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IN THE HIGH COURT OF JUSTICE

QUEEN'S BENCH DIVISION

ADMINISTRATIVE COURT

[2022] EWHC 2228 (Admin)



No. CO/2545/2021

Royal Courts of Justice

Tuesday, 2 August 2022

Before:

MR DEXTER DIAS QC
(Sitting as a Deputy High Court Judge,
s.9(4) Senior Courts Act 1981)

B E T W E E N :

THE QUEEN
on the application of
MANCHIKALAPATI & Ors

Claimants

- and -

FINANCIAL SERVICES COMPENSATION SCHEME

Defendant

MR H ASHWELL (instructed by Walker Morris LLP) appeared on behalf of the Claimant for judgment. At substantive hearing, MR J DRAKE QC and MR D GRANT of counsel.

MS L DE BRUYN (instructed by Dentons Solicitors) appeared on behalf of the Defendant for judgment. At substantive hearing, MR J CUTRESS QC and MS L DE BRUYN of counsel.

J U D G M E N T

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DEXTER DIAS QC
(sitting as Deputy High Court Judge):

- 1 This is the judgment of the court.
- 2 I divide it into ten sections to assist parties follow the court's line of reasoning. It is accompanied by an appendix listing the very many claimants in this case.

§I. INTRODUCTION

- 3 In this application for judicial review, there are 25 claimants. Along with Mr Manchikalapati, the first-named claimant, these parties are leaseholders of a housing development in Hulme, South Manchester called New Lawrence House. The impugned decision is that of the Financial Services Compensation Scheme ("FSCS"). But to understand how the FSCS decision on 6 May 2021 to refuse to pay compensation to these claimants for litigation costs and judgment sum interest came about, one must take a step back.
- 4 Although a new build, the New Lawrence House project was located in a historic stretch of land. Indeed, the name Hulme is of old Norse origin meaning "land surrounded by water and streams". The site, in fact, is situated south of the River Medlock and has Cornbrook, a tributary of the River Irwell, running nearby. The development consists of two blocks of flats fronting City Road and is not far from the famous Old Trafford cricket ground. The project was marketed as "an outstanding investment opportunity". It became a nightmare.
- 5 There is no other way to describe it. Very rapidly, this much-heralded "luxury" development disintegrated into a state of wretched and at times potentially lethal disrepair. One of the residents, Mr Denis Tarasov, leaseholder/owner of Flat 41 complained about bare walls with no rendering, significant health and safety issues in the block and stairs, unfinished ceilings with leaks entering the unit itself, leaking sewerage pipes into the car park. There were such serious safety issues that the Greater Manchester Fire & Rescue Service issued a prohibition notice. In 2017, residents had to be moved out after the Fire Brigade prohibited them from living there due to these fundamental dangers and defects. After that, the site lay empty in ghostly silence.
- 6 Sensitivities to these issues were acute, this being the first major case to come before the court following the Grenfell tragedy. Three hundred people lived in New Lawrence House with their children. There was building guarantee policy insurance in place. This was not because such insurance was compulsory under statute, but because in practice to secure funding, lenders insist on such insurance. As the property decayed and deteriorated around them, the leaseholders sued the insurers and then its successor. After years of bitterly contested litigation, the claimants won in the Court of Appeal. That victory was only a temporary respite. The successor insurers went into administration. When that insurance firm failed, there were outstanding monies owed to the claimants that had been ordered by the Court of Appeal. They were for two things (1) the legal costs incurred during their successful litigation; (2) interest on the judgment sum previously ordered by the High Court.
- 7 With the insurers in administration, the claimants sought relief from a public compensation scheme. The Financial Services Compensation Scheme ("the Scheme" or "FSCS") is a statutory compensation scheme created in the public interest. It is funded through levies from the general insurance market to provide appropriate protection to policyholders. These

could be members of the public or small businesses at risk of suffering greatly when insurance companies collapse or go under. However, by a decision letter dated 6 May 2021, the Scheme rejected the leaseholders' claims for compensation stating that their claims did not come within its rules. This was a grievous disappointment to so many people who had purchased property in New Lawrence House. It is this decision that they challenge today by way of judicial review.

- 8 The parties and representation are as follows. The claimants, all 25 of them, are listed in Appendix A to this judgment. There are actually more than 25 people making claims. But where flats were owned by more than one person, they have been treated as being effectively one claimant. A small number of claimants purchased more than one flat, which is why there are more flats than claimants. Equally, as I will come to, some of these flats went unsold in the first instance.
- 9 The claimants have been represented at the substantive hearing by Mr Drake QC and Mr Grant of counsel. Their interests are ably represented today by Mr Ashwell of counsel. The defendant is the Financial Services Compensation Scheme. At the substantive hearing the defendant was represented by Mr Cutress QC and Ms de Bruyn of counsel, and she appears again today. While I am particularly grateful to Mr Ashwell for stepping in to take this judgment, I express the court's gratitude to all counsel for their industry and focused submissions in this important litigation that impacts the lives of so many people.
- 10 The challenge to the decision is essentially on three grounds. First, that the claims are "in respect of" the civil liability which is subject to protected insurance and thus payable under the Scheme. I shall call this the "in respect of" ground. The court must determine what is the true meaning of "in respect of". Second, and in the alternative, the claimants claim for interest and costs because this is a "protected claim". This will be the "protected claim" ground. Third, and in the further alternative, the claims arise or are "owed" under a contract of insurance and thus are recoverable from the Scheme. This shall be called the claim "owed under a contract of insurance" ground.

§II. FACTS

- 11 I now set out in more detail the background facts. JCS Homes Limited ("JCS") was a company engaged in residential developments in the Greater Manchester area. Its name was an acronym for its active shareholder, Jason Alexander, and its two funding shareholders, Chandravan Mehta and Sunil Mehta. In 2003, JCS obtained planning permission for the construction of two blocks of flats, to be known as New Lawrence House, at Hulme in Manchester. The site, on City Road, is a location approximately a mile south of Manchester city centre, bordering Hulme in Manchester and Stretford in Trafford. There was a hiatus in the project until 2006, when JCS secured funding from the Bank of Ireland. JCS also needed to secure an insurance company which would provide building warranty type insurance policies, without which no mortgage company would lend on the security of the flat. Thus, these building guarantee policies (or BGPs) are vital to the operation of this sector of the housing market.
- 12 The insurance policies in this case were provided by Zurich International Plc (hereafter "ZIP" or "Zurich") trading as Zurich Building Guarantee ("ZBG"). Although ZIP and ZBG are separate limited companies, that separation was solely for regulatory compliance reasons. It did not reflect any substantive separation between the two businesses. ZIP/ZBG issued buildings warranties known as "Standard 10 Year New Home Structural Defects Insurance Policies" to cover structural and major defects in the development in general terms. The intention of the policies was to provide cover for the purchasers of new homes

of a similar nature to an National House Building Council guarantee. There is, as I have indicated, no statutory compulsion to secure such building guarantee insurance but, in practice, it is demanded by lenders before advancing a mortgage. Thus, it operates closely analogous to compulsory insurance.

- 13 From March 2007 onwards, various members of the public started to buy long leases of flats in the development off-plan. The leases were purchased for terms of 125 years. They were each purchased for approximately £120,000, although the price varied with the time of purchase and location of the flat within the development. The first spades in the earth were in June 2007 and construction continued after that. In October 2020, the last of the claimants entered into these leases. On taking up the lease, each claimant was issued with a policy of building warranty insurance underwritten by Zurich or ZBG. There were 104 flats in the development. Twenty-five claimants were leaseholders of thirty flats but, after this point, there were macro events that intervened.
- 14 The context for the claimants moving into the flats was the financial convulsions beginning with the collapse of Northern Rock in the summer of 2007. This had an effect on the commercial appeal of the development as it did with such building developments across the nation. Due to the global crash and depressed financial conditions, many of the flats remained unsold. Thus Messrs Alexander and the two Mehtas, who controlled JCS, formed a limited company partnership with a rearrangement of the letters in an acronym they chose to call CJS. The full title is CJS Investment LLP. CJS secured funding and purchased the remaining flats from JCS with a view to renting them out.
- 15 There were concerns expressed by leaseholders about the condition and maintenance of this development. The Fire Service wrote to JCS in January 2010 following an inspection enclosing an enforcement notice under the Regulatory Reform Fire Safety Order 2005. It contained a schedule of fire safety matters required to be rectified. During 2012 and 2013 serious defects in the building manifested themselves unmistakably. They ranged over many areas, affecting both individual flats and the common parts.
- 16 In 2013 and 2014 the claimants made claims against Zurich on the policies. Zurich declined the claims. There was a dispute between CJS and others about who controlled the development. This was litigated up to the Court of Appeal, where CJS lost: see *Sugarman v CJS* [2014] EWCA Civ 1239. The outcome of the decision in the Court of Appeal was disastrous for CJS. It was already in arrears with its loan repayments and, on 4 November 2014, the bank exercised its right to appoint administrators over CJS. Administration is a theme tellingly repeated in this story.
- 17 On 6 March 2015, the claimants issued proceedings against Zurich. On 16 March 2018, the High Court of the Republic of Ireland sanctioned the transfer of Zurich's policies and all liabilities under them to East West Insurance Company Limited (hereafter East West or EWIC). This was pursuant to an insurance business transfer scheme under Part 7 of the Financial Services and Markets Act 2000, a statute that will have great significance in this case. In July 2018, ZIP amended its defence to that effect. Therefore, on 20 July of that year, East West was joined as the third defendant following an unopposed application by the claimants.
- 18 The case came before HHJ Davies sitting as a Judge of the High Court in the autumn of 2018, and during the case the High Court sat at the Manchester Registry. The judge heard a four-week trial in October 2018 with two days of submissions in November 2018. HHJ Davies gave judgment on 30 January 2019: see *Zagora Management Limited & ors v (1) Zurich Insurance Plc, (2) Zurich Building Control Services Ltd, (3) East West Insurance*

Company Ltd [2019] EWHC 140 (TCC). The judge ruled in favour of the claimants and against ZIP and East West for a sum totalling £3,634,074.65. It was his assessment that the maximum liability cap was the purchase price of the flats of the successful claimants. He found that the structural steelwork lacked fire protection. This created a present or imminent danger to the physical health and safety of the occupants. The judge held that the development was “seriously defective and requires major and extensive repairs.” He dealt with these other defects shortly, the cap having been reached. These are related to the roof, the cladding, the basement car park, the balconies, aspects of fire protection other than the structural steelwork, mechanical and electrical services, lifts and other items. The judge set out his findings on individual items but he did not quantify those claims.

19 It appears that on the basis of the judge’s findings, the total cost of remedial works would be in the region of £9.7 million plus Value Added Tax. Pertinently for this application for judicial review, by an order dated 7 February 2019 and sealed on 19 February 2019, the judge also ordered EWIC to pay interest on the principal sum of 3.5 per cent per annum from 7 August 2013 until 7 February 2019, equal to £695,559.37. This rendered the total judgment sum, inclusive of interest, as £4,333,634.02. By an order dated 13 February 2019, and stamped 14 March 2019, the judge further ordered 80 per cent of the claimants’ costs of and incidental to the proceedings, to be assessed if not agreed, and an interim payment of £1,350,000 on account of those costs.

