THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

REPORTABLE
Case number: 143/04

In the matter between:

CONSTANTIA INSURANCE COMPANY LTD **APPELLANT**

and

COMPUSOURCE (PTY) LTD **RESPONDENT**

CORAM: **HOWIE P, FARLAM, BRAND, LEWIS, VAN HEERDEN JJA**

HEARD: **7 MARCH 2005**

DELIVERED: **30 MARCH 2005**

Policy insuring litigation costs – provision entitling insurer to claim full premium upon cancellation of the policy following discovery of facts adversely affecting insured's prospects of success in litigation – no intention by the insured to be bound by this provision – consequent lack of consensus – insurer's belief that consensus had been reached not reasonable – provisions thus not enforceable against insured.

1.1 JUDGMENT

BRAND JA/

BRAND JA:

[1] This case is about a type of insurance that is novel in this country, referred to as post dispute or post litigation insurance (PDL insurance). In England, where it originated, this type of insurance is known as 'after the event' insurance or ATE (see eg *Callery v Gray; Russell v Pal Pak Corrugated Ltd* [2001] EWCA Civ 1117, [2001] 3 All ER 833 (CA) paras 2 – 3, 15 – 17 and 65; *Callery v Gray (Nos 1 and 2)* [2002] UKHL 28, [2002] 3 All ER 417 (HL) paras 69 – 75; *Halsbury's Laws of England* (4 ed vol 25 2003 reissue) Insurance para 807). The risk insured by this type of insurance is the liability of the insured for legal expenses in litigation. It can cover the insured against own costs or against the costs of its opponent, or both, depending on the terms of the policy. Of course, insurance against litigation costs is not new. It is usually provided for as an adjunct to other indemnities, eg in terms of motor vehicle insurance, professional liability insurance or a house owner's policy, but even policies that insure legal expenses only are not unknown. A feature common to all these policies is, however, that they are sold before the event, that is before litigation arises. What makes PDL insurance novel

and unique is that it provides cover against the risk of litigation costs at a time when the dispute giving rise to the litigation or even the litigation itself has already ensued. The obvious advantage of PDL insurance is that it mitigates the potentially disastrous financial consequences associated with litigation. The disadvantage is that the premiums are substantially higher than in the case of 'before the event' insurance for the obvious reason that part of the risk has already materialised. Because of its special nature there are terms in the PDL insurance policy that one is unlikely to find in policies more commonly encountered. This appeal relates to such a term.

[2] The appellant ('Constantia') is an insurance company. It issued two PDL insurance policies to the respondent ('Compusource') through the agency of an insurance broker, Legal Protection Services (Pty) Ltd ('LPS'). Subsequently, Constantia cancelled the policies but claimed that, despite such cancellation, the premiums provided for in the policies, adding up to the total sum of R1 364 363,11, had become due and payable. As the basis for its claim it relied on clause 3.5 read with clause 3.3.2 of the respective policies. When Compusource disputed this claim, Constantia instituted action in the Johannesburg High Court. Compusource raised various defences, *inter alia,* that it was not bound by the provisions of clause 3.5 because these provisions were unknown to its representative and had not been brought to his notice by LPS

when the policy agreements were entered into. This defence found favour with Jajbhay J in the court *a quo*. Consequently, Constantia's claim was dismissed with costs. The appeal against that judgment is with the leave of the court *a quo*.

[3] A consideration of the defence upheld by the court *a quo* requires a somewhat detailed exposition of the background facts. These background facts appear from the evidence of the three dramatis personae who testified at the trial. They were Mr Simon Fegen, the representative of LPS in Cape Town, Mr Christopher Binnington, the joint managing director of LPS, whose office was in Johannesburg, and Mr Simon Rust, a co-director of Compusource.

[4] Rust went to see Fegen in his office in Cape Town on 6 June 2001. The following day Rust went there again. This time he was accompanied by his fellow director, Mr John Viveiros. The reason for these visits related to litigation instituted by Compusource against three other companies as defendants in the Cape High Court. The names of these defendants are not material. They were referred to in these proceedings as 'CQP', a description that I will adopt. The litigation concerned a damages claim for R590m by Compusource against CQP, based on the repudiation by the latter of a joint venture agreement between them. At some stage the dispute between the parties was referred to arbitration.

Prior to such reference, however, Compusource had been ordered by the Cape High Court to furnish security for CQP's costs in the sum of R800 000. The deadline fixed for compliance with this order was 15 June 2001.

