The latest legal news on

Insurance and Reinsurance

IN THIS ISSUE

Lords overrule Court of Appeal in Wasa v Lexington

Court joins insurers to proceedings against broker

Master policy did not ‘drop down’ in respect of claim for legal costs

English Court has jurisdiction notwithstanding French arbitration agreement

Equality Bill – age and insurance

Client money

Equitas transfer sanctioned

Agent not entitled to conduct run-off

Newsletter

Issue Number 33 Summer 2009

the angle

Insurance & Reinsurance Angle Summer 09. © 2009 Lawrence Graham LLP. All Rights Reserved.

Lords overrule Court of Appeal in Wasa v Lexington

Wasa and AGF v Lexington House of Lords – 30 July 2009.

The House of Lords has overturned a decision of the Court of Appeal in February last year, which had effectively allowed Lexington to recover pollution claims for which it was found liable under Pennsylvania law, even though the damage occurred outside the applicable policy period.

Insurance and Reinsurance

The facts

Lexington insured Alcoa in respect of loss or damage to property from noon on 1 July 1977 until noon on 1 July 1980. Wasa and AGF provided facultative reinsurance to Lexington in respect of all risks of physical loss or damage to the property reinsured occurring in the period of 36 months from 1 July 1977. The reinsurance contained a full reinsuring clause and a follow settlements provision.

The claim and settlement

In the early 1990's, various US environmental agencies found that Alcoa had wrongfully caused pollution over some 44 years up to the mid 1980's and required the company to clean up contaminated land and water at a number of sites. Alcoa brought proceedings in the Washington State Courts against various insurers who provided liability or all risks property insurance during the period. Three test sites were chosen. Evidence was heard as to the existence, extent and time of occurrence of damage at each test site. At the end of the trial Alcoa asked the court to hold that as a matter of law, the pollution damage was indivisible. The court refused and allocated the damage on a pro-rata, yearly basis, including under the Lexington policy.

Alcoa appealed. The Supreme Court of the State of Washington reversed the ruling on allocation and held Lexington jointly and severally liable to indemnify Alcoa for all property damage, including damage which had occurred before the policy with Lexington had incepted. The action was returned to the State Court, but shortly before the re-trial, Lexington agreed to pay Alcoa US$103m in a compromise settlement, in the face of a claim of US$180m.

Commercial court decision

Lexington's reinsurers, Wasa and AGF declined to pay on the basis that the reinsurance policy was governed by English Law and under English Law, reinsurers can only be liable for damage which actually occurred during the policy period of the reinsurance. Whatever a Washington Court might say, they could not be liable for damage which occurred before or after that period.

The Commercial Court upheld that contention on the basis that the period provision was fundamental. The reinsurers had not agreed to reinsure Lexington in relation to an earlier or later period, nor in relation to its liability generally to Alcoa.

Court of Appeal

Lexington appealed. They argued, inter alia, that the contracts were intended to be back to back and the fact that the reinsurance contract was governed by English Law was not sufficient to displace that. The parties must at the outset have anticipated that disputes between Lexington and its cedants would be litigated in the US. Further, where polices are back to back, where the terms of the insurance contract have been determined by a competent court, it must be presumed that the parties to the reinsurance contract intended that, in relation to the same claim, the same meaning and effect should bind a reinsurer absent any provisions to the contrary.

The reinsurers contended that the reality was that they provided reinsurance to their reassured in respect of the risk of loss and damage to the original policyholder for a 3 year period, not a 50 year period. The period of cover was fundamental to the bargain.

The Court of Appeal said that neither of those approaches was correct. The real question was: where the parties used the same wording in the reinsurance as in the underlying insurance, did they intend that wording to have the same meaning in both contracts? Longmore LJ concluded that the period provisions in the insurance and reinsurance, although expressed in different words, were effectively identical. He acknowledged that the manner in which the Washington Court focused on the period of cover in the original insurance was "not quite the way an English Court would" do, but where an insurer had sought and obtained facultative reinsurance in a manner in which Lexington had here, then the policy period must bear the same construction in both policies.

The Lords' decision

The Lords disagreed with the Court of Appeal. The period provision in the reinsurance was fundamental. It should be given its ordinary meaning under English law, which was the governing law of the reinsurance, such that only loss and damage which actually occurred during the three year period of the reinsurance was recoverable by Lexington.

