

London Market newsletter

October 2008

This edition includes a brief update on:

Market seminar

Over 110 people attended our London Market Seminar at the Old Library at Lloyd's on 8 October 2008. The subject was "(Re)insurance disputes/claims: a legal update on some common problems".

Colin Peck (Partner) chaired the seminar in which Aidan Christie QC (4 Pump Court) and Ling Ong (Partner) reviewed recent Court decisions on common troublesome topics and discussed the application of those decisions to insurers and reinsurers on a practical level.

Anyone who couldn't attend but who is interested in receiving a copy of the seminar pack should contact Sarah Seddon at sarah.seddon@weightmans.com.

Summary judgment refused in breach of claims co-operation clause dispute

Ling Ong reviews the Commercial Court decision handed down on 24 October 2008 in **Markel Capital Ltd v Gothaer Allgemeine Versicherung AG**.

English Court refuses stay in Greek binder dispute

Colin Peck reports on the recent case of **Syndicate 980 v Sinco**.

Court strikes out Names' claims

Ling Ong takes a look at the decision in **David Harris v Society of Lloyd's**.

Arbitration clause not affected by Service of Suit clause

Christina Pye reports on the case of **Ace Capital v CMS Energy Corp**.

Equitas fail in pursuit of costs

Karen Purchase reports on the recent decision in **Equitas v Horace Holman & Others**.

English Court rejects stay in Common Account XOL dispute

Colin Peck considers the case of **Equitas v Allstate Insurance**.

Guest article

Fred Hawke of Australian law firm Clayton Utz considers "Side C Securities cover -



the albatross around the neck of Directors & Officers Liability Insurance”.

Catch up

Where to find members of our team in the Market over the next few months.



Summary judgment refused in breach of claims co-operation clause dispute

Mr Justice Andrew Smith's recent decision in **Markel Capital Ltd v Gothaer Allgemeine Versicherung AG** (24 October 2008) declined to give summary judgement for reinsurers who had denied liability on the basis of a breach of a claims co-operation clause ("CCC").

Gothaer Allgemeine Versicherung AG and Continentale Sachversicherung AG were reinsured by Markel in respect of their proportion of a directors' and officers' liability policy provided to West Deutsche Landes Bank Gironzentrale ("WDLB"). The placement of the reinsurance with Markel was through brokers, Bloemers, who were approached to place the business by VOV, who in turn had been asked by the reinsureds to obtain the reinsurance.

The insurance of WLB was led by Chubb. The underlying dispute concerned a claim made by Box Clever against WDLB's management board which was settled by Chubb. The reinsureds then paid their proportions of the settlement and sought to recover under the reinsurance.

Reinsurers denied liability on basis that it was a condition precedent to liability under the CCC that the reinsureds should notify reinsurers of any circumstance giving rise to a claim within 30 days. However, VOV had known of the circumstances relating to the Box Clever claim for over 30 days before the circumstances were advised to reinsurers and reinsurers argued that the knowledge of VOV amounted to knowledge of the reinsureds for these purposes.

The two issues before the Court on reinsurers' application for a summary judgement were:

1. whether the CCC was agreed as a term of the reinsurance contract; and
2. if so, whether the knowledge of VOV triggered the condition precedent.

On the facts before him, Mr Justice Andrew Smith did not accept that the first question should be decided summarily or that there is no real prospect of the reinsureds succeeding upon it. He considered that the trial judge would need to hear oral evidence from the broker and the underwriter concerned.

The second question in turn revolved round the definition of the reinsured in the slip which described the reinsured as Gothaer and Continentale "as per" VOV. Reinsurers argued that the definition of reinsured applies every time the term was used in the reinsurance contract and that "as per" VOV meant that the reinsureds were acting by VOV for all purposes connected with the reinsurance and that VOV was their agent for all such purposes. Alternatively, reinsurers argued that this definition meant that the reinsureds held VOV out as having their authority to receive information on their behalf so that VOV's knowledge is treated as the reinsured's knowledge because of ostensible authority.

The judge rejected both arguments and stated that the question depends on whether VOV had knowledge of the relevant circumstance in their capacity as the reinsureds' agent and this was not a question before the court on the summary judgement application.

Ling Ong, Partner, Weightmans LLP

English Court refuses stay in Greek binder dispute

In **Underwriting Members of Lloyd's Syndicate 980 v Sinco** (29 July 2008), the Commercial Court considered the implications of Articles 27 and 30 of the Brussels Regulation with regard to which Court was first seized of a matter and so had jurisdiction to hear proceedings.

