

Judgment 17/2009

**Woodbourne Trustees Ltd v Generali Worldwide
Insurance Company Ltd – Royal Court (Civil Action
File 993) – 8 April 2009**

Civil procedure – Royal Court Civil Rules, 2007 (Rule 38) – proper extent of 'case management' – interpretation of an implied term – whether a matter of pure law or to be viewed in the context of the parties' contractual relationship – relevance of expert evidence – held that the interpretation of the implied term, including the meaning of 'unreasonable' in this context, could not be resolved as a preliminary issue.

IN THE ROYAL COURT OF THE ISLAND OF GUERNSEY

Civil 993

The 1st day of April 2009 before Richard John Collas Esquire, Deputy Bailiff, sitting alone

Between:

WOODBOURNE TRUSTEES LTD

Plaintiff

**(previously R & H Trust Co (Bermuda) Limited)
A company incorporated pursuant to the laws of Bermuda**

-and-

GENERALI WORLDWIDE INSURANCE COMPANY LIMITED

Defendant

Whereas on 12th February 2009 the Deputy Bailiff considered an application by the Plaintiff in the following terms;

For an order [in accordance with Royal Court Civil Rules 2007 Rule 38(1) and (2) (b) (c) (d) (h) and (l)] that the following issue be heard as a preliminary issue of pure law in this matter:

“Whether the correct legal test to apply to the facts to establish whether a decision maker (not being a public body) exercised its contractual discretion in a manner that was “unreasonable, perverse or capricious” (i.e. in bad faith) thus entitling the Court to interfere with that decision is:

“that the decision maker came to a conclusion unreasonable in the sense of being arbitrary, perverse or capricious as it had no basis for reaching its decision”.”

and heard thereon Advocates A M Ozanne and C H Edwards counsel for the Plaintiff and Defendant respectively, the Deputy Bailiff this day handed down judgment in the terms attached hereto and **DECLINED** to order the hearing of a preliminary issue as sought.

**S M D ROSS
H M Deputy Greffier**

**IN THE ROYAL COURT OF GUERNSEY
ORDINARY DIVISION**

Between:

WOODBOURNE TRUSTEES LTD

Plaintiff

(previously R & H Trust Co (Bermuda) Limited)
A company incorporated pursuant to the laws of Bermuda

-and-

GENERALI WORLDWIDE INSURANCE COMPANY LIMITED

Defendant

Before:

Richard John Collas Esq., Deputy Bailiff

Judgment handed down: 8th April 2009

Advocate for Plaintiff: A M Ozanne
Advocate for Defendant: C H Edwards

Cases, texts & legislation referred to:

1. Civil Procedure Rules, part 60, section 2c - 95
2. Royal Court Civil Rules 2007, Rule 38(2)(c)
3. *Lymington Marina Ltd v Macnamara and others* [2007] EWCA Civ 151
4. *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223
5. *Gan Insurance Company Ltd v The Tai Ping Insurance Company Ltd* [2001] 2(Comm.)299
6. *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] 1 Lloyd's Rep. 558
7. *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472
8. *BP Refinery (Westernport) Pty Ltd v The President, Councillors and Ratepayers of Shire of Hastings* (1978) 52 ALJR 20

1. The facts of this matter have been pleaded at some length but they can be adequately summarised for the purposes of this application in a few sentences. The Plaintiff is in the business of providing trust services and the matter concerns three trusts known as the Spring Trust, the Summer Trust and the Winter Trust of which the Plaintiff was appointed trustee following the removal from office of another trust company. Each of the Trusts owned either an annuity contract or a life insurance policy issued by the Defendant (together "the Policies"). After the Policies had been issued, the fees payable to the Defendant were re-negotiated and the agreed, revised, fees were recorded in an endorsement to each of the Policies (known as Endorsement number one). The material wording of each endorsement was identical. The agreed fee

reductions were to apply on condition that the funds remained invested for five years unless a specified event occurred, including that:

“This condition will no longer apply in the event of the occurrence of any of the following: ...

Fee levels do not remain substantially competitive with market competition, as judged by the trustees.”

