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The Taylor Wessing Insurance and Reinsurance Review of 2009

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The TW Annual Insurance and Reinsurance Review summarises the key English case law developments in insurance and reinsurance throughout the year. Please note that some cases covered in this review may be subject to further appeal.

Property Insurance

When can an Insured's dishonesty vitiate a claim?

Direct Line Insurance Plc v. Fox [2009][1]? Queen's Bench Division, 10 March 2009

Where an insured commits fraud in the pursuit of a policy claim he puts himself in breach of his duty of utmost good faith. The result generally is that he cannot recover for any of the claim in question, including any part of it unaffected by the fraud (*Britton v. Royal Insurance Co* (1866)[2]). The policy may also be avoided prospectively but (unlike fraud or misrepresentation at and before inception) such avoidance does not operate *ab initio* (*Axa v. Gottleib* [2005][3]).

In the present case, a fire occurred at the insured's property, for which he pursued a claim. In addition to the duties that exist at common law, the policy contained an express provision that it would become void in the event of a fraudulent claim.

The insurer, Direct Line, accepted the claim and entered into a settlement agreement with the insured by which it would make an interim payment followed by a final VAT payment. The final VAT payment was subject to a condition precedent that the insured would supply supporting invoices from a contracting company (B). The interim payment was duly made, and subsequently the insured produced VAT invoices purportedly from B, even though B had not in fact carried out the work. When the authenticity of the invoices was queried, the insured simply retracted the VAT element of the claim.

The court held that the insured had acted dishonestly in sending the invoice to the insurer, as he knew that B had not done any work and therefore no VAT had been paid. However, it also found that the dishonesty had not been committed in furtherance of a claim under a policy so much as to satisfy a condition precedent appearing in the settlement agreement. The settlement agreement, though it related to an insurance claim, was not of itself a contract of insurance and thus not a contract of utmost good faith. Accordingly, the insured's dishonesty would not result in him having to repay to the insurer sums already paid. Furthermore, this position was unaffected by the express provision in the policy by which it would become void in the event of a fraudulent claim. Again, this could have only prospective effect, in line with the common law principle, and as such would not entail repayment of claims already settled.

Result: Judgment for the insured.

1 [2009] EWHC 386 (QB)
2 (1866) 4 F&F 905
3 [2005] EWCA Civ 112

Meaning of the Insured's "Wilful Act"

Porter v. Zurich Insurance Co [2009][4]
Queen's Bench Division, 5 March 2009

Whether in direct insurance policies or contracts of reinsurance, compliance with a claims notification and/or claims co-operation clause will often be expressed as a "condition precedent" to liability. Even where those precise words are not used, the same result will be achieved if the intention of the parties is clear (as in the recent case of *Aspen & Ors v. Pectel* [2008][5]). Where a clause is found to operate as a condition precedent, breach of the clause will be fatal to the claim, whether or not the re/insurer has actually suffered loss as a result.

By contrast, where the clause is found not to operate on a condition precedent basis, mere breach will not be enough. That was the position in *Thomas v. Zurich Insurance Co* [2009], a case decided on 5 March 2009, in the Liverpool District Registry of the High Court.

The claim arose under a household property insurance. The policy excluded "*any wilful or malicious act by a member of the family or by a person lawfully at or in the home*", and it also contained a clause specifying the requirement to give notification of a claim "*as soon as reasonably practicable*" and thereafter variously to co-operate with insurers and to provide all information and evidence as may reasonably be required.

The insured suffered from a delusional disorder and alcoholism, and attempted to kill himself by setting fire to the house. Having set the fire, however, the insured then changed his mind and escaped unharmed, but the house was severely damaged and was rendered uninhabitable. It was boarded up, but was subsequently burgled on three occasions. Following presentation of a claim, adjusters were appointed to deal with the theft claims. Due to lack of co-operation from the insured, however, no meetings or inspections of the property took place, and no statements were taken.

