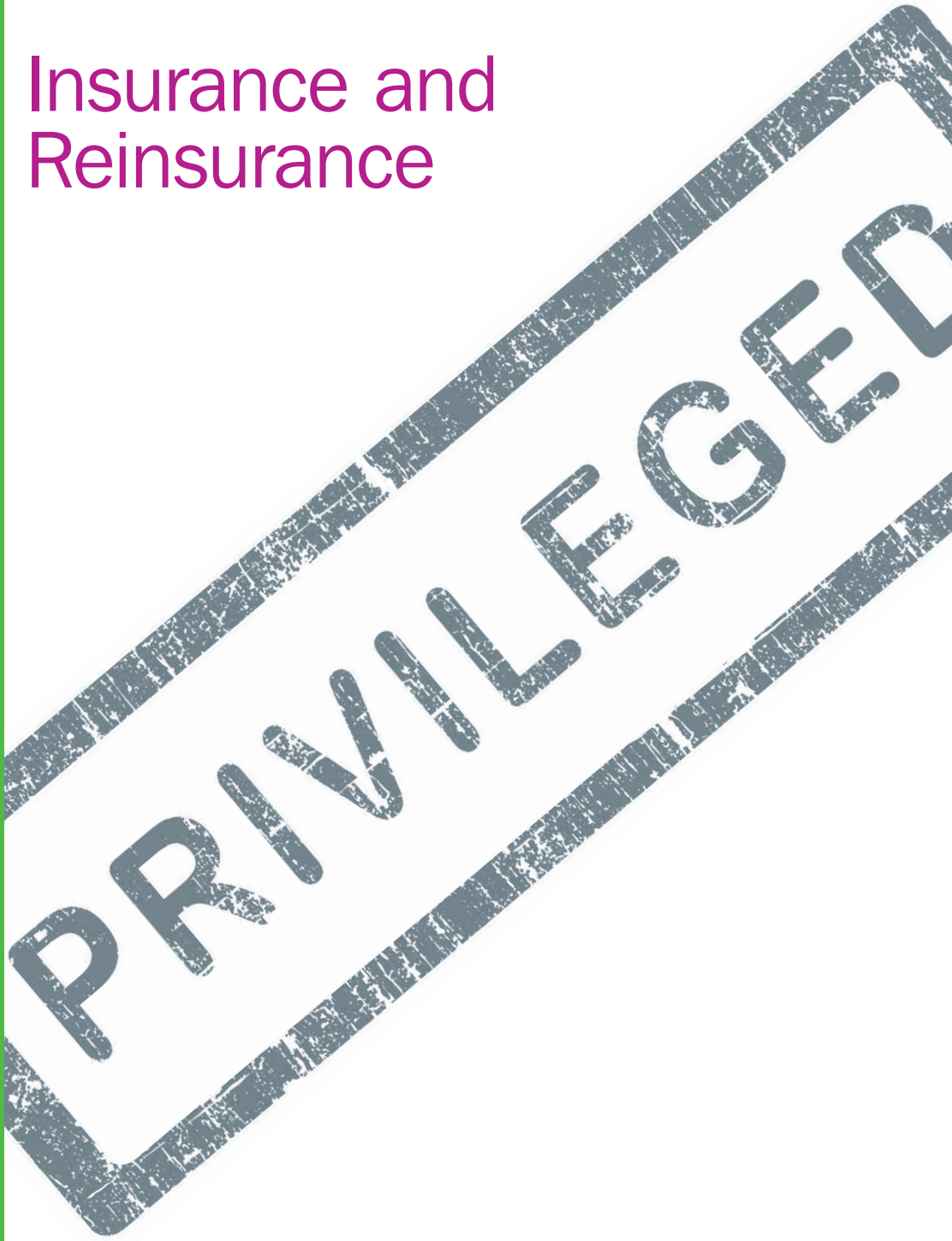


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# Insurance and Reinsurance



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Issue Number 27 Autumn 2007

Newsletter

**the angle** LG

## Privilege in respect of communications with in-house lawyers open to challenge

The decision of the European Court in *Akzo Nobel Chemicals Ltd and Akros Chemicals Ltd v EC*, which was handed down on 17 September 2007, has re-ignited the debate on the extent to which communications between in-house lawyers and their clients should be protected from production to third parties under the doctrine of legal advice privilege.