[5] Compusource was not in a financial position to put up the required security. Rust had heard that LPS might be able to assist. That was the reason for his visits to Fegen during the first week of June 2001. At both meetings Fegen handed first to Rust and later also to Viveiros a batch of documents meant to serve as an introduction to Constantia's PDL insurance policy, described as a 'welcome pack'. During these meetings Fegen also explained what the PDL policy could achieve for Compusource. With specific reference to their immediate predicament, he told Rust and Viveiros that the policy could be used directly or as collateral to furnish security for CQP's costs.

[6] Included in the welcome pack was a specimen copy of the PDL insurance policy and a document entitled 'questions and answers' which contained further information about the policy in the form of answers to 'questions most frequently asked'. Rust testified that at the meeting with Fegen he had glanced through the 'questions and answers' document and, under the question 'when is the premium payable?' he noted the following answer:

'Normally a minimum of 20% of the premium is payable in order to incept the policy. Flexible premium payment terms are, however, available, including fully deferred payments (to date of award or judgment) as well as "no win – no premium".'

Rust raised this with Fegen who explained that LPS could offer a form of policy where the premium was only payable if the outcome of the litigation was favourable to the insured. Because Compusource's very predicament was its lack of financial resources, this sounded to Rust like an ideal solution to its problem. It meant that Compusource would only have to part with any money if it received a capital award against CQP in the arbitration. Although the prospect of insurance against Compusource's own costs in the arbitration had also been also raised at the June meetings, it was agreed that, given the extreme pressure to furnish the security for CQP's costs, the possibility of own costs insurance would be investigated at a later stage. In the event, Rust completed and signed an application form for PDL insurance securing CQP's costs to a limit of R800 000. The form contained the required information, including the fact that Compusource was represented in its litigation with CQP by an attorney as well as by senior and junior counsel.

[7] Fegen forwarded the application form to Binnington in Johannesburg. He also conveyed to Binnington all the documents and information he had gathered from Rust and Viveiros concerning the merits of Compusource's claim, including a favourable opinion by

Compusource's legal team regarding its prospects of success. On the basis of what was conveyed to him, Binnington found himself in the position to assess the risk involved. On 12 June 2001 he therefore provided Compusource with a quotation for the insurance of CQP's taxed costs to the limit of R800 000. The quotation specifically stated that the insurer's liability 'shall be strictly in accordance with the terms of the policy'. As to the premium for this insurance Compusource was given the following two options:

'**Option 1**

1.1 The policy will incept against the payment of the sum of R180 006 (inclusive of VAT …).

1.2 Payment of a second equal tranche of R180 006 (inclusive) will be due not later than seven days before trial commences.

1.3 …

Option 2

2.1 This option is quoted on the basis of "self-insuring" the premium which effectively converts the policy into a "no win, no premium" type of policy. Providing there is no adverse award of costs contained in the judgment, the full premium of R594 815.37 would become payable upon a successful outcome. …

2.2 In the event of a judgement containing an adverse award of costs, then insurers would be liable up to the limit of indemnity and **no premium would be payable**.'

[8] The rather clumsy wording of the second option was understood by everyone concerned to mean that Constantia would become liable

under the policy if Compusource lost the arbitration with a costs order in favour of at least one of its opponents. Conversely, the premium would become payable only if Compusource won the case with a costs order in its favour against at least one of its opponents. On the basis of this understanding, Rust, acting on behalf of Compusource, accepted the quotation and agreed to pay the premium in accordance with the second option. The acceptance was conveyed to LPS in a letter dated 14 June 2001. Binnington thereupon issued the policy on behalf of Constantia. The policy consisted of a schedule which was bound together with the standard policy conditions. The latter document was in exactly the same terms as the specimen policy included in the welcome pack.

[9] CQP was not prepared to accept the policy itself as security for its costs in compliance with the court order. A bank guarantee for CQP's costs was, however, obtained on the basis of the policy as collateral security, against payment of an additional R125 000 by Compusource. Not long thereafter, Compusource took out a second PDL insurance policy. This time the risk insured was its own costs in the arbitration. The policy was preceded by a proposal form signed by Rust on behalf of Compusource on 10 July 2001 and a quotation provided by Binnington on 30 July 2001 which was accepted by Rust. The policy covered Compusource against liability for its own costs to a limit of R1m for which the premium payable on the 'no win – no premium' basis was

R769 547,74. The terms of the second policy were essentially the same as those of the first, save that this time Constantia required an 'inception fee' of R57 000. Because Compusource was unable to pay this amount, it was again postponed on the 'no win – no pay' basis, but the concession came at a price in that Compusource was required to pay an additional amount ('facilitation fee') of R25 000.