20 The claimants were aggrieved by the judge’s decision and the operation of a maximum liability cap. Accordingly, they appealed to the Court of Appeal. On 15 March 2019, Zurich and East West commenced a cross-appeal on seven bases, pleading judicial error after error. The appeal and cross-appeal were heard in 2019, on 15, 16 and 17 October. The three Lord Justices of Appeal each dealt with different grounds: *Manchikalapati & Ors v Zurich Insurance Plc trading as Zurich Building Guarantee and Zurich Municipal and East West Insurance Company Limited* [2019] EWCA Civ 2163. Giving the first judgment of the court, Sir Rupert Jackson dealt with the maximum liability cap. Coulson LJ dealt with the cross-appeal. McCombe LJ with the judgment interest issue relating to the interest on the judgment sum dated 7 February 2019. In short, the Court of Appeal upheld the appeal on the cap. The cross-appeals were dismissed. As Coulson LJ stated at para.82:

“As we shall see repeatedly throughout the following Sections of this judgment, what ZIP suggest as the proper interpretation of the words used in their own policy is, on analysis, nothing of the kind, and is instead a strained and artificial construction (often requiring the interpolation of words not present) with the result that it becomes impossible to see any circumstances in which ZIP would ever pay out under the terms of the policy.”

21 As to ZIP’s appeal on the interest judgment, the landscape changed with the Court of Appeal’s decision about the maximum liability cap. But the court would have nevertheless dismissed ZIP’s appeal on the interest judgment. The Court of Appeal also varied the costs from 80 per cent to 92.5 per cent recovery.

22 East West sought permission to appeal from the Court of Appeal. It was refused. A further application for permission was made to the Supreme Court. It was refused on 23 June 2020. In the event, rather than remitting the matter back to the judge, the parties were able to agree upon the precise quantification of the sums due in respect of remedial works. This came to an agreed figure of £9,728,420.63. On 2 October 2020, East West paid the claimants the balance of that sum owed for the remedial work. This agreement was formalised shortly

thereafter in a consent order of HHJ Davies dated 20 October 2020. But between these two days something of great moment happened.

- 23 On 12 October 2020, East West entered administration. Richard Baker and Simon Edel of Ernst & Young were appointed as joint administrators. As noted, as at that date the claimants had recovered from East West £9,728,420.63 in respect of remedial works, interest of £297,972.22 and £1,851,951 on account of costs. But there were outstanding sums divisible into three headings. First, VAT on the remedial work that was capped at £1,117,655.37. Second, costs of approximately – and I emphasise approximately – £3,283,000 subject to detailed assessment. Third, interest of 8 per cent on the judgment debt, totalling £781,331.88. The joint administrators informed the claimants that these claims would fall to be treated as unsecured claims.
- 24 On 11 February 2021, the claimants sent a letter through their solicitors Walker Morris LLP (hereafter “Walker Morris”) to the Financial Services Compensation Scheme seeking confirmation that the Scheme would compensate the claimants for these unpaid sums. By a letter dated 1 March 2021, the Scheme wrote to Walker Morris, first agreeing that the claim in respect of the VAT, capped at the sum quoted, was a protected claim under the Scheme but, second, contending that the sums sought in relation to interest and costs were not compensable under the Scheme. The letter stated:

“We do not consider that the liability of an insurer under a policy can be broader than what is covered by the policy wording.”

By a letter dated 30 March 2021, Walker Morris appealed against the Scheme’s preliminary determination.

- 25 We now come to the heart of the matter, for this claim is against the decision that was made on 6 May 2021. The FSCS dismissed the claimants’ appeal and declined the claimants’ application for compensation under the Scheme. According to the FSCS, the Scheme rules at rule 3.1(2) provides that the FSCS may pay compensation if the claim is “in respect of a protected claim against a relevant person who is in default.” A claim is defined as a “valid claim made in respect of a civil liability under a contract of insurance.” This civil liability must therefore arise “under” a contract of insurance. Rule 20.2 provides that the FSCS must calculate the set liability “in accordance with the terms of the contract.” A claim under a contract of insurance therefore means “in accordance with the terms of a contract of insurance.” The claimants’ claims for legal costs and interest are not “payable in accordance with the terms of an insurance policy.” The claimants’ claims are therefore not compensable.
- 26 The aggrieved leaseholders were disappointed. But they were determined to press on in what they perceived to be their quest for justice.

§III. THE CLAIM

- 27 By a claim form sealed on 26 July 2021, the claimants sought permission to apply for judicial review. The detail of the impugned decision was defined as:

“The Financial Services Compensation Scheme refused to grant compensation under the Policyholder Protection Scheme for interest and costs awarded to the claimants by a now insolvent insurer.”

The basis of the application was fleshed out in the statement of facts and grounds dated 16 July 2021. The claimants' challenged the decision on the grounds that the FSCS incorrectly interpreted the rules governing the payment of compensation under the Scheme. It had misdirected itself and/or erred in its interpretation of these rules on the grounds that (a) in order to comply with rule 3.1, the application for compensation under the Scheme need only be "in respect of" a claim as defined in the rules or, alternatively, it must be "in respect of" a "civil liability under a contract of insurance." The claimants' claims for interest and costs are in respect of their claims and/or East West's liabilities under the policy. That was Ground 1. Further, or in the alternative, East West's liability to the claimants for costs and interest constitutes a "civil liability under a contract of insurance." That is Ground 2. Later, a third ground, which stated that interest and costs were protected claims, would be added.

28 The relief sought was:

- (a) An order that the decision be quashed; and/or
- (b) A declaration that the claimants are entitled to be compensated in respect of unpaid costs and interest; and/or
- (c) An order quashing the decision and remitting the matter back to the FSCS with a direction to reconsider the claimants' application for compensation and reach a decision in accordance with the findings of the court.

29 The defendant acknowledged service and summary grounds of resistance were filed on 17 August 2021. They robustly opposed the two then existing bases of challenge. It was submitted that they were unarguable. On 16 November 2021, permission to apply for judicial review was granted on the papers by Andrew Thomas QC, sitting as a Deputy Judge of the High Court. The matter was set down for hearing. That concluded on 24 June, having heard argument from both Mr Drake QC and Mr Cutress QC. Judgment was reserved. Today, 2 August 2022, was the first available date for judgment to be handed down in court.

§IV. LEGAL & STATUTORY FRAMEWORK

30 There was common ground about which statutory provisions and rules were material to this application. The dispute was the perennial one: what those provisions actually mean. I subdivide this section into two (a) the Financial Services and Markets Act 2000; (b) the Prudential Regulation Authority Rules ("the Rules"). The Rules set out how claims under contracts of insurance should be dealt with. Since the Act and the Rules are common to all three grounds, I deal with them compendiously here.

(a) The Financial Services and Markets Act 2000

31 The Financial Services Compensation Scheme was established under Part XV of the Financial Services and Markets Act 2000 (hereafter "the 2000 Act" or "the Act"). Section 212 of the Act required the Financial Services Authority (as it was) to establish a body corporate to exercise the functions of the scheme manager under Part XV. As originally enacted, s.213 of the Act provided that the FSA must by rules establish a scheme for compensating persons in cases where relevant persons are unable or unlikely to be able to satisfy claims against them. The body corporate, so established, was the Financial Services Compensation Scheme. The FSCS replaced the Policyholders Protection Board, which had previously operated pursuant to the Policyholders Protection Act 1975 (hereafter "the 1975 Act"). By the Financial Services Act 2012, the Prudential Regulation Authority (hereafter "the PRA") assumed responsibility in place of the FSA for achieving the objective of

securing “an appropriate degree of protection” for policyholders. To complete that picture, the FSA was renamed the Financial Conduct Authority (the “FCA”). The Act sets out the duties and powers of the regulators at Part 1A. Chapter 2 thereof deals with the PRA, and s.2C is entitled “Insurance Objective”. It provides:

“(1) In discharging its general functions so far as relating to a PRA-regulated activity relating to the effecting or carrying out of contracts of insurance or PRA-authorized persons carrying on that activity, the PRA must, so far as is reasonably possible, act in a way—

- (a) which is compatible with its general objective and its insurance objective, and
- (b) which the PRA considers most appropriate for the purpose of advancing those objectives.

(2) The PRA's insurance objective is: contributing to the securing of an appropriate degree of protection for those who are or may become policyholders.”

32 Section 213 of the Act is entitled “The compensation scheme”:

“(1) The regulators must by rules made in accordance with an order under subsection (1A) establish a scheme for compensating persons in cases where—

- (a) relevant persons are unable, or likely to be unable, to satisfy claims against them,
- (aa) relevant exchanges are unable, or likely to be unable, to satisfy claims made against them in connection with a regulated activity relating to a trading facility carried on by the exchange, or
- (b) persons who have assumed responsibility for liabilities arising from acts or omissions of relevant persons or relevant exchanges (“successors”) are unable, or likely to be unable, to satisfy claims against the successors that are based on those acts or omissions.

(1A) The Treasury must by order specify—

- (a) the cases in which the FCA may, or may not, make rules under subsection (1), and
- (b) the cases in which the PRA may, or may not, make rules under that subsection.

(2) The rules (taken together) are to be known as the Financial Services Compensation Scheme (but are referred to in this Act as “the compensation scheme”).

(3) The compensation scheme must, in particular, provide for the scheme manager—

- (a) to assess and pay compensation, in accordance with the scheme, to claimants in respect of claims made in connection with—
 - (i) a regulated activity carried on (whether or not with permission) by relevant persons; and
 - (ii) a regulated activity relating to a trading facility carried on (whether or not in accordance with any requirements relating to that activity resulting from section 286) by relevant exchanges; and
- (b) to have power to impose levies for the purpose of meeting its expenses (including in particular expenses incurred, or expected to be incurred, in paying compensation, borrowing or insuring risks)—
 - (i) on authorised persons, or any class of authorised person;
 - (ii) on recognised investment exchanges carrying on a regulated activity relating to a trading facility, or any class of such exchanges; or
 - (iii) on authorised persons and on recognised investment exchanges carrying on a regulated activity relating to a trading facility, or on any class of such persons and exchanges.

(4) The compensation scheme may provide for the scheme manager to have power to impose levies—

- (a) on authorised persons, or any class of authorised person;
- (b) on recognised investment exchanges carrying on a regulated activity relating to a trading facility, or any class of such exchanges; or
- (c) on authorised persons and on recognised investment exchanges carrying on a regulated activity relating to a trading facility, or on any class of such persons and exchanges,

for the purpose of recovering the cost (whenever incurred) of establishing the scheme.

(5) In making any provision of the scheme by virtue of subsection (3)(b), the regulators must take account of the desirability of ensuring that the amount of the levies imposed on a particular—

- (a) class of authorised person;

- (b) class of recognised investment exchange carrying on a regulated activity relating to a trading facility; or
- (c) class of authorised person and of recognised investment exchanges carrying on a regulated activity relating to a trading facility;

reflects, so far as is practicable, the amount of claims made, or likely to be made in respect of that class of person, exchange, or persons and exchanges.

(6) An amount payable to the scheme manager as a result of any provision of the scheme made by virtue of subsection (3)(b) or (4) may be recovered as a debt due to the scheme manager.

(7) Sections 214 to 217 make further provision about the scheme but are not to be taken as limiting the power conferred on the [F1regulators] by subsection (1).

(8) In those sections “specified” means specified in the scheme.

(9) In this Part (except in sections 219, 220 or 224) “relevant person” means a person who was—

- (a) an authorised person at the time the act or omission giving rise to the claim against him, or against a successor falling within subsection (1)(b), took place; or
- (b) an appointed representative at that time.

(10) ...

(11) ...

(12) In this Part (except in sections 220 and 224) “relevant exchange” means a body corporate or unincorporated association which was a recognised investment exchange carrying on a regulated activity relating to a trading facility at the time the act or omission giving rise to the claim against it, or against a successor falling within subsection (1)(b), took place.

(13) In this Part “regulated activity relating to a trading facility” means—

- (a) the regulated activity of operating a multilateral trading facility; or
- (b) the regulated activity of operating an organised trading facility.

