



Client Alert  
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## Puff Goes the Cover - In Part

### Background

The Court of Appeal has given its ruling and has overturned, in part, the controversial Commercial Court decision in *Limit No 2 Ltd v AXA Versicherung AG* [2007] where it was held that a statement made by brokers on a fax coversheet, was not merely "brokers' puff", but was a misrepresentation entitling the defendant reinsurer to avoid two first loss fac/oblig treaties which had suffered significant losses.

The treaties provided cover for the energy accounts of two Lloyd's syndicates ("the Syndicates"), initially for a 12 month period effective from 1 July 1996. The reinsurance cover was extended for a period of 7 months by an endorsement in July 1997 and then renewed for a further 12 month period by way of a separate treaty in January 1998.

In placing the 1996 treaty, the Syndicates' broker included in a fax cover sheet the following statement:

*"As a matter of principle [the underwriters] maintain high standards and would not normally write construction risks unless the original deductible were at least £500,000 and preferably £1,000,000".*

Prior to the placement of the policy in July 1996, this had been the Syndicates' policy. However, by July 1996, the prevailing market conditions were such that only substantially smaller deductibles could be achieved: the statement had therefore ceased to be true.

The statement was not repeated by the broker either when the endorsement was agreed in 1997 or when the contract was renewed in 1998. Despite this fact, the Commercial Court held that the statement was a material misrepresentation on which reinsurers had relied and, as such, reinsurers were entitled to avoid both treaties.

### Court of Appeal Decision & Reasons

The Court of Appeal held that the words "*would not normally write construction unless*" meant that the Syndicates "*will normally write (namely intend normally to write) with the stated deductibles*". The broker's representation was not a statement of opinion or belief, nor was it a statement of expectation. It was a "statement of intention". This was crucial because for a representation to have legal effect, it must be a representation of existing fact and not of future fact or opinion.

The Court held that at the time of placement the representation was untrue and the Deputy Judge's decision in relation to the avoidance of the 1996 treaty was upheld.

In relation to the 1997 endorsement, the Court of Appeal confirmed that this was not a new contract but operated merely as an amendment to the existing 1996 treaty. Rather interestingly, the Court confirmed that a separate duty of disclosure existed at the endorsement stage. This leaves us in the position that a misrepresentation at the endorsement stage will avoid the contract from the date of the endorsement whereas a misrepresentation at placing will avoid the entire contract, even if after the endorsement has been added, the representation has become true.

The Court of Appeal then turned its attention to the 1998 renewal. Reinsurers argued that the 1998 treaty should be avoided on the basis that the Syndicates had not corrected the original representation. The Court of Appeal did not agree. Instead, the Court held that the representation made by the broker in July 1996 could not continue to be effective in 1998. The Court took the view that a representation of intention cannot last forever; it only relates to the time when it is made and there must come a time when it is spent. Longmore LJ considered that "*a court should not struggle to hold that everything said at inception is to be impliedly repeated on renewal*".

Overturning the first instance decision, the Court of Appeal confirmed that the broker's representation was spent "*well before the passage of 19 months*" and reinsurers were therefore not entitled to avoid the 1998 Treaty.

In reaching its decision on the 1998 treaty, the Court of Appeal appears to have been strongly influenced by what it called the "*powerful*" and "*stark*" nature of the remedy of avoidance.

It is understood that the case has been remitted to the trial judge for a hearing in relation to unresolved issues regarding the 1998 treaty.

## Ramifications of Decision for Practitioners:

Practitioners may wish to take the following guidance from the Court of Appeal decision:

### Cedants

1. Cedants should be careful how they or their brokers describe their intentions.
2. Cedants should ensure that any extensions or renewals are not simply by way of endorsements but are constructed as separate contracts on expiring terms. In this way, the extension can survive even if the original policy does not.
3. If extensions or renewals are not constructed as separate contracts, cedants should look to previous representations which they have made and consider whether these representations are still true. If circumstances have changed and previous representations are no longer accurate, this fact must be disclosed to reinsurers.

### Reinsurers

4. Reinsurers should be aware that representations made in one year may not necessarily still be operative in subsequent years. If reinsurers are unsure whether a representation remains true, they must ask.

## Further Matters:

As highlighted in our bulletin on the first instance decision, one subsidiary issue which was commented on by the court was the attachment of risks under an open cover. The comments made by the court on this subject may have come as a surprise to practitioners. In short, the court concluded that where a treaty is written on the basis that a "risk" must "attach" during a stated period, an open cover under which risks can be declared is not itself a "risk" which can attach under the treaty. The risk covered by the treaty is the declaration of the individual risk to the open cover. The relevant date is the date of such declaration. This issue was not looked at again in the Court of Appeal.

It is unfortunate that this issue was not brought before the Court of Appeal and no further clarification was provided.

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