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FINANCIAL INSTITUTIONS ● ENERGY ● INFRASTRUCTURE AND COMMODITIES ● TRANSPORT ● TECHNOLOGY

"Reinsurance Snakes & Ladders"
AIDA XIII World Congress, Paris
Reinsurance Working Party

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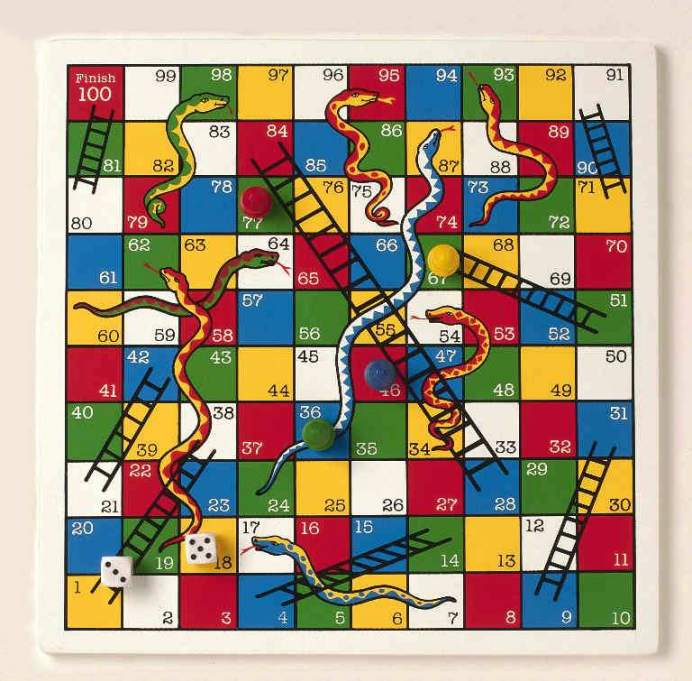
“Reinsurance Snakes & Ladders”

Legal developments which help or hinder cedants in recovering reinsurance indemnities



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… ou, parce que nous sommes à Paris –

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Outline

- Loss notification clauses – mismatch between original policies and reinsurance contracts
- Good faith in relation to matters of belief
- Impact of misrepresentation at time of original placement on renewal of contract
- Claims co-operation after denial of cover
- Contract certainty and missing terms
- Proof of loss within underlying terms
- Incorporation in reinsurance of terms of original policy subject to different law – whose interpretation governs?
- Solvent schemes of arrangement

Notification clause mismatches

- Source of problem
- *RSA v Dornoch* (CA, 2005)
  - Condition precedent that reinsured should "upon knowledge of any loss" advise reinsurers within 72 hours
  - Notification late, but within six weeks of claim
  - Insured (directors and officers of Coca-Cola) disputing allegation that company's share value inflated
  - "Loss" held to mean actual loss rather than unproved claim

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Notification clause mismatches (cont'd)

- Compare *AIG v Faraday* (CA, 2007)
  - Announcement of restatement of accounts led to immediate drop in share price and class action against insured directors
  - Insurer did not notify reinsurer until after settlement, more than one year later
  - CA held notification condition breached; reinsurer therefore not liable to indemnify

- How was *RSA v Dornoch* distinguished?

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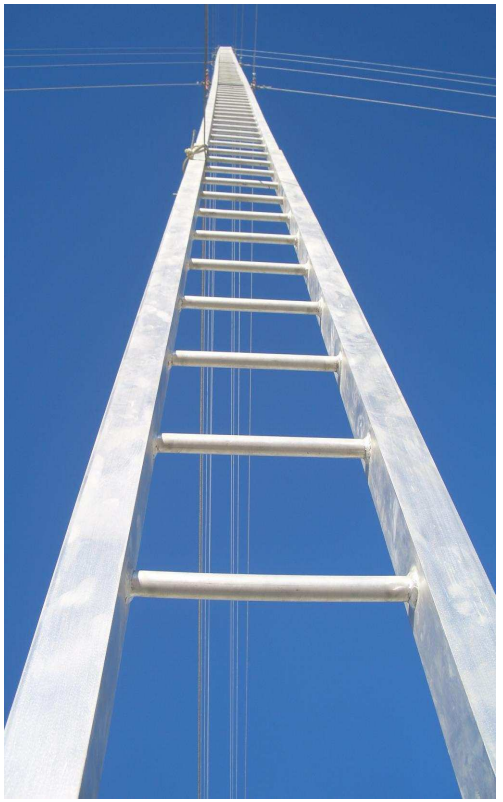
Rendall v Combined Insurance (Comm Ct, 2005)

