

## HKSA PII MASTER POLICY BULLETIN

*This Bulletin is prepared by Aon Risk Services Hong Kong Limited and Windsor Professional Indemnity Insurance Limited, the appointed brokers of the HKSA Professional Indemnity Insurance (PII) Master Policy (“the Brokers”).*

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### A. THE INSURANCE MARKET FOLLOWING THE WORLD TRADE CENTER ATTACK

There has been a great deal of publicity on the effect of the World Trade Center attack on the insurance industry and how this will impact on the insurance purchased by the public.

The professional indemnity insurance market, although not directly affected by the event, will nonetheless be affected indirectly as the full costs are established by the World-Wide insurance market.

The insurance market was already hardening at the beginning of 2001, as the capacity became more limited due to the decreasing number of available insurers. This led to premium rates beginning to rise. Capacity and rates were further affected by the failure of HIH Casualty and General Insurance Limited (“HIH”) and Independent Insurance Company (“Independent”). Following the events of September, many insurers have been either downgraded or put on credit watch by the rating agencies. In addition the reinsurance market, which suffered heavily from these losses, will greatly increase their premiums which in turn will see the direct insurers providing the policies to the public, raise their prices as future capacity becomes even more expensive.

For those Members insured with the HKSA PII Master Policy, the Brokers would like to reassure you that the premium rates charged this year will remain unaffected by the changes to the rest of the market as a result of the long term commitment given to the HKSA by the Insurers. It is still also possible to fix the rate until 2003 if a two-year policy is effected from 1 December, 2001.

For those Members not insured with the HKSA PII Master Policy, you are advised to contact your insurer/broker at the earliest opportunity to enquire as to the financial standing of your insurer and the likely change to your current premium rate that may be applied at your next renewal.

In relation to the other insurance policies purchased by you or your Practice, again you are urged to contact your insurer/broker for advice at the earliest opportunity.

## **B. RISK MANAGEMENT**

### *Causal Relationship Between Breach of Contract and Loss Suffered*

It has been a long established principle of law that even if a breach of duty is established, no loss and damage will be recoverable if too remote. This means that no damages will be payable by the wrongdoer if the act complained of has a relationship to the loss that is too remote. So it is the relationship between the wrongful act and the loss that is important and this relationship depends on each set of circumstances.

In order for the plaintiff to recover damages it must establish that the loss and damage were caused by the relevant breach of duty and were foreseeable. So there are two elements to the test and the plaintiff must establish both on a balance of probabilities. Relevant factors may include the sequence of events, knowledge of the implications of the transaction and any special circumstances which were known.

These principles apply to cases involving accountants.

When considering the recoverability of loss in professional negligence cases, it is important to evaluate the reason why the particular defendant was engaged and the level of his role in relation to the transaction in question and to each element of loss claimed. In essence, one should ask the question: was the particular loss within the reasonable scope of dangers against which it was the defendant's duty to provide protection?

The principle was illustrated in the following two cases:

1. Peter Lingham & Co v Karl Lonkvist [2001] Lloyd's Rep PN 885

This case concerned the advice given by Peter Lingham & Co ("PL & Co") on the profitability of a butcher's business, which turned out to be a bad bargain. Karl Lonkvist ("Lonkvist"), the purchaser of the business, alleged that PL & Co, the accountant to the sellers, had prepared untenably optimistic projections of the profitability of the business, upon which he relied in proceeding with his purchase. Lonkvist claimed damages from PL & Co for breach of its contract of retainer in the negotiation of finance for the purchase.

At first instance, the judge found that, in assisting Lonkvist in finding finance for his purchase, PL & Co had misrepresented the profitability of the business to a prospective lender ("the Bank"). The Bank, in the course of considering Lonkvist's application for loan, raised questions regarding some figures in Lonkvist's business plan. However, PL & Co had not carefully and accurately answered these questions. The judge held that PL & Co was in breach of duty in failing to ensure that the figures given to the Bank were accurate. PL & Co was held liable to Lonkvist for substantial damages on the basis that Lonkvist would have withdrawn from the purchase had PL & Co checked the accuracy of the figures and revealed the error.