As a matter of English law, legal advice privilege protects confidential communications passing between lawyer and client in relation to the seeking or giving of legal advice. In contrast to litigation privilege, the ambit of which is wider in the sense that it is not limited solely to communications between lawyer and client, there is no requirement for either the existence or contemplation of legal proceedings.

It has been well established since the early 1970s that communications between in-house lawyers and their clients enjoy the same privilege under English law. The rationale is simple and, it is submitted, well founded. The public policy rule underlying legal advice privilege is that an essential feature of the right to obtain proper legal advice is that a client should be able to be frank with his or her lawyer, without fear that anything said might subsequently be disclosed to any third party or indeed to the court in the event that legal proceedings are ultimately brought. The English courts have recognised that this is no less relevant to situations where the legal advice is sought from an in-house lawyer.

The *Akzo* case concerned an inquiry by the European Commission into alleged anti-competitive practices. As part of the investigation, a number of documents were seized by the Commission. *Akzo* asserted that certain of the documents seized were subject to legal professional privilege. Included within the documents for which

privilege was claimed were two communications passing between *Akzo* and its legal department. The Commission rejected *Akzo's* claim for privilege and the decision was appealed to the European Court of First Instance.

The European Court recognised that the principle underlying legal advice privilege was the need to be able, without constraint, to consult a lawyer whose profession entailed the giving of independent legal advice. However, it noted that this principle was closely linked to the concept of the lawyer's role as an officer of the court and thereby in "*collaborating in the administration of justice by the courts*".

The Court stressed that the protection of legal advice privilege was, in accordance with Community law, limited to situations where the lawyer concerned was independent and not "*bound to his client by a relationship of employment*". The rationale was to ensure that the lawyer was truly independent, such that his or her obligation to act in the overriding interests of the administration of justice was not in any way impeached.

The Court therefore held that the communications passing between *Akzo* and its legal department were not covered by legal advice privilege even where, had the communications been made to/from external lawyers, they would have satisfied the relevant test. In reaching its decision, the Court took note of the fact that a number of member states still excluded in-house lawyers from the protection afforded by legal advice privilege.

So what does this mean for in-house counsel in the insurance and reinsurance industry?

The position under English law remains that communications between in-house lawyers and their clients, which are made for the purpose of seeking or giving legal advice, are protected by legal advice privilege. However, and whilst a number of groups continue to lobby the EC to change its stance, the English law position is now open to challenge on the basis that it is inconsistent with European Community law.

Therefore, in circumstances where legal proceedings are not in existence or in reasonable contemplation such that litigation privilege can be said to apply, in-house lawyers will need to be very careful in communications with their clients.

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# Public liability policies require a liability in tort



In *Tesco Stores v David Constable & Others* (14 September 2007) the claimant, Tesco, took out public liability insurance as part of a standard project insurance package for a construction project. The project consisted of enclosing a section of railway by installing concrete tunnel sections over a cutting and then building a supermarket on top. The insuring clause gave Tesco an indemnity against “all sums for which [Tesco] shall be liable at law in respect of a) death of or bodily injury to or illness or disease of any person b) loss or damage to material property...c) obstruction, loss of amenities, trespass, nuisance or any like cause...”

Before the commencement of the project, Tesco gave the train operator, Chiltern, a contractual indemnity under a Deed of Covenant “for all and any costs, losses or expenses arising...out of the Works”.... In June 2005, a section of the tunnel collapsed. Chiltern made a claim under the Deed for loss of passenger revenue. Tesco settled the claim and sought an indemnity

under their public liability insurance in respect of the sums paid to Chiltern.

The defendant underwriters refused to pay. The defendants contended that the public liability section of the underlying policy only covered the liability of Tesco to third parties who, as a result of the carrying on of the project, suffered the kind of harm that would give rise to an action in tort. Chiltern suffered no such harm to bring an action in tort whether in negligence or nuisance. The damage suffered by Chiltern was pure financial loss recoverable only in contract under the Deed.