(14) In this Part, “funeral plan contract” has the same meaning as in article 59(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.”

33 Section 214 is entitled “General”. Subsection (1) states:

“The compensation scheme may, in particular, make provision—

...

- (f) for a claim to be entertained only if it is made by a specified kind of claimant;
- (g) for a claim to be entertained only if it falls within a specified kind of claim ...”.

(b) The PRA Rules

- 34 The PRA promulgates rules governing the Scheme. These rules are set out in elaborate but necessary detail in the PRA Rulebook Policyholder Protection. Rule 1.2 has a glossary. In that glossary the term “claim” is defined. It is absolutely central to this case and great dispute has raged about it. I set it out in full:

“claim

means a valid claim made in respect of a civil liability:

- (1) owed by a *relevant person*; or
- (2) owed by a *relevant person* which has been assumed by a *successor* and which is based on the acts or omissions of the *relevant person*;

under a contract of insurance.”

- 35 Note in particular the terms “in respect of”, “civil liability” and “under a contract of insurance”. I now lay out the other relevant rules:

“

“1. Application and Definitions

building guarantee insurance

means a contract of general insurance providing building guarantee, construction warranty and/or structural defects cover in relation to newly built, converted or renovated residential property, including but not limited to the risk of physical damage and/or defect arising from non-compliance with relevant building or fire regulations or standards.

protected contract of insurance

means a contract of insurance which is covered by the policyholder protection scheme as defined in 9.2.

2. FSCS

2.1 The FSCS must administer the policyholder protection scheme in accordance with the rules in this Part ...

...

2.3 The FSCS may agree to pay the reasonable costs of an eligible claimant bringing or continuing insolvency proceedings against a relevant person (whether those proceedings began before or after a determination

of default), if the FSCS is satisfied that those proceedings would help it to discharge its functions under the requirements of this Part.

3. Qualifying conditions for Paying Compensation

3.1 The FSCS may pay compensation to an eligible claimant, subject to 18, if it is satisfied that:

- (1) an *eligible claimant* has made an application for compensation (or falls within the category of persons referred to in 3.2);
- (2) the claim is in respect of a *protected claim* against a *relevant person* (or where applicable, a *successor*) who is in *default*;
- (3) Where the *FSCA* so:
 - (a) requires, the claimant has assigned the whole or any part of his rights under the *protected contract of insurance* against the *relevant person* (or where applicable, a *successor*) or against any third party to the *FSCS*, on such terms as the *FSCS* thinks fit; and/or
 - (b) determines, the claimant has immediately and automatically subrogated all or any part (as determined by the *FSCS*) of its rights and claims against the *relevant person* (or where relevant, a *successor*) under the *protected contract of insurance* or against any third party to the *FSCS*, on such conditions (under 13) as the *FSCS* thinks fit; and
- (4) It:
 - (a) is not reasonably practicable or appropriate to make, or continue to make, arrangements to secure continuity of insurance under 4.1; and/or
 - (b) would not be appropriate to take, or continue to take, measures under 5.1 to safeguard policyholders of a *relevant person* in financial difficulties.

9. Protected Claims

9.1 A *protected claim* is a *claim* under a *protected contract of insurance*.

17. Limits on Compensation Payable

17.1 The limits on the maximum compensation sums payable by the *FSCS* for *protected claims* are set out in 17.2.

17.2 (1) For a *protected contract of insurance* when the contract is a *relevant general insurance contract*:

- (a) if the *claim*:
 - (i) is in respect of a *liability subject to compulsory insurance*; or
 - (ii) is in respect of a liability subject to *professional indemnity insurance*; or
 - (iii) is in respect of and arises from the death or incapacity of the policyholder due to injury,

sickness, or infirmity;

the level of cover is 100% of the *claim*; and

- (b) in all other cases the level of cover is 90% of the *claim*; and in each case, cover shall be determined in accordance with 19 and 20 and there is no upper limit on the amount that can be paid.
- (2) For a *protected contract of insurance* when the contract is a *contract of long-term insurance*, the level of cover is 100% of the *claim* determined in accordance with 19 and 20 and there is no upper limit on the amount that can be paid.

19. Calculating Compensation - General

19.1 The amount of compensation payable to the claimant in respect of a *protected claim* is the amount of the overall net *claim* against the *relevant person* (or where applicable, the *successor*) at the *quantification date* and any reference in this Part to overall *claim* shall be construed accordingly
...

19.3 A claimant's overall *claim* is the sum of the *protected claims* of the same category that he has against a *relevant person* (or where applicable, a *successor*) *in default*, less the amount of any liability which the *relevant person* (or where applicable, the *successor*) may set off against any of those *claims*.

20. The Compensation Calculation

20.1 The *FSCS* must pay a sum equal to 100% of any liability of a *relevant person* (or where applicable, a *successor*) in respect of a *liability subject to compulsory insurance* to the claimant as soon as reasonably practicable after it has determined the *relevant person* (or where applicable, the *successor*) to be in *default*.

20.2 The *FSCS* must calculate the liability of a *relevant person* (or where applicable, the *successor*) to the claimant under a *relevant general insurance contract* in accordance with the terms of the contract, and (subject to any limits in 17.2(1)) pay that amount to the claimant."

- 36 Everything in this case turns on the construction of these rules. But what are the canons of statutory interpretation and rule construction that should govern that exercise? It is to this I now turn.

§V. CANONS OF CONSTRUCTION

- 37 This case turns on a construction of a statute and the construction of rules that are derivative of that statute. Broadly, the canons of construction are well settled and understood but, as Sir Rupert Cross observed in his seminal book **Statutory Interpretation**, 3rd Ed. 2006, at p.48:

"There are not binding judicial decisions on the subject of statutory interpretation generally as opposed to the interpretation of particular statutes."

- 38 The parties helpfully laid before the court pertinent extracts from **Bennion, Bailey & Norbury on Statutory Interpretation** 2020 (which I shall call “**Bennion**”). At p.398 of **Bennion** it is stated:

“The primary indication of legislative intention is the legislative text read in context and having regard to its purpose.”

This approach was, in fact, articulated as far back as 1844 in the *Sussex Peerage Case* [1844] 11 Cl and Finn at p.143. It is a mark of the long recognition of this principle that *Sussex Peerage* was decided forty years before these Royal Courts of Justice were even opened. In that case, the vexed and controversial question was whether the deceased peer in question, the father of the claimant, had been married or not. The statute in question requiring interpretation, was the Royal Marriage Act. Lord Tindal CJ stated:

“If the words of the statute are of themselves precise and unambiguous, then no more can be necessary than to expound those words in their natural and ordinary sense. ... But if any doubt arises from the terms employed by the Legislature, it has always been held a safe mean of collecting the intention to call in aid the ground and cause of making the statute ...”.

- 39 Back then to more recent sources. At p.638 in **Bennion** it is stated:

“An Act or other legislative instrument is to be read as a whole so that an enactment within it is not treated as standing alone and is interpreted in its context as part of the instrument which may reveal that a proposition in one part of the Act sheds light on the meaning of provisions elsewhere in the Act.”

At p.400 of **Bennion** it is stated:

“A decision on the interpretation of one statute generally cannot constitute a binding precedent with regard to the interpretation of another statute. It follows that an expression may have different legal meanings in different Acts.”

- 40 In *IRC v McGuckian* [1997] 1 WLR 991 at p.999, Lord Steyn noted the shift away from literalism and that “a modern emphasis is in a contextual approach designed to identify the purpose of a statute and to give effect to it.” In *R v The Secretary of State for Health, ex p Quintavalle* [2003] UKHL 13 Lord Bingham stated at p.21:

“... nowadays the shift towards purposive interpretation is not in doubt.”

In *R (on the application of Black) v Secretary of State for Justice* [2017] UKSC 81, Lady Hale said at para.37 that the question of the statutory interpretation in that case depended upon “the words used, their context and the purpose of the legislation.” In the Court of Appeal, in *An Informer v A Chief Constable* [2012] EWCA Civ 197 Toulson LJ (as he then was) stated at para.67 that:

“Construction of a phrase in a statute does not simply involve transposing a dictionary definition of each word. The phrase has to be construed according to its context and the underlying purpose of the provision.”

I mentioned to counsel on several occasions that this was not trial by Google Translate and the Oxford English Dictionary.

- 41 In his book of Hamlyn Lectures, **Thinking about Statutes: Interpretation, Interaction, Improvement (2018)**, Lord Burrows, writing extrajudicially, stated at p.3 that almost all of the canons of construction relevant to statutes are “equally applicable to secondary legislation.” In similar vein, **Bennion** adds at p.125:

“The general principles of interpretation that apply to Acts, apply equally to delegated legislation but with the added consideration that since delegated legislation derives its authority from the enabling Act, it must be interpreted in light of that Act.”

§VI. SUBMISSIONS

- 42 I will deal first with the submissions of the claimants and then move on to the defendant’s submissions.

(a) Claimants’ submissions

- 43 The claimants challenge the decision on three alternative bases. First, the claimants’ application for compensation qualifies for compensation because it is applicable “in respect of” a protected claim. Rule 3.1(2) provides that the FSCS may compensate if a claim is in respect of a protected claim against a relevant person who is in default. The term “claim” in rule 3.1(2) is plainly a reference to an application to the FSCS for compensation, thus the claimants’ application for compensation need only be in respect of a protected claim. It is, the claimants submit, common ground that the claimants’ claim for an indemnity under the policy is a protected claim. The claimants’ application for compensation for unpaid interest and costs is in respect of that protected claim or indemnity.
- 44 Second, and in the alternative, the claimants’ claim for interest and costs qualifies for compensation because it is a protected claim. Properly construed, it is submitted that the term “protected claim” means “a valid claim made in respect of a civil liability owed under a protected contract of insurance”. A “protected contract of insurance” is defined as a contract of insurance covered by the Scheme. As noted, it is common ground that the policies are protected contracts of insurance. The claimants’ claim for interest and costs is a valid claim in respect of the civil liability owed by East West under the policies.
- 45 Third, and in the further alternative, the claimants’ claim qualifies for compensation because it is a protected claim. A protected contract of insurance is defined as a contract of insurance covered by the Scheme. As noted, it is common ground that these policies are protected contracts of insurance. East West’s liability for interest and costs is owed “under” the policies, being a liability owed pursuant to the insurance relationship between the claimants and East West and not pursuant to some extraneous insurance relationship.
- 46 The claimants rely upon the case of *Geologistics*, both at first instance and in the Court of Appeal. See: *R (Geologistics Limited) v FSCS* [2003] 1 WLR 1696, which was the decision of Davis J, and *R (Geologistics Limited) v FSCS* [2004] 1 WLR 1719, where Waller LJ handed down the decision of the court with which Latham and Thorpe LJ agreed. I will examine the submissions on *Geologistics* in due course.