- Combined provided business travel insurance to Aon employees
- Reinsurance quote sought on basis of "estimated days of travel"
- Claims in respect of Aon employees killed in 9/11 attack on WTC denied (inter alia) on grounds of misrepresentation of estimate
- Court held that as long as estimate provided honestly, no need to show reasonable grounds for belief in its accuracy



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Limit v AXA Versicherung (CA, 2008)

- Fac/oblig treaty protecting Limit's energy account placed in 1996, extended by endorsement for 1997, and renewed in 1998
- Misrepresentation on placement concerning level of deductible above which risks would attach
- AXA held entitled to avoid 1996 contract and 1997 extension because no new contract
- No express repetition of mis-representation on 1998 renewal
- CA (reversing trial judge) held repetition should not be implied; thus no avoidance for 1998

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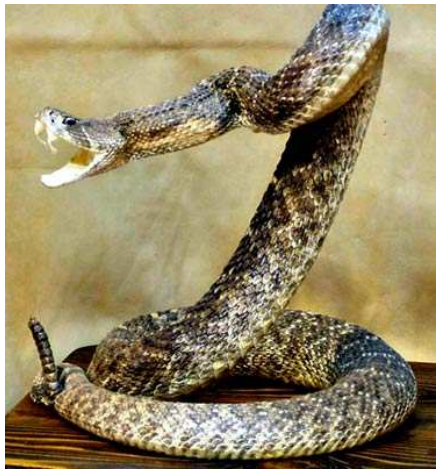
Lexington v Multinacional de Seguros (Comm Ct, 2008)

- Property and business interruption cover placed by way of fronting arrangement with claims co-operation clause (CCC) as condition precedent
- Following a loss, reinsurers asserted reinsured had breached CCC by reason of failure to follow recommendation of loss adjuster and denied liability
- Parties nevertheless remained in contact on “without prejudice” basis

Lexington v Multinacional de Seguros (2)

- Reinsured subsequently waived limitation defence against original insured
- Reinsurers once again asserted breach of CCC
- Reinsured argued reinsurers had waived compliance by virtue of their previous denial of liability
- On trial of preliminary issues, judge held:
  - (on facts) that reinsurers remained willing to co-operate
  - reinsured remained bound by CCC
  - waiver of limitation defence amounted to clear breach of CCC



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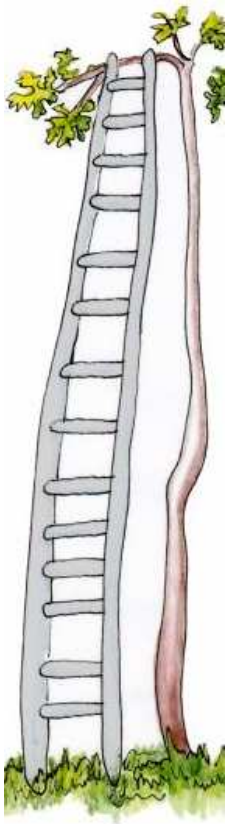
Allianz Egypt v Aigaion Insurance (CA, 2008)