2. The Plaintiff alleges that in May 2003, shortly after being appointed trustee of the Trusts, it decided that the fees were not competitive with market competition. Its decision was, apparently, based upon a report prepared by the National Insurance Consulting Group of Deloitte & Touche (located in Boston) who were engaged by the settlor of the Trusts to assess the fees. Early in 2004, after the Plaintiff had established that the policies could not be transferred *in specie*, it gave notice to the Defendant to surrender the Policies with the intention of using the proceeds to acquire new policies from new insurers. The Defendant disagreed that the fee levels were uncompetitive and before remitting the proceeds of surrender it deducted fees calculated not in accordance with the agreed reduced rates but the higher level of fees to which it would be entitled if the Plaintiff was unjustified in giving early notice of surrender.
3. The present application arose out of an application by the Plaintiff, in a Case Management Conference, to limit the scope of expert evidence to be adduced at the trial. Skeleton arguments were produced on that issue for a hearing in December that was rescheduled for 19 January. At that hearing I had three written arguments: two from Advocate Ozanne for the Plaintiff dated 29 August and 25 September respectively; and one from Advocate Edwards for the Defendant dated 5 September.
4. The Defendant has pleaded (in paragraphs 11 and 12 of its Defences) that:

“11. It was an implied term of the Policies and/or of Endorsement Number One that the Plaintiff would not exercise its judgment unreasonably, perversely or in bad faith”

“12.....Moreover, the Defendant denies that:

- (i) the Plaintiff exercised any judgment at all;*
- (ii) alternatively, that any purported exercise of judgment by the Plaintiff was reasonable and/or that the Plaintiff had any material on which to make any such purported judgment; and*
- (iii) the fee levels being charged at the time were not substantially competitive with market conditions within the meaning of Endorsement Number One.”*

5. At the hearing on 19 January, there was argument on the question of what “*unreasonable*” means in this context. The Defendant submitted that the implied term required the Plaintiff to take account of all relevant factors (whatever they may be), ignoring all irrelevant factors, and to take its decision “*honestly, in good faith, with genuineness and without arbitrariness, capriciousness, perversity and unreasonableness*” and submitted that was analogous to *Wednesbury* unreasonableness. The Plaintiff disagreed and said the Plaintiff was required to exercise its judgment “*without arbitrariness, capriciousness, perversity and unreasonableness such that no trustee would have reached that decision*”. (There is also an issue as to whether the Plaintiff exercised any judgment at all. However, that is a question of fact to be determined at the trial and is not relevant to the present issue.) The Plaintiff argues that public law principles of unreasonableness and, in particular, *Wednesbury* concepts should not be imported into commercial contracts.
6. On 19 January there was also argument as to whether, at the substantive hearing, the Court will have to hear evidence of what the market conditions were at the time of the decision to surrender the policies, as the Defendant alleges. Or, whether the reasonableness of the Plaintiff’s decision is to be assessed only by reference to the information that was then available to the Plaintiff and whether matters of which it was unaware are irrelevant, as the Plaintiff alleges. If the former is the correct test, it will involve expert witnesses in having to investigate the state of the competitive market at that time, thereby incurring expense in a, no doubt, time-consuming exercise that could be avoided if the latter is the correct test.
7. Advocate Ozanne, on behalf of the Plaintiff, submitted that Rule 38 (2) (c) of the Royal Court Civil Rules 2007 which specifies that the Court’s duty to manage cases includes “*deciding promptly which issues need full investigation and trial and accordingly disposing summarily of the others*” required me to decide this issue now in order to save expense and in the hope that it might lead to a speedy resolution.
8. I did not disagree with the need to try to control the costs that are being incurred in these proceedings, which are already considerable, but my concern was that in effect I was being asked to decide, as a preliminary issue, a matter that seemed to go to the heart of the dispute. I referred Counsel to part 60 of the Civil Procedure Rules, the Technology and Construction Court Guide, which in my opinion gives helpful guidance as to the hearing of a preliminary issue and, for example, at section 2C-95, para 8.6 states:
 - “8.6.1 *If a party wishes to seek a PI hearing, either at the first CMC or thereafter, the party must circulate a precise draft of the proposed preliminary issues to the other parties and to the court well in advance of the relevant hearing.*
 - 8.6.2 *If the court orders a PI hearing, it is likely to make such an order only by reference to specific and formulated issues, in order to avoid later debate as to the precise scope of the issues that have been ordered.*”