Mr Justice Field held that public liability policies were generally regarded as not affording cover against liability in contract for pure economic loss. Words such as “liable at law” or “all sums” in the insuring clause were to be construed in their setting within the clause. Paragraphs a) to c) of the insuring clause envisaged a liability in tort. Therefore, the contractual liability extension was to be construed as doing no more than extending cover to an insured who was liable in contract for a tort comprehended by paragraphs a), b) or c). Mr Justice Field held that Tesco were not entitled to be indemnified.

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## Defendants ordered to disclose details of insurance

The case of *Harcourt v FEF Griffin & Others* (27 June 2007) is likely to be of some concern to insurers as it runs contrary to the basic principle that a non-party to an insurance contract has no right to know the coverage provided under that insurance contract (save for circumstances covered by the Third Parties (Rights Against Insurers) Act 1930, the Contract (Rights of Third Parties) Act 1999, and the Motor Insurers Bureau).

The case concerned an application prior to trial to determine the damages for the severe spinal injuries suffered by the Claimant. The issue of liability was settled before trial with the Defendant agreeing to pay 75% of the full value of the claim. It was expected that the damages awarded would be significant given the young age (19) and long life expectancy of the Claimant, who valued the claim at £8 million to £10 million.

The Claimant made an application under CPR Part 18 for an order that the Defendant be made to disclose information relating to the nature and extent of the Defendant’s insurance cover. This would assist the Claimant to decide whether or not to proceed with the

claim, given the significant legal costs he had already incurred, and also whether to seek a periodical payment rather than a lump sum.

Mr Justice Irwin found that this application did fall within the scope of Part 18. Although the Defendant’s insurance cover was not a “matter in dispute”, the information would enable the parties to deal efficiently and justly with the matters in dispute and this was the intention behind Part 18.

He acknowledged the Defendant’s argument that, if allowed, this kind of application may become standard tactical manoeuvring for claimants in litigation. However, he considered that the disclosure was necessary to determine whether further litigation would be useful and cost effective. In addition, as the Defendant had failed to demonstrate any prejudice suffered if the insurance cover was disclosed, he granted the order.

Whilst of concern to insurers, the decision must be put in the context of its particular facts. The judge also made it clear that such disclosure should be approached with caution and only ordered where the claimant could demonstrate a genuine concern that an award might not be satisfied and the defendant could not demonstrate any prejudice in such disclosure.

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# European commission inquiry into the business insurance sector

On 25 September 2007, the European Commission published its final report on its inquiry into the European business insurance sector. In this article, we focus on one of the key issues raised in the report, namely distribution channels and, in particular, the form of remuneration received by intermediaries. When brokers act as both distribution channels for insurers and as advisors to their clients, brokers assume, (according to the Commission), a dual role which is a potential source of conflict between the objectivity of the advice they provide to their clients and their own commercial considerations.



In respect of the provision of services by intermediaries to insurers, the Commission notes that the potential for such conflicts may be greatest where the intermediaries act under delegated underwriting authorities for insurers in respect of their own insurance broking clients.

## Form of remuneration

Another potential source of conflict which the Commission has identified is in respect of the form of remuneration received by intermediaries.

In particular, the Commission has highlighted contingent commissions which it believes could create incentives for intermediaries to steer high volume or profitable business to selected insurance companies, not necessarily in the interest of clients.

This, in turn, according to the Commission, has the potential to undermine fair competition in the insurance market around terms and conditions of cover, service, and insurers' financial strength.

The Commission defines contingent commissions as being any kind of payment made by an insurer to an intermediary based on the achievement of agreed targets relating to business placed by the intermediary with that insurer.

## Commission disclosure

The Commission comments that disclosure of relevant information by intermediaries in relation to remuneration received from insurers and services provided to insurers may help to mitigate conflicts of interest by enabling customers to make a more informed decision.

However, significantly, the Commission notes that it is questionable whether full and automatic disclosure alone is sufficient to mitigate conflicts of interest "in particular in

relation to those types of remuneration that specifically aim at aligning the interests of brokers with that of insurers."

It is interesting that the Commission does not specifically refer to contingent commissions in this respect. This may be because the Commission is concerned about particular kinds of contingent commission only or because it has formed the view that its definition of contingent commission may be too narrow and may not catch all of the arrangements which could potentially undermine competition.