(b) Defendant’s submissions

- 47 The defendant cautioned the court that, tempting though it may be, the court should not order the defendant to pay out on the basis of sympathy. The policy objective of the Scheme is to provide an “appropriate” degree of protection, no more, no less. That is not complete, exhaustive and comprehensive cover in all circumstances. What is appropriate requires a balancing of the cost of the scheme and the nature of the policy. Section 214 (f) and (g) of the Act delimit the types of claim eligible and, thus, the Scheme was set up to limit the amount of compensation payable. If there is a liability *under* the contract of insurance, the Scheme will pay. For example, the Scheme has paid out £1 million approximately of Value Added Tax. That is because there is a claim for rectification of damage and the VAT on it is a reasonable cost arising explicitly under the contract of insurance. The key element is that liability arose under the contract of insurance and is thus payable.
- 48 But that is very different from the costs of litigation. The court should not adopt an expansive interpretation of the rules. In *Geologistics* the costs were insured under the contract anyway. That is different to this situation. Those were the costs of defending a claim by an employee. That has little or no relevance to this situation. Here the source of the claim for interest is statute. What is being claimed is statutory interest. That cannot properly have been envisaged by Parliament as compensable. What is envisaged by the Scheme is for cover under the contract of insurance, nothing else.
- 49 This interpretation is supported by the PRA Policy Statement of October 2020, which heralded the change of cover from 90 per cent to 100 per cent for building guarantee insurance. At para.1.4:
- “Policyholder Protection 17.2(1)(a) sets out that protected policyholders are covered for 100% of any benefit under their contract of general insurance (GI) where the claim:
- is in respect of a liability subject to compulsory insurance; or
 - ... professional indemnity insurance ...”, etc.”
- 50 What all of this makes clear is that when one looks at 1.6 of the Policy Statement there is a reflection upon what is appropriate by the PRA. What was envisaged, as late as October 2020, is that the Scheme benefits are restricted to benefits arising under the contract and not arising otherwise or collaterally.
- 51 As to the claimants’ argument 1, “in respect of” does not mean “in connection with”. Instead, it means “for payment of”. One arrives at that conclusion by looking at the statute and the rules as a whole and understanding their proper purpose. The Scheme obligation is to pay protected claims. These two heads of claim are not protected, nor do they arise under the contract. The wide interpretation urged by the claimants makes no sense because it would necessitate payment for claims not covered by the Scheme. Rule 17 sets out the limits to protected claims and there is no provision for these more remote claims. Rule 18.1 and 18.2 point to the fact that there is not a second category of remote claims. Further, rule 19 provides the mechanism for calculating the compensation payable for a protected claim. Again, there is no mention of wider claims.
- 52 Rule 20 is a knock-out blow to the claimants’ argument. It specifies the compensation calculation. The Scheme must calculate the liability in accordance with the terms of the contract. That is the clearest possible indication that there is not a second category of claim outside the terms of the contract. Rule 20 is a very extensive and precise rule. The

suggestion that there are claims beyond it “makes no sense at all”, as Mr Cutress QC succinctly put it. Such an approach is further supported by rule 9.1, which specifically requires that the claim is under a protected contract of insurance. The claimants’ case is inconsistent with a natural and obvious reading of rule 9.1. Rule 9.8 is a deeming provision, deeming certain claims to be under a protected contract of insurance. It is significant that there is no deeming of costs and interest. The claimants’ argument that costs and interest arise under the policy is “plainly wrong”. Having a liability under a contract is not the same thing as arising out of the contract.

- 53 As to *Geologistics*, the court should view *Geologistics* with caution. The costs were costs that arose under the contract and there was a specific contractual term. Hence those costs were indemnifiable. There is here no such contractual term. In *Geologistics* the costs were of an insured policyholder defending a liability claim. The costs were under the policy. Even though they were not compulsory, they were specifically catered for by an explicit contractual term. Therefore, *Geologistics* is of no real assistance as to the meaning of “in respect of”. Meaning, in any event, is context specific. This was emphasised by the Court of Appeal itself. The context of *Geologistics* of “in respect of” is different - a different set of rules, with a different structure. It is important to understand, Mr Cutress submits, how actually narrow the decision was in *Geologistics*. All that was covered in the judgment is whether the costs arose under a contract. The court held that they did; nothing more. Those costs were payable there because they were insured under the contract which was for compulsory insurance.
- 54 The *Barras* principle, enunciated in *Barras v Aberdeen Steam Trawling & Fishing Co. Ltd* [1933] AC 402, is no more than a starting point. The **Bennion** commentary on *Barras* makes this plain. Therefore, *Geologistics* provides no support for the proposition that the Scheme must cover the costs of pursuing the insurer or, indeed, the statutory interest. The refusal by the Scheme to pay the costs and interest is not an arbitrary decision, as the claimants submit. This Scheme will always pay what is payable under the contract. That does not depend on the whim or the interpretation of the Scheme or its rules. It depends on what is stated in the contract and ascertainable from it using the usual principles of contractual construction.
- 55 Having set out the rival arguments, I turn to the court’s analysis of them. I examine each of the three grounds in turn.

§VII. GROUND 1 – The true meaning of “in respect of”

(a) Introduction

- 56 The analytical process reflected in this judgment has inevitably been an iterative one. But a judgment must be written and delivered in a linear fashion. I have considered the statute, the rules and the authorities placed before me by parties all together.
- 57 The starting point must be the objective of the compensation scheme. Here it is to contribute to securing an appropriate degree of protection for policyholders, whether members of the public or small businesses. The question is what is meant by “appropriate”. That depends on all the circumstances of the particular type of liability that is subject to protected insurance and the purpose of the Scheme. There is no doubt that a balance must be struck. The Scheme cannot be open-ended and limitless in range. That is because the Scheme grants powers to the scheme manager to impose levies on the insurance market to fund it. Somebody has to pay for this. Thus, there is force in the defendant’s submission that the Scheme is structured to impose limits on what it should pay out to policyholders. That must be. It would not be fair to the insurance industry and would lack business

efficacy to impose limitless burdens on scheme funders. It must be fair to all, to the extent that this is possible. This necessitates that a balance must be struck and struck fairly and in the public interest.

- 58 I cannot see that a scheme would not be decisively informed by such obvious and fundamental principles. This approach was confirmed by the research paper that I drew to the attention of parties. It was part of the Parliamentary papers broadly construed in post-*Pepper v Hart* terms: see *Pepper v Hart* [1992] WLR 1032. It made clear that the scheme was designed to provide “limited compensation”. But again, limited in what respects? During the Parliamentary passage, Mr Heathcoat-Amory stated:

“The scheme will be of considerable concern to those in the market who pay for it to be set up and consumers want to know that it is properly run and can award compensation in appropriate circumstances. The FSCS is doing something of great importance in setting up the Compensation Scheme. It is also doing something quite difficult because the Compensation Scheme will become large and will handle considerable sums.”

It was said by Miss Johnson that:

“The underlying principle of the single scheme is to improve access for claimants and remove confusion about where claimants go for help and advice and to recover some of their losses.”

And Sir Nicholas Lyell observed:

“Our anxiety is that liabilities under the scheme should not be so open-ended as to frighten reasonable people from entering the market.”

- 59 Thus, I accept that the cost to those who must fund the Scheme was carefully considered by the legislature. The Scheme, as passed, does indeed contain limitations about who is an eligible claimant (rule 7); there are geographical restrictions (rule 9.2(b)). But I also remind myself of the words of Lord Mackay, Lord Chancellor (as he then was), writing extrajudicially, that there are many cases where Hansard “does not provide the court with much assistance”: see **Finishers, Refiners and Polishers: The Judicial Roles in the Interpretation of Statutes**, 1989 Statute Law Review 151. In this case, I am bound to say that I found Hansard of limited assistance. There are better sources for understanding exactly what the term “in respect of” means.
- 60 However, I accept Mr Cutress’ submission that, as he succinctly put it, “the line must be drawn somewhere.” And, equally, I am satisfied that the court should be vigilant against artificially extending - in fact, distending - the scheme to cater for hardship in cases on the wrong side of the properly demarcated line. The Scheme is not, in my judgment, created to provide limitless indemnity. That said, it is clear that if the claim comes within the purpose and object of the Scheme then there is “no upper limitation” to any amount that can be paid. Rule 17.2(1)(b) makes this plain (“no upper limit”). Thus, once your claim is four square within the parameters of the scheme, there is no upper ceiling on compensation vertically. Instead, it seems to me there is a horizontal perimeter that fences off what is an eligible claim by the intrinsic nature of the claim and not its quantitative value.
- 61 That is the vital question here. What does a valid claim mean? What is the horizontal range of recovery? This case is about the extent of that horizontality.

- 62 It obviously encompasses claims that arise under the insurance contract. The defendant accepts that. The defendant has paid out, for example, the VAT precisely because it arose under the insurance contract. But is there anything else? The decisive question, it seems to me, is what “in respect of” means for the purposes of a valid claim in the rule 1.2 definitions glossary. The two rival interpretations of those three words result in two diametrically opposed answers to this critical question. The defendant’s definition is “for payment of”, which results in no payment of costs and interest. The claimants’ definition is “in connection with”, which results in payment of costs and interest. Which is correct, if either?
- 63 There was an interesting interlude in forensic argument between counsel about the significance of the increase in cover for building insurance contracts, from 90 per cent to 100 per cent. It is important to track the reasoning of the PRA that led to this change. I shall cite it in some detail. It repays careful consideration. The rationale for this was articulated in the PRA’s policy statement from October 2020, PS21/20, “Extending policyholder protection for building guarantee policies”:

“1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) contains a rule change to increase protection for eligible policyholders of building guarantee policies (BGP). It makes amendments to the Policyholder Protection Part of the PRA Rulebook (Appendix).

...

1.6 The PRA considers that 90% coverage for protected policyholders of a BGP no longer amounts to an appropriate degree of protection, as discussed in paragraphs 1.8 to 1.13. The PRA defines BGP as a contract of general insurance providing building guarantee, construction warranty and/or structural defects cover in relation to newly built, converted or renovated residential property, including but not limited to the risk of physical damage and/or defect arising from non-compliance with relevant building or fire regulations or standards. The PRA also notes that in the case of BGP the ultimate beneficiaries of BGP policies have little choice in the selection of their insurer as the policy is usually provided to property owners by the builder and the policy is transferred to policyholders in onward sales.

1.7 Under rule changes set out in this PS protection will be extended, from 8 October 2020, to 100% for protected policyholders of BGPs.

1.8 In its last consultation on FSCS protection for GI policies (CP21/14, confirmed in PS5/152) the PRA explained that the two-tier approach to GI compensation limits reflected differences in the significance to policyholders of the risk insured, and the potential for significant adverse consequences for GI policyholders of cover being disrupted or obligations not paid.

1.9 The 90% cover for most GI policies was retained on the basis that these GI policies were short-term, they did not feature any contractual lock-in, and there were no significant costs of exiting and switching cover to another provider.

1.10 The PRA noted that this would leave the policyholder to bear some residual financial cost in the event of failure, but on balance rejected the alternative option of increasing cover to 100% for other insurance policies on the basis that it made no allowance for the different types of risk that disruption to cover could cause, as well as the higher costs for some FSCS levy payers.

1.11 The wider context of BGP has evolved significantly since the PRA set out its policy rationale for policyholder protection in 2014, particularly in light of the Grenfell tragedy, subsequent changes to building regulations and high profile court cases. The PRA considers that some features of BGP are similar to the policies for which 100% cover is available. For example:

- 100% protection is provided for claims arising from death or incapacity. This reflects the policyholder's likely lessened ability to seek alternative cover and mitigate risk in other ways. BGP has similar features because, even if alternative cover is available, it may be prohibitively expensive.
- 100% protection is also provided for liabilities subject to compulsory insurance (i.e. where that insurance is required by legislation). Notwithstanding that BGP is not required by legislation, it is likely to be a necessary requirement for any lender when advancing a mortgage in respect of a new build property or when re-mortgaging an existing property, and therefore it has some features analogous to compulsory insurance.

