RE/INSURANCE

Latest legal news

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BERWIN LEIGHTON PAISNER

Follow the settlements

Two recent cases underline the difficulties which reinsurers will have in challenging settlements made by reinsureds, even if details of each and every claim are not available

Equitas v R&Q might have the distinction of being the last case to address the Exxon Valdez oil spill, and Kuwait war claims.

The case was an attempt to resolve the impasse which developed in relation to LMX claims, and following the decision, a settlement was reached in that case notwithstanding earlier references to an appeal. This may now lead to settlement of other claims.

The reinsurance contracts contained a provision in the well known form used in *Hill v M&G*:

"All loss settlements by the reassured, including compromise settlements... shall be binding upon the reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts... and within the terms and conditions of this reinsurance."

Although the claims had entered the spiral, they included elements not covered by the reinsurance. It was Equitas' position that the actuarial modelling which was carried out was sufficient to establish the claim to the requisite level of proof, namely the balance of probabilities. R&Q's position was that Equitas had to prove that each sum was properly due on a contract by contract basis and that, not only was the general actuarial model unacceptable in principle, but that the model used by Equitas was flawed.

The Commercial Court's clear view was that there was no obligation on the reinsured to prove liability under each and every underlying contract. Although *Hill v M&G* clarified and confirmed the "double proviso" requirements, the methodology was not prescribed by that case. In principle, the Court thought that the reinsured could seek to prove its claims by whatever evidence they thought appropriate, which included an actuarial model. Although accepting that the actuarial model was *"complex, expensive, imperfect and not ideal in the context of this litigation"* it thought that it was sufficient to provide a *"reasonable representation of reality"* and was therefore regarded as an acceptable methodology.

(continued overleaf)

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In *IRB v CX Re*, IRB appealed against an arbitration award relating to its reinsurance of CX Re's casualty business for 1976 to 1983. CX Re had entered into a number of settlements with underlying insurers and over several years of account without identifying an exact match with the underlying claims. The Arbitrators concluded that not only were the settlements reasonable and businesslike, but that it was sufficient for CX Re to establish that the total payments made were equivalent, on the balance of probabilities, to its share of losses. It was not necessary to show that CX Re was liable for each individual payment.

The Court's view was that, although some of the statements in the Award expressed the law erroneously, it was clear that the Arbitrators had applied the proper tests, and applied them to the facts.

The decision does give some wider scope to reinsureds to settle on what they consider to be a prudent commercial basis and, in some ways, might be thought to be contrary to earlier case law where market settlements were regarded as insufficient to trigger reinsurance coverage. Again, there is a clear policy decision on the part of the Courts not to interfere more than is required.

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Forthcoming Reinsurance seminars

Our next update seminars will be on the evening of Wednesday 17 November and the morning of Thursday 18 November. If you are interested in joining us, please get in touch.

Challenges to arbitration awards

A recent case illustrates how difficult it is for the unsuccessful party to challenge an Arbitration Award under Sections 67/68 of the Arbitration Act 1996

The dispute in *B v A* arose from a Share Sale Agreement between Spanish companies, which was written in English, but governed by Spanish law. It provided for disputes to be referred to arbitration in London under the rules of the International Chamber of Commerce. There was no other connection with England or English law. The Arbitrators made an Award in favour of the Claimant (by majority) but one of the three Arbitrators issued a strong dissenting opinion to the effect that the majority of the panel had ignored the relevant provisions of Spanish law and had decided the dispute on the basis of what they considered to be fairness and equity.

The unsuccessful party challenged the Award under Section 67 (that the tribunal did not have substantive jurisdiction) and Section 68 (serious irregularity affecting the proceedings) of the Arbitration Act 1996, on the basis that the majority arbitrators failed properly to apply Spanish law. Although the Appellant provided extensive expert evidence of Spanish law, the Commercial Court decided, on a preliminary issue, that there was no basis for the challenge. An error in the application of the chosen law did not involve a lack of substantive jurisdiction on the part of the Tribunal, nor did it constitute a serious irregularity such that the Tribunal had failed to decide the dispute *"in accordance with the law chosen by the parties as applicable to the substance of the dispute"*.

