CLYDE&CO

Run off update

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1) When are london market reinsurers not bound to follow US pollution settlements?

WASA International Insurance Co Ltd v Lexington Insurance Company

A significant component of the legacy business exposures of the London Reinsurance Market is liability for claims by cedants in respect of US pollution losses. The Commercial Court has delivered a judgment which clarifies the extent to which London Market Reinsurers are bound to follow the settlements of US ceding companies.

The original insurance was written by Lexington and was governed by the law of Pennsylvania. It covered Alcoa in respect of loss or damage to property caused by an occurrence between July 1, 1997 and July 1, 1980. An occurrence was defined as, "any one loss(es), disaster(s), or casualty(ies) arising out of one event or common cause".

Lexington reinsured its exposure to Alcoa with WASA and AGF in the London Market under a reinsurance contract governed by English law. It was held that the reinsurance contract included a full reinsuring clause requiring the reinsurers to follow the settlements of the reinsured. Accordingly, the reinsurance was on "back-to-back" terms with the original insurance.

Polluting events had occurred at various Alcoa sites from as early as 1942, some 35 years prior to the three year period insured by Lexington and reinsured by WASA and AGF. Alcoa claimed against its insurers on various years in respect of clear up costs.

The language of Lexington's cover was wide and contained no wording excluding liability for pollution losses arising from events occurring in years prior to the actual years insured. The Washington Supreme Court held that as a matter of Pennsylvanian law, Lexington was jointly and severally liable with other insurers for the clean-up costs relating to pollution occurring in all years. Arguments by Lexington to the effect that losses ought to be pro-rated over specific years failed.

When Lexington's claim was presented to WASA and AGF it was rejected on the basis that it was not covered under the reinsurance and proceedings were commenced in the Commercial Court seeking a declaration to that effect. It was argued for WASA and AGF that they had not agreed to reinsure claims settled by Lexington which arose from occurrences which took place prior to their period of reinsurance.

The Commercial Court agreed with WASA. It was held that the period clause was of fundamental importance. In this respect, the Court placed reliance upon the previous decision in *Municipal Mutual Insurance Ltd v Sea Insurance Company Limited*.

Mr Justice Simon said:-

> "The follow settlements clause and the back-to-back nature of the insurance and reinsurance contracts are both important features of the reinsurance; but they are not sufficient to displace the importance of the prescribed period of cover. The reinsurers in this case agreed to reinsure Lexington in relation to Alcoa's property damage occurring between noon on 1 July 1977 and noon on 1 July 1980, or to use the words of the NMA 1779 Form, "during the continuance of the policy." The reinsurers did not agree to reinsure Lexington in relation to an earlier or later period … The reinsurance contract cannot be construed as if it provided cover in respect of the cost of remedying damage whenever such damage occurred (both before and after the policy period) solely on the basis that some damage occurred within the policy period."

The Judge expressly left open the question of whether Lexington could still successfully make a claim under the reinsurance contract in respect of losses which could be shown to have occurred within the three year period of the reinsurance cover.

This case illustrates the importance of analysing settlements entered into by US cedants before accepting any liability to follow such settlements, even where there is strong "back-to-back" language in the reinsurance wording.

Although US courts applying the law of a particular state may be prepared to conclude that a US insurer is exposed to liability arising from years other than those insured, an English court, applying English law, will not hold that reinsurers are liable for losses other than those provided for in the policy wording, usually those relating to events occurring in reinsured years.

2) Bringing brokers to book

Equitas Limited v Horace Holman and Company Limited.

Concerns abound over the question of whether brokers have accounted fully for funds they receive for the account of their principals. Such concerns are perhaps most acute in the run-off market where the on-going relationship with brokers is diminished by the absence of continuing business.

Equitas had such concerns over whether Horace Holman had accounted fully to them in respect of sums received by Horace Holman from Equitas' reinsurers.

Equitas sought an account of balances due from Horace Holman and required production of ledgers and accounts showing what was due to them. Horace Holman provided a "composite account" which stated that they had conducted "a thorough review of the claims files" and on the basis of that review Horace Holman concluded that they were holding nothing by way of funds received from reinsurers that were due and payable to the Syndicates reinsured by Equitas. The accuracy of the "composite account" was challenged by Equitas.

It transpires that Horace Holman's accounting systems depended upon accounting information recorded on the claims files cover sheets. It was held that Horace Holman did not keep their records in accordance with a Lloyd's brokers standard accounting system which required (i) insurance broking accounts ("IBA") ledgers, recording the transactions and balances arising from the insurance business, including debit and credit entries on the underwriters' ledgers and client's ledgers; (ii) IBA cashbooks, recording the receipts and payments of cash; and (iii) a nominal ledger recording the non-insurance transactions and balances and the controls accounts over the cashbooks and the insurance ledgers. It was held that brokers would normally be expected to maintain a double-entry book-keeping system.