1.12 Further, once known defects exist in a property covered by a BGP, the loss of BGP protection in the event of the subsequent failure of the insurer may have significant potential adverse financial and social consequences for policyholders, meaning that 100% FSCS coverage for protected policyholders represents a more appropriate degree of protection. These potential adverse consequences include:

- current owners may be unable to re-mortgage without comprehensive BGP, and it may not be possible to get a new BGP providing replacement cover without rectification of any defects which arose under the original BGP. An inability to re-mortgage may result in policyholders reverting to more expensive standard variable rate terms at the end of any initial discounted or fixed rate mortgage period, potentially creating 'mortgage prisoners';
- for similar reasons, current owners may be unable to sell their property;
- in a BGP context, the 10% residual amount that policyholders will have to contribute beyond the 90% FSCS compensation is, in reality, likely to amount to a significant amount of money which many BGP policyholders may struggle to find. This could mean they face the prospect of staying in a building that may be considered unsafe, and one they cannot afford to repair. The issue is exacerbated by the fact that, in buildings with multiple

occupants, building repairs may be a collective issue; and

- as an ancillary risk, the wider market consequences of BGPs not being covered at 100% appear potentially to be significant and difficulties in selling such properties will be exacerbated. These may have an impact on parts of the housing market. This in turn may have knock on impacts on the rate at which BGPs are available to current and potential policyholders, making these policies unaffordable for a potentially significant segment of the market.

...

1.15 When making rules in relation to the FSCS, the PRA ordinarily consults the public, conducts a cost benefit analysis and, where relevant, complies with additional statutory requirements relating to mutuals.

1.16 The PRA is aware that a firm with a book of BGP business has filed for administration. In order that protected BGP policyholders of this firm may benefit from 100% cover, the rule change set out in this PS must take effect before the FSCS declares the firm to be in default. In this context, the PRA considers that the delay involved in consulting the public, conducting a cost benefit analysis and following the additional requirements relating to mutuals would be prejudicial to securing the appropriate degree of protection for policyholders.

...

1.18 The costs to the FSCS (and ultimately the general insurance industry through any FSCS levies) of the change from 90% to 100% for BGP will depend on the future incidence of firm failure and the protected liabilities of these firms at the point of failure. FSCS costs from general insurance policies are spread across general insurance levy-payers in proportion to the business undertaken, and any future additional FSCS levy costs would likely be spread across a number of years as claims against any failed firms arise. Based on the PRA's current understanding of liabilities within the BGP market, the PRA does not consider the costs of this change for the general insurance sector are likely to be material

1.19 Therefore, under section 138L(2) of the Financial Services and Markets Act 2000, the requirements to consult the public, conduct a cost-benefit analysis and the additional requirements relating to mutuals do not apply.

Implementation

1.20 The rule change came into effect on Thursday 8 October 2020."

- 64 What is the significance of all of this? Note that, as 1.1 makes plain, the purpose was to *increase* protection for policyholders. Note also that the failure mentioned at 1.16 was not some unconnected event, but the failure of the successor insurer *in this case*, East West. This was following the decision of the Court of Appeal in favour of these claimants and against East West. Thus, the increase in cover sought by the PRA was a direct response to the failure of the insurance company in this case which jeopardised the interests of these

claimants. Here there was concern by the PRA as a result of East West's failure that even a 10 per cent shortfall in cover would result in significant difficulties for policyholders generally, but these policyholders were obviously at the forefront of the PRA's thoughts. And rightly so. Hence, the urgency of it all. The PRA Policy Statement is dated 8 October 2020. On 12 October, the two joint administrators from Ernst & Young were appointed. The PRA had been given notice that East West were filing for administration. Hence the PRA bypassed the due diligence consultation that would ordinarily take place.

65 In the October Policy Statement, the PRA expresses concern not only about a debilitating lack of cover the claimants might suffer, but also that there could be wider adverse market consequences. Thus, there was a public policy aspect. Such building guarantee policy failure may have a negative impact on a "potentially significant segment of the housing market."

66 The argument of the claimants is that this concern with the 10 per cent shortfall must be of relevance to the court in interpreting the extent of cover the Scheme actually affords. The claimants rely upon what was said by Waller LJ in *Geologistics* in the Court of Appeal at para.7:

"... the [1975] Act as a whole is clearly by the provisions such as Section 8(2) concerned with protecting policy holders albeit in that context private policyholders, and only to the extent of 90%. The language of Section 8(2) and Section 6(4) is the same save for the fact that the indemnity is 100% and corporate policyholders are now included. Furthermore the fact that corporate bodies are included and the extent of the indemnity is increased to 100%, is consistent with the notion that, because insureds have been forced to take out insurance and pay premiums, therefore, if insurance companies become insolvent, all policyholders ought to be protected completely."

It is that last sub-clause that Mr Drake QC particularly places reliance upon - complete protection.

67 The submission is that it would be an absurdity if the PRA took the dramatic step to raise cover to 100 per cent without public consultation when the claimants would suffer the far greater impact of unpaid costs and interest in this case. Mr Drake argues that these developments clearly indicate a policy of what he calls "full compensation".

68 I do not consider this the right way to look at these developments. Mr Drake submits that the Scheme should put the policyholders in a position as if the default had not occurred. However, I cannot think that the Scheme was developed as a full indemnity mechanism for policyholders horizontally, as I have called it, that is in terms of categories of compensable claims. The PRA was rightly concerned about the serious impact on policyholders of shortfalls even of the order of 10 per cent. But that does not mean that heads of claim that were not envisaged by Parliament should be artificially shoehorned within those defined horizontal perimeters of the Scheme.

69 But I do find that these East West/PRA events cast light on the purpose of the Scheme and thus help point to the correct interpretation of the rules. Plainly there is great concern by the designated authority about the plight of entirely innocent policyholders. It is a responsible thing for the PRA to have taken urgent steps to protect policyholders and circumvent the usual cost benefit analysis and due process of public consultation to ensure prompt extra protection before East West was actually placed in administration. It seems to me that such

an initiative, emanating from wider public protection concerns, is of relevance when understanding the purpose of this scheme as a whole. It exists to offer protection to members of the public and small businesses who would otherwise be vulnerable to corporate or institutional failure that is not their fault and that they could do absolutely nothing about. That much is clear.

- 70 The protection comes from ensuring that the benefits policyholders would have had *under* the contract of insurance protected by the Scheme will be honoured by the Scheme completely - that is, raised for BGP to 100 per cent. The cost of the increased cover will be funded by the levy payers, the general insurance market, spreading the load of insurance failure throughout those actors and entities engaged in this financial sector. It cannot, however, be limitless horizontally. As Sir Nicholas Lyell said, it is important not to deter reasonable people from joining the insurance market.
- 71 So how and why, if at all, can litigation costs and/or the judgment sum interest come within the legitimate 'ground and cause' of the Scheme (to borrow Lord Tindal CJ's phrase)? It strikes me that *Geologistics*, while not being dispositive, does cast light on this question, but not necessarily for the reasons that the parties have advanced. I, therefore, turn to *Geologistics*, considering, first, the decision of Davis J in this court, *R (on the application of Geologistics Ltd) v Financial Services Compensation Scheme* [2003] EWHC 629 (Admin), before moving on to the Court of Appeal.

(b) *Geologistics* – first instance

- 72 On 17 June 2001 the Independent Insurance Company Limited ("Independent") was placed into provisional liquidation, provisional liquidators being appointed on that date. The question that was then raised was this: is the Financial Services Compensation Scheme, the successor to the Policyholders Protection Board, liable on the true construction of s.6(5) of the Policyholders Protection Act 1975 to bear the costs of solicitors retained by a limited liability company? The company had taken out the relevant insurance with Independent. The costs were incurred in the unsuccessful defence of a claim for damages for personal injuries brought by an employee of that insured company.
- 73 The claimant in the judicial review claim was a company called Geologistics Limited. At the relevant time, it was insured in respect of, amongst other things, employers' liability by Independent. What had happened was that on 4 January 1997 an employee called Mr Froggatt, who was employed as a cargo handler at the claimant's premises in Manchester, as it happens, suffered an injury at work. A bar weighing over a ton fell on Mr Froggatt's foot and injured him. He commenced proceedings for damages. The claimant notified its insurers, who were, of course, Independent. The policy in question taken out by the claimant with Independent was a composite policy. That means it did not cover solely employers' liability but extended to cover various other heads of liability. For example, in what was called "general policy extensions" the policy provided as follows:

"(1) Claimants' Costs and Expenses

The Company will provide indemnity against legal liability for all costs and expenses recoverable by any claimant in connection with any claim to which the indemnity expressed in Sections 1, 2 or 3 applies."

And then significantly:

"(2) Defence Costs and Expenses

The Company will provide indemnity in respect of all

(a) costs incurred with the Company's written consent of legal representation at any

(i) coroner's inquest or other inquiry in respect of any death;

(ii) proceedings in any court in respect of any act or omission causing or relating to any occurrence.

(b) other costs and expenses incurred with the Company's written consent in relation to any matter which may be the subject of indemnity under Sections 1, 2 or 3."

- 74 The claim brought by Mr Froggatt was defended by the claimant with solicitors DAC acting on their behalf. In due course, the liability to Mr Froggatt was admitted. Quantum, however, was not. There was a trial at Manchester County Court and ultimately judgment was given in favour of Mr Froggatt on 7 February 2001 for damages in the sum of £110,650.87, including interest with costs. The costs of DAC acting up to 17 June 2001, that is the date of the provisional liquidation, were put at £15,710.55. The costs of DAC in acting after that date amounted to £8,984.81. It was submitted that since Independent had been placed in insolvent liquidation, the claimant was entitled to recover these costs from the Financial Services Compensation Scheme. That was because of the provisions of the Policyholder Protection Act 1975 (as amended). The claimant requested payment from the Scheme and correspondence ensued - very similar to the situation in this case.
- 75 By a reasoned letter dated 25 July 2002, the Scheme denied that it had any legal obligation to pay such legal costs incurred by the claimant through DAC in its unsuccessful conduct of the defence in the proceedings prior to 17 June 2001. The claimant was aggrieved by such decision and commenced the proceedings by way of claim for judicial review, issued on 22 August 2002. By its claim form, the claimant sought declaratory relief as to its claim of entitlement to be paid such costs by the Scheme and also an order for the payment.
- 76 The statutory background was that by virtue of the Employers' Liability Compulsory Insurance Act 1969 ("the 1969 Act"), insurance against liability for employees is, broadly speaking, made mandatory. As the title to that Act states, it is "an Act to require employers to insure against their liability for personal injury to their employees and for purposes connected with the matter aforesaid." The claimant was therefore required by statute to insure against liability for bodily injury or disease sustained by its employees in accordance with s.61 of the 1969 Act.
- 77 A few years after the introduction of the 1969 Act, and in the wake of some highly publicised collapses of certain insurance companies, the Policyholders Protection Act 1975 was passed. The long title to that Act is "an Act to make provision for indemnifying (in whole or in part) or otherwise assisting or protecting policyholders or others who have been or may be prejudiced in consequence of the inability of authorised insurance companies carrying on business in the United Kingdom to meet their liabilities under policies issued or securities given by them and for imposing levies from the insurance industry for the purpose." Section 1(2) states:

"The function of the Board [that is to say the Policyholders Protection Board, now the Scheme] shall be—

- (a) to take the measures provided for by sections 6 to 16 below for the purpose of indemnifying (in whole or in part) or otherwise

assisting or protecting policyholders and others who have been or may be prejudiced in consequence of the inability of insurance companies carrying on business in the United Kingdom to meet their liabilities under policies issued ...”.

- 78 The judge held that it was clear from those provisions, including the long title, what the policy behind the 1975 Act essentially was. It was to provide a degree of financial protection to those policyholders exposed by the collapse of insurance companies. The judge found s.6 of the 1975 Act (as amended) to be of central relevance to the claim. It provides:

6. “Compulsory insurance policies and securities

(1) This section applies to any policy which satisfies the requirements of any of the following, that is to say—

...

