

IN THE HIGH COURT OF JUSTICE  
QUEEN'S BENCH DIVISION  
COMMERCIAL COURT

B E T W E E N:-

**JUSTCARD PLC**

Claimant

- and -

**CYBERSAFE LTD**

Defendant

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**DEFENDANT'S SKELETON ARGUMENT**

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- 1 In these proceedings the claimant assured ("JustCard") claims an indemnity under a Cyber Protection Insurance Policy ("the Policy") issued by the defendant insurer ("Cybersafe") in respect of losses suffered and expenses incurred following the "hacking" by Spooknet of JustCard's processing system between 26 and 28 January 2011.
- 2 Cybersafe denies that it is liable to indemnify JustCard under the Policy in respect of the sums claimed or at all. It sets out the grounds for that denial under the following headings below: (1) JustCard's failure to upgrade its Processing System; (2) JustCard's claim pursuant to Insuring Agreement 3; and (3) JustCard's claim pursuant to Insuring Agreement 6.
- 3 The parties have agreed and the Court has directed that the present hearing deal only with issues of principle and that matters of detail (including the reasonableness of any particular expense incurred) be dealt with at a later hearing.

**JustCard's failure to upgrade its processing system**

- 4 JustCard used a bespoke specialist software system designed by Software Solutions Limited called ProcessSys. The version of that system purchased by JustCard was known as edition 3.16. Prior the Policy being placed, an upgrade, known as edition 3.17 and offering improved security, had become available. JustCard, however, chose not to purchase edition 3.17. Cybersafe understand that JustCard took this decision on grounds of cost.

- 5 The above matters were not disclosed to Cybersafe at placement. Thus, while Cybersafe was provided with details of ProcessSys edition 3.16, it was not told of the existence of edition 3.17 or of JustCard's decision not to purchase that upgrade.
- 6 If JustCard had purchased 3.17 then this would have prevented the hacking of JustCard's systems the subject of the claim. The hackers used a form of "buffer overflow" known as "Quizling" to access the JustCard system. Edition 3.16 had a flaw which made it vulnerable to such an attack. This flaw was corrected in version 3.17.
- 7 In the above circumstances, Cybersafe is entitled to avoid for non-disclosure; alternatively JustCard's claim is excluded from cover pursuant to exclusion 2A to the Policy.

#### *Non-Disclosure*

- 8 Cybersafe says that the non-disclosure of JustCard's decision not to purchase edition 3.17 was both material and induced it to offer cover on the terms that it did. Cybersafe relies in this respect on the evidence of its underwriter Mr Frye (the parties have agreed that no independent expert underwriting evidence will be called and that Cybersafe can rely on Mr Frye's evidence in relation to the issue of materiality).
- 9 Contrary to JustCard's contentions, the presentation made to Mr Frye was not fair. It omitted a key fact, namely the availability of edition 3.17 and JustCard's decision not to purchase that upgrade. It is trite law that an underwriter is not required to be a detective (but see, if necessary, the decision in *WISE*, cited by JustCard, at paragraph 42). He is not required to question the assured to elicit facts which should have been included in the presentation. Instead, it is the duty of the assured to ensure that the disclosure made is full and frank. This did not occur in the present case.
- 10 It follows that there can be no question of Cybersafe having waived disclosure as a result of Mr Frye not enquiring as to whether there were any upgrades available. Mr Frye was entitled to assume that JustCard's software was up to date unless told the contrary. There was nothing in the presentation made to Mr Frye which might have put him on notice that there was an upgrade available which JustCard had chosen not to purchase. The situation is fundamentally different from those cases where a failure to enquire has been held to give rise to a waiver (see, for example, the decision in *Pan Atlantic* cited by JustCard where the assured disclosed its claims records for some years but not others and it was held that the underwriters failure to enquire about those other years gave rise to a waiver).
- 11 Nor does the fact that policy was subject to exclusion 2A (which is set out below and is concerned with claims arising out of a failure to update a system) affect the materiality of JustCard's decision not to purchase edition 3.17 or relieve JustCard of its obligation to disclose that decision. In this respect JustCard seeks to rely on the general rule (which finds statutory basis in section 18(3)(d) of the Marine Insurance Act 1906) that an assured is not obliged to disclose "that which is superfluous to disclose by reason of any express or implied warranty" and contends that a similar approach can be adopted in relation to matters covered by exclusions.
- 12 This argument is misconceived. The above rule will apply where the existence of a particular state of affairs is warranted. Breach of that warranty will discharge the cover. In the circumstances, disclosure of matters the subject of the warranty is superfluous.