With respect to the fire claim, the court noted the general rule of insurance law that an insured cannot normally recover the policy monies when he has intentionally brought about the event upon which the policy specifies the monies to be payable (*Britton v. Royal Insurance Co* (supra)). As a matter of construction of the policy, it is presumed that the insurers have not agreed to pay in those circumstances, although this presumption can be overturned by the particular terms of the policy. In this case, the policy expressly excluded a wilful act by the lawful occupant of the property, and for these purposes an act would be wilful unless it could be shown that the perpetrator was legally insane (i.e. so impaired that he did not know the nature and quality of the act he was doing or did not know that it was wrong). Having considered the medical evidence, the court concluded that this was not so in the insured's case. Accordingly, the fire claim failed.

As to the theft claims, the court agreed with insurers that the insured was in breach of the obligation to co-operate in relation to the loss. However, breach of itself would not be enough to defeat the claim, the relevant requirement falling short of a condition precedent. To reject the theft claims entirely, the insurer would have to show that, had it been able to investigate the claims, it would have been entitled to decline coverage for them, or that it was now impossible to investigate. Failing that, the policy claim could only be reduced by such actual loss proved to flow from the insured's breach, the precise amount of which would need to be proved at a separate quantum hearing.

Result: Judgment for the insurers on the fire claim. Theft Claims deferred to quantum hearing.

4 [2009] EWHC 376 (QB)

5 [2008] EWHC 2804 (Comm). And see Taylor Wessing Insurance and Reinsurance Review of 2008

Fire protection and the "Material Change" clause

Ansari v. New India Assurance Ltd [2009][6]
Court of Appeal, 18 February 2009

The Porter v. Zurich decision came shortly after Judgment on another property insurance policy claim, in Qayyum Ansari v. New India Assurance Ltd [2009], handed down by the Court of Appeal on 18 February 2009.

This case was an appeal by the insured against an earlier High Court decision dismissing his claim for fire damage to the insured property. The insured had stated on the proposal form that the property was protected by an automatic sprinkler system. Furthermore, the policy contained a standard "Change of Facts" clause providing that the insurance would cease to be in force upon any "material change in the facts" stated in the proposal form, unless the Insurer agreed in writing to continue the insurance.

A fire broke out in the property, causing considerable damage for which the insured claimed under the policy. It transpired that, at the time of the fire, the sprinkler system had not been working, and following investigation the court found that the system had in fact been turned off by the tenant, by closing the isolation valve at the junction with the main water supply and placing a filing cabinet against the control handle so as to prevent it being opened. The water supply to the system had been disconnected following the tenant's failure to pay water charges.

The court held that a statement in the proposal form that the premises were protected by a sprinkler system meant a properly functioning sprinkler system that was ready to operate in the event of a fire, and not merely that the system was capable of functioning. The insurers must be taken to understand that there might be occasions on which the sprinkler system would be turned off temporarily, for example, for maintenance or repairs. There was also the possibility that the system might be turned off for other reasons, but again only temporarily. What the insurers could not contemplate was that the system would be turned off indefinitely. The sprinkler was intended to provide constant protection against fire, and where a protection system of that kind was turned off for an indefinite period the result was to alter the nature of the subject matter of the insurance. The court held that this was precisely the sort of situation to which the Change of Facts provision was intended to apply.

The only remaining question, therefore, was whether the insured was actually aware of the actions of its tenant in isolating the system. The court found that the insured had visited the property regularly, and there was also evidence that he had advised the fire investigation officer that the sprinkler system had not been operational for some time. In the circumstances, it was clear that the insured had been aware of the notifiable change of facts. Accordingly, the claim failed.

Result: Judgment for the insurers.

6 [2009] EWCA Civ 93

Breach of Warranty

Construction of warranties and the Insured's knowledge

A C Ward & Sons Ltd v. Catlin (Five) Ltd & Ors [2009][7]
Commercial Court, 3 December 2009

This case was the latest in a number of recent decisions concerning breach of warranty in insurance contracts.[8] The claimant was a member of the Booker Group of companies, operating (amongst other things) a warehouse in West Thurrock, Essex. During the weekend of 17 and 18 March 2007, a quantity of cigarettes and alcohol was stolen from the warehouse by burglars who had cut through the first floor level of the building, leading them to a mezzanine level where the stock was stored.

