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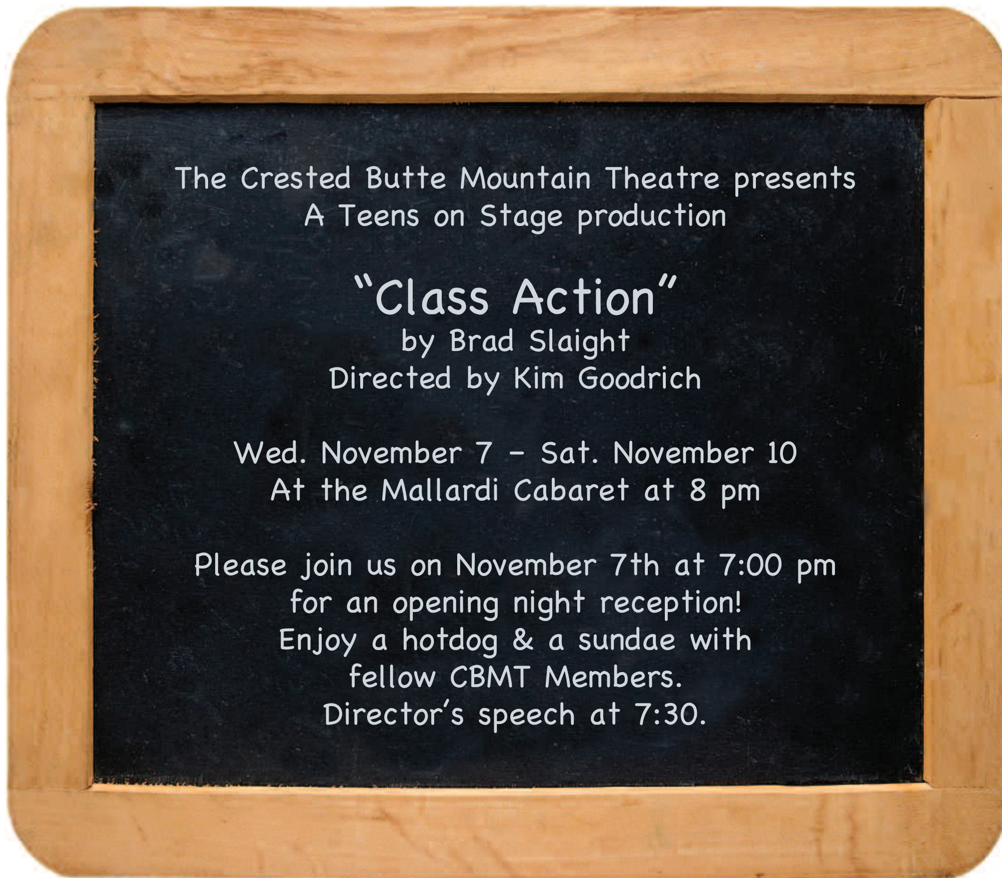

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"Are class actions coming our way?"

There is widespread concern within the European D&O community as to the increasing globalisation of the class action culture. This was one of the key messages from a survey conducted by LG in conjunction with C5, organisers of a recent D&O European Forum in Cologne on 7/8 October 2008. The conference, held annually, is one of the main events on the D&O circuit and always well attended by underwriters, claims managers, brokers, consultants and others. The survey was of delegates who registered to attend.

More specifically, it was the experience of 60% of those responding that the compensation culture, ie the propensity to sue professionals and directors, is growing to a serious extent. For 33% of respondents, the compensation culture is now a serious issue facing business.

In August 2008, the UK's Civil Justice Council (the group of Judges presiding over the rules of civil procedure) made a series of recommendations to the Lord Chancellor for a more efficient and effective procedure for so-called 'collective' actions in the UK. The recommendations relate to the streamlining of such actions in the English courts, and include 'opt out' arrangements, certification by the court and aggregate damages.