The Court of Appeal concurred with the judge that PL & Co was in breach of duty in failing to answer carefully and accurately the questions put to it by the Bank. Nevertheless, the Court held that Lonkvist could not have suffered more than nominal damages as a result of the breach since he received the loan. The further issue was to consider whether the loss suffered by Lonkvist in the purchase was too remote. The Court decided that PL & Co had no duty to advise Lonkvist on the true trading position of the business or the wisdom of the transaction. There was no causal link between the soliciting of finance and the decision to

purchase. The duty owed therefore must relate directly to the loss suffered and this test had not been satisfied in this case.

Source: Barlow Lyde & Gilbert

## 2. Sasea Finance Limited (in liquidation) v KPMG [2000] 1 All ER 676

The Liquidators of Sasea Finance Limited claimed damages from their former auditors, KPMG, for failing to detect in the course of audit large scale thefts from the Sasea Finance Limited group of companies, and for failing to alert the directors of the fraud. The judge at first instance on the application that there was no arguable case, struck out the claim in relation to certain items of loss on the basis that they were not caused by KPMG's assumed breach of duty. He accepted that the auditor's alleged failings provided merely the occasion for the loss, and were not its cause. This argument was rejected by the Court of Appeal who held that the transactions which caused the loss were fraudulent or irregular and, accordingly, the sort of transaction in respect of which KPMG had a duty to warn. It followed that KPMG's presumed breach was causative in law of the alleged losses and that Sasea Finance Limited had an arguable case.

Source: Barlow Lyde & Gilbert

In the cases involving accountants as in others, causation gives rise to difficulties, primarily in the application of the principle to the huge variety of circumstances which arise. In the above two cases, judges in the appellants courts, despite applying the same principle as followed by judges at the first instance, came up with a different conclusion. Every case depends on its own facts.

### **C. POLICY RENEWAL**

The HKSA PII Master Policy will be due for renewal on 1 December, 2001. The Brokers have sent out forms to member practices to collect the necessary information in early October 2001. Enquiries are welcome all the

time. Member insureds can opt for either a one-year policy which carries an expiry date of 30 November, 2002 or a two-year policy where the cover will not expire until 30 November, 2003.

### **D. CLAIMS ARISING OUT OF WEBTRUST ACTIVITIES**

As mentioned in the March 2001 Issue, the HKSA PII Master Policy has been extended to include the activities of Members under the WebTrust initiative. Cover is subject to each Member complying with the training and regulations imposed by the HKSA for conducting such activities.

Usual policy terms and conditions apply but as WebTrust activities could incur liabilities for Members in the USA or Canada, the HKSA PII Master Policy has been amended to respond to this. In respect of any claim made or legal proceedings made within the USA and/or Canada and/or territories which come under the jurisdiction of the USA and/or Canada (including the enforcement by courts of any other country of any judgement originally obtained in any court of the USA and/or Canada) the HKSA PII Master Policy can respond, subject to its existing terms and conditions, but Members should also note that any such claim shall be subject to the following additional conditions:-

- The maximum amount payable shall not exceed in the aggregate the sum insured as specified in the schedule.
- Any costs and expenses incurred during the investigation, defence and settlements shall be included within the annual aggregate limit and deductible as specified in the schedule.
- You shall not be covered for:-
  - Any punitive and/or exemplary damages.

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- Claims based upon the Employment Retirement Income Security Act of 1974 and any amendment thereto.
- Claims arising out of any actual or alleged violations of the Racketeer Influenced and Corrupt Organization Act 18 USC Sections 1961 et seq and any amendments thereto.
- Claims arising out of actual or alleged violation of any of the provisions of the Securities Act of 1933, the Securities Exchange Act 1934 or any similar Federal or State law or any common law relating thereto.
- Claims arising out of seepage, pollution and/or contamination howsoever caused.

**IMPORTANT NOTES:**

1. Do **NOT** assume policies other than the HKSA PII Master Policy provide similar cover for these activities.
2. Contact the Brokers with any concerns or questions that you have in relation to the protection provided by this improvement.

**E. COLLAPSE OF HIIH AND INDEPENDENT**

You will have seen from reports in the press that the insurance industry has been rocked recently by the news that two Insurers, HIIH and Independent, have been placed into provisional liquidation/liquidation.