Sinco had authority under binding authority agreements (“the Binder”) to bind Greek motor insurance on behalf of the Syndicate. The Binder contained an exclusive jurisdiction clause in favour of England. The Syndicate terminated the Binder and brought proceedings in England in January 2007 based on allegations of fraudulent retention of policy premiums and misrepresentation of the amount of claims brought under the Binder. Before the claim form was served in June 2007, Sinco had commenced proceedings in Greece against the Syndicate alleging unlawful termination of the Binder.

Sinco sought a stay in the English proceedings under Article 27 on the basis that the Greek Court was first seized of the claim. Article 27 provides for a stay of proceedings in favour of the Court first seized where the proceedings involve the same cause of action.

The Commercial Court held that:

- (i) As the English claim form as served was different to the claim form as issued, the English Courts were not “first seized” as provided for by Article 30. The application for a stay could not be dismissed on the ground that the English Court was first seized.
- (ii) In considering the claims as a whole, the substantive issues in the English proceedings were for breach of contract whereas the Greek proceedings were for breach of statute and in tort. Moreover it was significant that the English proceedings had been instituted prior to the Greek proceedings even though Sinco had not been served with them prior to commencing Greek proceedings. No stay was therefore granted under Article 27.

Sinco have appealed to the Court of Appeal.

Colin Peck, Partner, Weightmans LLP



Court strikes out Names' claims

In **David Harris v Society of Lloyd's** (1 July 2008), the Commercial Court struck out claims brought by Lloyd's Names against the Society of Lloyd's as an abuse of process as the Names had already had an opportunity to put their case.

The case arose once again from the difficulties faced by Lloyd's in the 1980s and 1990s. The Names were bringing an action in deceit on the basis that Lloyd's had misrepresented the nature of the reinsurance to close ("RITC"). They claimed that the brochures and the verification forms furnished by Lloyd's had fraudulently misrepresented that the RITC constituted a novation and that the Names would not be liable for further losses after the year closed.

Lloyd's argued that a claim could not be brought in deceit as the documentation clearly stated that the RITC was a form of reinsurance and not a novation. Further they argued that any claim was an abuse of process following **Lloyd's v Jaffray** [2002] EWCA Civ 1101, and that the application was time barred in any event.

The Court held that the application was an abuse of process and should be struck out. The Jaffray litigation was clearly designed by the Court to constitute the one and only opportunity for prosecuting a claim in fraud against Lloyd's. The Names were all parties in the Jaffray litigation and had therefore already had an opportunity to present their case. The documentation which the Names sought to rely on had been at the forefront of the Jaffray litigation. In short, "It is an abuse of process to allow the marshalled proceedings in respect of fraud to be undermined by a later action, based on the same cause of action and indeed the same documents."

In the alternative, the Court held that the claim of deceit would fail in any event as the Names would not be able to make good all of the ingredients. Further, all that the Names were relying on was reasonably discoverable more than 6 years before proceedings were issued and the claim was therefore time barred.

The Names have sought permission to appeal to the Court of Appeal.

On 9 September 2008, the High Court granted civil restraint orders to prevent Lloyd's Names from bringing further actions against Lloyd's, relating to their underwriting, without first obtaining permission from the Court. Lloyd's anticipate that this may impact upon the decision of the Court of Appeal in whether or not to grant permission to appeal.

Ling Ong, Partner, Weightmans LLP

Arbitration clause not affected by Service of Suit Clause

In **Ace Capital v CMS Energy Corporation** (30 July 2008), the Commercial Court considered the relationship between an arbitration clause and a service of suit clause.

CMS were an American corporation which had invested in a natural gas pipeline between Chile and Argentina. They suffered loss due to certain acts by the Argentinean government which rendered the project economically unviable and sought to recover from their insurers (Ace).

The insurance policy contained the following (seemingly contradictory) wording:

- “a) The construction, validity and performance of this Policy, shall be governed by the laws of England and all disputes that may arise under, out of, or in relation to this Policy or to the determination of the amount of loss hereunder shall be submitted to arbitration at the London Court of International Arbitration.

- b) The parties hereto agree that the speedy resolution of any disputes between them to be had as a consequence of this clause is a mutual and material inducement to enter into this Policy and that this in no way infringes on any rights accorded in the Service of Suit clause of this Policy the effect of which is to provide without waiver of any defence an ultimate assurance of the amenability of Underwriters to process of certain Courts.

