(RE)INSURANCE ROUND UP

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Carter Perry Bailey

DEVELOPMENTS IN THE LAST YEAR

- **Brexit**: It might be said that this does not sit well under the heading "Developments", as we seem no wiser than we were a year ago as to what, if any, terms will be agreed as the basis for Brexit. Meanwhile, the London market has been planning for a no deal Brexit, setting up EU based subsidiaries and transferring business by Financial Services & Markets Act 2000 Part VII transfers (and often reinsuring it back). A similar model has been adopted by the Brussels based Lloyd's Insurance SA. All Part VII transfers require sanction by the English Courts. A number have been heard by Mr Justice Snowden, who summarised the Court's view in his judgment on the Scottish Widows transfer (to a Luxembourg based company), stating *"there is still no clarity as to what will happen in the Brexit process"* and *"the bottom line is that the Scheme guarantees that* [the UK company] *can provide certainty to its EEA policyholders that their policies will continue to be able to be serviced, irrespective of the outcome of the political process"*. These considerations outweighed the loss of policyholder protection from the UK's Financial Services Compensation Scheme. He concluded, *"the highly unusual circumstances of Brexit require the Court to consider the risk of harm to policyholders if nothing is done and there is a no deal Brexit, balanced against the solution proposed under the scheme."* He considered this remained so even where EU countries had announced transitional arrangements.

- **Climate change:** The UK regulator, the Prudential Regulation Authority ("PRA"), published a paper *"Enhancing banks' and insurers' approaches to managing the financial risks from climate change – SS Number 3/19"*. The PRA has now published a framework for assessing financial impacts of physical climate change. Further focus on climate change planning can be expected.

- **Pool Re:** The cover provided by Pool Re has continued to evolve. This year, Pool Re introduced business interruption cover that does not require physical damage.

- **In the English Courts:** There have been significant procedural changes in the Commercial Court, where a disclosure pilot has incorporated many aspects that will be familiar to those practising international arbitration, and bound them up in Court procedural rules. This will result in significant obligations to produce documents with pleadings and substantial changes to the disclosure regime.

As ever, there have also been Court cases that will be of interest to the insurance and reinsurance market, a number of which we summarise below. Several of them relate to jurisdiction and to arbitration clauses, the latter possibly becoming more prevalent given the uncertainties over enforcement of judgments (but, by virtue of the 1958 New York Convention, not arbitration awards) in the EU after Brexit.

However, we will begin with a topic that has been much in the news this year, sanctions.

SANCTIONS

- **Mamancochet Mining Ltd v Aegis Managing Agency Ltd & Ors [2018] EWHC 2643**

The English law policy contained a sanction clause:

> *"No (re)insurers shall be deemed to provide cover and no (re)insurer shall be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose that (re)insurer to any sanction, prohibition or restriction under the United Nations resolutions, the trade or economic sanctions, laws or regulations of the European Union, United Kingdom or the United States of America".*

Insurers contended that this applied where there was a risk that the US enforcing agency would conclude that there was prohibited conduct, even if in law there was not. The Court disagreed. It found that the clause was only effective when sanctions would actually apply under the relevant law (in this case US law).

Insurers therefore have to prove, if necessary using expert evidence of foreign law, that the transaction would be sanctioned under that law.

The Court also held that the effect of the clause is to suspend insurers' liability during the period for which the sanctions apply, not to extinguish it. Hence, when sanctions are lifted, the liability remains. The Court considered (obiter) that such a clause suspending liability would not engage the EU Blocking Regulation (which if engaged would render compliance with the US sanction a criminal offence).

Where liability is suspended under the clause, (re)insureds may be well advised to issue proceedings before expiration of the six year limitation period, in order to protect their position, and apply for a stay until such time as sanctions are lifted. Insurers will also need to consider their reserving during the period of suspension. Finally, this decision was based on the particular sanctions clause, so different sanctions clauses will have to be construed on their own distinct terms.

