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Swiss Federal Supreme Court decision: interpretation of exclusion clause

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Introduction

Professional liability insurance policies usually contain specific clauses that exclude coverage for occurrences or claims that are the result of the insured having acted with a degree of intent. These clauses typically exclude coverage for acts or omissions of the insured which are committed either:

- "wilfully";
- "intentionally"; or
- as stated in the clause in question here, "knowingly".

Such exclusions are rooted in article 14(1) of the Federal Insurance Contract Act (ICA). Through this provision, the insurer is exempt from any obligation to cover the insured's damage if the latter has acted with "intent". Swiss case law and the prevailing legal doctrine define that article 14(1) of the ICA only covers "direct intent". However, the provision is not mandatory, and the parties are free to agree to cover direct intent (subject to the general limitation that such coverage is not contrary to public policy) or, instead, to extend the exclusion to lesser degrees of intent, or even to gross negligence.

In its decision,[(1)] the Swiss Federal Supreme Court had to interpret a clause in an insurance contract that excluded coverage for, amoung other things, claims arising from damages caused by a "knowingly" committed violation of law. While the claimant held that "knowingly" is supposed to mean "direct intent", the defendant was of the opinion that the exclusion clause only required knowledge of the violated law, regardless of intent on the insured's part. The Court did not completely agree with either party and came to an interesting conclusion.

While the Court's decision is not recent, its topic remains of interest considering it is the only decision known in Switzerland that deals with the interpretation of the word "knowingly" in exclusion clauses. Discussions in legal doctrine regarding this topic are still virtually non-existent, even though this wording is regularly used in insurance policies.

Facts

The claimant was B. AG, which held 100% of E. AG, an audit company. The defendant was A. AG, an insurance company. B. AG had taken out a professional liability insurance with A. AG for itself and its subsidiaries, including E. AG.

From February 1999 onwards, E. AG was the auditor of F. SA, an asset management company. In August 2004, the Swiss Federal Banking Commission withdrew F. SA's licence as a securities dealer and opened bankruptcy proceedings against F. SA.

In December 2009, the bankruptcy estate of F. SA filed an action for audit liability against E. AG, claiming 10 million Swiss francs (approximately £5.9 million). Furthermore, two creditors and investors of F. SA initiated civil actions against E. AG for direct damages in July 2012. The insurance company A. AG refused to bear E. AG's costs to defend against the lawsuits filed against it. The claims were based in particular on breaches of law and duty committed by different auditors employed by E. AG. Subsequently, B. AG filed a lawsuit against A. AG claiming coverage under the professional liability insurance policy.

According to the exclusion clause in the policy, the insurer denied coverage for "claims arising from damages caused by the intentional commission of felonies and misdemeanours or by a knowingly committed violation of law, of a governmental regulation or a contractual obligation".

The parties' dispute focused on the interpretation of the clause's second option, the exclusion of "a knowingly committed violation of law, of a governmental regulation or a contractual obligation". More precisely, the parties had differing views on the meaning of the word "knowingly".

The claimant, B. AG, held that "knowingly" was to be understood as meaning direct intent. On the other hand, the defending insurance company A. AG argued that the exclusion clause did not require any intent at all, considering that the clause only referred to the insured's "knowledge" and not its "willingness". According to the insurance company, the clause would therefore not require any intent to violate the law or a contractual obligation. It would suffice that the insured knew or should have known the law or the obligation which was violated. Furthermore, the insurance company argued that it is the knowledge of an average auditor under banking or stock exchange law that should be applied to determine which laws and obligations an insured auditor should have known in the context of this clause.

Decision

As the interpretation of the word "knowingly" remained disputed by the parties, the Court had to rule on this question.

The Court held that in the context of the clause at hand, "knowingly" required that the insured:

- had knowledge of the law or regulation which was violated; and
- made a wilful decision to act anyway (ie, against better judgement).

Furthermore, according to the decision, it is not the knowledge of an average auditor that should be applied to determine the first requirement, but the actual knowledge of the insured auditor in question. The lower court had reasoned – and the Court agreed – that the liability of an auditor is always based on a breach of statutory (or regulatory or contractual) provisions. Therefore, if knowledge as measured by the diligence of an average auditor would suffice for the exclusion of coverage, there would be no coverage in most cases, because it would have to be assumed that a diligent auditor would have known about the provision in question. The insurance coverage under the policy would thus be largely undermined.

The Court also concluded that the defendant had to prove which specific auditor employed by the claimant (or by any of the claimant's subsidiaries) violated which provision, and that this person had knowledge of this provision but made the conscious decision to act anyway.

Comment

The Court's statements regarding the insurer's burden of proof are notable. As a general rule of Swiss procedural and material law, the insurer must prove the facts that lead to the denial of insurance coverage. This includes, for example, proving the purely subjective fact of an insured person's intent, which is notoriously difficult to accomplish, even though the required standard of proof for subjective facts is lower than for objective facts. This decision indicates that using the word "knowingly" in an exclusion clause does not ease the requirements for the insurer's burden of proof, as the insurer may not simply rely on substantiating what knowledge (of the law and of contractual obligations) an averagely diligent insured would have. Rather, according to the decision, it is the actual knowledge of the specific insured at fault which is relevant.

It is further notable that the Court and the lower court interpreted the exclusion clause as to require:

- knowledge of statutory, regulatory or contractual provisions; and
- a wilful decision to act anyway.

However, there was no comment on the subject of intent. This is peculiar because an insured who knows the pertinent provisions is aware of the prohibited acts and outcomes outlined therein. If the insured decides to wilfully act against the provisions, the insured wilfully commits the acts described, and most likely not only accepts the outcome but intends to cause it. In intending to cause a certain outcome or to accept it, the insured acts with intent. Therefore, if the exclusion clause requires a "wilful decision to act anyway" it paraphrases the requirement of intent.

Consequently, following the decision of the Court, the exclusion clause would require that the insured had both knowledge of the provision and the intent to violate it. In criminal law, culpability requires that the perpetrator who acted with intent knew or should have known that their actions were unlawful. In that respect, the exclusion clause as interpreted by the Court would not go beyond the law. Culpability according to civil law, however, never requires knowledge of the contravened provision. Based on the decision at hand, a purely civil case, it seems that the parties to an insurance contract may differ from the principles of civil law and make such knowledge a requirement for the exclusion of insurance coverage.

The Court came to its conclusion without discussing one notable distinction in the wording. The clause excludes coverage for intentionally committed acts or omissions and for knowingly committed violations of law. The fact that the clause contains two different options for the exclusion suggests that the parties did not want to require the same degree of intent or knowledge to be applied to each option. Otherwise, they likely would have used the same term – "intentional" or "knowingly" – for both options.

Arguably, the Court's conclusion does indeed reflect the parties' intent to stipulate two different options, as "knowingly" requires more than intent alone and is thus different from the term "intentional". However, it could also be contended that the parties did not want to prescribe any intent for the second option, and for this reason deliberately used the differing term "knowingly".

It is possible that in a future case where a court is confronted with a similar clause that differentiates between intentionally and knowingly committed violations of law, the court will consider this differentiation and come to a different conclusion.

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Endnotes

(1) 4A.552/201, 25 May 2016.