- c) Service of Suit Clause ... It is agreed that in the event of the failure of Underwriters hereon to pay any amount claimed to be due hereunder, Underwriters hereon, at the request of the Insured, will submit to the jurisdiction of a Court of competent jurisdiction within the United States ...”

CMS commenced proceedings in the State of Michigan relying on clause (c). Ace sought an injunction from the Commercial Court restraining CMS's proceedings, relying on clause (a). The Commercial Court granted the injunction sought by Ace on the basis of 4 factors:

1. There is a strong legal policy in both England and America in favour of arbitration and the policy was drafted with this in mind. It was to be assumed that reasonable businessmen would have intended a single tribunal to deal with all the disputes before them (House of Lords in **Premium Nafta Products v Fili Shipping** [2007] UKHL 40). In this case the arbitration clause provided for all disputes to be arbitrated.

2. US case law in the main treats an arbitration clause and a service of suit clause as not being inconsistent. The service of suit clause is intended “to ensure that the insurer is subject to personal jurisdiction in any one of the States for the purpose of, inter alia, enforcement of the award”

3. Clause (b) attempts to explain the relationship between clauses (a) and (c). The service of suit clause does not operate to prevent Ace's right to insist on arbitration (based on the US principle of arbitration as a defence to an action).



4. There was no wording in clause (c) as to an undertaking that matters in dispute would be determined by a US Court. The arbitration clause, on the other hand, did contain an undertaking to determine the merits.

Christina Pye, Weightmans LLP

Equitas fail in pursuit of costs

In **Equitas Ltd v (1) Horace Holman & Co Ltd and (2) Arwyn Morgan Powell** (3 October 2008), the Commercial Court had to determine whether to make a non-party costs order against Powell, the owner and sole director of the defendant company.

Holman was a Lloyd's broker which was in run off. It administered various outward contracts of reinsurance or retrocession which had been written to protect Lloyd's syndicates for 1992 and earlier years of account. The rights under the contracts were assigned to Equitas.

Equitas brought proceedings against Holman seeking delivery up of documentation showing balances due under the insurance contracts, as well as an account and payment of sums found to be due to Equitas. After the proceedings commenced, Holman produced certain accounts and made payments to Equitas. At trial, Equitas no longer sought delivery up or an account, contending that while it was entitled to this, there was no point in pursuing those claims, given the state of Holman's accounting records.

The hearing focused on who should pay the costs of the proceedings. It was ordered that Holman pay a substantial part of Equitas' costs. Holman subsequently went into liquidation. Equitas applied for a non-party costs order against Powell under s51 of the Supreme Court Act 1981. Powell asked the judge to recuse himself from hearing the application, submitting that: (1) he should not have mentioned at the hearing the possibility that an application for a non-party costs order might be made and (2) the cross-examination of Powell had violated his witness immunity. Holman contended that Powell should pay the costs of the proceedings after Holman had rejected a settlement offer made by Equitas, as Powell had been the real party controlling and funding the defence of the proceedings in his own interest.

Refusing the applications, the Court held that:

1. An application for a non-party costs order should be made to the trial judge, notwithstanding that he had expressed a view about the conduct of the non-party. It was a trial judge's duty to hear the application, unless there was a compelling reason precluding this (**Bahai v Rashidian** [1985] 1 WLR 1337 CA (Civ Div) applied). It was not wrong for a judge to mention the possibility of an application for a non-party costs order.
2. The immunity of a witness did not prevent his evidence being used on a subsequent application for a non-party costs order. Even if the judge had erred as Powell contended, a fair-minded and informed observer would not have concluded that the judge would be biased in determining the application.
3. On the basis of legal advice Powell and Holman reasonably believed that Holman would successfully defeat Equitas' claim and might therefore recover costs. Before rejecting Equitas' settlement offer and making a counter-offer Holman was advised that that the best result that Equitas could obtain was that each party should bear its own costs. Powell and, through him, Holman relied on that advice.



4. The liquidation of Holman was not part of a prepared plan to ensure that if Equitas obtained judgment it could not be enforced. Powell was not acting for his own benefit in relation to the litigation and was not funding it. He exercised control over it in his capacity as the director of Holman.

Karen Purchase, Weightmans LLP

English Court rejects stay in Common Account XOL dispute

In **Equitas v Allstate Insurance** (17 July 2008), the Commercial Court rejected the application by Allstate to stay proceedings in an action brought by Equitas.