[10] After this, nothing noteworthy happened until 10 January 2002 when Binnington received a letter from the attorney acting for Compusource in the arbitration proceedings. According to the letter, the attorney, as well as Compusource's senior and junior counsel, had come to the discouraging conclusion that their client's case had taken an abrupt turn for the worse. The cause of this, the attorney explained, was that CQP had introduced two new defences by way of an amendment to their plea which, in the opinion of Compusource's legal team, considerably improved CQP's overall chances of warding off the claim against them. Whereas the legal team had previously expressed the opinion that their client's prospects of success were more than reasonable, so the letter stated, that was no longer the case.

[11] Binnington contacted Rust about the letter. Rust's response was that he had lost confidence in his legal team and that he did not share their sombre view regarding Compusource's prospects of success.

Binnington suggested that Rust consult an independent senior counsel for a second opinion. When the independent senior counsel agreed with Compusource's legal team, Binnington told Rust that in these circumstances he intended to invoke Constantia's right of cancellation provided for in clause 3.3.2 of the policies, which he eventually did on 29 January 2002. Rust realised that the cancellation rendered continuation of the arbitration impossible because it would result in the withdrawal of the bank guarantee providing security for CQP's costs. In the event, Rust testified, Compusource had no choice but to settle with CQP. After Rust had taken the decision to settle for much less than he had hoped for, Binnington had further bad news for him, namely, that despite the cancellation of the policies, Constantia was holding Compusource liable for the full premium of approximately R1,3m, by virtue of the provisions of clause 3.5 of the policies.

[12] Clause 3.5 read with those parts of clauses 3.3 that are material, provided as follows:

'3.3 If any fact or evidence or other matter is discovered … which materially adversely affects or might materially adversely affect the Insured's prospects of success in the Proceedings … the Insurers may:

3.3.1 Determine in their sole discretion the increase in the Premium that the Insured shall be obliged to pay … or

3.3.2. Issue a notice to the Insured cancelling forthwith the Policy.

…

3.5 If … the Insurers exercise the option granted by Clause 3.3.2, the Premium as stated in the Schedule shall have been fully earned. For the purposes of this Clause 3.5, the cancellation date shall be seven days from … the date of the Insurer's cancellation notice.'

[13] According to Rust, he was blissfully unaware of the provisions of clause 3.5 until Binnington referred to them shortly before the cancellation of the policies and Binnington's reliance on the clause at that late stage therefore came to him as a complete surprise. The reason for his ignorance, Rust explained, was that although he realised that Binnington's quotations were subject to the provisions of the standard policy when he accepted them and although he might even have read clause 3.5 at the time, he never appreciated the impact of this clause. When he received the 'welcome pack' from Fegen, Rust said, he 'skim read' the questions and answers document which was included in the pack. He then glanced at the specimen policy which was likewise included and came to the conclusion that the policy was the same as the 'questions and answers' in terms of the topics covered. He did not study or try to understand all the detailed provisions of the standard policy because he assumed that it would not deviate in any material respect from what was explained to him by Fegen, the overriding feature of which was the 'no win no pay' premium.

[14] Had he been aware of clause 3.5, Rust testified, he would never have agreed, on behalf of Compusource, to insurance policies that were subject to those terms. This evidence of Rust was not challenged by Constantia. It therefore accepted, at least impliedly, that Rust did not actually intend to bind his principal to the provisions of clause 3.5. Its case, simply stated, was that, since Rust had accepted quotations that were expressly subject to the terms of Constantia's standard PDL insurance policy, which obviously included clause 3.5, it was not open to Compusource to rely on Rust's subjective lack of intent to be bound by the provisions of that clause.

[15] Compusource did not dispute that, in the circumstances prevailing during January 2002, Constantia was entitled to invoke the cancellation provisions in clause 3.3.2. Likewise it was not disputed that, on a prima facie construction of clause 3.5, Constantia would in such circumstances be entitled to payment of the agreed premiums. Compusource's answer to Constantia's claim was, as I have said, that it was not bound by the provisions of clause 3.5. As the basis for this answer, it relied on the contention that Rust was unaware of the clause when he entered into the agreement and that both Fegen and Binnington had failed in their duty, imposed upon them by law, to alert Rust to its existence.