The position is very different in relation to an exclusion. In the case of an exclusion no promise is given as to the existence of a particular state of affairs and there is no remedy of discharge. Instead, the effect of an exclusion is to limit the cover provided by excluding certain types of claim.

- 13 The distinction between warranties and exclusions is illustrated by the present case. If it had been warranted that best efforts would be used to install all available updates, then there would have been no need for JustCard to disclose its decision not to purchase edition 3.17 (but the cover would have been discharged as a result of JustCard's failure to purchase edition 3.17). In the absence of such a warranty, JustCard's decision not to purchase edition 3.17 was material and needed to be disclosed.

#### *Exclusion 2A*

- 14 Exclusion 2A provides as follows:-

*“We shall not be liable for any claim directly or indirectly arising out of or in any way attributable to:*

2A. 1. ...

*2. the failure to use best efforts to install commercially available software product updates and releases, to apply security related patches, to computers and other components of the Insured Organization's Computer Systems.”*

- 15 JustCard contends that the above exclusion does not apply because its decision not to purchase edition 3.17 was reasonable in all the circumstances (that is having regard to the cost of the upgrade and the fact that the ProcessSys was, even without the upgrade, a very modern system). Cybersafe does not accept that JustCard's decision was in fact reasonable, but says that, in any event, this is irrelevant. The exclusion does not allow JustCard a discretion as to whether or not upgrades are to be installed. Instead it imposes a positive obligation upon JustCard to use best efforts to install all commercially available updates. JustCard did not do this. It made no efforts to obtain or install edition 3.17.
- 16 JustCard also argues that its claim is not a claim “directly or indirectly arising out of or in any way attributable to” its decision not to purchase edition 3.17. This is on the basis that even if edition 3.17 had been installed Spooknet or an associate of Spooknet would still have attacked its systems and would have been able to circumvent (albeit by somewhat different means) the improved security provided by edition 3.17.
- 17 This argument confuses the loss which has occurred and which is the subject of JustCard's claim (an attack by Spooknet on 26 to 28 January 2011 which successfully circumvented edition 3.16 using the Quizling technique) with a loss which has not occurred and in respect of which no claim is made (a hypothetical attack by Spooknet or an associate on a date unknown which might have circumvented edition 3.17 using a different technique). The actual loss which occurred was caused by JustCard's failure to purchase edition 3.17. That edition would have prevented Spooknet gaining access to JustCard's system using the Quizling technique. It is that loss in respect of which

JustCard seeks to make claim. Accordingly, exclusion 2A applies. It matters not that if JustCard had purchased edition 3.17 it might still have been attacked and suffered loss.

### **JustCard's claim pursuant to Insuring Agreement 3**

18 Insuring Agreement 3 provides as follows:-

*“We shall pay on your behalf all damages and defence costs which exceed your excess as stated within item 4 of the Schedule, which you become legally obliged to pay as a result of any claim first made against you and notified by you to us in writing, in accordance with section 11 of this policy, during the policy period or any extended reporting period, if applicable, arising from a security breach or privacy breach by you or others on your behalf for whom you are legally responsible...”*

19 Cybersafe understands that JustCard seeks an indemnity pursuant to Insuring Agreement 3 in respect of the following sums:-

- (1) £15.8 million; this being the total of the sums which were withdrawn by Spooknet and which were then re-credited by JustCard to its customers' accounts.
- (2) £26 million; this being the total costs incurred by JustCard in recalling customers' pre-paid cards. Cybersafe understands JustCard to contend that such sums are recoverable as mitigation costs, incurred so as to prevent further withdrawals by Spooknet as referred to in (1) above.

20 The first point to be made is that the withdrawals made by Spooknet constituted a loss to JustCard, not its customers. This is because such withdrawals were unauthorised. Accordingly, JustCard continued to be liable to its customers in respect of the pre-existing balances on their cards and the money paid out was money belonging to JustCard, not its customers. In the circumstances there can be no question of JustCard being entitled to recover under Insuring Agreement 3 in respect of such withdrawals or its re-crediting of customers' account. Insuring Agreement 3 does not provide cover for losses suffered by JustCard itself. JustCard's re-crediting of customer accounts simply reflected what was the correct legal position (that is that the debits previously made were unauthorised and of no effect).