The Claimant was insured by the Defendants under a "Multiline Commercial Combined Policy" of insurance ("the Policy") containing both a Protection and Maintenance Warranty ("the P&M Warranty") and a Burglar Alarm Maintenance Warranty ("the Alarm Warranty"). The P&M Warranty stipulated that:

> "the whole of the protections provided for the safety of the insured property shall be maintained in good order throughout the currency of this insurance and … they shall be in full and effective operation at all times when the Insured's premises are closed for business and at all other appropriate times."

The Alarm Warranty read as follows:

> "It is warranted that:
>
> (a) the premises containing the Insured property are fitted with the burglar alarm system stated in the Schedule, which has been approved by the Insurers and that no withdrawal, alteration or variation of the system, or any structural alteration which might affect the system shall be made without the consent of the Insurers,
>
> (b) the burglar alarm system shall have been put into full and effective operation at all times when the insured's premises are closed for business, and at all other appropriate times, including when the said premises are left unattended,
>
> (c) the burglar alarm system shall have been maintained in good order throughout the currency of this Insurance under a maintenance contract with a competent specialist alarm company who are approved by the Insurers…
>
> All defects occurring in any protections must be promptly remedied."

Initially, the insurers sought summary judgment against the insured on the grounds of breach of the above warranties. The alarm system in place at the time of the theft was not fully operational, which insurers contended was enough on its own to defeat the claim. Although no specific burglar alarm had been stated in the schedule to the Policy, they argued that any burglar alarm or other manner of security protection installed at the warehouse, whether present at the time of inception or subsequently, was required to be in full and effective operation at all times when the warehouse was unattended, failing which the entire policy would be automatically discharged. This would also be true, argued insurers, even if the defective operation of the system was unknown to the insured and could not reasonably have been known to them. The requirement for compliance, on insurers' case, was strict.

In a judgment issued by the Commercial Court in December 2008, insurers' application for summary judgment was rejected, a decision affirmed by the Court of Appeal in September 2009. In giving its reasoning, the Court of Appeal described insurers' argument as "draconian"; it said that the insured had a real prospect of arguing successfully for what it described as "*a more reasonable commercial meaning*" of the warranties, in other words, that the "*protections provided for the safety of the insured property*" as referred to in the warranty were to be limited to those protections actually identified in

7 [2009] EWHC 3122 (Comm)

8 For example, *Pratt v. Aigaion Co SA ("THE RESOLUTE")* [2008] EWHC 489 (Admlty). And see Taylor Wessing Insurance and Reinsurance Review of 2008

the original proposal form, and similarly that the burglar alarm system referred to in the Alarm Warranty meant the system as specified in the Schedule (of which here there were none). The Court of Appeal was also attracted to the argument that breach of the warranties could only arise by reason of defects within the knowledge, or reasonably capable of being within the knowledge, of the insured and its agents.

Accordingly, these and other matters were referred back to the Commercial Court for trial on the merits, upon which the Commercial Court gave its judgment on 3 December 2009. Having heard all the evidence, the Commercial Court concluded that the P&M Warranty was *not* limited to the particular "protections" specified in the proposal form, nor was the Alarm Warranty confined to such alarm system as might have been identified in the Schedule. As a matter of commercial common sense, the warranties referred to whatever protections or alarms actually existed, whether identified in the policy documentation or not. However, the court added that the warranties could only relate to such facilities as *existed at the time of inception*. New or improved systems installed after inception would not be subject to the warranty.

As to knowledge, the Commercial Court adopted the view heralded by the Court of Appeal. It said that a breach of warranty will occur only in the event of a defect in the particular protection or burglar alarm system of which the insured was, or should reasonably have been, aware, and which it had then failed to remedy promptly. On the evidence, the Court rejected insurers' argument that the insured was aware of the defects. It also rejected the insurers' case that one of the insured's employees had in fact colluded in the theft.