Highlands, a Texas based company, had entered into common account excess of loss reinsurance contracts (“XOL contracts”) with Allstate. These were pursuant to Highlands’ obligations under a number of quota share reinsurance contracts. The quota share reinsurers included Lloyd’s syndicates reinsured by Equitas.

Highlands went into receivership in 2003, it received a number of substantial claims which were settled under funding arrangements with the quota share reinsurers including Equitas. Highlands then billed the XOL reinsurers including Allstate. Allstate argued that by a commutation agreement with Equitas, it was discharged from all liability and therefore owed no money to Equitas in respect of this claim. Highlands commenced Texas arbitrations to recover the money.

The commutation agreement was governed by English law and contained an exclusive English jurisdiction clause. Equitas therefore issued proceedings in England to determine the scope of the commutation agreement. Allstate applied for a stay of those proceedings under the Court’s case management powers pending the outcome of the Texas arbitration. Allstate argued that Equitas had indirectly participated in the Texas arbitration through Highlands and had delayed issuing proceedings in England for almost 2 years.

The Court rejected Allstate’s application and no stay was granted on the basis that:

1. As the commutation agreement contained an exclusive jurisdiction clause, it will be very rare for a stay to be ordered based on case management powers.
2. There was little overlap between the English proceedings and the Texas arbitration. “The significant issue is the scope of the commutation agreement, not whether Highlands is entitled to recover in its own name in respect of Equitas’ interest.” Allowing proceedings to continue would result in a final, binding, determination about the commutation agreement.
3. Equitas’ involvement in the Texas arbitration had not been beyond that to be expected of a quota share reinsurer where the quota share reinsured is in receivership.
4. Equitas would be prejudiced if a stay was granted as it would in effect be bound to proceedings in Texas to which it was not a party.

Colin Peck, Partner, Weightmans LLP



Guest article

We are delighted to have a guest article in this edition from Fred Hawke, a Partner in the insurance and reinsurance group at Clayton Utz in Melbourne, Australia.

Our London Market team has good relations with a number of insurance and reinsurance law firms throughout the globe and we are pleased to count Clayton Utz amongst those contacts.

Please note, however, that there are no formal ties between Weightmans and any other law firm and the views expressed in this article are those of the author.

SIDE C SECURITIES COVER – THE ALBATROSS AROUND THE NECK OF DIRECTORS AND OFFICERS LIABILITY INSURANCE

The inclusion in Directors' and Officers'/Company Reimbursement liability policies of cover for the company's own liabilities, arising from continuous disclosure and other securities market conduct breaches and known variously as "Side C", "Company Securities" or "Securities Entity" cover, is one of those aberrations of financial services product development which probably can best be explained by invoking the stalker's defence: it seemed like a good idea at the time. This class of insurance was originally intended to be, and has until relatively recently been, directed exclusively at the liabilities of individuals, specifically Directors, Company Officers and senior managers, arising from their corporate governance responsibilities. It was never intended to be an insurance of their corporation's own liabilities, except for obligations of the company to indemnify the individuals (Company Reimbursement cover).

A third insuring clause in these policies for the company's own liability toward third party claimants, arising from the provision of deficient or misleading information to investors in the company's securities (so called "securities fraud"), is a relatively recent innovation. It emerged in the United States during the 1990s, in the context of a proliferation of securities-related class actions against corporations and their Directors, and was initially intended as a device to side step conflicts between the Insurers and the Policyholder companies over defence costs allocation.

Essentially, the problem was that in order to avoid disputes over free riding or duplication of defence costs, case law had left the American D&O Insurers with only three real options:

1. Tighten up the allocation language, so as to require a contribution from so called "free riders";
2. Include a pre-set allocation percentage or calculation formula; or
3. Remove the issue by insuring the company as well.

The first of these options proved hard to draft, the second was hard to sell. The third was seen to be the Goldilocks option, especially if an additional premium could be charged for it, and offered the added benefit of allowing insurers to exercise more control over the disposition of covered claims. This meant that they could extricate individual defendants early from the proceedings and economise on defence costs. Since D&O/company reimbursement insurance is underwritten on an aggregate, costs inclusive policy limit, this was initially seen as a win/win solution for everybody.

Ironically, however, the measure which was originally intended to conserve limits has proved in practice to have the effect of potentially compromising access to them by the very persons for whom they were originally intended, the individual Director, Officer and Senior Manager defendants. There are two reasons for this.