[16] Compusource's approach to the case was that its defence was one of misrepresentation by the representatives of Constantia in the form of an omission: the non-disclosure of clause 3.5. Essentially the same starting point was adopted by the court *a quo*. This led to an investigation, along the lines established in cases concerning delictual liability for negligent misrepresentation by omission, such as *McCann v Goodall Group Operations (Pty) Ltd* 1995 (2) SA 718 (C) and *Absa Bank Ltd v Fouche* 2003 (1) SA 176 (SCA), as to whether Fegen and Binnington were under a legal duty to refer Rust to the existence of clause 3.5. I do not agree with this approach. As often happens, the failure to recognise the appropriate legal niche tended to misdirect the focus and gave rise to inappropriate enquiries. The true issue in this case is not one of misrepresentation by omission. It is one of *dissensus*. Constantia's representatives thought that Rust had agreed to clause 3.5 read with clause 3.3.2 whereas in fact he had not. The reason for the misapprehension on the part of the former was that Rust created the impression that he did agree to clause 3.5 by accepting the quotations that were made subject to the provisions of a standard policy, including that clause. Under these circumstances our law is that Rust's principal would, despite this lack of actual consensus, be bound to the provisions of the clause if Constantia's representatives were reasonable in their reliance on the impression created by Rust. If a reasonable person in

their position would have realised that Rust, despite his apparent expression of agreement, did not actually consent to be bound by the clause, this clause could not be said to be part of their agreement.

[17] These principles appear from *Sonap Petroleum SA (Pty) Ltd (formerly known as Sonarep (SA) (Pty) Ltd) v Pappadogianis* 1992 (3) SA 234 (A). In that case Harms AJA referred as his starting point (at 239G-H) to the following frequently quoted statement by Blackburn J in *Smith v Hughes* (1871) LR 6 QB 597 at 607, namely:

'If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon the belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.'

He then proceeded to formulate the key inquiry in matters of this kind as follows (239I-240B):

'In my view, therefore, the decisive question in a case like the present is this: did the party whose actual intention did not conform to the common intention expressed, lead the other party, as a reasonable man, to believe that his declared intention represented his actual intention? … To answer this question, a threefold enquiry is usually necessary, namely, firstly, was there a misrepresentation as to one party's intention; secondly, who made that representation; and thirdly, was the other party misled thereby? … The last question postulates two possibilities: was he actually misled and would a reasonable man have been misled?'

(See also *Steyn v LSA Motors Ltd* 1994 (1) SA 49 (A) 61B-J; Schalk van der Merwe, L F van Huyssteen, M B F Reinecke and G F Lubbe; *Contract: General Principles* 2 ed (2003) 46-47; Dale Hutchison in R Zimmerman and D Visser (eds) *Southern Cross: Civil Law & Common Law in South Africa* 192-193.)

[18] In this case it is clear, in my view, that Constantia's representatives laboured under the genuine misapprehension that Rust had in fact agreed, on behalf of Compusource, to be bound by the provisions of clause 3.5 read with clause 3.3.2 and that that misapprehension was caused by the conduct of Rust. The first two questions formulated by Harms AJA in *Sonap Petroleum* must therefore be answered in favour of Constantia. The outcome of the appeal is therefore dependent on the third question: would a reasonable person in the position of Fegen and Binnington also have laboured under the same misapprehension?

[19] Constantia's contention was that the reasonable person would also have thought that Rust had agreed to all the terms of the standard policy, including clause 3.5. In support of this contention reliance was placed on a number of considerations that would, according to Constantia, have influenced the reasonable person. First, Rust and Viveiros came across as articulate and well-educated businessmen, which they obviously were. Second, Rust was in possession of the standard policy for several

days before he received the first quotation and a further two days before he accepted it. Third, it was abundantly clear from the quotation itself that it was made subject to the terms of the standard policy. Fourth, there was nothing that prevented Rust from reading the standard policy document and from discussing it with the legal team representing Compusource in the pending arbitration. Fifth, Rust in no way indicated that he did not read or understand the provisions of the standard policy. Sixth, there is no general obligation on an offeror to enquire whether or not the other party to the contract has read and understood the offer documentation accepted by him or her. Seventh, having regard to the nature of the policy and the risk that Constantia undertook in litigation over which it had no direct control, clauses 3.3.2 and 3.5 could not be described as so unusual or unduly onerous as to be unexpected. I agree that most of these considerations would have weighed heavily with the reasonable person in the position of Constantia's representatives. At the same time, however, the reasonable person would have realised that they do not represent the full picture.