REINSURANCE ALLOCATION

- **Equitas Insurance Ltd v Municipal Mutual Insurance Ltd [2019] EWCA Civ 718**

A special rule of causation has been developed in English law in respect of mesothelioma cases, whereby an employee exposed to asbestos over a period of time working for multiple employers, can claim his damages in full from any one employer. That employer, in turn, can claim a contribution, pro rata periods of employment, from other employers (*Fairchild v Glenhaven Funeral Services [2002]* and the Compensation Act 2006). The employers' insurers must pay the liability of their respective insureds, and if that is the full amount of damages, they can then claim contribution from other employers' insurers (or uninsured employers), again pro rata periods of employment (*Zurich Insurance plc UK Branch v International*

Engineering Group [2005]). Claiming in full from a single employer/policy is known as "spiking".

Municipal Mutual Insurance ("MMI") had paid claims on a spiked basis and now sought to recover reinsurance from Equitas.

The Court of Appeal (overturning the Judge arbitrator) found that the reinsurance claims *"must be presented in a manner that is not arbitrary, irrational or capricious, and … that they be presented by reference to each year's contribution to the risk, which will normally be measured by reference to time on risk unless in the particular circumstances there is a good reason (such as differing intensity of exposure) for some other basis of presentation."*

Accordingly, a reinsured cannot simply pass on the spiked claims payments in full to its reinsurer on the year concerned. The reinsurance claims must be presented by the reinsured on a rational basis by reference to each year's contribution to the risk. Were that not the case, it may present difficulties to reinsurers who had paid a spiked claim, when collecting from the reinsurers on other years, if the reinsurance programmes and the layers concerned were to be different.

FAIR PRESENTATION: INSURANCE ACT 2015

❖ Young v Royal & Sun Alliance plc [2019] CSOH 32

In this Scottish case, the insured argued that insurers had waived provision of information at placement, the non-disclosure of which insurers sought to rely on as a breach of duty to make a fair presentation. The insured, in a broker's presentation (importantly not an insurer generated proposal form) failed to disclose that one of its directors had been a director of four other companies that had been declared insolvent. RSA, which was unaware that the broker had asked the insured about such circumstances, confirmed cover subject to confirmation that the *"insured has never been declared bankrupt or insolvent"*. The insured argued that this was a *"limiting"* question from which the insured could reasonably infer that the insurer did not want to know about its directors' interests in other companies.

The Court found that the test for waiver is *"would a reasonable person reading the proposal form be justified in thinking that the insurer had restricted its right to receive all material information and consented to omission of the particular information not disclosed?"* The onus is on the insured to prove waiver, which the Court will not readily infer.

The Court observed that matters going to moral hazard are generally to be disclosed, and it would have been clear that the reference to *"insured"* in this context included a director of the insured (including in relation to companies other than the insured). The Court commented that the 2015 Act was said to have *"shifted the burden of identifying what is material to the insured in the form of the duty to make a fair presentation of the risk"*, and suggested that this may make it harder for insureds successfully to argue waiver.

POLICY INTERPRETATION: EXCLUSIONS

❖ Zagora Management Ltd v Zurich Insurance plc [2019] EWHC 140 (TCC)

In a lengthy judgment that turns largely on its facts, the Court made some useful observations, including that although the natural meaning of the words of a policy cannot be overridden by what an insured may reasonably believe is covered, where there is *"reasonable room for doubt as to what was intended, a construction which would unreasonably limit the scope of the cover which was the declared purpose of the policy to provide is to be avoided. That applies particularly where the insurer has put forward a policy which contains exclusions from cover which is otherwise afforded which are genuinely ambiguous …"*

The Judge also confirmed that if a loss is caused concurrently by an insured and an uninsured peril, the insured can recover under the policy, but if the loss is caused concurrently by an insured and an excluded peril, the insured cannot recover. However, his comment that *"words of exclusion are to be construed narrowly"* probably needs to be viewed in context, as the principle appears out of step with other recent cases.

PROPERTY INSURANCE: REINSTATEMENT

❖ Sartex Quilts & Textiles Ltd v Endurance Corporate Capital Ltd [2019] EWHC 1103 (Comm)

A property policy provided for *"reinstatement of the property lost, destroyed or damaged"* to a position substantially the same as it was when new, provided the reinstatement was pursued without undue delay and the cost had been incurred. However, although the property had been damaged by a serious fire in May 2011, it had not been reinstated by the time of trial in March 2019, so this reinstatement as new clause did not apply.