Figure 1
Frequency of claims – respondents' experience

Figure 2
Most commonly made allegations

Those involved in D&O claims at the European level are all likely to have received claims relating to class actions brought against companies such as Parmalat, Royal Dutch Shell, Daimler Chrysler, Vivendi, Deutsche Telecom and Ahold, EU companies which have all felt the long arm of jurisdiction adopted by the US courts. Furthermore, it has been noticeable how US law firms, specialist in pursuing class actions, are increasingly making themselves known throughout Europe.

The response to the survey was to the effect that, in Europe, directors are most under scrutiny from their shareholders, with the regulators shortly behind. In terms of claims frequency, claims by liquidators are the principal source of claims. This is followed by claims in respect of misstatement in accounts and securities documentation, and claims by the regulatory authorities. (See figure 1)

William Sturge who presented the results of the survey to the European Forum said: "The combined effect of an increased level of claims, broader coverage and the facilitation of group litigation, is likely to result in higher loss ratios. However, it is unclear whether that will result in a generally harder market for D&O at this stage".

As well as looking at D&O claims in general, the survey also covered sub-prime and credit crunch claims and coverage issues.

In relation to sub-prime/credit crunch, perhaps surprisingly, 54% of claims professionals had not received notifications in this category. This reflects the fact that claims from this source are currently confined to the area at financial institutions. Of those who had, professional indemnity is the most exposed class, ahead of D&O. Other classes exposed were fiduciary and

pension trustee insurance, bankers blanket bonds and unauthorised trading. The most common allegations are misrepresentation as to the value of investments, ERISA related complaints, and failure to observe contractual parameters at the point of managing investments. (See Figure 2)

Perhaps reflective of the current climate, 82% considered that the credit crunch had led to an increase in notifications generally.

As to what is actually being paid out on D&O policies, defence costs on side A cover are the principal type of payment, followed by indemnification of the company under side B and then indemnification of the company in respect of costs of defence on side C. In Europe, and contrary to the US experience, the payment of damages or fines accounts for the lowest element of D&O policy payouts.

One thing is certain: we are about to see an increase in both litigation and arbitration in London, as in the US, and probably across Europe.

If you would like a copy of the full results of the survey, please contact William Sturge on *william.sturge@lg-legal.com* or visit our *website www.lg-legal.com*

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Application for stay of English proceedings dismissed

In *Equitas Ltd v Allstate Insurance Co* (17 July 2008), the Commercial Court had to consider whether English proceedings should be stayed pending the outcome of a Texas arbitration.

In January 2007 Highlands Insurance Company, a Texan company in receivership, commenced arbitration against Allstate in Texas relating to the common account excess of loss (CAXOL) reinsurance contracts by which Allstate reinsured Highlands and their Quota Share reinsurers. These reinsurers included various Lloyd's Syndicates represented by Equitas. Equitas were not a party to the Texas arbitration.

The English action, commenced by Equitas in March 2008, concerned the scope of a commutation agreement between Allstate and Equitas in December 2004. The issue was whether the definition of "Reinsurance Agreements" in the commutation included the Lloyd's Syndicates' participation in the CAXOL contracts. The agreement was governed by English law and contained an exclusive English jurisdiction clause.

Allstate applied to the Commercial Court for a stay of the proceedings, based on Equitas' participation "through Highlands" in the Texas arbitration for a period of 14 months and its failure to institute the English proceedings until shortly before Highlands' dismissal motion was rejected in the Texas arbitration.

Highlands argued that the Texan arbitral tribunal did not have jurisdiction to determine the construction of the commutation agreement because the Syndicates and Equitas were not parties to the CAXOL contracts pursuant to which the arbitration had been commenced.

Allstate's application was based on the court's case management powers and not on any residual power based on the principle of forum non conveniens. The court held that it would require "rare and compelling" circumstances to grant a stay on this basis. Where the parties had agreed an Exclusive Jurisdiction Clause these circumstances would have to be even rarer and more compelling. Allstate were unable to provide strong enough reasons and their application was dismissed.