Horace Holman's records were deficient because their IBA accounting records were not reconciled with the claims files. Furthermore the accounts provided did not show a balance of sums owing to Horace Holman's principals.

The proceedings were protracted and the judgment is interesting primarily for the conclusions reached with regard to the duties of brokers. Horace Holman admitted that they owed the Syndicates a duty to take reasonable care to maintain proper and adequate records which would allow the Syndicates at any stage to ascertain the true state of their account with them and to ascertain what sums were owed to the Syndicates and Equitas by their reinsurers. Horace Holman also admitted that they owed the Syndicates a duty to "preserve and be constantly ready with correct accounts of all its dealings and transactions on behalf of each … Syndicate".

The Court held that Horace Holman were also under a duty to provide to Equitas their records, or copies of their records, in so far as they relate to transactions done as the agent of Equitas or the Syndicates. If the records were kept in such a way that they were inextricable from records relating to other principals it was the responsibility of Horace Holman to provide the records in such a way that Equitas could extract what was relevant to them from the other material. If no means of separating information could be devised then Equitas would have to see the irrelevant material in addition to material relating to their own position.

Horace Holman denied that they were obliged to disclose or provide copies of documents created for their own purpose including their IBA ledgers, cashbooks and nominal ledgers. The Judge rejected this argument and held that Horace Holman was obliged to provide copies of such documents in so far as they recorded transactions that Horace Holman carried out as the agent of Equitas.

The Judgment is also of interest on the question of the burden of proof upon a principal alleging that sums are due to it from a broker. The Judge held that it was for Equitas to show that sums were received by Horace Holman, and if they did so, it was for Horace Holman to show that they had paid them over to Equitas. It was held that Equitas had proved that monies had been paid to Horace Holman for its account. This had been done by Equitas co-operating with one of its reinsurers, River Thames Insurance Company Limited, whereby the records of River Thames were utilised to establish that reinsurance claims payments had been made to brokers, including Horace Holman, for the credit of Equitas.

Brokers will be unhappy about the decision which illustrates how exposed they may be to criticism and potential claims when their record keeping falls short of accepted standards. Parties in run-off will be more confident in requiring production of records and calling on brokers to provide an account of all balances due.

It may be that companies entering into commutations with reinsurers will now consider including language requiring their reinsurers to provide evidence of payments to intermediaries so that such evidence may be used to put the burden on brokers to prove such payments have been properly accounted.

3) New Jersey court declines IBNR claims

A recent ruling by a New Jersey appellate court concerned the proposed plan by the liquidator of an insolvent insurance company to allow incurred but not reported claims to be treated as actual losses and to therefore be allowed to share in the insolvent estate. Following an objection by reinsurers, the court ruled that the plan should not be approved because it contravened the provisions of New Jersey's Liquidation Act. That act provides, in relevant part, that no contingent claim shall share in the a distribution of the assets of an insolvent insurer unless such claim has become "absolute" against the insurer on or before the last day fixed for filing of proofs of claim against the assets of the insurer.

There is no definition in the act of what is meant by "absolute", but the appellate court ruled that it meant "conclusive", "unconditional" or "non-contingent". As the IBNR claims were actuarial estimates, they did not fall within that definition.

In reaching that conclusion, the appellate court followed the decisions of courts in various other jurisdictions. The court also rejected an argument that the IBNR claims fell within an exception in the act which allows contingent claims if it may be reasonably inferred that an individual would be able to obtain a judgment against the an insured of the insolvent insurer. IBNR claims are not identified claims against the insured, but instead are estimates whereby the identity of the potential claimant and the type, date and amount of the loss are all currently unknown.

4) Proposals for reform of the current regime on limitation of actions

The Law Commission's proposals for reform of the current rules on limitation of actions have been on the back burner since the commission's report and draft bill in 2001. The primary proposals were that there should be a limitation period of three years starting from the date the claimant knows, or reasonably ought to know the facts which give rise to the cause of action, the identity of the defendant and the significance of the injury, loss or damage. There is also a proposal for a long stop date of 10 years from the accrual of the cause of action for any claim, although this will not apply to personal injury claims. After a six year hiatus, the law commissions proposals are now back on the government's agenda. An additional consultation will take place shortly which should be published in June or July this year. The consultation will take a closer look at the draft bill with a view to enacting it into legislation possibly before the end of the year.

Further information

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