The Judge nevertheless found the appropriate measure of damage to be the notional reinstatement cost. insurers' submission that the insured has to show that it had, at the time of loss, and continues to have a genuine, fixed and settled intention to reinstate, failed: *"...the primary focus is on the position as at the time of (and immediately before) the fire. If the insured intended then to use the property, as opposed (for example) to selling, or demolishing it, the appropriate measure of indemnity, and the best reflection of the value of the property to him at that time, is likely to be the reinstatement basis. But subsequent events (and not just those foreseeable at the time of the fire) may show that such measure would over-compensate the insured, in which case the court at trial is likely to consider another measure of loss to be more appropriate."*

The Court also, albeit apparently reluctantly, considered itself bound by precedent to apply the principle of betterment, being a deduction to reflect the better condition and quality that a notional reinstatement would result in (as compared to the condition and quality at the time of the loss). However, the Judge rejected the notional percentage discount methodology that was applied by loss adjusters and found that *"the onus is on the insurers to identify and justify any particular reductions"*, for which specific evidence would be needed. As no such evidence had been presented, the Court made no reduction for betterment.

The Judge spoke approvingly of comments made by Lord Justice Clarke in *Great Lakes v Western Trading* that *"in circumstances where the insured has chosen (or has received) the most reasonable and least expensive option available to him, it is a benefit that is in effect an unavoidable consequence of the loss. It is very arguable that in such circumstances making a deduction for betterment deprives the insured of a full indemnity for his loss"*. It will take a decision of a Superior Court to establish this, but in the meantime, the principle of betterment applies unless the policy provides otherwise. However, insurers will have to produce evidence to justify reductions, rather than simply applying a notional percentage.

LIMITATION

❖ Midnight Marine v Thomas Miller Underwriting [2018] EWHC 3431 (Comm)

The insured sued insurers in the Canadian Courts. Insurers then sought a declaration of non-coverage, in arbitration in London, under the arbitration clause in the policy. The Canadian Court stayed proceedings in favour of the arbitration, However, no further step was then taken for seven years until the insured appointed its arbitrator. The Tribunal found (i) that the claim was time-barred, as the arbitration related only to insurers' application for a declaration of no cover, not to the insured's claim under the policy; and (ii) that in any event the claim would be dismissed for *"inordinate and inexcusable delay of the claimant"* (the insured being treated as counterclaimant) under Section 41(3) of the Arbitration Act 1996.

The insured sought leave (under Section 69 of the Arbitration Act) to appeal to the English Court, but was refused on the basis that an appeal of (ii) above would be hopeless. The limitation issue became otiose, but the Judge observed (obiter), *"I can see an argument that in the circumstances of the Canadian proceedings, one important purpose of the Underwriters' notice of arbitration law to enable it to submit to the Canadian court and Assured's claim had been referred to arbitration in London. There would have been little benefit to the Underwriters in telling the Canadian court that its claim for a negative declaration had been referred to arbitration but that the Assured's claim for an indemnity had not"*.

PART VII TRANSFERS: REFUSAL OF COURT SANCTIONS

❖ The Prudential Assurance Company Ltd and Rothesay Life plc [2019] EWHC 2245 (Ch)

This was not a Brexit related transfer of the sort referred to above, but was heard before the same Judge, Mr Justice Snowden. The purpose of the proposed transfer was to facilitate the demerger of Prudential plc's business in Asia, the USA and Africa.

Prudential entered into a reinsurance agreement with Rothesay Life for around 400,000 annuity policies with the intention of subsequently transferring the policies to Rothesay under Part VII of the Financial Services & Markets Act 2000. For a transfer to take place under Part VII, the English Court must "sanction" (approve) it. In this case, Mr Justice Snowden declined to do so.

Although the PRA and the FCA had approved it and the independent expert had concluded that it would not have material adverse effect on policyholders, the Court observed that its discretion to approve could take account of broader considerations than actuarial analysis or regulatory criteria, such as reputation and the likelihood of parent company support. The Judge also referred to the reasonable expectation of policyholders, particularly in the light of statements made by Prudential in key information supplied at placement and on its website. The annuities often represented the policyholders' life savings and were required to pay out for their lifetimes, so such considerations were of particular importance.