9. I was concerned that the issues had not been formulated with the required degree of clarity. I therefore invited Advocate Ozanne to consider whether she wanted to pursue the matter at this stage, and if so, to formulate the issues and to apply to have them heard in advance of the trial. The hearing was adjourned to enable her to do so.
10. Advocate Ozanne then issued an application dated 30th January in the following terms:

“[The Plaintiff applies] in accordance with Royal Court Civil Rules 2007 Rule 38(1) and (2) (b) (c) (d) (h) and (l) for an order that the following issue be heard as a preliminary issue of pure law in this matter:

“Whether the correct legal test to apply to the facts to establish whether a decision maker (not being a public body) exercised its contractual discretion in a manner that was “unreasonable, perverse or capricious” (i.e. in bad faith) thus entitling the Court to interfere with that decision is:

“that the decision maker came to a conclusion unreasonable in the sense of being arbitrary, perverse or capricious as it had no basis for reaching its decision”.”

11. The application was supported by a written skeleton argument dated 30 January to which Advocate Edwards responded with a written argument received at the Greffe on 9th February. Advocate Ozanne urged me to consider this as a preliminary issue in furtherance of the overriding objective in Rule 1 of the 2007 Rules. She submitted that the costs and time associated with compiling evidence to satisfy the wider test put forward by the Defendant would be avoided and she informed me that her proposed expert had estimated the saving in costs to be a minimum of £44,000 and potentially as much as £100,000, before allowing for any costs that would be incurred in dealing with requests for further information and investigations after exchanging his opinion with the other side.
12. Advocate Edwards opposes the application to take this as a preliminary issue. The crucial difference between the two advocates is the question as to whether the correct interpretation of the implied term is a matter of pure law or whether it has to be viewed in the context of the parties’ contractual relationship and hence can only be determined after hearing evidence.
13. Advocate Ozanne has referred to the decision of the Court of Appeal in Lymington Marina Ltd v Macnamara and Others [2007] EWCA Civ 151. The appellant (“LML”) developed land at Lymington to form a marina and in order to finance the project it issued 52 debentures for £4,000 each and granted each debenture holder a 98 year licence to berth a yacht in the marina. One such licence was issued in 1973 to Mr R S Armitage who transferred it to Air Commodore Macnamara and after his death, following a protracted dispute, his executor assigned the licence to the eldest son of Air Commodore Macnamara who wished to grant a sub-licence to his two

brothers and sought permission for the sub-licence from LML. LML declined to give its approval on the ground that the proposed sub-licensee had not yet taken up residence. According to LML, one of the original reasons for setting up the marina was to provide a regular clientele and a source of income for the adjacent repairing business. LML feared that sub-licensees would be casual users of berths in the marina and hence less likely to use the repairing facilities and it had a concern that sub-licensees would not fit into the ethos of the marina.

14. The proposed sub-licensee challenged LML's refusal to approve the sub-licence. A number of arguments were put forward by LML in the trial at first instance, including an argument that it had an absolute discretion whether or not to approve a sub-licence to a third party subject only to a restriction that it should act honestly and in good faith. In his judgment, Patten J held that LML had been wrong in taking the view that it could refuse consent on the ground that the sub-licence would be one of a number to be granted successively. He then held that LML's decision was invalid on the test propounded in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223* namely that a public body which misconstrues its own powers acts unlawfully and it is no answer to say that it acted in good faith. So, he held that LML's decision was also invalid on this principle.
15. He rejected the argument that LML was entitled to act as it did because its belief as to the scope of its power to refuse approval was held in good faith. He rejected this argument on the grounds that the refusal of approval in the circumstances would be outside the scope of the power of refusal. Alternatively, the exercise of the discretion to refuse in the circumstances would be unreasonable in the *Wednesbury* sense.
16. The issues raised in the appeal included on what grounds LML could refuse to approve a third party as sub-licensee; was its refusal in fact for reasons that were permitted under the terms of the licence agreement and; was a refusal on good faith but in error as to the permitted grounds for refusing approval a valid refusal?
17. At paragraph 37 of her judgment, with which the other two appeal judges agreed, Arden LJ said:

"[37] In my judgment, the judge was in error in using public law principles in this context, and so the declaration in para 4 of the judge's order requires amendment. The right approach was to ask whether any term should be implied into cl 3(k)(ii) so that, even if LML exercised the power for reasons related to the identity of the proposed sub-licensee, the exercise of the power could still be set aside if the grounds for refusal of approval were, for instance, in bad faith or wholly unreasonable. A term is only to be implied into a contract in this type of situation if it is so obvious that reasonable parties would not have thought it necessary to include it or if the implication of the term is necessary to give the contract business efficacy: see Chitty on Contracts, Vol 1 (29 ed) paras 13-004 to 13-007."

18. Having held that the grounds on which approval may be withheld are limited to those which relate to the proposed sub-licensee himself and which arise out of his proposed use of the marina, she considered whether there was any constraint on how LML exercises its powers within those limits. Is the decision valid provided LML did not act wholly unreasonably or is a higher standard to be implied? She held at paragraph 42:

“42.....There can be no doubt that LML must act in good faith. But, leaving aside the obligation on LML to consider the application in good faith and to exercise the power within its proper scope, there is a range of possibilities. At one end of the spectrum, it may be said that the proper implication into the licence is that LML can only withhold approval if its decision is objectively justifiable. At the other end of the spectrum, it may be said that the only term to be implied is a term that LML should not act arbitrarily. There is a practical difference between these two ends of the spectrum, which is illustrated by the following example. Suppose that LML refuses to approve the grant of a sub-licence to X on the ground that it genuinely and on the basis of some material, but nonetheless mistakenly, considers that X's understanding of English is poor, and that this could lead to an accident when X is manoeuvring his yacht into or in the marina. The licence holder may respond that LML has failed to make any appropriate investigations into X's ability to speak English and that X is in fact able to understand and speak English sufficiently well. If LML has to establish that its decision is objectively justifiable, it may have to make investigations in this situation as to X's ability to speak English. If its only obligation is not to act arbitrarily, then it need only have some basis for its decision.

[43] I have already set out the test for implying terms into a contract (see the end of para 37 above). To apply that test, the power of approval in cl 3(k)(ii) has to be considered in the context of the operation of the licence as a whole. The implication of a term that any refusal of approval should be objectively justifiable would be onerous to LML and therefore cannot be so obvious that the parties to the licence would not have thought it necessary to mention it. Likewise, and this is relevant to the question of business efficacy, the provisions of cl 3 can work even if under cl 3(k)(ii) LML's rejection does not have to be on objectively justifiable grounds. If LML refuses its permission, the licence holder cannot go ahead with the sub-licence and that decision will no doubt result in inconvenience, but it will not as such impose any liability on either him or LML to prevent the licence holder making another application. In those circumstances, I do not consider the term could be implied that consent can only be withheld on objectively justifiable grounds.

[44] Nonetheless, I consider that there has to be implied a term that the power to withhold approval should be exercised in good faith and that the approval will not be withheld arbitrarily.”

19. In the present case, the funds were to remain invested unless *“Fee levels do not remain substantially competitive with market competition, as judged by the trustees”*. In my view, the addition of the words *“as judged by the trustees”* adds a significant

qualification. If the qualification had been omitted, I believe the question of whether the fees remained substantially competitive with market conditions would have been an objective test. But the qualification suggests a subjective, not objective, test. What the trustees may regard as competitive may not be what someone else would regard as competitive; the trustees may take account of factors that another person might disregard; or the trustees might regard some factors as being more significant than another person would judge them to be and the trustees may attach less weight to factors that another might regard as important. Adopting the reasoning of Lady Justice Arden in paragraph 43 of the quotation above, I believe that if it was intended that the trustees were to be able to justify their judgment on objective grounds, the parties to the endorsement would have had to have said so. Instead, what the endorsement states suggests that the trustees were to judge the competitiveness according to their own criteria.