[20] In considering the full picture, the reasonable person would have borne in mind that PDL insurance in general and Constantia's standard policy in particular, were novel in this country. Even if it could therefore be said that clauses 3.3.2 and 3.5 were not unusual in policies of this kind, they would still be unexpected to the uninitiated in this specialised

field. What would also have weighed heavily with the reasonable person, I think, is the very fact that the policies were sold to Rust on the basis that no premium would be payable unless Compusource won the arbitration with costs. This gave rise to an expectation on the part of Rust that Compusource would be able to pay the premium out of the capital award in its favour while its own costs would be paid by CQP. All this was known to both Fegen and Binnington. In fact, they also knew that Compusource was simply unable to pay the R1,3m premium unless it was successful in the arbitration. At the time of the second policy, this was confirmed by the fact that Compusource even had to borrow the inception fee of R57 000 since it was unable to pay this amount, let alone the premium of nearly R800 000 under that policy. Having this knowledge, the reasonable person would therefore have realised that, if clauses 3.3.2 and 3.5 were to be invoked by Constantia, Compusource would have no hope of meeting its obligations under clause 3.5. In such event Compusource would, in a worst case scenario be unable to continue with the arbitration; it would not receive any capital award; it would be liable for its own costs and most probably for CQP's costs as well. On top of all this, it would be liable for the full premium of R1,3m. In these circumstances the reasonable person would, in my view, have serious doubts whether Rust, as an articulate and well-educated businessman, would have agreed to an obligation that his principal could

never meet. Added to this, clause 3.5 read with clause 3.3.2 obviously meant that if something came to light the very day after the policy agreements had been entered into which materially adversely affected Compusource's prospects of success in the arbitration, Constantia would be entitled to cancel the policy and hold Compusource liable for the full premium. Realising all this, the reasonable person would have been surprised, I think, that someone like Rust was prepared to accept these obligations entirely without demur.

[21] The reasonable person would also have realised that if the prospective insured had read the questions and answers document, as Rust did, he could be lulled into a sense of false security regarding the existence of clause 3.5 read with clause 3.3.2. Although the document refers to most of the material clauses in the standard policy, there is a somewhat curious and very significant absence of any reference to these two. What is more, the document contains relatively full explanations of clauses that appear to be far less unpredictable than clause 3.5. So, for example, it discusses the question:

'What happens if the insured has misled his advisors and/or underwriters as to the facts of the case?'

The answer to this question reads:

'Where an insured misleads or is guilty of deliberate nondisclosure to his attorneys and/or underwriters, underwriters will be entitled to avoid the cover.'

These quotations refer to clause 10 of the policy, which indeed affords Constantia the right to avoid the policy on the basis of non-disclosure by the insured. But clause 10 does not entitle Constantia to claim payment of the premium after such cancellation. It is clear that the conduct of the insured contemplated in clause 10 could be considerably more 'blameworthy' than in clause 3.5, while the 'penalty' imposed by the latter is far more severe. Where the more predictable consequence is discussed, absence of any reference to the less predictable could very well mislead by default and the reasonable person would have borne this in mind.

[22] Finally, the reasonable person would, in my view, have realised that clause 3.5 is not very clearly worded. Instead of saying in plain English that, in the event of a cancellation under clauses 3.3.2, any outstanding premium will become payable, it uses the curious expression that the premium 'shall have been fully earned'. In this light the reasonable person would have foreseen that a prospective insured who did not peruse the policy with care, could very well have missed the full implications of this clause.

[23] In all the circumstances, I am therefore satisfied that the reasonable person in the position of Fegen and Binnington would not have inferred simply from the fact of Rust's acceptance of the quotations

that his true intention was to bind Compusource to the provisions of clause 3.5. I believe that the reasonable person would thus have enquired from Rust at the time whether he appreciated the meaning of the clause. If his answer was in the negative, as we now know it would have been, the reasonable person would have explained the clause to him. The legal consequence of the failure by Fegen and Binnington to follow this approach, is that Compusource cannot be held bound by the provisions of a clause to which its representative did not and could not reasonably have been thought to agree.

[24] It follows that the appeal cannot succeed. The only other defence advanced by Compusource on appeal was that clause 3.5 was unenforceable as being offensive to public policy. In the circumstances it is not necessary to deal with that defence. As to the question of costs on appeal, the parties were in agreement that whoever was successful would be entitled to the costs of two counsel.

[25] The appeal is therefore dismissed with costs, including the costs of two counsel.

……
F D J BRAND

JUDGE OF APPEAL

Concur:

Howie P
Farlam JA
Lewis JA
Van Heerden JA