Snowden J also stated that the Court must balance the commercial interests of the insurers against the interests of the policyholders, in which respect the existence of the reinsurance had already achieved 90% of the required release of regulatory capital. Even though the reinsurance was part of the overall plan, there was no provision for its recapture if the Part VII transfer was not sanctioned.

Not only will this decision have to be taken into careful account in the drafting of schemes to transfer both live and legacy market business, but its findings should be taken into account when drafting key information and in internet and other promotional materials, so that the reasonable expectations of policyholders, which played a significant role in the decision, may be better managed.

However, this may not be the end of the story, as the applicants have been granted leave to appeal.

JURISDICTION

❖ Catlin Syndicate v Weyerhaeser Co [2018] EWHC 3609 (Comm)

When proceedings are brought abroad under a contract that provides for a London arbitration, the English Courts' remedy is to order an anti-suit injunction restraining the party from proceeding with the overseas action. However, the policy in this case provided both for US Court jurisdiction and for London arbitration. The latter provision continued that *"solely for the purpose of effectuating arbitration"* if the insurer failed to pay any amount claimed, the insurer at the request of the insured will submit to the jurisdiction of any Court of competent jurisdiction within the United States.

The English Court, which will not lightly conclude that there is a conflict in commercial drafting, found that London arbitration applied and that the jurisdiction of the US Courts was restricted to enforcing an award resulting from arbitration or giving jurisdiction in the event that the parties agreed to dispense with arbitration. The Court therefore ordered an anti-suit injunction.

❖ Airbus SAS v Generali Italia SPA [2019] EWCA Civ 805

Generali sought to bring a subrogated action in Italy by way of recovery against a third party, Airbus SAS, of their outlay. The relationship between the insured and Airbus was governed by more than one contract. One provided for an English jurisdiction and another for ICC arbitration in Geneva.

Airbus applied to the English Court for declarations that (i) it had no liability to insurers; (ii) the Italian action was within the scope of the exclusive English jurisdiction clause; (iii) the Italian proceedings were being pursued in breach of that clause.

English Courts are reluctant to find that rational businessmen intend a dispute to be litigated in different tribunals, and will only do so if that intention is clear. The Court agreed that the English jurisdiction clause was applicable, and went on to find that insurers exercising subrogated rights are bound by an English arbitration or jurisdiction clause to the same extent that the insured would have been had it brought the claim. Although insurers were not a party to the contract concerned, so could not be in breach of it, it was held that they were in breach of *"an equivalent equitable obligation which the English court will protect"*.

❖ AIG Insurance Hong Kong v Lynn McCullough & Anor [2019] HKCFI 1649

Mr & Mrs M, US residents, suffered serious injury whilst on a Caribbean cruise, during an excursion to Rain Forest Adventures ("RFA"). RFA carried D&O insurance with AIG. This covered the Defence costs for a bodily injury claim, but excluded damages for bodily injury. Mr & Mrs M sued RFA in Miami. The case went to an ad hoc arbitration in which Mr & Mrs M were awarded damages of US$65.5m against a Director. AIG indemnified against the defence costs, but declined cover for the damages.

Mr & Mrs M (as judgment creditors of the Director) then sued AIG, also in Miami, for bad faith arguing that AIG's conduct had exposed the Director to the liability of US$65.5m, rather than a lesser sum.

However, under Florida law, there must be a determination of coverage before an insurer can be liable for bad faith. AIG applied to the Hong Kong Court to restrain the Miami action, on the basis that, under the terms of the policy, coverage was an issue that should be determined in arbitration in Hong Kong. Although Mr & Mrs M were not parties to the policy, the Hong Kong Court found that the Miami proceedings were in substance proceedings to enforce a contractual obligation under the policy. The Court concluded that under Hong Kong law (the same as English law in this respect) if you found a claim on an insurance policy, you are bound by the dispute resolution provisions of that policy; in this case the Hong Kong arbitration clause. The anti-suit injunction which had been granted at first instance was therefore upheld.