## Next steps

The Commission has identified certain key issues which will need to be followed up by it and/or national authorities.

One of these issues relates to, as the Commission describes it, "indications of potential market failure in respect of insurance brokerage".

The Commission does not reach any definitive, final conclusion on insurance brokerage, but it states that it intends to look anew at the issues relating to this within the framework of the review of the Insurance Mediation Directive.

## Final thoughts

Pending the outcome of its review, the Commission is clearly looking for market-led initiatives to address the competition concerns which it has identified in connection with insurance brokerage.

Just in case there was any doubt as to the Commission's resolve in this matter, the Commission reminds us that it will not hesitate to make use of its enforcement powers under competition law if necessary.

Full and automatic disclosure of remuneration would appear to be a minimum requirement of the Commission.

As to what else the future may hold is not clear. It is quite possible that there will be more of a move away from commissions in favour of fees and more of a move towards pricing premium net of brokerage. There is likely to be much more transparency around the services being provided by the intermediaries (both to clients and insurers). Some intermediaries may even consider setting up separate legal entities to provide services pursuant to delegated underwriting authorities in order to ring-fence these activities from its mediation activities and create a "chinese wall" of sorts. However, an outright abolition of contingent commissions would appear, at this particular stage, to remain an outside bet.

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# Solvency II

After a very lengthy gestation period, the European Commission has finally issued its Solvency II proposal for EU insurance companies.



Solvency II is structured around three pillars:

- Pillar I imposes two separate capital requirements on insurers, the minimum capital requirement to enable it to continue in business and the solvency capital requirement which relates to the capital required for the insurer to operate its normal business with a buffer for catastrophe scenarios. Insurers can choose between the standard solvency capital requirement to be developed by the supervising authority or they can agree their own customised approach.
- Pillar II sets out the details of the supervisory framework to be adopted by regulators to ensure that capital requirements are met and that insurers operate on a properly managed basis.
- Pillar III deals with the passing of information between insurers and regulators to ensure compliance with Pillars I and II.

Solvency II involves a more sophisticated approach to insurance solvency. It is based not only on the risks arising out of the particular insurance cover provided to policyholders by the insurer but also on an analysis of the capitalisation required by that insurer to withstand investment, counterparty and other operational risks.

Other changes to the way in which particular assets are valued for solvency purposes could lead to a more prudent approach being adopted by insurers with risks being matched to a greater extent against bonds rather than equities.

The implementation process is due to begin in 2009. The adoption of the proposals might be a lengthy process although, in the UK at least, the FSA has been moving towards solvency standards which are consistent with the approach likely to be implemented under Solvency II.

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# Permitted links

The FSA is consulting on wholesale changes to the description of assets to which long term insurance companies can link returns on investment policies.



Unit-linked business accounts for an increasingly large share of the insurance market given the move away from with-profits policies.

The permitted links regulations are intended to ensure that the underlying assets are in a form which is transparent, sufficiently liquid and capable of proper valuation for the protection of policyholders. Unfortunately, the description of eligible investments has not kept pace with the increasingly sophisticated types of asset which are now available for investment.

These changes can be seen as deregulatory and as part of the general move from rules, to principal, based regulation by the FSA.

The main changes are:

- Permitting links to property held through investment vehicles rather than directly.
- Defining the location of property investments through investment markets rather than specified territories.
- Replacing the requirement that certain assets are readily realisable with the principle that they should meet the obligations of the insurer under the policy.

- Allowing policies to be linked to any authorised or recognised collective investment scheme where the policy is issued to trustees of a defined benefit occupational pension scheme.
- Allowing leeway for compliance to avoid the need for waivers.

Although it has been possible to obtain waivers from the FSA to recognise assets which do not fall within the existing categories, these changes will facilitate the creation of innovative unit linked contracts without the uncertainties and delays inherent in the current system.

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# Solvent schemes and Part VII transfers update



## Second Part VII transfer of Lloyd's business

Following on from the Spectrum Syndicate 982 transfer to Sterling Life Ltd in May 2006, Syndicates 37 and 2037 have become only the second Lloyd's syndicates to transfer business out of Lloyd's under Part VII of FSMA, this time to Highway Insurance Co Ltd.