On breach of warranty, therefore, insurers' case failed. Ultimately, however, the dispute was determined in favour of insurers on an entirely different ground, namely non-disclosure or misrepresentation. The decisive point, in the end, related to an endorsement that had initially been imposed as part of the policy terms, by which it was:

> "hereby noted and agreed that Theft cover in respect of Stock of Cigarettes & Tobacco ... [in the warehouse] ... is not operative outside of Business Hours unless the Stock is kept within the special secure store on the ground floor".

On the terms of the endorsement, the claim would not have been recoverable, since at the time of the theft the stolen goods were stored within a wire mesh cage located on the mezzanine floor. Prior to the theft, the underwriters had agreed to remove the endorsement and to allow cigarettes and alcohol to be stored in the cage upon an assurance that additional movement detectors had been installed in the mezzanine area, along with "vibration inertia detectors" (i.e. guardwire) on the walls and ceiling of the mezzanine. In fact, so the court found, there were no movement detectors additional to those already installed, and the guardwire had been installed in only two of the four walls of the cage. The statements were therefore incorrect and they amounted to misrepresentations which the court found to be material to insurers' decision to relax the endorsement.

Accordingly, the court held that insurers we entitled to avoid the agreement to waive the endorsement, with the effect that it became reinstated to the policy terms. The effect of this was to take the loss outside the terms of coverage.

Result: Judgment for the insurers.

Proposal Forms

Construction and status of proposal form questions

R&R Developments Ltd v. Axa Insurance UK Plc [2009][9]
Chancery Division, 28 September 2009

This case was an appeal from a High Court Deputy Master. It concerned a claim under a "Commercial Combined and Contract Works" insurance policy taken out by the Claimant to protect itself against theft and damage at a small property development.

General Condition 1 stipulated that the policy would be voidable in the event of any misrepresentation, mis-description or non-disclosure in any material particular. The insured had been asked the following question in the proposal form: "*Have you or any... directors either personally or in connection with any business in which they have been involved ... ever been declared bankrupt or are they the subject of any bankruptcy proceedings or any voluntary or mandatory insolvency*". To this question, the answer "no" was given.

In fact, it transpired that one of the company's directors had been a director of company that was in administrative receivership, and was previously a director of a number of companies that had gone into liquidation. However, none of the directors had themselves been declared bankrupt or been subject to any personal bankruptcy proceedings.

Nevertheless, the insurer contended that it was entitled to avoid the policy, since the question was designed to elicit information not just as to the personal bankruptcy status of the directors but also that of any other companies of which any of them were or had been directors. At issue, therefore, was the proper construction of the question in the proposal form, and in particular how the court should resolve any ambiguity in the words used.

Upon review of the relevant authorities, the court concluded that the proposal form question was confined to the status of the insured company and that of the directors, each in their personal capacity. This was the literal construction of the words used and it also happened to make "good commercial sense". It was perfectly reasonable to ask the insured about the directors' personal position, whether arising from their personal affairs or from any businesses which they have been involved, without going further and asking about the position of the companies as well. While it might also have made good commercial sense for the insurer to ask questions about the claims and insurance history of other companies with which the directors had been involved, the fact is that they failed to do so by the words actually employed in the proposal form.

Furthermore, even if the Judge had taken the view that the question was ambiguous, he said he would still have held that the meaning contended for by the insured was a fair and reasonable meaning to be attributed to the question. Accordingly, applying the *contra proferentem* principle, he would still have found in the insureds' favour.

Result: Judgment for the insured.

9 [2009] EWHC 2429 (Ch)

Marine Insurance

Inevitability and Inherent Vice: Loss of jack-up rig under tow

Global Process Systems Inc v. Syarikat Takaful Malaysia Berhad [2009]
Commercial Court, 31 March 2009
Court of Appeal, 17 December 2009

As Lord Birkenhead LC noted in the famous case of *British & Foreign Marine Insurance v. Gaunt* [1921], a policy on "all risks" terms cannot be held simply to cover all damage howsoever caused "*for such damage as is inevitable from ordinary wear and tear … is not within the policies*". The principle is simply this: insurance covers risks, that is to say something that might or might not happen, and not certainties.