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Application for disclosure of third party's insurance cover refused

In *West London Pipeline and Storage Ltd v Total UK Ltd* (9 June 2008), the Commercial Court considered the issue of whether, having regard to the overriding objective and to paragraph 1.2 of the Practice Direction to CPR Part 18, disclosure of the extent of a defendant's insurance cover could be ordered under CPR Part 18.

The defendants, Total, were seeking a contribution from a third party, TAV Engineering Ltd (TAV), in respect of any liability resulting from the explosion and fire at the Buncefield Oil Terminal. Total alleged that TAV had designed, manufactured and supplied a switch that failed to operate causing an overflow of fuel, that lead to the explosion.

TAV had ceased trading and had assets of only £1,500, but they did have liability insurance cover. Total made an application under CPR Part 18 for disclosure of this cover on the basis that: (i) it was relevant to the issues in the case; and/or (ii) it was necessary for efficient case management in that it would enable them to determine whether litigation against TAV would serve a useful purpose.

TAV successfully argued that the court had no jurisdiction to require disclosure of their insurance cover as this had no bearing on the issue of what was 'just and equitable' in deciding the claim for contribution nor was it directly pertinent to matters in dispute in the proceedings as required by CPR Part 18.

Declining to follow the liberal approach taken by the court in *Harcourt v FEF Griffin* [2008] (see Angle, Issue 27), David Steel J held that notwithstanding the current trend towards a more open approach to litigation and in particular the need for case management that would save expense and achieve expedition, Total's submission would require re-writing CPR 18.1 and the relevant Practice Direction, and therefore could not be upheld.

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Deleted words in slip admissible to establish what the parties had "agreed not to agree"

In *Mopani Copper Mines Plc v Millenium Underwriting Ltd* (16 June 2008) the Commercial Court has provided further guidance as to what material is admissible as an aide to construction of a slip, in the context of deciding a number of preliminary issues. The proceedings concerned a claim brought by Mopani, a Zambian company, under a *Commissioning/Erection All Risk* (CAR/EAR) policy.

Mopani sought cover for the construction of a copper smelting plant in Zambia. In order to comply with local law, the risk was placed with a Zambian insurer and reinsured in London. In reality, the risk was placed in the London market and the terms of cover negotiated with reinsurers. A loss was notified in February 2007 and an issue arose as to whether the cover extended to operational risks, such that it fell within cover, or only to construction risks, such that it did not.

The cover had been agreed through the exchange of several e-mails (two of which had been scratched by reinsurers), a number of revised slips and several endorsements. An earlier version of the slip had included provision for the extension of cover for operational risks up to the date of final handover, however this had been struck through in pencil by the leading underwriter and replaced with the acronym *'TBA MLM'* [to be agreed by Millenium]. The slip was subsequently further amended, and the pencil deletion struck through permanently in ink.

The court held that the cover did not include operational risks and the loss therefore fell outside the cover. Although not specifically relying on the deleted words in deciding this issue, Clarke J noted that they supported the conclusion he had reached. Conceding that the diversity in authorities on recourse to deleted words made it difficult to assess when such recourse was appropriate, he emphasised that he regarded it as *"open to the court, in this particular case, to look at the deletion which the parties agreed upon as indicating ... what it is that the parties did not agree and why"*.

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Insurance Arrangement Fees – Insurance Premium Tax

In the recent decision of *Homeserve GB Limited v The Commissioners for HM Revenue and Customs* the issue of Insurance Premium Tax (IPT) payable on an 'arrangement and administration fee' in relation to an insurance contract was examined.

Homeserve offered to homeowners an emergency assistance insurance which covered, for example, plumbing and drainage cover, insured with Inter Partner Assistance SA (IPA). During the period considered by the tribunal, Homeserve had amended its agreements with IPA and homeowners so that homeowners entered into a contract to arrange and administer their policy with Homeserve and a separate contract for insurance with IPA. The amount paid for the cover included a charge for the administration of the policy by Homeserve as well as the premium. The question arose as to whether this charge was subject to IPT.