(b) section 1 of the ... Employers' Liability (Compulsory Insurance) Act 1969 ...

...

(4) Subject to sections 9, 13 and 14 below and the following provisions of this section, it shall be the duty of the Board to secure that a sum equal to the full amount of any liability of a company in liquidation towards any policyholder or security holder under the terms of any policy or security to which this section applies is paid to the policyholder or security holder as soon as reasonably practicable after the beginning of the liquidation.

(5) Subsection (4) above does not apply by reference to any liability of a company in liquidation under the terms of a policy to which this section applies **arising otherwise than in respect of a liability of the policyholder which is a liability subject to compulsory insurance.**”
(emphasis provided)

- 79 The judge found that the crux of the case lay in the words “in respect of” as used in s.6(5) of the 1975 Act. He found that it was reasonably clear that s.1 of the 1969 Act does not compel an employer to insure against liability for employees’ costs of litigating a claim. He said, however, at para.38:

“In my view, however, the suggestion that the victim's costs are sufficiently connected to the liability to be within the phrase “in respect of” but the unsuccessful defendant's costs are not sufficiently so connected is unconvincing. Those defence costs are incurred precisely by reason of this very claim which was of a kind for which insurance cover as to liability had been required.”

He continued:

“As it seems to me, these defence costs can be said to relate to and be connected with a liability required by the specified statute to be covered by insurance such that they are within the ambit of the phrase “in respect of” in section 6(5), on a fair and natural reading of the subsection.”

The judge held that the exclusion “otherwise and in respect of” liability of the policyholder, which is a liability which is subject to compulsory insurance is not simply disposed of as a matter of definition. He found that it was also a matter of degree; that is, by reference to the terms of the particular policy in question. Regard must be had to the circumstances of each case to assess whether the degree of connection is shown to be sufficient to bring the liability within or, as the case may be, outside s.6(5). Therefore, the judge concluded, at para.41:

“I accordingly think that, on its natural and ordinary meaning, section 6(5) extends full protection to the claimant for its costs of unsuccessfully defending Mr Froggatt's claim. Those costs in my view are in effect part and parcel of that claim and are part and parcel of, and integrally linked to, the liability for which insurance cover was required under section 1 of the 1969 Act, and are within the reach of what was designed to be recovered from the Scheme under section 6(4) and (5).”

80 The judge felt that this was, firstly, fair. He said at [42(1)] that he thought it was:

“... hard indeed, in such circumstances, and where the insurance concerned was compulsory, for the insured to be left to bear these legal costs of such defence; and one really must wonder whether Parliament could have intended that.”

He found that the logic of the argument that the pre-liquidation costs incurred in a successful defence do not relate to a liability and cannot be recovered from the Scheme was little short of what he said was “monstrous”. If the logic of such an argument compelled such conclusion, then it suggests at least that the premise must be wrong. Moreover, such a conclusion would hardly stand to enhance the reputation of the British insurance industry, which one would have thought would be at least a relevant consideration. Therefore, the judge’s conclusion was that the claimant, on the true interpretation of this business policy and of the provisions of s.6(5) of the 1975 Act, is entitled to be paid by the Scheme its proper costs of defending the proceedings brought by Mr Froggatt up to the period of 17 June 2001, which was the date of the provisional liquidation of Independent. He said that he thought that the reasons for the Scheme’s rejection of such a claim, by its letter of 25 July 2002, were “wrong in law.”

(c) **Geologistics – Court of Appeal**

81 As I have indicated, there was an appeal by the FSCS and this matter came before the Court of Appeal in November and December 2003: see *R (Geologistics Ltd) v Financial Services Compensation Scheme* [2003] EWCA Civ 1905. The Court of Appeal dismissed the FSCS’s appeal.

82 The court held that s.6(5) of the 1975 Act produced the result that what the policyholder could recover under s.6(4) of the Act “went beyond” the liability which was required to be compulsorily insured. What was contemplated was that under a policy which was required to be taken out, the policyholder would be entitled to recover against the insurance company some indemnity *beyond* that for which the statute compelled insurance. However, that by virtue of s.6(5) a policyholder would only be able to recover from the defendant if that right to indemnity was “in respect of” the liability subject to compulsory insurance; that the words “liability subject to compulsory insurance” in s.6(5) were descriptive of the type of insurance covered by the policy and not intended to describe an established liability. Accordingly, on a proper reading of the policy of insurance, the defendant was liable to pay the claimant’s costs of defending a claim.

83 In the Court of Appeal, counsel placed before the court various authorities in which courts, not only in this jurisdiction but also elsewhere, as for example in Australia, gave their views on what the words “in respect of” mean. Cited to the Court of Appeal was *Trustee, Executors & Agency Co Limited v Reilly* [1941] VLR 110, which was a decision on an Australian statute, the Farmers Protection Act 1940. The judgment was given by Boreham J. He stated that “in respect of”:

“convey[s] some connection or relation between the plaintiff's claim and the personal injuries that she sustained, that is, a claim against her ex-solicitors.”

84 There were other authorities cited about the meaning of “in respect of”. However, at para.17 Waller LJ stated:

“I do not get much assistance from the authorities. They simply demonstrate that the proper construction of the words will depend on their context.”

And then he continued at para.23:

“In any event it seems to me that the narrow construction placed on Section 6(5) by [the defendant] is inconsistent with there being the two subsections. If Section 6 (4) and (5) were intended to provide an indemnity against only that which was required to be the subject of compulsory insurance, Section 6(4) could have so provided without the need for Section 6(5). That alone supports the view that the words "otherwise than in respect of a liability of the policyholder which is a liability subject to compulsory insurance", must be intended to produce the result that what the policyholder can recover under section 6(4) goes beyond the liability which must be compulsorily insured. What is contemplated is therefore that under a policy which is required to be taken out, the policyholder will be entitled to recover against the insurance company some indemnity beyond that for which statute compels insurance, but by virtue of Section 6(5) that right to indemnity must still be "in respect of" "the liability subject to compulsory insurance".”

85 Waller LJ held that the arguments put in front of the court by the defendant did not, in his view, face up to the interpretation of the language of s.6(5) of the 1975 Act. In s.6(5) the words are descriptive of the type of insurance. “In respect of” has to mean “in connection with”, and that is the reason why the claimant’s costs are recoverable. His Lordship said at [28]:

“Once the narrow construction is rejected, and "in connection with" becomes the route to the claimant's costs being recovered, I do not see how defence costs "in connection with" or "in relation to" fall into some different or irrecoverable category. Certainly the object or purpose of the statute relied on does not require a strained construction to be placed on Section 6(5) to achieve that result.”

And continued at [29]:

“Clearly the Scheme was not intended by section 6(4) to cover matters which were not the subject of compulsory insurance nor any costs incurred in respect of the same. Section 6(5) is intended to make that position clear and no more.”

86 That brings me to the end of the two *Geologistics* decisions. I turn, therefore, to the court’s conclusions about the *Geologistics* litigation.

(d) Conclusions about *Geologistics*

87 I find that the analysis offered by the defendant in this case of *Geologistics* is flawed. The decisions, at first instance and then in the Court of Appeal, did not primarily turn on whether there was a specific term in the contract directed towards costs – the “narrowness” of the decision submitted by Mr Cutress. It happened that the policies did contain such a term – they were composite policies. But there is no suggestion in either court that if the costs were not sufficiently connected to the liability, the costs would have been recoverable from the Compensation Scheme if they were covered by a contractual term somewhere within a composite contract. The Scheme was concerned with liabilities that had to be insured against as a matter of compulsion. That was the qualifying condition for protected liability. The nature and significance of *that* stipulation is something I will examine shortly.

88 The question is what else, if anything, would be payable by the Scheme. The costs in *Geologistics* were not subject to compulsory insurance. The issue was whether they were sufficiently connected to the protected liability. The Court of Appeal approved a decision of this court whereby a policyholder’s costs were deemed recoverable from a previous compensation scheme. I accept the submission that one must exercise caution since it was a different scheme with different rules. Nevertheless, it was also a compensation scheme aimed at protecting policyholders from the failure or collapse of insurers.

89 In terms of background and purpose, it bore a marked and material resemblance to the current scheme and that is an important context too. The FSCS was established by the 2000 Act to replace the Policyholders Protection Board that was established by the 1975 Act. . But I accept that the decisions only provide limited assistance to me. The first instance decision is of an equivalent judicial tier and is persuasive at best. The Court of Appeal decision is not, in my judgment, binding on me about the meaning of “in respect of”. It is about a different statute. Furthermore, I have at the forefront of my mind the *Barras* principle; more exactly, the limitations on it, cited in **Bennion** at para.24.6:

“24.6 Judicial interpretation of earlier legislation ‘*Barras* principle’:

(1) Where an Act uses a word or phrase that has been the subject of previous judicial interpretation in the same or similar context, it may be possible to infer that the legislature intended the word and phrase to bear the same meaning as it had in that context. This is sometimes known as the ‘*Barras* principle’.

(2) This is at most a presumption, the strength of which will vary according to the context. There is no rigid rule that words must be given the same meaning that they have been given in an earlier Act. The question in the end is always whether the legislature intended the term to be given a meaning it has been given previously.”

90 That said, I am also mindful of what Sir Rupert Cross said at p.152 of his **Statutory Interpretation**:

“So far as judicial decisions are concerned, although those with regard to the meaning of words in one statute are not binding as far as words in another statute are concerned, unless the second statute consolidates the first, they often have quite persuasive force.”

- 91 To me, rather than any binding effect (or otherwise) of the ratios in these decisions, what I find of far greater assistance is the nature of the court’s reasoning at each level. The assistance is limited. But it is not non-existent. There is, it seems to me, some residual persuasive force.
- 92 What is striking in *Geologistics* is there the costs “went beyond” the liability that was prima facie covered or protected by the Scheme. They were the costs of defending a claim brought by an employee for personal injury. The policyholder was obliged to insure against this liability. The liability was covered by the Scheme as compulsory insurance was a qualifying condition for protected liability, and thus compensable cover. But the policyholder was not obliged to insure against the litigation costs. The fact that the composite policy in *Geologistics* happened to contain a contractual term for such costs was not, to my mind, the significant matter. What was crucial was the reason the Scheme had to pay out those costs. It was clearly explained by Davis J in his judgment. The “crux of this case”, as he put it, lay in the proper interpretation of the words “in respect of” (para.30). The costs could be said to relate to and be connected with any liability subject to compulsory insurance. As such, they were within the ambit of the phrase “in respect of” (para.38). The costs were “part and parcel of that claim and are part and parcel of and integrally linked to the liability of which insurance cover was required” (para.41). The Court of Appeal endorsed the analysis of Davis J that “in respect of” for the purposes of the statute meant “in connection with” (para.28, Court of Appeal). The policyholder can recover what is beyond the protected liability, here subject by statute to compulsory insurance - if, and only if, the head of claim was in respect of that liability. That is, in connection with the protected liability. Costs of defending a claim went beyond what statute compelled, but were recoverable because they were connected to that protected liability and were part and parcel of it and integrally linked to it.
- 93 I am bound to say that I find the interpretation of “in respect of” advanced by the defendant in this case as strained. I do not see why there would be a need in the definition section of the rules to say that a valid claim is a claim for payment of a civil liability. It seems to me that on the defendant’s interpretation, the words “in respect of” add precious little. What I do find, however, is that they are not there by chance. Before I explain their true import and effect, I must deal with a vital question arising out of *Geologistics*.
- (e) **Significance of compulsory insurance**
- 94 There is a difference in the insurance requirements between the situations in *Geologistics* and here. The question is how significant it is. I have considered this question at some length and now provide my analysis. In *Geologistics* the liability was subject to compulsory insurance by virtue of statutory requirement. In the instant case, however, the building guarantee insurance is not a statutory requirement, but the policyholders receive 100 per cent cover from the Scheme for the liability arising under such a protected contract.
- 95 Put another way: in *Geologistics* the costs are incurred because they are necessarily expended to defend in litigation concerned with the protected liability (employee injury) – there subject to insurance compulsory as a matter of law. In the case before me, the costs are incurred because they are necessary to secure the benefits arising from the protected liability. Although in this case the insurance is not compulsory as a matter of law,

prospective leaseholders such those of New Lawrence House, in practice must obtain building guarantee insurance to secure funding. I explain why shortly.

