be slow, complex, uncertain and expensive.

For insurers, the costs involved are also potentially very significant. Investigating cover will require the insurer to:

- Instruct two panel firms (one to investigate liability, the other to investigate cover), usually obtain Counsel's opinion, convene an indemnity conference and potentially go through an indemnity arbitration or defend proceedings for a declaration;
- Either defend the claim against the insured or risk allowing the lender to gain an uncontested judgment; and
- Defend a potential claim against the lender pursuant to the Act.

It is often the case that, if the claims against the insured consist of, for example, a modest number of residential conveyancing matters, the costs and risks associated with pulling cover may exceed the amount being claimed. If the lender and insurer can take a realistic view of the difficulties, uncertainties and costs facing the other party, it is our experience that there is scope for both to consider together from the outset the most cost-effective way of dealing with such claims.

## FURTHER INFORMATION

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