Firstly, the allocation of part of a combined aggregate limit to the defence and liability of the company itself must necessarily reduce the proportion of limit available for the individual Directors and Officers whose exposures, including for prosecution defence costs, are not necessarily extinguished by settlements between civil claimants and the company.

Secondly, should the company itself become insolvent, the existence of a direct right of the company to claim upon the Policy in respect of its own liabilities can have the effect of converting the Policy into a putative asset of the company, without the company having provided any indemnification to the Directors under their Deeds of Access, Indemnity and Insurance or as otherwise required by the Company's constitution. Under Australian law, this could result in applications by Liquidators to attach the proceeds of the Policy and apply them to the company's liabilities, in accordance with the provisions of Section 562 of the Corporations Act 2001 (Cth).

Such a claim by a Liquidator may place the Insurer in an invidious position, effectively restraining it from applying the Policy proceeds to rival claims of individual Insureds, for payment of their defence costs. This undermines the value of the Policy's Advancement of Defence Costs extension and also potentially compromises the substantive cover which D&O Liability Insurance has traditionally provided against exposure to liability for inadvertent insolvent trading.

Faced with such competing claims over a finite limit, the D&O Insurer may have no safe alternative but to pay the Policy proceeds into Court, for determination of the order of distribution. This would obviate the risk to the Insurer of being obliged to pay more than its aggregate limit, however, it effectively leaves the individual Insureds at the mercy of the common law principle of "first in best dressed", in terms of applying the Policy limits to crystallised liabilities. See *Charter Reinsurance Co Ltd (In Liquidation) v Fagan* [1997] A.C.313.

To mitigate these problems, overseas D&O insurers developed the practice of including in policies, where Side C securities cover was provided, a provision known as an "Order of Payments" or "Priority of Payments" clause. This provides, essentially, that in any situation where valid claims can be made upon the Policy by both the company and by the individual insureds, the individual insureds' claims are to be met first. Only after these have been fully satisfied is any remaining balance of the limit available to meet the company's claims, under either the Company Reimbursement or the Side C cover at the company's election. These clauses are now making their appearance in Australia and the question is whether they adequately address the problems described above.

It is this writer's humble opinion that they do not. In the first place, in order to avoid the risk of complications arising from possible conflict between the clauses and statutory insolvency law, which Liquidators might invoke to try to override them, it would be better for the clauses to provide that no policy entitlement of the company arises unless and until all individual insureds' claims arising from notified circumstances have been paid or otherwise extinguished. This would also help to get around the second aspect of concern, which relates to timing.

An Order of Payment clause in the presently popular form will offer little protection to the interests of individual insureds, if the company alone is sued first in securities-related litigation to which they are not parties. The company alone will have an immediate, enforceable right to claim under the Policy and by the time other claimants or regulators get around to commencing proceedings against Directors, Officers or management, much or all of the limit may have been eroded by defence and/or settlement of the company's liabilities. Such settlements will not necessarily preclude legal action against the individual insureds, especially where prosecutions are concerned.

As a more practical alternative, given the uncertainties inherent in access to the limits of Directors' and Officers' Liability insurance where Side C cover is included, perhaps the financial liability insurance market should look at taking Side C cover out of the D&O/Company Reimbursement Policy altogether and offering it, if there is really a market for it, as a separate insurance product. This would essentially be a "securities liability" insurance which could be underwritten as a stand alone policy or as an adjunct to a corporation's Civil Liability/Professional Indemnity Insurance program. At least then the market could reasonably expect to obtain a proper premium for the cover.

In the meantime it is this writer's usual practice, when asked by companies whether they should include limits for Side C in their D&O/Company Reimbursement insurance contract, to ask them in turn for whose benefit they are really buying this insurance.

Fred Hawke, Partner, Clayton Utz

Catch Up

You can catch up with members of our London Market team at the following events:

- **Excess/Surplus Lines Claims Association**, Ruschlikon, Switzerland 10–11 November 2008 – Colin Peck and Ling Ong attending
- **Norwich Insurance Institute**, 11 November 2008 – Dan Cutts attending
- **Forum of Insurance Lawyers AGM**, 19 November 2008 – Dan Cutts chairing
- **OPERA 30th Anniversary Seminar**, London 25 November – Ling Ong attending
- **AirSP Christmas Drinks**, London 4 December 2008 – Colin Peck and Ling Ong attending
- **Insurance Christmas Ball**, London 10 December 2008

If you need to contact any members of our London Market team before these events or if any queries arise from the contents of this newsletter, please see below for contact details:



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