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Limitation of the insured risk

From the repurchase of a US investment fund to an insurance dispute in Switzerland

Par Nicolas Rouvinez le 25 November 2021

In a recent judgement concerning the interpretation of an insurance contract, the Federal Court was required to determine the extent of the insured risk in light of the concepts of ‘primary limitation’ and ‘secondary limitation of risk’ (TF 4A_72/2021 of 28 September 2021).

A Swiss holding company provides financial services through its subsidiaries, including a US subsidiary.

In order to protect itself against the civil liability risks associated with its commercial activity, the holding company has taken out civil liability insurance for itself and its subsidiaries with an English insurer.

In 2013, the holding company submitted a claim for compensation to the insurer. In essence, the holding company made the following insurance claim :

- in March 2009, the American subsidiary entered into negotiations with an investment fund manager with a view to the American subsidiary taking over an investment fund controlled by the fund manager in question ;
- In April 2009, three former managers of the fund manager initiated civil proceedings against the latter. They argued that the proposed transaction between the manager and the US subsidiary would have violated their contractual rights : the manager had in fact undertaken to pass on to the three managers a percentage of the management fees it charged to the investment fund in question. However, the sale of the fund to the American subsidiary would have put an end to the collection of these fees, and consequently also to the payment of retrocessions ;
- in July 2009, the fund manager and the American subsidiary nevertheless concluded the proposed transaction ;
- subsequently, the three managers requested and obtained the extension to the American subsidiary of the civil proceedings pending against the fund manager ;
- in spring 2013, the American subsidiary reached a multi-million dollar settlement with the three aforementioned managers.

It should be noted here that the American subsidiary transferred all the rights conferred on it by the insurance contract to the holding company.

Faced with the insurer's refusal to consider its claim for compensation, the holding company took legal action for payment. Its conclusions were rejected in the first and second instances on the grounds that the claim had been made late. When the Federal Court first heard the holding company's appeal, it ruled that, although the claim had indeed been made late, the holding company's rights had not expired as a result. The case was therefore referred back to the appeal body for a new judgement (TF 4A_490/2019 of 26 May 2020). However, the appeal body once again dismissed the holding company's case on the grounds that it had not demonstrated the occurrence of an insurance case, which the holding company is now contesting before the Federal Court.

The Court began by interpreting the contract in order to define the scope of the insured risk.

The relevant clause reads as follows :

'Underwriters shall indemnify the Assured for Loss resulting from claims made against the Assured by third parties for Civil Liability provided such claims arise out of the provision by or on behalf of the Assured of financial […] services to third parties in the course of the Assured's business'.

In making an objective interpretation of the contract, the Federal Court observes that the meaning of this clause is clear : only losses resulting from the provision of financial services by the insured are eligible for compensation. In other words, the losses incurred must be causally related to the provision of financial services.

Secondly, the Federal Court must determine whether the requirement that the damage result from the provision of financial services ('provided such claims arise out of the provision […] of financial […] services') constitutes a primary or secondary limitation of the insured risk.

In theory, a primary limitation circumscribes the insured risk, while a secondary limitation excludes certain risks within the circle defined by the primary limitations. In practice, primary and secondary limitations have the same function of circumscribing and excluding. The real distinction between primary and secondary limitations is in the burden of proof : the insured must prove that the damage incurred falls within the scope of the contract as defined by the primary limitations. If this proof is not provided, there is no insurance case. Conversely, it is up to the insurer to prove that an exclusion case (secondary limitation) has occurred. Determining whether a risk limitation should be categorised as primary or secondary is also a question of interpretation.

In this case, the Federal Court considers that the requirement of a causal link between the damage and the provision of financial services does constitute a primary limitation of risk, which can be deduced from the purpose of the topical clause and the systematic nature of the contract. The holding company therefore had to demonstrate the existence of such a link : however, according to the contested judgement, this was not done, as the holding company failed to allege the relevant facts at first instance. The appeal body was therefore right to conclude that an insurance case had not been made.

The reasoning of the Federal Court is to be approved : through a simple operation of interpretation, our High Court manages to make its way through a complex state of affairs to arrive at a convincing solution. The main lesson to be learnt from this ruling is that the primary

limitations and secondary limitations of the insured risk must be clearly distinguished in the insurance contract. The consequences of this dichotomy are too important to be left to chance in a subsequent interpretation. Ideally, the example of the insurance contract analysed in this ruling should be followed : a clause should be included to state the insured risk and a separate clause to list the cases of exclusion. As the Federal Supreme Court suggests, this editorial technique – which is, after all, quite intuitive – makes it easy to distinguish between primary and secondary limitations.

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