Lord Mance observed that a reinsurance contract is a separate contract. In order to recover, an insurer was required to establish both its liability under the terms of the insurance and its entitlement to an indemnity under the reinsurance. The former task was "eased" by a follow settlements provision, but the effect of such a provision was less obvious where, as in the present case, the terms of the insurance and reinsurance, whilst similar in form, had clearly different effects because they were governed by different laws.

Crucially, the Lords considered that it was unlikely that the parties had contemplated, at the time the contracts were entered into, that the interpretation of the period clause in the insurance would differ so radically under the law applicable to that contract (in the event Pennsylvania law), from the interpretation of the similar provision in the reinsurance contract under English law. In all the circumstances, it could not be said that the parties had agreed that the interpretation ultimately applying to the insurance should also apply to the reinsurance.

Comment

The Lords' decision will come as a welcome relief to reinsurers. It is well established as a matter of English law that a reinsurer is always entitled to rely on the terms of its own contract, ie the reinsurance. It would now seem clear that save in certain limited circumstances (such as a truly back-to-back contract), the terms of the reinsurance will be given proper effect in accordance with English law, where English law has been agreed by the reinsurer as the law governing the reinsurance.

It is also of note that it appears to have been common ground, both as between the parties and in the views of their Lordships, that the comments made by Sedley LJ in the Court of Appeal to the effect that reinsurance is really a form of liability insurance, were unfounded.

simon.king@lg-legal.com

Court joins insurers to proceedings against broker

In *Dunlop Haywards (DHL) Limited v Erinaceous Insurance Services Limited* (28 April 2009) the Court of Appeal considered whether insurers should be joined to proceedings brought by an insured against its broker where interpretation and rectification of a policy was at issue.

The appellant brokers were instructed to place professional indemnity cover for the insured's business of commercial property, surveying and valuations. The policy issued by the respondent insurers limited cover to the 'assured's commercial property management activities only'. Insurers subsequently denied liability for claims arising out of negligent valuations on the basis of the limiting condition.

In their defence to the claim brought by the insured for obtaining inadequate cover, the brokers argued that, on their true construction, the words "commercial property management" included commercial property valuations, alternatively that the policy should be rectified so that the limiting condition applied not to a restricted range of activities of the whole broking group, but to all the activities of a single insured subsidiary of the broking group.

It was held that the Judge at first instance had erred in determining that he could make a finding against rectification without a trial, when rectification was necessarily a fact-based enquiry. The brokers had overcome the first hurdle of showing that there was a prior common intention as to the meaning of the policy. There was reasonable evidence that a mistake of some kind had been made. Further, there was a good arguable case that the cover obtained (subject to the remaining issues as to construction) lacked sense commercially. Accordingly, it was desirable to join the insurers to the proceedings, so that the issues of rectification and of construction could be argued between all parties concerned and so that all parties could be bound by the decision.

E/ susannah.fink@lg-legal.com

Master policy did not 'drop down' in respect of claim for legal costs

In *Flexsys America L.P. v XL Insurance Company Limited* (20 May 2009), the Commercial Court reviewed the construction of a 'drop down clause' in a master insurance policy.

The defendant, XL, insured the claimant US chemical manufacturer under a public and products liability policy ('the master policy') as part of a global insurance programme, under which local policies were also issued. A Korean company brought proceedings against the claimant alleging, inter alia, that the claimant had conspired to exclude it from the US market. The claimant incurred costs of US$2 million defending the claim, and sought an indemnity under the local policy issued in Ohio ('the local policy'). The claim was settled for policy limits of US$1 million. The claimant then sought to recover the balance of its legal costs under the master policy, which had an aggregate limit of US$25 million.

The master policy contained narrower terms and conditions than the local policy, and it was common ground that under the terms of the master policy, the claimant would have no claim. However, the claimant argued that a 'drop down clause' in the master policy provided that when the local policy was exhausted the master policy would respond on the terms of the local policy but subject to the higher limits of the master policy.

The Judge held that this interpretation was not correct in circumstances where due to the difference in conditions between the local and master policy, the claim was not within the cover of the master policy.