HIIH is a general insurer based in Australia. It was placed into provisional liquidation there on 15 March, 2001 and subsequently went into liquidation on 27 August, 2001. Some HIIH companies are based in Hong Kong, and most of these were placed into provisional liquidation in Hong Kong on 9 April, 2001.

Independent is based in London. It was placed into provisional liquidation on 18 June, 2001.

HIIH and Independent are underwriters of professional indemnity insurance and all professionals, including accountants need to check their insurance policies to see if they were insured by either. Remember to check policies of previous years. This will be relevant if you have claims in previous years which remain active.

Many of the companies that form part of the HIIH group may not be immediately identifiable as "HIIH" does not appear in the company name.

If you are in any doubt about whether your cover has been placed with HIIH or Independent, you are advised to consult your insurance advisor immediately.

**F. MEMBERS' QUESTIONS ANSWERED**

1. *Does my practice still have cover if we have an HIIH or Independent insurance policy?*

Generally speaking, the insurance policy will remain in place for the time being and the provisional liquidation/liquidation will not automatically terminate the policy. However this may change in future.

With an Insurer in provisional liquidation/liquidation there is a real risk that claims payments may be reduced and may be delayed.

You should consult your insurance adviser immediately to consider the effect of the provisional liquidation/liquidation on your policy and whether alternative cover should be found.

2. *I have a client which is a party in legal proceedings and has made a claim under its insurance policy where that Insurer is*

You should consult your insurance adviser immediately to consider the effect of the provisional liquidation/liquidation on your policy and whether alternative cover should be found.

2. *I have a client which is a party in legal proceedings and has made a claim under its insurance policy where that Insurer is now in provisional liquidation. Will this affect the claim?*

Yes. In most cases, the provisional liquidators are unlikely to continue financial support for the legal action until the financial position of the insurance company has been fully assessed.

This means that Insureds in such a situation must act prudently, as if uninsured. So, Insureds must fund the litigation and seek to reclaim under the policy from the insurance company in provisional liquidation. Like any other claims, the extent of and timing of any claims payments from the insurance company in provisional liquidation is uncertain.

Your client may require advice on making adequate financial provision.

3. *I have a policy with HIH covering a period of 12 months from 1 February, 2001. For fear of inadequate cover following the demise of HIH, I have arranged a second*

*policy with another insurer in mid May 2001. Can I benefit from both policies?*

In general, the answer is no. Most of the policies contain the so called "Other Insurance" clause where in the existence of other policy or policies, the policy will only cover claims in excess of the amount of payment from such other policy. If for example both of your policies are insuring at a limit of HK\$10M and both policies contain the "Other Insurance" clause, it is possible that your first HK\$10M loss is not protected.

While most of the policies carry the "Other Insurance" clause, some policies may carry the "Contribution" clause, which state that in the existence of any other policy or policies, the insurer will be entitled to claim contribution from the other insurer. Therefore there is possibility that 50% of your loss under the HIH policy is not covered.

Therefore when considering a new policy to replace HIH, it is important that you have a resolution for your HIH policy, i.e. either cancel the HIH policy or carefully structure your new policy in the way that none of the above mentioned clauses will apply.

**IF YOU HAVE ANY DOUBTS OR QUESTIONS, YOU SHOULD CONSULT YOUR INSURANCE BROKER.**

~ END ~

The contents of this Bulletin are for general guidance only. Any Members who feel that any of the points raised may be relevant to them should contact the PII Hotline for specific advice. Comments regarding coverage in this Bulletin refer to the HKSA PII Master Policy only.

Please call Aon Risk Services' (HKSA) PII Hotline if you have any doubt.

TEL : 2862 4242 / 2862 4243

If you are insuring PI elsewhere, it is recommended that you review your existing policy to ensure that it provides sufficient coverage for your needs. Should you need any professional advice, Aon Risk Services Hong Kong Limited would be able to provide any assistance required.

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I would like to know more about :-      Signed .....

the topics in this issue      Name .....

the HKSA PII Master Policy      Position.....

Practice.....

Tel No. ....

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