

Pratt's Journal of Bankruptcy Law

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UK Court of Appeal Considers Whether Insurance Proceeds Paid to a Company in Liquidation Are Assets of the Company or Held on Trust for Third Party Claimants

*By Michael Fiddy, Stephen Moi, Tom Hunter and Kieran Freear**

In this article, the authors examine a recent judgment by the United Kingdom's Court of Appeal concerning whether third party claimants could have an entitlement to the proceeds of an insurance claim in circumstances where those proceeds were paid to the insured, a company in liquidation, prior to its entering into liquidation.

The United Kingdom's Court of Appeal gave judgment¹ in a case concerning whether third party claimants could have an entitlement to the proceeds of an insurance claim in circumstances where those proceeds were paid to the insured, a company in liquidation, prior to its entering into liquidation.

The Court of Appeal rejected arguments that terms should be implied to establish a trust or proprietary interest over the proceeds in favour of the claimants. Rather, the Court confirmed that the Third Parties (Rights against Insurers) Act 2010 (the Act) can only transfer an insured's rights against its insurer to a third party upon the occurrence of a qualifying insolvency event. If the insurance proceeds were received by the insured prior to insolvency, the Act does not apply and third parties generally acquire no rights against an insurer. The proceeds instead belong absolutely and beneficially to the insured.

The judgment includes important analysis of the competing arguments and provides clarity on an issue of practical significance for both insolvency practitioners and insurers.

BACKGROUND

The Appellants engaged Boscolo Ltd (Boscolo or the Company), an interior design and project management company, to design a refurbishment scheme for a luxury apartment in Hampstead, London (the Design Contract), as part of which Boscolo was required to have in place professional indemnity insurance in respect of the works.

Boscolo provided negligent advice to the Appellants that Listed Building Consent was not required for the works. The Appellants later made allegations

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¹ Desai v. Wood [2025] EWCA Civ 906.

of negligence against Boscolo and asserted that they had suffered loss as a result of the advice. As a result, Boscolo made a claim under its professional indemnity policy (the Policy) in respect of its potential liability. After the commencement of pre-action correspondence but prior to the commencement of proceedings, the insurers exercised their right to pay the policy limit of £250,000 to Boscolo. Under the Policy, this relieved the insurers of any further liability for the Appellants' claim.

Two months later, the Appellants commenced proceedings against both the Company and the insurers, claiming an entitlement to the insurance proceeds pursuant to a trust in their favour. Shortly afterwards, Boscolo went into liquidation, with the only material asset being cash at bank of £246,000, representing what remained of the insurance proceeds.

ARGUMENTS

The Appellants' case was built on two main grounds: first, on implied terms in the Design Contract and/or the Policy; second, on the imposition of a constructive trust.

The term argued by the Appellants to be implied into the Design Contract was as follows:

If the Company had reasonable grounds to believe that the Company might be unable to meet the Appellants' claim [. . .] it would not dissipate those insurance monies or use them to pay other creditors or for any purpose conflicting or inconsistent with the Paramount Purpose [for which the insurance was (compulsorily) required; namely, to secure that the Company was financially able to compensate its clients].

In other words, the Appellants maintained that the insurance proceeds should be protected by a trust to ensure that their claim against Boscolo could be satisfied by Boscolo, rather than the proceeds being distributed to other creditors in the course of the insolvency process.

The Appellants also argued, in the alternative, that there was an implied term in both the Design Contract and the Policy such that, if the Appellants made a professional negligence claim against Boscolo and Boscolo's insurance claim was accepted and paid out by the insurers, Boscolo would be required:

to transfer the insurance monies to the client [. . .] or alternatively would [. . .] not use those insurance monies otherwise than for the paramount purpose for which the insurance was (compulsorily) required [. . .] namely to secure that [the Company] was financially able to compensate its clients.

Further, the Appellants argued that, even if no such implied terms existed, the insurance proceeds were nevertheless held on trust for them, on the basis that it would be “unconscionable” for Boscolo to retain the benefit of the insurance payment in circumstances where the funds were intended to compensate clients such as them and in view of the alleged implied terms.

Conversely, the position of the Respondents (Boscolo in liquidation, acting through its liquidators) was that, unless there are express contractual terms or a clear proprietary interest in place, insurance proceeds paid to an insured prior to the commencement of insolvency proceedings remain the property of the insured company absolutely. On this basis, third party claimants such as the Appellants do not acquire any direct right to the insurance proceeds simply by having made a claim against the insured.