Further and in any event, it was held that 'exhaustion' of the local policy was achieved by one or more prior claims rather than by the instant claim, with the intention that the master policy provided a reinstatement of the local policy for subsequent claims subject to local policy limits. Hence the master policy 'dropped down' only in the sense of providing cover at a lower level or attachment point for subsequent claims.

It followed that the claimant could not recover the balance of its costs under the master policy.

E/ lucy.macdonald@lg-legal.com

English Court has jurisdiction notwithstanding French arbitration agreement

In *Youell v La Reunion Aerienne* (11 March 2009) the Court of Appeal used the reasoning of the ECJ in the *West Tankers* decision to uphold proceedings commenced in the English High Court where a French counterparty had challenged its jurisdiction.

The case concerned the insurance of a helicopter manufacturer by French and English insurers. A claim was made against the company, which was settled in 1995. Further proceedings were brought by the claimant against the company and its insurers alleging that fraudulent misrepresentation had induced the 1995 settlement.

The French insurers settled the proceedings and sought a contribution from the English insurers, having been assigned the company's rights under the English policy. The English policy was expressed to be on full follow terms to the French policy, which contained an agreement to arbitrate disputes in Paris and a Co-Insurance clause giving the leading insurer full authority to settle claims. The French insurers commenced arbitration in Paris against the English insurers, relying on these clauses.

The English insurers denied liability on the basis that claims for fraudulent misrepresentation were not covered under the policies and, as the settlement had not been agreed by them, it was not binding on them. They started proceedings in England for a declaration of non-liability. French insurers challenged the jurisdiction of the English court, contending, inter alia, that the proceedings fell within the arbitration exclusion of Council Regulation 44/2001.

The Court of Appeal refused the French insurers' application, relying on the *West Tankers* decision, in which it was held that the subject matter of proceedings is determinative as to whether those proceedings fall within the scope of the Regulation or not. In this case, the relevant claims were clearly not claims arising out of the arbitration agreement, but from an alleged liability as between co-insurers. It followed that the English Court had jurisdiction.

E/ viran.ram@lg-legal.com

Equality Bill – age and insurance

Insurers have always looked to the age of a potential insured, among other characteristics, when underwriting long-term business. The issue is, however, treated somewhat differently in the underwriting of travel and motor insurance. Currently there are no restrictions on the ability of insurers to take blanket decisions based largely on age. The introduction of the Equality Bill may, however, change the position.

The Government has indicated that the Bill, which is designed to abolish age discrimination in the provision of goods, facilities and services, will include an exemption covering the use of the age factor in insurance. The extent of this, however, remains uncertain.

The Bill will render it unlawful, directly or indirectly, to discriminate against an individual aged eighteen or over on grounds of age when providing insurance services. An exception to this is available where the treatment can be shown to be 'a proportionate means of achieving a legitimate aim'.

One of the concerns which informed the Bill stemmed from statistics provided by Age Concern and Help the Aged indicating that older people are often unsuccessful in obtaining motor insurance, travel insurance or car hire. The ABI disputes this and, indeed, considers that the effects of the Bill will be to disadvantage all customers on the basis that:

"Insurers oppose unfair discrimination. But outlawing the use of age would lead to higher insurance costs for all customers, as insurers would have insufficient information to fully assess the risk, and less choice for consumers.

"We dispute the Government's claim that one in five older people have trouble getting motor or household insurance. Our research shows that 99% of older customers can obtain motor insurance, with 98% able to buy travel insurance. We will be monitoring secondary legislation carefully to ensure that insurers remain able to offer competitively priced products to all ages."

The working group set up by the Government reached no conclusion on this issue.

These developments are taking place against the backdrop of the forthcoming EU Equal Treatment Directive. This is currently in draft form and is being considered by the Council along with a report from the European Parliament. The ABI is lobbying for an exemption for the use of age factors in insurance.

A note on the Directive states that:
"Article 2(7): Notwithstanding Paragraph 2, in the provision of financial services proportionate differences in treatment where, for the product in question, the use of age and disability is a determining factor in the assessment of risk based on relevant actuarial principles, accurate statistical data or medical knowledge shall not be considered as discrimination for the purposes of this directive."

Insurers have voiced concerns as to the potential impact of two separate pieces of legislation as the Government is planning to introduce the Equality Bill shortly, although with implementation by Autumn 2010, probably before the draft directive is in final form. The provisions of the two pieces of legislation are not uniform and this may lead to unnecessary costs for insurers having to comply with the requirements of the Bill followed shortly by the need to consider the Directive.