❖ Aspen Underwriting v Credit Europe Bank NV [2018] EWCA 2590

Credit Europe Bank NV, a Dutch bank, was the mortgagee and assignee of a marine policy, under which Aspen, the hull and machinery insurers, had settled a loss. However, the Court then found in a Limitation Action that the vessel had been deliberately sunk, at the request of its owner. The insurers therefore sought to recover their outlay from the bank, in the English Courts, claiming in restitution and in the tort of misrepresentation. The Bank argued that the proceedings should have been brought in the Netherlands. The bank was not a party to the settlement agreement or the policy, so it was not bound by the English exclusive jurisdiction clauses that they contained (although had it been itself relying on the policy to claim against insurers, it would have been bound by its dispute resolution procedures, as in the AIG Insurance case above).

Article 14 of the Recast Brussels Regulation provides that an insurer can only sue an insured or a beneficiary of the policy, such as the bank, where it is domiciled, which in this case was the Netherlands. However, the Court of Justice of the European Union had previously decided that Article 14 does not apply to professionals in the insurance sector. The Court considered the bank was analogous to an insurance professional, it being normal for ship mortgagees to take assignments of insurance policies. Accordingly, Article 14 did not apply.

Under Article 7(2) of the Recast Brussels Regulation the Court of the place where the harm occurs has jurisdiction over claims in tort. The court therefore had jurisdiction to hear the misrepresentation claim. However, the court did not have jurisdiction to hear the restitution claim, as claims in restitution do not fall under Art 7(2). The court expressed regret that all aspects of the claim could not be heard together in England.

SETTING ASIDE ARBITRATION AWARDS

It is rare for a party successfully to have an arbitration award set aside under Section 68(2)(a) of the Arbitration Act 1996, which provides that the Court may set aside an award for serious irregularity which causes a party substantial injustice. However, this past year has seen three such cases in which arbitrators had relied on matters that had not been properly argued before them. These are not (re)insurance cases, but the principles apply equally to (re)insurance arbitrations. The judgments constitute a clear message from the Courts that arbitrators must afford the parties the opportunity to make submissions on matters on which the arbitrator relies in reaching a decision.

❖ RJ v HB [2018] EWHC 2833 (Comm)

The arbitrator had decided this case on a basis that was significantly different from anything previously raised by either party. The substantial injustice was that the tribunal found RJ to be the beneficial owner of shares in circumstances which risked exposing him to regulatory fines. As neither party had raised this point, the arbitrator had a duty to give them the opportunity to comment on it. The award was set aside.

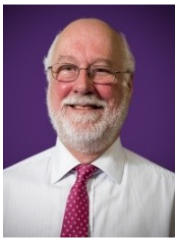
An application to remove the arbitrator failed both procedurally, as the applicant had not joined the arbitrator to the action for this purpose (Section 23 of the 1996 Arbitration Act) and substantively, as the Court declined permission to join the arbitrator on the basis that it could not be justified.

❖ P v D [2019] EWHC 1277 (Comm)

The Court set aside an award on the basis that the tribunal had made a finding of fact on a core issue that had not properly been put to a witness in cross-examination. It was also considered that in fairness to the witness, he must be given fair opportunity to deal with the allegation (where his honesty and integrity were being questioned) in cross-examination. The Court also found the tribunal was in breach of its duty by basing its decision on a case that had not been properly argued before it.

❖ Fleetwood Wanderers Ltd (t/a Fleetwood Town FC) v AFC Fylde Ltd [2018] EWHC 3318 (Comm)

We end on a case for all those who, like the writers, are football fans. AFC Fylde alleged that Fleetwood had procured a breach of contract by one of its players, arising out of his transfer. The arbitrator sought the opinion of the Football Association's Judicial Services Manager as to the applicability of FIFA's Regulations on the Status and Transfer of Players ("RSTP") and then based his award partly on that opinion and on research that he had carried out on the internet. The Court found that it was likely, had the arbitrator raised the question of obtaining the opinion on the status of RSTP, that Fleetwood would have made submissions leading to a real prospect of the arbitrator concluding that RSTP did not apply, so that part of the award was remitted to the arbitrator.



Stephen Carter
Partner

T: 0203 697 1902
M: 07887 645 262
E: stephen.carter@cpblaw.com

Bernadette Bailey
Partner

T: 0203 697 1903
M: 07887 645 263
E: bernadette.bailey@cpblaw.com