Under the Finance Act 1994, IPT is charged on receipt of premium by an insurer in connection with a taxable insurance contract. It is not, however, charged on any amount in relation to the insurance if that amount is charged under a separate contract and is identified in writing to the insured as such (section 72(1A)(b)). Homeserve argued that the administration charge fell within this exemption. HMRC disagreed, arguing that there was no contract between Homeserve and the homeowner. At best, it was argued, there was a three-way contract between Homeserve, IPA and the homeowner.

The tribunal held that IPT was payable on the administration charge. Homeserve may have provided separate services to the homeowner in consideration for the administration charge, however these services were not provided under a 'separate' contract. The price presented to the customer was inclusive of both the administrative charge and the premium and there was overlap between Homeserve's obligations under its contract with IPA and its contact with homeowners.

The administration of the contract was inseparable from the insurance element, such that the administration charge was not an amount charged under a *separate* contract. It did not therefore fall within the exemption.

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Update on Payment Protection Insurance

The FSA have recently been reviewing the practices in the market regarding selling and advising on payment protection insurance as part of the retail strategy to "promote resilient, effective and attractive financial markets that deliver fair outcomes for consumers". They recently conducted a mystery shopper exercise and were, on the whole, disappointed with the practices they found.

The main issues which arose in the mystery shopper exercise included that customers were not generally informed, orally, at the time of the sale that the cost of the whole policy would be added to the loan, what the insurance was to actually cover and that interest would be charged on the whole amount of the loan, including the premium. Customers' needs and eligibility were also not properly explored, showing "unacceptably poor levels of sales competence" and many customers were not given adequate information about the costs of the policy.

Firms should look very carefully at their procedures for offering and selling PPI, especially in light of the recent fine imposed on Alliance & Leicester in the amount of £7 million, in relation to advised telephone sales of PPI offered in connection with unsecured personal loans. It was found that A&L pressured people to purchase PPI when taking out a loan in an inappropriate fashion, did not tell people details of the product or the fees or the effect of cancelling the policy outside the cancellation period and the information which was provided was often inaccurate, unfair or misleading.

Continuing from the mystery shopper exercise, the FSA are looking at intermediaries who sell PPI and are exploring appropriate responses to the increased level of complaints received by the Financial Ombudsman Service.

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Solvency II

The FSA is seeking feedback by the end of this year from insurers and reinsurers on their September discussion paper on Solvency II. Responses will be consolidated into a statement to be published in March 2009. Although the Directive is not in force until October 2012 companies should begin considering how it will impact on their business.

Solvency II is a capital adequacy and risk management regime for European insurers and reinsurers, designed to bring about a cultural change in internal procedures, improve transparency, protect policyholders, promote better regulation and make it easier for insurers to operate in Europe. Its inspiration is the Basel II standards for banks. Currently, the insurance industry has no equivalent universal solvency standard. Solvency II will introduce the following three pillars in a drive towards a European single market for insurance.

- Pillar 1 requires firms to demonstrate adequate financial resources. This will involve calculating and reporting Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) data to supervisors annually and quarterly respectively.
- Pillar 2 will establish a system of governance whereby firms can apply for approval to use their own internal models to calculate regulatory capital requirements instead of using the standard formula. There are onerous conditions to satisfy but, for many firms, this may be advantageous.
- Pillar 3 lays down the reporting and disclosure requirements.

PriceWaterhouseCoopers commenting on the discussion paper stated that companies need to be setting aside resources and implementing the directive now. They agree with the FSA that companies should be given a degree of flexibility in the implementation process. The latest European Commission Quantitative Impact Study 4 highlighted to participating firms the likely impact of Solvency II, although PWC notes that the number of participating firms remains low across Europe.

In October 2008 the Economic and Monetary Affairs Committee (Committee) voted on Solvency II. The most contentious issue was the group supervision regime, aimed at companies with cross border operations whereby the firms would have both a group supervisor and a subsidiary supervisor. Many EU States are concerned that they would lose control to regulators in the UK, France or Germany where many insurers have headquarters. The Committee voted that in the event of a disagreement between the supervisors, it must be referred to the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). The final decision would rest with the group supervisor but if they went against CEIOPS' advice then detailed reasons would need to be given.