E/ robert.smith@lg-legal.com
E/ jane.harding@lg-legal.com

Client money

Firms are required under FSA Principle 10 to provide adequate protection of clients' assets and money. This is important in the best of times but in the current climate it's paramount. Client's money must be protected while it is being held on the client's behalf by an organisation such as an insurance intermediary.

For consumers the risks are two fold (i) the insolvency of the intermediary and (ii) the insolvency of the bank at which the client money is held. If either the intermediary or the bank goes under the consumer may have a long and drawn out process recovering its money. The insurer, if there has been a risk transfer, has an even more drawn out process, having subordinated its claims to those of the consumers.

If client money is held, it must be held in a trust account. This goes some way to protecting the client as the money in the trust account cannot be used for payments to general creditors. As demonstrated by the recent case of Global Trader, if the money is not held in a trust account (in breach of FSA rules and, one assumes, in breach of contract) then the client does have a claim against the firm, but if it cannot see its money in a trust account it must join the throng of creditors all baying for their money. Tracing money into general funds of a company, although not impossible or legally prohibited, is very difficult and may be virtually impossible if the company bank accounts are overdrawn.

It should be noted by clients that even if their money is held within a client account, if the account is mismanaged there are still problems. If, for example, money is withdrawn in error and is not recoverable, all clients must take a hit and would be entitled to only a proportion of the whole, supplemented by a claim for the balance as an ordinary unsecured creditor.

Yet another risk lies in the choice of bank at which client money is held. One assumes that banks within the EEA are 'safe', and indeed the FSA client money rules require a bank account with an 'approved bank'. This includes credit institutions established in an EEA State other than the United Kingdom and duly authorised by the relevant Home State regulator. Although firms are under a duty to consider the bank at which the client account is held, there was previously little to indicate that the Icelandic banks were going to suffer quite as spectacularly as they did. Money could have been legitimately held within those banks and there is the potential for such monies to be tied up within the system for some time, if indeed it is recovered at all.

Another point to note when considering client money is the agreement with the client. The FSA is quite prescriptive in what it requires the client to be told and to sign up to. This is mitigated slightly by the Global Trader case, where logic shone through. It is always worth checking terms and conditions to ensure that they include the relevant terms to cover holding client money.

When going through client money arrangements it is also vital to check that the money is held in a client trust account and is known to the bank as such. It is also important to consider the covenant of the bank.

There are many other issues which should be at the forefront of an intermediaries' mind when it comes to client money. These include making sure that the right amount of money is in the right account, there is no non-client money held within the account and all money is correctly allocated to an identified individual. One activity which is long over due with many brokers is cleaning up their client accounts following the beginning of FSA regulation in 2005. Many balances have been 'grandfathered' across which maybe shouldn't have been. Clients have become uncontactable over the years and may have died, gone out of business or moved away. In these cases firms may consider 'credit write backs' – ie, once it has been properly established that the money cannot be allocated to a client or the client is not responding to letters the money can be written back to the profit and loss account. Naturally there are rules and regulations covering this topic, and there are many practical and legal issues which need to be considered but it is well worth considering such an exercise and cleaning up any client money accounts out there with unclaimed balances.

E/ richard.everett@lg-legal.com
E/ jane.harding@lg-legal.com

Equitas transfer sanctioned

On 25 June 2009, the English High Court approved the statutory transfer of all 1992 and prior non-life business of members and former members of Lloyd's to Equitas Insurance Limited, a newly formed FSA regulated insurance company.

The transfer, which includes all business reinsured by Equitas Reinsurance Limited at the time of Reconstruction and Renewal in 1996, including the PCW and Warrilow syndicates' business, became effective on 30 June 2009.

This represents the final step in the acquisition by National Indemnity Company, part of the Berkshire Hathaway group, by which it agreed to reinsure all Equitas' liabilities and took on the staff, operations and run-off of Equitas. It also provides, at long last, finality for the Names who participated in 1992 and prior year non-life business at Lloyd's.

E/ simon.king@lg-legal.com

Agent not entitled to conduct run-off

In *Temple Legal Protection Ltd v QBE Insurance (Europe)* Ltd (6 April 2009) the Court of Appeal confirmed that, following the termination of an underwriting agency agreement, the agent had no entitlement to conduct the run-off of its principal's business.