- 96 It strikes me that the situation can be helpfully simplified with a clear taxonomy. I use it as a method of explication, not as a rule of law or other gloss.
- 97 In *Geologistics* recovery from employers' liability is what I shall call for clarity's sake a Class 1 claim. It is compensable as it is for a protected liability and is unquestionably covered by the Scheme. But there is a second class of claim, a Class 2 claim. This court and the Court of Appeal made it clear in *Geologistics* that recovery could 'go beyond' the protected liability, although I emphasise that neither court used the 'class' taxonomy. I use it to clarify the situation. That further Class 2 claim for costs in *Geologistics* was compensable because it arose in respect of the Class 1 claim for a protected liability and, critically, was integrally connected to it or part and parcel of the protected liability. It had a sufficient degree of connection to the liability to be compensable beyond - and that is the critical word - a liability that was protected, there subject to compulsory insurance.
- 98 In the case before me, the BGP liability is compensable under the rules. Indeed, the VAT on it has been paid out by the Scheme without any question. The payment out is a classical Class 1 claim. But I find that litigation costs and judgment sum interest are integral to the BGP protected liability. They are part and parcel of it and have a sufficient degree of connection to it to constitute a compensable Class 2 claim. Take costs: without incurring them, the sums for the protected liability are likely never to have been recovered. They are absolutely integral to the recovery of the protected benefit.
- 99 I test this conclusion by the following thought experiment. Consider a case where there was no compulsory insurance requirement, but the designated regulatory authority was so concerned about the shortfall in protected cover that for non-compulsory cases it increased the cover to 100 per cent of liability in the event of insurance firm failure. Now consider a further claim beyond the protected liability claim. Let us call it for the sake of argument for "expenditure", and that was inextricably and integrally connected to the securing of the benefits unarguably arising under the protected insurance policy and without which those benefits would not in all likelihood be secured. It seems to me an absurdity that such expenditure would not be compensable under the Scheme. That is because the expenditure has been necessary and unavoidable for the policyholders to enforce and give life to their protected policy benefits which would otherwise very likely be lost. Consider the position of the claimants: such expenditure is not an optional add-on, a luxury, irrelevancy or indulgence. Such an approach chimes strongly with the core ambition of the Scheme: to protect policyholders from seriously damaging shortfalls caused by insurance firm failure.
- 100 Thus, I find that there is a simple taxonomy that provides helps explain both *Geologistics* and this case. It is a two-stage test:
- Stage 1:** ask what liability is protected and thus compensable under the Scheme. This is a Class 1 claim.
- Stage 2:** ask whether any further claim is integral to, part and parcel of or sufficiently connected to the compensable Class 1 protected liability. This is a Class 2 claim.
- 101 Seen through this lens, this is why costs were compensable in *Geologistics* as what I call a Class 2 claim. That is why costs are also compensable in this case as a Class 2 claim. Both are integrally connected to protected liabilities and, thus, integrally connected to protected

claims. The true conceptual distinction dividing compensable claims is not between liabilities subject to compulsory insurance and those that are not. Non-compulsory insurance liabilities for building guarantees are 100 per cent compensable under the present scheme. Instead, the true distinction is between those heads of claim that are integrally connected to a protected liability covered by the Scheme and those that are not.

- 102 But even if the question turned on compulsory insurance (and I am convinced it does not), I would find that BGP is so materially analogous to compulsory insurance cases to be similarly compensable. I derive support for that conclusion from the PRA itself. As noted, it extended cover to 100 per cent due to the failure of East West in this case and thus to the same level of cover as compulsory insurance cases. In the PRA Policy Statement in October 2020 that announced the cover extension, it stated at para.1.11:

“Notwithstanding that BGP is not required by legislation, **it is likely to be a necessary requirement** for any lender when advancing a mortgage in respect of a new build property or when re-mortgaging an existing property, **and therefore it has some features analogous to compulsory insurance.**” (emphasis provided)

Thus, the features of BGP as it operates in the real world – and that is what this court must consider - are materially analogous to compulsory insurance. Indeed, the PRA has recognised as much. I find that it operates sufficiently analogously.

- 103 While the Class 1/Class 2 taxonomy is a simple explanatory tool, the ramifications for this case are profound. I note, and as previously cited, that at first instance in *Geologistics* Davis J stated that given the compulsory insurance requirement, it would be “hard” for the insured policyholder to bear the litigation costs: see [42]. But looking at the judgment overall, what is plainly of great significance is the degree of connectedness between litigation costs and protected liability. The critical feature is not the compulsory nature of the insurance, but the degree of connection to the protected liability covered by the structure of the Scheme in question. I find that there is a great similarity between that aspect of *Geologistics* and the 25 claimants in this case having to litigate to vindicate their right to benefits under the protected insurance contracts which they were all but compelled to take out, given the practical operation of the housing and mortgage/loan funding markets for new builds.

(f) Meaning of “in respect of”

- 104 As previously indicated, after this interlude on compulsory insurance, I return to the words “in respect of” in the modern scheme. In short, I find that they mean “in connection with”. But the real question is how to assess what the necessary degree of connection is.
- 105 The three words exist for a very clear and obvious reason. It is precisely as the High Court and the Court of Appeal found in *Geologistics*. It envisages that a valid claim can indeed go beyond what is strictly recoverable under the contract of insurance per se. It did in *Geologistics*. I am bound to say, however, that I reject the claimants’ argument that one should construe costs and interest as arising under a contract of insurance. They do not. But they are plainly ancillary to it. They are materially connected to it because to recover that protected benefit under the contract of insurance litigation costs were necessarily incurred. They have been awarded by the Court of Appeal for precisely that reason. They are part and parcel of the recovery of the benefit that itself arises under the protected contract. They are, therefore, integrally linked to it. One can apply a straightforward “but for” test. Given the intransigent and stubborn attitude of the insurers in this case – so witheringly deprecated by Coulson LJ in the Court of Appeal (their “strained and artificial” approach: see [82]) - the

sums owing to these claimants would not have been recovered from the insurers but for the incurring of the litigation costs.

- 106 Let me be clear about my approach. I do not find that the interpretation of “in respect of” by the Court of Appeal in *Geologistics* is determinative of the interpretation of “in respect of” in this case. I do not hold that it is a binding precedent, but it is a valuable steer given the similarities of the situations and I have used it when looking at the purpose of the 2000 Act and the Scheme rules as a whole, all considered together in context. That is because as the Court of Appeal held, as Davis J at first instance held, the meaning of a phrase like “in respect of” depends on its context. It is, however, of some persuasive force that the Court of Appeal interpreted “in respect of” to mean “in connection with”. I find that it means the same.
- 107 The conclusion of the Court of Appeal in *Geologistics* is, frankly, a million miles away from the “for payment of” interpretation argued for by the defendant here. I regard that as an artificial gloss. If what the PRA rules sought to say was that a claim is exclusively restricted to a civil liability under a contract of insurance they could have said precisely that in the definition section. They do not. Further, looking at *Geologistics*, such an approach to “in respect of” for those rules would have prohibited the payment of the litigation costs there. Yet the Court of Appeal approved them.
- 108 Instead, what the Court of Appeal held in *Geologistics* was that an earlier insurance failure compensation scheme should pay out for a head of claim that went beyond the protected liability that was covered by the scheme. But there was a clear condition precedent. It was only compensable if there was a sufficient connection between what is claimed and the liability that is protected by the scheme.
- 109 I find that there is a similar sufficiency of connection in this case between the costs and the interest sought by these claimants and the building guarantee liability that is protected by this Scheme. It strikes me that it would be an absurdity if they were not able to recover the costs necessarily and integrally incurred to recover what was owed to them under the insurance contract that fell comfortably and completely under the protective umbrella of the Scheme. It would be an absurdity if they could not recover the outstanding judgment interest sum for a similar reason. The point of this Scheme is to protect members of the public and small businesses. This is a matter of high public concern. It seems to me that it would be an affront to that principle if blameless members of the public may never recover the very substantial but reasonable costs they were forced to incur to enforce their rights against an insurer under a protected contract of insurance – particularly where these costs have been expressly approved by the Court of Appeal.
- 110 It was essential for the claimants to take out insurance in this case. The PRA felt that the situation had analogies to compulsory insurance situations. My judgment is that it would do nothing for public confidence in the protective mechanism to exclude such protection. It would mean that the safety net would have a rip in it. I cannot believe that Parliament would have contemplated such an unjust and illogical outcome. I am convinced that Parliament did not. The words “in respect of” in the definition of valid claims in the rules are there for a reason. They are there not to tell us what we already know, that the Scheme must pay out for liabilities under a protected contract. That tells you nothing. Rather, these three words exist for another reason: to indicate that a claim can be valid beyond the protected contract if it is integrally connected to it and thus “in connection with” it. Viewed thus, the words “in respect of” are an important part of the protective mechanism. They open the door to (what I have called) Class 2 claims where, *and I emphasise only where,*

there is a sufficient degree of connection to the central protected liability. The words are not there to artificially restrict what could be recovered by members of the public and small businesses, but to ensure that innocent people and small companies going about their business are appropriately protected from insurance firm failure and collapse if, as here, they have to litigate to enforce their benefits under the policy. There may be other reasons. But this must be one of them.

- 111 To reach this conclusion, it is not necessary to contort the meaning of the words of the compensation scheme. Instead, the true understanding of the policy and object of the scheme makes it absolutely plain what the proper interpretation of those three words should be. This has nothing to do with sympathy but everything to do with proper legal construction.

(g) Explanation of the Scheme

- 112 I have been careful to look at the statute and the rules together as a whole and to view them along with the decisions in *Geologistics*, to the extent those decisions have relevance. There is, it strikes me, an obvious underlying coherence and consistency in all this. This is not surprising. So now I revisit the Scheme as a whole in its full context to provide the court's interpretation of each of these particular provisions about which argument has been heard.

(i) The statute

- 113 **Section 2C(2)** of the 2000 Act makes it plain that the objective is to secure an "appropriate" degree of protection for policyholders. What is appropriate will be informed by all the circumstances and the particular vulnerabilities and exposure to risk, along with the consequences of it, of a particular class of claimant. There is, quite rightly, concern about the potentially debilitating financial impact of a shortfall of coverage in building guarantee insurance contracts. To respond to that concern, the Scheme coverage has been increased from 90 per cent to 100 per cent, triggered by the failure of the successor insurers in this very case. Thus, protection has been increased for this specific class of policyholders. This is not just to protect them directly. But is in the public interest due to the concomitant negative impact insurance failure and the consequent inability to remedy defective properties would have on vital segments of the housing market. It strikes me that all these considerations inform what "appropriate" must mean and are of significance in assessing whether, as part of the wider protection, the Scheme should compensate for litigation costs integrally linked to protected liability and/or interest on judgment sums also closely and integrally connected. Construing these as being part of a valid claim is part of the appropriate protection.
- 114 **Section 213(3)(a)** states that the Scheme must assess and pay compensation in accordance with the Scheme. This is a point that is significantly relied upon by the defendant. But the Scheme includes a definition of what is a valid claim and that is the very question which is at the crux of the dispute here. The question is what are the perimeters horizontally of the Scheme.
- 115 **Section 214(1)(g)** makes it plain that a claim will only be entertained if it falls within a specific kind of claim. The definition glossary at rule 1.2 goes out of its way to define what a claim - and more precisely a valid claim - is for the purposes of this Scheme. Thus, returning to the taxonomy, there are potentially two types of claim that can make up a valid claim. What I have called for convenience "Class 1", a claim under a protected contract of insurance. That is the simple (civil) liability that the glossary defines. Both parties agree about this. It is the existence or non-existence of a second type ("class") of claim that is in dispute. I judge that there must be a further class of valid claim. But to qualify for this second class of claim, the item sought must be integrally linked to the protected claim and

part and parcel of it. That is what “in respect of” means. That is what it adds to the definition. It is why those words are there.