- Contract of marine reinsurance negotiated by e-mail
- Reinsurer insisted upon class warranty
- Draft slip e-mailed to reinsurer omitted warranty
- Reinsurer did not sign slip but replied by e-mail that cover "is bound … as we had quoted"
- Insured vessel became constructive total loss
- Reinsurer denied indemnity on basis that no contract concluded – no agreement on warranty
- Trial judge and CA held for reinsured on basis of agreement by e-mail but (perhaps surprisingly) that class warranty not included



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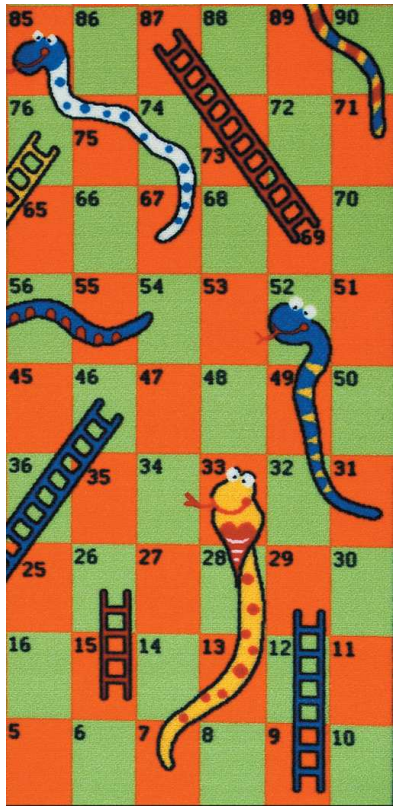
Equitas v R&Q (Comm Ct, 11 November 2009)

- LMX spiral losses paid by Lloyd's syndicates; recoveries claimed from retrocessionaires
- Underlying losses either wrongly aggregated (KAC and BA aircraft in first Gulf War) or irrecoverable (Exxon Valdez)
- R&Q argued no indemnity as legitimate loss settlements "tainted" by wrongly paid losses
- Equitas argued actuarial modelling could strip out tainted elements to leave only recoverable losses



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Equitas v R&Q (2)

- Equitas had to show that loss settlements were within terms and conditions of original policies and reinsurance contracts
- Gross J: Nothing in prior authorities as to exactly how Equitas had to do that. It was free to deploy such evidence as it chose to satisfy this burden of proof, on the balance of probabilities
- No proper logical or principled objection to use of actuarial models

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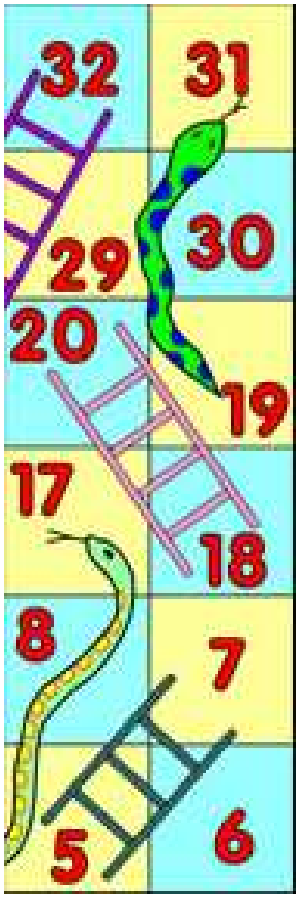
IRB Brasil Resseguros v CX Re



- Significant Commercial Court judgment delivered on 7 May 2010
- Excess of loss reinsurance subject to "double proviso" loss settlements clause (as in *Equitas v R&Q*)
- Reinsured settled various APH claims (breast implants, contaminated blood, asbestos and chemical pollution) as part of market-wide compromises

IRB Brasil Resseguros v CX Re (2)

- Arbitral tribunal held reinsurer must indemnify cedant for "arguable liability"
- On appeal, Burton J criticised arbitrators' choice of words, but held that effect of award was finding that settlements in fact fell within original policy terms "on the balance of probabilities"
- Sensible commercial decision or thin end of wedge?
- Note upholding of arbitrators' finding that Owens Corning "determination to … install … insulation products" was a single "event"