The decision confirms the reluctance of the Courts to interfere in Awards made in an arbitration process to which the parties voluntarily submitted at the time the contract was concluded.

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Fraudulent claims

The Court held that exaggeration of a claim following a fire at a domestic property was fatal to the entire claim

In *Yeganeh v Zurich* the insured claimed for damage to building and contents following a fire. The policy provided that Zurich would not make any payment if the claim was, in any way, found to be fraudulent or false. The insurers contended that the insured, or a person acting on his behalf, had caused the fire, and that the contents claim was overstated. That said, Zurich accepted the damaged contents claim in the sum of £38,788, which was only just short of the insured limit of £40,000.

> “The policy provided that Zurich would not make any payment if the claim was, in any way, found to be fraudulent or false.”

Although the Court found that Zurich had not established that the insured had committed arson, particularly in the absence of any motive, it concluded that the insured's approach to the contents claim was at best careless. The Court found him to be untruthful when giving evidence, and it was quite clear that he had falsely claimed for damaged clothing so as to inflate the contents claim as a whole. The Court therefore found the claim failed in its entirety.

Notwithstanding the fact the insurers failed on what might be seen as the most significant argument (i.e. prove arson), and that the amount which could have been in issue with the contents claim was small, the entire claim was dismissed (as it was overstated). The Courts have been criticised by insurers on a number of occasions for being generous to claimants who over-inflate their claims, and this may be seen as something of a rebalancing of the position, and an encouragement to policyholders to maintain only genuine claims.

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Conduct of claim

The Commercial Court emphasised that non-compliance with the claims handling conditions of the policy by an insured can deprive it of the benefit of any claim which might otherwise be payable

Horwood v Land of Leather arises from claims brought by customers of Land of Leather. Personal injuries were suffered by the purchasers of sofas in consequence of certain materials being used in their manufacture by Linkwise, a Chinese company. Land of Leather subsequently became insolvent, and the customers pursued claims against Zurich as product liability insurers for Land of Leather under the Third Parties (Rights Against Insurers) Act 1930.

Although the problems were correctly reported to Zurich, Land of Leather purported to enter into an Agreement with Linkwise for a settlement in the sum of US$900,000. The policy issued by Zurich contained the following terms:

"The due observance of the terms, provisions, conditions and endorsements of this policy by the insured in so far as they relate to anything to be done are complied with by the insured... shall be a condition precedent to any liability of the insurer to make any payment under this policy.

The Insured shall not, except at his own cost, take any steps to compromise or settle any claim or admit liability without specific instructions in writing from the Insurer nor give any information or assistance to any person claiming against him, but the Insurer shall for so long as they shall so desire have the absolute conduct and control of all proceedings (including arbitrations) in respect of any claims for which the Insurer may be liable under this policy, and may use the name of the Insured to enforce for the benefit of the Insurer any order made for costs or otherwise or to make or defend any claim for indemnity or damages against any third party or for any other purpose connected with this policy."

"Land of Leather subsequently became insolvent, and the customers pursued claims against Zurich as product liability insurers for Land of Leather under the Third Party (Rights Against Insurers) Act 1930."

The Commercial Court held that the agreement between Land of Leather and Linkwise, although not well crafted, did constitute a settlement of claims against the supplier, had been entered into without the consent of Zurich, and therefore constituted a breach of a condition precedent to Zurich's liability. The parties seem to have accepted that the very broad "due observance" provision was enforceable.

"Without prejudice" communications

The Court emphasised that the circumstances under which "without prejudice" communications can be placed before the Court are very limited

Although *Oceanbulk Shipping v TMT* Asia is not an insurance case, insurers commonly use the phrase "without prejudice" on the assumption that words and communication accompanied by that mantra cannot be used in subsequent court proceedings.