- 116 This was the situation for the Compensation Scheme under the 1975 Act. The Court of Appeal held that “in respect of” means “in connection with”. The Court of Appeal definition of “in respect of” in *Geologistics* is a world away from the definition advanced by the defendant in this case. That was a different scheme under a different statute, but its policy and object was materially similar: to protect policyholders where there is insurer failure. That was the position in *Geologistics*. That is the position here. *Geologistics* supports my analysis of the policy and object of the modern scheme as a whole. It would be wrong in principle to disregard *Geologistics* when the context has such a degree of similarity. The Court of Appeal’s decision is a valuable steer and cross-check for how the present scheme should be properly understood. But I emphasise it is no more and no less than that. I turn to an explanation of the rules.

(ii) *The rules*

- 117 **Rule 2.3.** It strikes me as interesting that rule 2.3 states that the Scheme is authorised to pay the “reasonable costs” of a policyholder bringing or continuing insolvency proceedings against an insurer. Why would that be? And once one knows that, how is it consistent and rational for the Scheme to nevertheless refuse to pay the costs ordered by the Court of Appeal to be paid to the claimants in recovering their benefit under the protected contract?
- 118 **Rule 9.1.** I find that the definition of “protected claim” of rule 9.1 does not disqualify the claimants’ claim. Nor is it, objectively viewed, inconsistent with it. It is, indeed, the case that a *protected* claim is one arising under a protected contract of insurance, but that does not mean that a *valid* claim is exclusively restricted to the liability that arises under a protected contract of insurance. These are different questions. It is noteworthy that “protected claim” is not defined in the glossary, whereas a claim, which means a valid claim, is.
- 119 **Rule 9.8.** I find the defendant’s argument about rule 9.8 and the deeming provision to be misconceived. There is no need to deem interest and costs as arising under a protected contract of insurance. This is because the definition of a valid claim is sufficiently flexible and sensitive to include them naturally. But this is if, and only if, these heads of claim have a sufficient degree of connection with the civil liability which itself must arise under the protected contract of insurance.
- 120 **Rule 17.** The fact that wider claims, beyond those arising under the contract of insurance, are not explicitly mentioned with this rule misses the point. Rule 17.1 makes it plain that this rule is directed at limits to the level of compensation payable by the Scheme for various categories of protected claims – the “level of cover” as the rule terms it. For building guarantee insurance claims, the level of cover is, as a result of East West’s failure, 100 per cent of the claim. It is the same for professional indemnity insurance claims and compulsory insurance situations. For all other categories of insurance claims, the level of cover is 90 per cent of the claim. This does nothing to define what a valid claim is. For that one must go back to the definition of “claim” and thus valid claim.
- 121 **Rule 19.3.** The overall claim is the net claim that the policyholder has. This is the net aggregate sum of protected claims less any legitimate set-offs. The overall claim is simply that figure. It really means the overall protected claim but does not mean the definitive valid claim. These, again, are two separate concepts.

122 **Rule 20.** It is unquestionably true that rule 20 is important. It provides the compensation calculation. The Scheme undoubtedly must calculate the liability, as rule 20 makes clear, of the insurers to the policyholders in accordance with the terms of the contract. That is unarguable. But it seems to me that this is dealing with quantifying what the glossary calls the “civil liability”. That civil liability must be calculated in accordance with the insurance contract. But rule 20 does not deal with what “in respect of” that civil liability (as calculated in accordance with rule 20) means. It certainly does not prohibit or prevent a claim for items that are part and parcel of the protected liability or integrally linked to it. It deals with the civil liability element of the definition of claim. Indeed, here the Scheme has paid 100 per cent of what was owed in respect of Value Added Tax under the protected contract. But rule 20 does not dispose of the question whether costs and interests on the judgment sum are compensable in respect of that protected liability. It is a different question.

123 One simply has to pause and ponder the business efficacy of the argument advanced by the defendant. It seems mystifying that in a contract of insurance written by an insurer such as Zurich, there should be a contractual term that insures the litigation costs of pursuing that same insurer if it refuses to respond to a claim on its own policy. This makes next to no business sense. Or is it the case that the structure of the Scheme necessitates that in practical terms to secure a mortgage not only must BGP insurance be taken out, but also, at the same time, the borrower should take out litigation insurance in case that policyholder has to pursue the insurer at some indefinite point in the future. If it literally were the case that the Financial Services Compensation Scheme should never pay litigation costs for pursuing a recalcitrant insurer that then failed, it is surprising indeed that there is no public alert, let alone warning, about this. Surely the public interest would demand this. The answer is straightforward. No such warning is needed. This is because if the litigation costs are part and parcel of the protected liability, they are “in respect of” that liability and in connection with it. As such, they are payable by the Scheme.

(h) Conclusion – Ground 1

124 Stepping back, there is a unity and consistency with this interpretation that broadly mirrors the approach of this court and the Court of Appeal in *Geologistics*. This should not be the cause of astonishment. Both cases deal with the question of whether costs incurred by policyholders are payable under a statutory compensation scheme which is designed to protect policyholders for protected liability when there is a failure or collapse of insurers when the costs are beyond the protected liability but integrally connected to it. The statutory mechanisms created to protect members of the public are also connected. The FSCS was established to replace the Policyholders Protection Board. In both cases, costs are payable by the respective scheme because they are part and parcel of the protected liability. There is in both cases a sufficient degree of connection. Interest on the judgment sum is, in my view, undoubtedly similarly and integrally linked for the reasons I have already given and, thus, compensable under the Scheme. In *Geologistics* the protected liability was subject to compulsory insurance. In the case before me, the liability is for a category of insurance closely analogous to compulsory insurance and elevated by the PRA itself to the same highest level of protection as compulsory insurance cases - that is 100 per cent cover - as a result of the insurer’s failure in this very case.

125 Therefore, Ground 1 succeeds.

126 Having comprehensively provided my analysis of Ground 1, I can deal with the remaining two grounds with far greater rapidity.

§VIII. GROUND 2 – Protected claim

127 It will be obvious from my analysis that a protected claim is a claim under a contract of insurance. Rule 9.1 makes that plain. I do not see how costs and interest are protected claims under a contract of insurance. They may arise in respect of the protected policy (and a protected claim) but they are not themselves protected claims. Therefore, Ground 2 fails.

§IX. GROUND 3 – Claim “owed under a contract of insurance”

128 Consistent with the above analysis, I am clear that costs and interest are not “owed” under a contract of insurance. There is no explicit contractual term insuring for these two heads of claim, nor can I find one by necessary implication. I accept the defendant’s submissions in resisting this ground of challenge. Therefore, Ground 3 fails.

§X. CONCLUSION & RELIEF

129 Before I turn to the relief I grant, may I say the following to the leaseholders of New Lawrence House. There has been a lot of legal technicality in this judgment, so let me be clear. You have won today.

130 You won on your first ground. That is enough to quash the unlawful decision of the Financial Services Compensation Scheme that you complain of. This court rules that you should be compensated for both costs and interest. That said, I appreciate that this seemingly endless labyrinth of litigation must have been something akin to a nightmare for you. To ordinary members of the public, it must appear puzzling that the Court of Appeal, our second highest court, unanimously ordered that you should receive costs and interest from the insurers and then the very Scheme that has been created to protect the public when such an insurer fails or collapses, refuses to pay the costs you reasonably incurred so that you could receive the benefits you were entitled to under the protected insurance contracts. It is also must appear puzzling that the Scheme refused to pay the interest on the judgment that the High Court awarded you.

131 For years you complained about the abject and dangerous conditions at New Lawrence House, and rightly so. This ordeal must have been an enormous strain. In all of this, what have you done wrong? Nothing. You trusted the builders and were let down. You trusted the insurance companies and were let down. When the insurers went into administration, you sought relief from the very compensation scheme created by Parliament to protect the public and you were let down. The Scheme made a decision that you found unfair and inexplicable. This court has found it to be unlawful. But let me make myself very clear. My decision today is not based on sympathy for your predicament, terrible as many right-minded people will find it to be. Instead, it is a ruling by this court as a matter of law that the compensation scheme we, as a community, have created to protect you does, in fact, protect you, despite its earlier unlawful decision. Now this compensation scheme must compensate you for the costs you have had to incur in your successful litigation against your insurers to recover your benefit under the protected insurance contracts and the interest that has accrued on the judgment sum ordered in your favour by the High Court.

132 Therefore, subject to any further submissions on disposal and relief to be made by parties at the forthcoming hearing on consequentialia on 15 September 2022, I grant the following relief, subdivided into three constituent elements:

(1) I grant the declaratory relief sought in favour of the twenty-five claimants;

(2) I find that the Scheme's decision, expressed in its decision letter dated 6 May 2021 to reject the claims for costs and interest was wrong in law;

(3) I grant an order pursuant to s.31(5)(a) of the Senior Courts Act 1981, quashing that decision which was based on an error of law and remit the matter to the Financial Services Compensation Scheme with a direction to reconsider the claimants' application for unpaid costs and interest in accordance with the findings of this court.

133 When *Geologistics* was before this court, Davis J stated at para.42 that "the blameless often suffer". These claimants have had to endure much over the years. I trust that this decision will give them some relief, even though the property they purchased leases in still lies in what amounts to a ghostly silence.

134 That is my judgment.

APPENDIX

	Claimants
1.	Mr Paul Montgomery
2.	Mrs Beverley Goldman
3.	Mr Bharatkumar Shah and Mr Dineshkumar Shah
4.	Mrs Emma C Emin
5.	Mr Clive Allen and Miss Jane Whale
6.	Mr Sebastian Green as executor of the estate of Ms Wendy Green
7.	Mr Stuart Mills
8.	Mr Grant Sugarman
9.	Mr Rajendra Manchikalapati and Mrs Sowjanya Manchikalapati
10.	Mr Michael Kennedy And Adam Trutwein
11.	Mr Denis Tarasov
12.	Mr Adrian Nicholas Bartlett
13.	Miss Sarah Horley
14.	Aktimon Limited
15.	Mr David A Kraftman
16.	Dr Obori Ikpeme

17.	Mr Grant Gledhill and Darren Bell
18.	Dr Martin and Dr Katherine Spadaro
19.	Mr Roger Creber and Mrs Jeanie Creber
20.	Mr Syed Adnan Hussain
21.	Mr John Martin Dickie and Ms Alexandra Dickie
22.	Mr Harold Roberts and Mrs Jane Roberts
23.	Ms Anjali Bedi
24.	Suchira Tanti Apichart
25.	Mr Sayad Asad Hussain and Iram Fatima Husain

CERTIFICATE

Opus 2 International Limited hereby certifies that the above is an accurate and complete record of the Judgment or part thereof.

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5 New Street Square, London, EC4A 3BF
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CACD.ACO@opus2.digital

This transcript has been approved by the Judge