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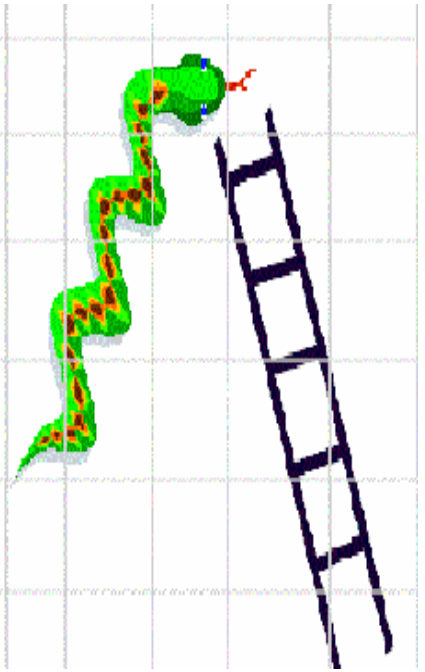
Wasa and AGF v Lexington

- Following adverse judgment in Supreme Court of Washington (under Pennsylvania law), Lexington settled insurance claim by Alcoa for indemnity for environmental clean up costs where property damage occurred over period of more than 40 years
- Alcoa's policy was for term of three years from 1 July 1977 to 1 July 1980; Wasa and AGF reinsured Lexington for same period on "losses occurring" basis
- Reinsurance (governed by English law) included "full R/I clause" with "follow settlements" language

Wasa and AGF v Lexington (2)

- Simon J in Commercial Court (2007) held “follow settlements” language insufficient to bind reinsurers to settlement which included damage occurring outside period of reinsurance
- Court of Appeal (2008) reversed
  - Reinsurers bound by settlement going beyond policy period because reinsurance on “back to back” facultative contributory basis with all material terms derived from original cover
  - Effect of period clause in original policy and reinsurance ought to be the same



Wasa and AGF v Lexington (3)

- On further appeal (2009), House of Lords restored first instance judgment
  - Reinsurance separate contract from underlying policy and not entirely "back to back" with original because of different choice of law

  - On proper (English law) construction of R/I contract, reinsurers not liable
  - Prior cases distinguishable because impossible to state, when reinsurance entered into, what law governed original policy – or, therefore, to hold reinsurers bound by that law's construction of R/I

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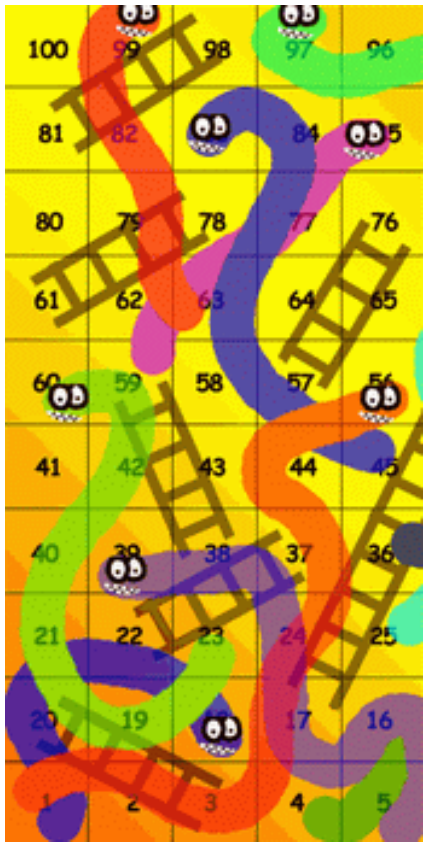
Re Scottish Lion (Court of Session, 2010)



- Solvent scheme of arrangement
- First instance judge held relevant provisions of Companies Act only applicable in situation of insolvency ("where … there is a problem requiring a solution")
- Court of Session reversed on issue of principle involved
- Nevertheless, merits hearing still required
- Solvent schemes likely to remain source of conflict for (re)insurers with long-tail or IBNR creditors

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Any comments or questions?

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