It is established law that "without prejudice" communications can be looked at by the Court to determine whether or not they did in fact result in a compromise agreement, and the terms of that agreement, but are not admissible for determining how those terms are to be construed. Evidence of negotiations is not admissible to resolve a dispute as to the meaning of a particular clause in a settlement agreement, for example.

The particular case concerned a settlement agreement in respect of various forward freight agreements, and whether or not settlements were contingent on settlements of other parallel transactions. The Court rejected an attempt to introduce evidence relating to those discussions, when the parallel transactions were not referred to in the settlement agreement itself.

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Stay of proceedings

Although there were parallel proceedings in England and Florida, the English Court would not grant a stay of the action here unless the foreign court was clearly the most appropriate forum

In *RSA v Rolls Royce*, Rolls Royce made a number of payments to cruise ship operators following proceedings in the Florida Court arising out of a failure of a marine propulsion system. The insurers declined to meet the claim, and Rolls Royce commenced proceedings against them in Florida.

Prior to service of the Florida proceedings, the insurers commenced a declaratory action in England.

The policy was governed by English law, but it did not contain an English jurisdiction clause. Rolls Royce applied to the High Court for a stay of the English proceedings, which was refused. The Court decided that proper service had been effected in England, and the English Court did have jurisdiction as a matter of principle. The Court also took the view that, on the facts, England was the more appropriate forum.

Although Rolls Royce and its legal advisers had knowledge of the matter in Florida, this was effectively a dispute between an English insured and predominantly English insurers under an English law policy placed in London.

Solvent schemes: Scottish Lion

The Scottish Appeal court has ruled that Scottish Lion's petition to sanction a solvent scheme is to be reheard by the lower court

In 2008, Scottish Lion Insurance Company Limited ("Scottish Lion") petitioned the Scottish Court to request that its proposed scheme of arrangement, opposed by a small number of number of its policyholders, be sanctioned.

The Outer House of the Court of Session dismissed Scottish Lion's petition (which is a persuasive decision for an English court), leading to concern amongst members of the insurance market (and in the run off market in particular) that any opposed solvent scheme would fail, except where there was a "problem requiring a solution" by the scheme. The implication of this decision was that the courts would not sanction a solvent scheme (except in very limited circumstances) in the face of creditor opposition.

Earlier this year, the Inner House of the Court of Session upheld Scottish Lion's appeal and overturned the dismissal of the petition to sanction the scheme. It should be noted however, that the decision did not address the merits of the scheme, only that Scottish Lion's petition should not have been dismissed at this preliminary stage.

The case has been sent back to the Outer House which will hear argument on whether the scheme should be sanctioned. The decision might not, ultimately, prove to be the seminal decision that the insurance market had hoped for, but it is certainly a start. In all likelihood, it will still prove difficult to obtain court sanction for schemes in the face of significant creditor opposition.

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Communications with insurers

The Court of Appeal's emphasis on the client's privilege will cause difficulty for solicitors with policy conditions requiring notification of circumstances

In *Quinn v Law Society*, the background was that claims had been made by clients against a two partner law firm regarding certain conveyancing transactions. Quinn, as the firm's professional indemnity insurers, were of the view that one of the partners in the firm had been dishonest, and so declined to provide indemnity to him.

> "Whilst the decision in itself is not exceptional, far greater concern will arise from observations by the Court of Appeal to the effect that a solicitor is neither obliged nor entitled to disclose privileged information to insurers without the consent of the client."

The Law Society intervened in the practice, and Quinn requested access to other files held by the Law Society to see whether there was evidence linking the other partner to the dishonesty. Quinn's argument in the Court of Appeal was that, as providers of the policy of professional indemnity insurance, they were part of the supervisory and regulatory system, and were therefore entitled to information which was made available to the other parties to that system. The Court of Appeal's view was that Quinn's role was only as insurance providers, and therefore they were not within the "circle of confidence" and were not entitled to obtain information available to other parties in the regulatory system.