21 Further, no customer has made any claim against JustCard and JustCard has not at any relevant time been legally obliged to pay damages to any customer in respect of a claim made by it as required by Insuring Agreement 3. JustCard seek to answer this objection by saying that if it had not re-credited customers' accounts, they would have made claims against it. This may be right but is nothing to the point. The cover provided is in respect of a legal liability for damages in respect of a claim. It does not include costs incurred to avoid such a claim being made. The Policy does not contain any “mitigation clause” (i.e. a clause providing cover for costs incurred in mitigating an insured loss).

22 Further, if JustCard had refused to re-credit customers' accounts and customers had then made claim against it, any award of damages in favour of the customer would not be recoverable under Insuring Agreement 3. This is because such liability would not arise out of an insured wrongful act (such as a cyber attack) but instead arise out of a refusal by JustCard to pay to customers sums to which they were contractually entitled.

- 23 So far as the £26 million of recall costs is concerned, JustCard argues these are recoverable as mitigation costs. However (and as stated above) the Policy contains no mitigation clause and does not provide cover for mitigation costs. Further, the loss which JustCard claims it was seeking to mitigate (further withdrawals by Spooknet leading to further re-crediting of customer accounts) was not an insured loss. Accordingly even if mitigation costs were otherwise recoverable under the Policy, these costs would not be because they were not incurred in mitigating an insured loss.

### **JustCard's claim pursuant to Insuring Agreement 6**

- 24 JustCard seeks to recover £24 million pursuant to Insuring Agreement 6 in respect of "Crisis Management Costs". That term is defined in the Policy as follows-

*"Crisis management costs means any fees reasonably incurred by you and approved by us for the employment of a public relations consultant if you reasonably consider that action is needed in order to avert or mitigate any material damage to any of your brands and which constitutes a newsworthy event that has been notified to us and has arisen due to a claim."*

- 25 The effect of the above definition is that costs can only be Crisis Management Costs and will only be recoverable as such under the Policy if they have been approved by Cybersafe. It is accepted that in the present case JustCard did not at any time seek or obtain Cybersafe's approval in respect of the costs of £24 million referred to above. As a result such costs are irrecoverable under the Policy.
- 26 JustCard says that its failure to seek and obtain Cybersafe's approval was unintentional and asserts that what it did by way of crisis management was exemplary. Even if true, this is irrelevant. The Policy only covers costs approved by Cybersafe.
- 27 JustCard argues that the above definition does not require Cybersafe's approval to have been obtained before the relevant costs were occurred. While it is accepted that the definition does not use the phrase "prior approval" (or some equivalent) it is nonetheless clear from the use of the past tense ("*approved by you*") that the approval referred to is approval given before the costs have been incurred. In this respect it will be appreciated that if approval could be sought and given after the event, then difficult questions would arise as to what factors Cybersafe could take into account when deciding whether to give its approval and, in particular, as to what regard it could have to events occurring after the costs were incurred.
- 28 JustCard also argues that the Policy is subject to an implied term that Cybersafe cannot withhold its approval unreasonably. There is no basis for any such implication. The position is analogous to that considered by the Court of Appeal in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (Nos 2 and 3)* [2001] Lloyd's LR (I & R) 667. Just as in that case it was held that a requirement that a reinsurer's consent be obtained to any settlement was not subject to an implied term that that consent not be unreasonably withheld, so in the present case there is no requirement that Cybersafe should not unreasonably withhold its approval of Crisis Management Costs.
- 29 The above issue arises only in the event that the Court holds (contrary to the above) that JustCard is entitled now to seek Cybersafe of the costs it has incurred in respect of crisis management. In such circumstances Cybersafe asks the Court to direct that its right to give or withhold approval is unfettered save that (as set out in *Tai Ping*) it must act in

good faith and only have regard to relevant considerations and not reach a decision which is “Wednesbury” unreasonable (i.e. so unreasonable that no insurer in its position could reasonably reach such a decision).

**TOM WEITZMAN QC**

**NICHOLAS CRAIG**

**3 Verulam Buildings**