The Respondents further emphasised that, under general legal principles, the risk of a company’s insolvency falls on its counterparties. In other words, it is not the role of the insurance policy or the insurers to protect third parties from the potential consequences of the insured’s insolvency. They observed that the terms of the Policy expressly permitted the insurers to pay the policy limit directly to the insured in respect of a claim. Once this payment was made, the insurers’ liability was fully discharged, and they were entitled to step back from any further involvement in the claim.

JUDGMENT

The Court of Appeal rejected the Appellants’ arguments.

The Court held that the alleged implied terms were neither necessary to make the contract work nor sufficiently certain to be implied. The parties could have expressly provided for this protection in their agreements but did not do so, and the suggested term lacked the clarity and precision required for implication. As a result, there was no basis to imply such terms into the Design Contract or the Policy.

The Court of Appeal rejected the Appellants’ argument with regard to the constructive trust. Even if the implied terms existed, they would not give rise to a trust over the insurance proceeds in favour of the Appellants. A trust in these circumstances would require an intention to create one, as well as certainty as to the subject matter of the trust and the beneficiaries of the trust. Here, there was no indication in the contracts or the parties’ conduct that the insurance monies were intended to be segregated or ringfenced for the Appellants’ benefit. The company was not required to keep the proceeds separate from its own funds, and could use them for its own purposes, including defending the Appellants’ claim. The elements necessary for a trust to arise were not present.

The Court also rejected the Appellant's argument that it was "unconscionable" for the company to retain the insurance proceeds. There was no justification for the imposition of a constructive trust, as there was no evidence of fraud, mistake, or any special factor that would make it inequitable for Boscolo to keep the insurance proceeds. In the circumstances, even had the implied terms arguments succeeded, the Appellants would still not have prevailed in the absence of a trust in their favour, given that the Company was in liquidation by this point.

The Court of Appeal observed that the benefits of the Policy afforded to Boscolo's clients is indirect. The purpose of the Policy is to provide *the insured* with funds in certain circumstances in order to protect *it* from having to turn to its assets to meet a claim. In general, clients or customers of an insured have no beneficial entitlement to the insured's insurance proceeds. Accordingly, the direct benefit of the Policy remained with Boscolo as the policyholder, not any third party, and there was no basis for suggesting that an insurance policy needed to include restrictions as to how the insured could use potential insurance proceeds.

COMMENT

Although the Court of Appeal's judgment does not particularly represent a venture into uncharted territory, it serves as a useful reminder that:

- There is in general a high hurdle to argue successfully that terms ought to be implied into a contract, especially in business contracts entered into by commercial parties acting at arms' length. In order for terms to be implied, they must be necessary for the efficacy of the contract, and the terms to be implied must be sufficiently certain. The Court's starting position is sceptical of the notion that contractual terms were intended but not included in the agreement; and
- Pursuant to the Act, if an insured's liability to a third party is covered by an insurance policy, the insured's rights against the insurer in respect of that liability are assigned to the third party in the event of insolvency. However, that assignment does not take place unless and until a qualifying insolvency event occurs. Accordingly, in this case, the assignment was of no avail to the third party because the insurer's liability to the insured had already been discharged by that point in time i.e. prior to insolvency.

The decision is likely to be welcomed by insurers and insolvency practitioners as it provides clarity on their rights and obligations in these circumstances, and on the status and treatment of insurance proceeds paid to an insured prior to insolvency, it having been confirmed that such proceeds are part of the

insolvent estate for the benefit of the company's creditors as a whole. In this regard, it is worth emphasising the Court's remarks that an insurance policy is not in general intended to benefit third parties with claims against the insured, less still provide third parties with protection in the form of enforceable proprietary rights in the event of the insured's insolvency.

On the other hand, it might be observed that the position does not appear particularly favourable to third parties with claims that might be covered by an insurance policy in circumstances where the insured is on the brink of insolvency. If liability is not established prior to insolvency, the third party's claim is likely to be treated alongside other unsecured debt subject to a claim being available under the Act. It will be interesting to see whether this decision leads to different tactical approaches by such parties in how they seek to resolve disputes with companies believed to be in financial difficulties.