The transfer is in respect of motor business and has been approved by the English High Court. The effective date of the transfer was 2 August 2007.

## Court sanctions Part VII where majority of policies not governed by English law

In what is believed to be another first for Part VII transfers, the English High Court recently sanctioned a transfer from the UK branch of Sompo Japan Insurance Inc to Transfercom, notwithstanding that only 27% of the policies being transferred were governed by English law.

The transfer involved both insurance and reinsurance business written between 1950 and 2000, including policies with asbestos and WTC claims. Mr Justice Richards had to consider whether concerns over the worldwide enforceability of the transfer would make sanctioning it a hollow act. Sompo presented a review of 35,000 sample policies which showed that (i) 27% (by value and number) subject to English law; (ii) 30% (11% by value) were governed by the law of another EEA State; (iii) 21% (60% by value) were governed by US law; and (iv) only a small number were governed by Japanese law.

In addition, Sompo submitted evidence on the likely enforceability of the transfer in other EEA States and the US.

Although not wholly convinced that the scheme will definitely be enforceable in

relation to a large part of the policyholders, the Judge sanctioned the scheme on the basis that it would "achieve a substantial purpose" because it would be effective in relation to the 27% of policies governed by English law.

## GLM Pool and Great Lakes Schemes sanctioned

The English High Court has also recently sanctioned a solvent scheme of arrangement for the reinsurance business written through the GLM Pool. The Pool companies are Ecclesiastical Insurance Office, Global General and Reinsurance Co, MMA IARD Assurances Mutuelles, Swiss Re and Axa UK. Mr Justice Lewison was satisfied that a single creditor class for voting purposes was appropriate. The scheme was sanctioned on 9 July 2007 and the final claims submission date is 25 January 2008.

The English High Court also sanctioned a solvent scheme of arrangement for Great Lakes Reinsurance (UK) plc on 3 July 2007, with a final claims submission date of 7 January 2008. Great Lakes is a wholly-owned subsidiary of Munich Re and the scheme is in respect of its treaty reinsurance book of business written between 1 January 1988 and 10 October 2004.

## FSA provides guidance on Schemes

The Financial Services Authority (FSA) has issued a paper headed 'FSA process guide to decision making on Schemes of Arrangement for insurance firms'. The guide sets out the FSA's process for reviewing schemes and the criteria it uses in making that assessment. For further information visit [www.fsa.gov.uk](http://www.fsa.gov.uk)

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## Dates for your diary



LG's Environmental Group will be holding their next breakfast briefing at LG's offices on 13 November 2007.

The seminar is free and will take a look at the effects of the Environmental Liability Directive, and recent case law, on environmental insurance.

For more information please contact Lisa Hanmore at [lisa.hanmore@lg-legal.com](mailto:lisa.hanmore@lg-legal.com)



LG's Insurance & Reinsurance Group will be holding the next in its series of market seminars in the Captains' Room at Lloyd's on 14 November 2007.

The seminar is free and will take a look at the possible effects of the sub prime lending crisis in the US on D&O and professional indemnity insurers in the UK and Europe.

For more information please contact Carole Mehigan at [carole.mehigan@lg-legal.com](mailto:carole.mehigan@lg-legal.com)

## Look out

- For the court of appeal decision in *Bartoline Ltd v Royal & Sun Alliance Insurance Plc*, regarding the meaning of the word 'damages' in a public liability policy, which is due to be heard in early October 2007.
- For the House of Lords decision in *Rothwell v Chemical & Insulating Co Ltd*, relating to the recoverability of compensation for pleural plaques, which has been set down for hearing on 11 October 2007.
- For our William Sturge at the '2nd Annual European Forum on D&O Liability Insurance' in Cologne on 9 and 10 October 2007.
- For our Martin Mankabady who will be chairing a panel session on the "Globalisation of insurance regulation" at the International Bar Association conference in Singapore on 18 October 2007.
- For our Nick Bradley and David Breslin's presentation on 'Aggregation of Claims and Follow the Settlements' to the Bermuda Insurance Institute on 23 October 2007.
- For our Martin Mankabady at Insurance Day's Middle East Insurance Summit in Dubai on 20 and 21 November 2007.

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