Also, the Committee agreed that group supervision arrangements should enable national supervisors to be responsible for European groups to facilitate cooperation, exchange of information and consultation between themselves.

The Committee voted that there should be no arbitrary limits on the group support regime allowing the financial strength of the parent company to underpin the operation of its subsidiaries. However companies should note that it should be conducted with a view to wider financial stability of the Community in addition to the health of the individual company. It was also decided that the calculation for the amount of capital that insurance companies should hold will be made up of the SCR and MCR, with the MCR being 25-45% of a Company's SCR.

Companies in run-off before 10 December 2007 will be outside Solvency II.

What next?

Solvency II requires forward planning by insurers and reinsurers. They should begin formulating an implementation plan as the FSA intends to ask firms about their plans in March 2009. Companies may also want to consider developing an internal assessment of their solvency needs, risk profile and their compliance capital requirements. CEIOPS' advice on implementing measures is due in 2009 and legislation containing technical implementing measures should be finalised in early 2011. Forward planning by companies will facilitate a seamless transition into the new regime.

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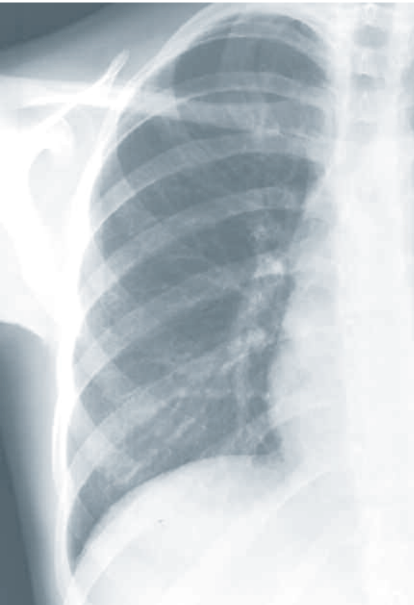
Asbestos update



Pleural plaques

A review of the law on pleural plaques and the question of whether they can form the basis of an action in negligence has been undertaken by the Scottish Parliament and the Ministry of Justice in England. In Scotland a change in the law is already underway whilst in England a consultation has recently been completed. Estimates are that the costs of a change in the law could amount to somewhere between £10 billion to £30 billion.

Scottish legislation

The Scottish Parliament continues to push through legislation to overturn the House of Lords' decision of 17 October 2007 in *Johnston v NEI International Combustion Ltd* (known at earlier stages as *Rothwell v Chemical & Insulating Co Ltd*) in which it was held that pleural plaques do not constitute compensatable damage for the purposes of a negligence claim. Previously, damages could be awarded in cases where negligent exposure to asbestos lead to the presence of pleural plaques.

The Damages (Asbestos-related Conditions) (Scotland) Bill was introduced in the Scottish Parliament on 23 June 2008. On 13 October 2008, the Justice Committee published a report recommending support of the Bill. The only concern expressed in the Report related to the estimated financial impact of the Bill. The Committee have asked the Scottish Parliament to reconsider the estimates of the number of claims that would arise and the costs of these claims. In particular, the Committee was sceptical as to the cost to defendant businesses, local authorities and insurers which the ABI estimated between £76m and £607m annually. This would bring the total cost to between £1.1bn and £8bn.

Once the financial impact has been re-assessed, the Bill is to be reconsidered by the Scottish Parliament.

English consultation

The Ministry of Justice launched its own consultation paper on 9 July 2008 to seek views on the Government's response to the *Johnston* decision. The consultation looked at the law and medical evidence underpinning that decision and considered the issues relating to a change in the law of negligence and whether this would be appropriate.

The consultation also looked at a 'no fault' payment scheme for those diagnosed with pleural plaques. The introduction of such a scheme would mean that a claimant would not have to prove negligence, only that they have been diagnosed with pleural plaques and worked in an environment involving asbestos exposure.