Whilst the decision in itself is not exceptional, far greater concern will arise from observations by the Court of Appeal to the effect that a solicitor is neither obliged nor entitled to disclose privileged information to insurers without the consent of the client. The privilege is deemed waived only when an actual claim is brought against the solicitor but the Court's comments on the scope of the confidentiality obligation means that a solicitor who discloses a circumstance to his insurers (and includes privileged information) will be in breach of his duty of confidentiality to a client.

> "Proposals for anonymised notifications have been put forward, but the decision is likely to give rise to serious practical difficulties, as the matter on which notification is given usually relates to the advice to a client which, by definition, attracts privilege."

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Directors and officers insurance

A claim for recovery of fines may impact on directors and officers insurance policies

The dearth of cases directly relating to policies of this nature continues, but it is an issue in the background in *Safeway v Twigger*.

In that case, Safeway (now owned by Morrisons) sought to recover fines imposed on the company by the Office of Fair Trading from former directors and employees responsible for the alleged breach of competition law.

The directors and employees sought to have the case struck out but failed, the Court accepting that Safeway had an arguable case that the employees owed a direct duty to them and that the claims against them by their former employers were not prohibited by public policy.

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After the event insurance ("ATE")

The Court held that after the event insurance is subject to the same entitlements on the part of the insurer to avoid for non-disclosure and misrepresentation as other types of policy

In *Persimmon v Great Lakes*, Persimmon had been a defendant in litigation with a property development company who had taken out ATE insurance with Great Lakes. Persimmon were successful in defending the action, in which the Judge found that the claimants had been dishonest and had fabricated evidence.

The claimant was subsequently wound up, and Persimmon sought to recover under the claimant's ATE policy with Great Lakes under the Third Parties (Rights Against Insurers) Act 1930. Great Lakes avoided the policy for non-disclosure on the basis that the Claimants had failed to disclose their dishonest conduct and fabricated evidence when the policy was written.

Persimmon sought to argue that in the context of an ATE policy, the factual issues were not material to the risk and that Great Lakes had waived any right to avoid.
The Court held that neither of these arguments were correct, and that ATE fell within the normal rules where a policyholder had been dishonest. This does, of course, limit the utility of the ATE policy in such circumstances, and may encourage applications for security of costs instead.

In another recent case (*Michael Phillips v Riklin*), the Court has held that an ATE policy which could be terminated by the insurers is insufficient, and that the defendant is entitled to seek security for costs in the ordinary way. The issue in that case arose out of the insurer's entitlement to cancel the policy at any time for no reason.

Business interruption insurance

The decision highlights a potential pitfall for insureds when looking to recover business interruption claims

Orient-Express Hotels v Generali, demonstrates a potential difficulty that insureds might face in looking to claim for business interruption losses which arise from a devastating catastrophe such as a hurricane, flood or an earthquake.

This case involved a claim for business interruption following the claimant's New Orleans hotel being damaged by hurricanes Katrina and Rita. The hurricanes also caused extensive damage to the surrounding area in New Orleans and beyond. A mandatory evacuation of the city was ordered immediately following hurricane Katrina, which effectively shut down the city for over a month.

The claimant's business interruption insurance policy was drafted in a form commonly in use, linking recoverable business interruption losses to those resulting directly from physical damage to the property insured (*"...loss due to interruption or interference with the business directly arising from [direct physical] Damage [to the hotel]..."*).

The policy also contained a "trends clause" which provided for revenue figures to be adjusted as necessary so as to *"represent as nearly as may be reasonably practicable the results which but for the Damage [to the hotel] would have been obtained...."*

It was not disputed that the hotel itself had been damaged in the hurricanes, nor that the claimant had suffered business interruption losses resulting from this damage. What was in dispute was whether the cause of the loss had to be shown to be interruption or interference resulting from the physical damage to the hotel only.