The appellant (T) entered into a binding authority with the respondent insurance company (Q), which came into effect on 1 January 2006. Under the binder Q appointed T to write various classes of legal expenses insurance as Q's agent. Relations between T and Q quickly deteriorated and in August 2006 T served notice to terminate the binder.

T submitted that, on a proper construction of the binder and its associated contracts, it had a right to manage the run-off of the business written during the currency of the binder. T argued that it was T and not Q who was party to the certificates of insurance and coverholder agreements. T also argued that, by virtue of the definition of 'insurer' in the certificate of insurance, Q had impliedly undertaken not to revoke T's authority to manage insurance on its behalf.

The Court of Appeal held that the binder did not require Q to become party to the coverholder agreements, and in the event concluded that it was not. However, Q being a party to the agreements did not of itself provide a definitive answer to the central issue of whether T was entitled to conduct the run-off. Despite the somewhat unclear definition of 'insurer', T was not a party to the contract of insurance for any purposes and no right existed in favour of T to manage the insurance on a continuing basis. On the contrary, the binder itself was worded in terms of a liability to perform obligations, not a right to do so.

Taking all the circumstances together the Court of Appeal concluded that, in the absence of very clear language to bring about such a result, it would not be commercial for a principal who had employed an agent to be obliged to allow that agent to act contrary to its wishes once the necessary degree of trust and confidence had been lost.

E/ elena.solaro@lg-legal.com

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 by the English courts over recent months, including the ECJ's decision in *Allianz SpA & Generali Assicurazioni Generali SpA v West Tankers Inc*, concerning anti-suit injunctions in arbitration proceedings. 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 can be found on our website (www.lg-legal.com) by clicking "Publications" – "Industry Sector" – "Insurance & Reinsurance".

Lloyd's Rugby 7s tournament

LG's Insurance & Reinsurance group once again hosted a marquee at the Lloyd's Rugby 7s Tournament at Richmond Athletic Ground on 14 May 2009. The event was very well attended by the market, and was probably the biggest to date. The LG team performed admirably against very tough competition.

Look out

- For the EU Commission's response to the Green paper issued in April 2009 on the operation of regulation EC 44/2001, including as to the enforcement of arbitration agreements in member states following the ECJ's decision in the Allianz v West Tankers case. The deadline for interested parties to provide comments was 30 June 2009.
- For LG's Nick Bradley and David Breslin at the Rendezvous de Septembre in Monte Carlo taking place between 4 and 10 September 2009.
- For the new UK Supreme Court, which will 'open for business' in early October 2009.

Contact details

Nicholas Bradley
Partner
T/ +44 20 7759 6405
E/ nick.bradley@lg-legal.com

David Breslin
Partner
T/ +44 20 7759 6928
E/ david.breslin@lg-legal.com

Robert Smith
Partner
T/ +44 20 7759 6541
E/ robert.smith@lg-legal.com

William Sturge
Partner
T/ +44 20 7759 6920
E/ william.sturge@lg-legal.com

Geoffrey Gouriet
Partner
T/ +44 20 7759 6788
E/ geoffrey.gouriet@lg-legal.com

Michael Lacey
Partner
T/ +44 20 7759 6579
E/ michael.lacey@lg-legal.com

Lawrence Graham LLP
4 More London Riverside
London SE1 2AU

T/ +44 20 7379 0000
F/ +44 20 7379 6854

Lawrence Graham LLP
PO Box 33090
8th Floor Convention Tower
Zabeel Road
Dubai UAE

T/ +971 4 329 2420
F/ +971 4 329 2430

Lawrence Graham
Est-Ouest
24 bd Princesse Charlotte
MC 98000 Monaco

T/ +377 93 10 55 10
F/ +377 93 10 55 11

Lawrence Graham (CIS) LLP
1-st Troitsky Pereulok 12/5
Moscow, 129090
Russia

T/ +7 495 799-5501
F/ +7 495 799-5502

info@lg-legal.com
www.lg-legal.com

Lawyers.
Just different.

the angle is designed to provide a summary of recent developments in insurance and reinsurance law. It does not purport to be comprehensive or a substitute for specialist legal advice in individual circumstances