The consultation period ended on 1 October 2008 and a response is awaited. A number of trade unions involved, including Unite and Ucatt, have called for the *Johnston* decision to be overturned. They have cited the possibility of a "postcode lottery" if the law in Scotland is changed but remains the same in England. The Ministry of Justice however, has expressed a reluctance to interfere with a unanimous decision of the House of Lords on a complex legal issue such as this and have said that very strong reasons would be needed to justify overturning the decision.

Employer's Liability Trigger Litigation

The High Court trial in the Employers' Liability Policy Trigger Litigation test cases commenced on 3 June 2008 has come to an end after 9 weeks. The litigation concerns the ruling of the Court of Appeal in *Bolton MBC v Municipal Mutual Insurance Co Ltd* on 6 February 2006. Although that case concerned the policy triggers in Public Liability Insurance and the meaning of the words "injury sustained" the same/similar wording is often found, historically, in Employer's Liability Insurance.

The issue is whether, for the purposes of an Employers' Liability Policy, injury is sustained when a claimant is exposed to asbestos or upon the development of mesothelioma, which occurs much later. In *Bolton* it was held that the claimant had only suffered an "insult" at the time of inhalation of the asbestos fibres and that the actual injury occurred when the mesothelioma began to develop.

The judgment is expected to be handed down during November. Whatever the decision, it is likely to be appealed. If the rationale in *Bolton* is upheld, the real losers are likely to be the underlying insureds whose policy wordings have changed over a number of years (eg from the non-contentious "caused during" wording to "occurring during" wording) and who, as a result of this decision, are likely to be faced with a gap in cover.

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Reinsurance notes

As well as the cases referred to in this edition of The Angle, LG's Insurance and Reinsurance Group has produced Reinsurance Notes on a number of other important decisions handed down recently by the English courts, including the decision in *Ace Capital Limited v CMS Energy Corporation* [30 July 2008] dealing with the interrelationship between service of suit and arbitration clauses. If you do not already receive copies of our Reinsurance Notes and would like to do so, please contact simon.king@lg-legal.com. Alternatively, copies of all Reinsurance Notes can be found on our website (www.lg-legal.com) by clicking *'Publications'* – *'Industry Sector'* – *'Insurance & Reinsurance'*.

Legal update – catastrophe losses

LG's Insurance & Reinsurance Group has updated its publication entitled *'Catastrophe Losses: Legal issues under contracts of reinsurance'*, to take account of the many important decisions handed down by the English courts during the last three years. The briefing note looks at, amongst others, issues in relation to aggregation, back-to-back cover and follow-settlements provisions, claims co-operation clauses and jurisdiction. If you would like a copy please contact david.breslin@lg-legal.com. Alternatively, it will shortly be available on the publications section of our website.

Date for your diary

LG's Insurance & Reinsurance Group will be holding the next in its series of market seminars in the Captain's Room at Lloyd's on 4 November 2008. The seminar is free to those invited and will take the form of a debate entitled 'End of the line ? – Is the London market facing a massive shake-up on competition?' For more information please contact dawn.severn@lg-legal.com.

Look out...

- For the outcome of the appeal in *HLB Kidsons v Lloyd's* [2007] concerning the validity of notifications under claims made policies, which was argued before the Court of Appeal in June. Judgment is expected imminently
- For the outcome of reinsurers' appeal to the House of Lords in *Wasa v Lexington* [2008], which it is understood will be heard in May 2009
- The Law Commission's Issue Paper on the reform of Business Insurance Law (including reinsurance) due later this year/early 2009, following publication on the 13 October of the summary of responses received by the Commission to its Consultation Paper issued in July 2007
- The Government's response to the recommendations of the Civil Justice Council on the issue of Collective Redress (see lead article on page 2 above)
- For LG's Nick Bradley and David Breslin who will be attending the ARIAS US 'Fall Conference and Annual Meeting' in New York on 6-7 November 2008, and who will be in Bermuda between 10 and 12 November 2008

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