20. At paragraph 44 of her judgment, Lady Justice Arden cited a paragraph from the judgment of Mance LJ in Gan Insurance Company Ltd v The Tai Ping Insurance Company Ltd. (The citation is from the decision of that Court on 3 July 2001, reported at [2001] 2 (Comm.) 299, not its decision of 1st March 2002 which is the case included in the Defendant's bundle at Tab 7). The Gan case concerned the interpretation of a claims co-operation clause in a facultative reinsurance policy which provided that no settlement and/or compromise shall be made and liability admitted without the prior approval of reinsurers. In the passage cited by Lady Justice Arden, Mance LJ held:

"76. In summary, the right to withhold approval was, here, Gan's, and no-one else's. It is a right to be exercised in good faith after consideration of and on the basis of the facts giving rise to the particular claim, and not with reference to considerations wholly extraneous to the subject matter of the particular reinsurance or arbitrarily. It is to be exercised by considering the claim as a whole. The court cannot substitute its own view of the reasonableness of a reinsurer's decision to withhold approval under sub-clause (c)."

21. In my view, similar considerations apply in the present case and it would not be for the Court to substitute its judgment of market competitiveness for that of the trustees.
22. In reaching that conclusion, I believe I have arrived at an answer to the question I was first asked by Advocate Ozanne namely that it would not be relevant to receive expert evidence as to the general state of the insurance market at the relevant time or to decide whether, in absolute terms, the Defendant's fees were objectively competitive with the market.
23. There remains an issue as to the manner in which the Defendant should have reached its judgment and what terms in that regard, if any, are to be implied into the written endorsement. In Socimer International Bank Ltd v Standard Bank London Ltd [2008] 1 Lloyd's Rep. 558, paragraph 105, Rix LJ approved the judgment of Sir Thomas

Bingham MR (as he then was) in *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472 in which he set out what Rix LJ called a “*useful and authoritative modern restatement of the relevant principles upon which terms may be implied and of the rationale of doing or not doing so*”. He included the following passage from *BP Refinery (Westernport) Pty Ltd v The President, Councillors and Ratepayers of Shire of Hastings* (1978) 52 ALJR 20 at p.26, a decision of the Judicial Committee of the Privy Council:

“In [their Lordships’] view, for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) It must be reasonable and equitable; (2) It must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) It must be so obvious that ‘it goes without saying’; (4) It must be capable of clear expression; (5) It must not contradict any express term of the contract.”

24. The Master of the Rolls added:

“This passage.....distils the essence of much learning on implied terms. But its simplicity could be almost misleading.

The courts’ usual role in contractual interpretation is, by resolving ambiguities or reconciling apparent inconsistencies, to attribute the true meaning to the language in which the parties have expressed their contract. The implication of contract terms involves a different and altogether more ambitious undertaking: the interpolation of terms to deal with matters for which, ex hypothesi, the parties themselves have made no provision. It is because the implication of terms is potentially so intrusive that the law imposes strict constraints on the exercise of this extraordinary power.....

*The question of whether a term is to be implied, and if so what, almost inevitably arises after a crisis has been reached in the performance of the contract. So the court comes to the task with the benefit of hindsight, and it is tempting for the court then to fashion a term which will reflect the merits of the situation as they then appear. Tempting, but wrong. For, as Scrutton LJ said in *Reigate v Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592 at 605:*

‘A term can only be implied if it is necessary in the business sense to give efficacy to the contract; that is, if it is such a term that it can confidently be said that if at the time the contract was being negotiated someone had said to the parties, ‘What will happen in such a case’, they would both have replied, ‘Of course, so and so will happen; we did not trouble to say that; it is too clear’. Unless the court comes to some such conclusion as that, it ought not to imply a term which the parties have not themselves expressed’

25. Advocate Edwards submits that the Plaintiff relied on material which it ought not to have relied upon in making its decision and that the report produced was fundamentally flawed in that it failed to address the relevant questions. Yet the

Defendant has not pleaded that there was any express or implied term as to any factors that the Plaintiff was required to take into account or any factors that it was to ignore on the grounds that they were not relevant.

26. The issue in the present case about implying a term into the endorsement includes argument about how the implied term is to be interpreted, including what the word “unreasonable” means in this context. In my view it is not going to be possible to resolve that issue as a preliminary issue because it will be necessary to hear evidence about the surrounding circumstances in order to understand what term can properly be implied and what the parties would have intended it to mean if it had been drawn to their attention at the time. I therefore feel it would be wrong for me to attempt to order the hearing of a preliminary issue as requested in the application before me.