The Court upheld an arbitrator's award that, in these circumstances, the policy wording required adoption of a "but for" approach to causation. Accordingly, it was necessary to assess the business interruption loss on the hypothesis that the hotel was undamaged whilst the city was.

In addition, the Court held that interpreting the "trends clause" to allow recovery of the whole business interruption loss suffered as a result of the hurricanes (as opposed to only the loss which could be shown to be a result of the damage to the hotel) was inconsistent with the basis on which cover was provided.

> "Therefore, as the hotel would have been closed for a period of time even if it had been undamaged, that part of the loss was irrecoverable under the policy."

Therefore, as the hotel would have been closed for a period of time even if it had been undamaged, that part of the loss was irrecoverable under the policy.

The decision was heavily influenced by the specific wording of the insurance policy. However, it might lead to insurers providing business interruption and catastrophe cover seeing an increase in insureds seeking to negotiate an amendment to covers in an attempt to calculate business interruption losses without reference to recoverable losses only arising from damage to their property.

Statutes and regulation

A brief comment on a number of recent and pending statutory and regulatory changes which will affect the insurance industry

The change of government in May is likely to give rise to significant regulatory changes in relation to financial services, with a new Prudential Regulation Authority and a Consumer Protection and Markets Authority, under the general supervision of the Bank of England.

Whatever the merits of this arrangement so far as banking is concerned, the consensus in relation to insurance that *"if it ain't broke don't fix it"* seems to have cut no ice with politicians, as the Financial Services Authority was generally regarded as having performed well in relation to insurance regulation.

Whilst many of the details are yet to be provided, it seems likely that some aspects of the business of insurers and others in the insurance chain will be regulated by both of the new bodies, which is likely to lead to increased costs and bureaucracy.

Changes in government do not lead to a change in everything and a number of the decisions of the last government will remain, including:

1 The Third Parties (Rights Against Insurers) Act 2010 was given Royal Assent earlier this year. No date has yet been set for this to come into force, but it makes the process of enabling proceedings to be brought by third parties against the insurers of insolvent insureds substantially easier.

2 The coalition government will proceed with the proposal for an Employer's Liability policy tracing office, but only on a forward looking basis. In addition, consideration is still being given to an Employer's Liability Insurance Bureau, along the same lines as the Motor Insurance Bureau for injured employees where no policy can be traced.

3 The coalition government will not review the position in relation to pleural plaques. The last administration decided not to legislate to reverse the *Johnson v NEI International Combustion* decision, but agreed to compensate those who had lodged claims prior to that decision, with a lump sum of up to £5,000. Attempts by insurers to defeat legislation in Scotland which reversed that decision have been unsuccessful, so there now exists the prospect of forum shopping for claims of this nature.

4 The Bribery Act will come into force in April 2011. Some guidelines are expected later this year, but in many ways, the legislation is wider than the United States Foreign Corrupt Practices Act, and will require consideration of the extent to which the insurance industry engages in hospitality, as well as imposing criminal sanctions on the more obvious forms of corruption. At present, the Financial Services Authority is of the view that the insurance industry pays insufficient attention to such risks, a point evidenced by the fine imposed on Aon in 2009 of £5,250,000 for failure to have proper anti-corruption systems in place.

5 The government is to consider the recommendations put forward by the Jackson review into civil justice costs. Precisely how these will work in conjunction with the Department of Justice's costs saving programme remains to be seen. Although Lord Justice Jackson was of the view that his proposals were an entire package and should not be implemented selectively, selective implementation does seem the most likely outcome.

6 The European Union's plans for Solvency II continue with a revised implementation date of 1 January 2013. Debate continues as to the extent to which capital requirements imposed by Solvency II will require changes to the standards adopted by most UK entities.

7 The Financial Services Authority has published a policy statement on how it expects the insurance industry to address complaints by the purchasers of payment protection insurance. Arrangements must be in place by 1 December 2010 to ensure that customers are treated fairly in these matters.

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