The point was developed further in *Soya GmbH v. White* [1982], concerning a claim for heat damage to a consignment of soya beans on a voyage from Indonesia to Antwerp. The court in that case drew a distinction between cargo shipped with greater than 15% moisture content, which on the expert evidence it said was bound to suffer heat damage during the intended voyage, and cargo shipped with between 13% and 15% moisture content, which it said "might or might not" result in such damage. In the former case, damage would be regarded as inevitable and thus irrecoverable in principle; in the latter case the damage was *fortuitous* but resulted from an inherent vice, that is to say the moisture present in the cargo at the time of shipment. In that particular case the claim succeeded because the policy expressly included such loss, by way of an extension covering "heat, sweat and spontaneous combustion".

Most recently, the point came up again in the case of *Global Process Systems Inc v. Syarikat Takaful Malaysia Berhad*. The claim concerned the loss of a jack-up rig being towed on a barge from Galveston to Malaysia. The jack-up rig design allows a working platform to be floated into position and jacked up on cylindrical legs, to suit the sea depth at the point of operation. Steel pins are engaged into the legs through pinholes spaced at six foot intervals and, to reduce stress at the corners of the pinholes, circular holes are incorporated at each corner roughly an inch and half in diameter. For the present tow, the rig was carried on a barge with its legs in place and elevated in the air above the deck.

The tow was interrupted mid way through the voyage, near Cape Town, where some cracking was found in the way of certain of the pinhole corners. Repairs were carried out and the voyage resumed, but soon after, three of the legs fell off into the sea.

The rig was insured as cargo under Institute Cargo Clauses (A), containing the standard exclusion in respect of loss or damage caused by "*inherent vice or the nature of the subject matter insured*".

Insurers argued that the loss was inevitable and as such there was a lack of the necessary fortuity. Alternatively, they relied upon the inherent vice exclusion. They argued that the legs were not capable of withstanding the normal incidents of the tow, as demonstrated by the fact that they failed in weather conditions that could reasonably have been expected on this voyage. For their part, the assured contended that the question of inevitability had to be judged subjectively; thus, they argued, a claim for inevitable loss would be recoverable unless it could be shown that the assured knew the loss to be inevitable when taking out the insurance. As to inherent vice, the assured contended that the true proximate cause was the failure to carry out adequate repairs in Cape Town.

In the Commercial Court, the trial Judge determined that the failure of the legs, though very probable, could not be said to be objectively "inevitable." Citing the British & Foreign case, the Judge noted that the onus of proving fortuity "*represents a low hurdle for the assured*", which in this case the assured had cleared. As such, the insurers' defence of lack of fortuity failed.

However, a loss could still be caused by inherent vice though not be inevitable. In appearing to apply the test described by Mr Justice More-Bick in *Mayban General Insurance v. Alstom Power Plants* [2004][10] the trial Judge noted that the legs had broken off despite the fact that the weather experienced was "*within the range that could reasonably be contemplated*". That was enough to lead to the conclusion that the cargo was incapable of withstanding the ordinary incidents of the voyage, and as such the cause was inherent vice.

10 [2004] 2 Lloyd's Rep 609

That ruling was, however, reversed by Court of Appeal, in a Judgment handed down on 17 December 2009. Having reviewed the authorities and academic texts in some detail, the Court of Appeal came to the conclusion that the test for claims on a cargo policy should in principle be no different to that for hull policies. If the action of the sea is the immediate cause of the loss, which clearly was true here, a claim may still lie under the policy even though the conditions were within the range of "*what could reasonably be anticipated*". If, on the other hand, the cargo had been damaged by the motion of the vessel in weather that could be described as "perfect" or "favourable", then the obvious inference in most cases would be that any damage was indeed the result of inherent vice or the nature of the cargo.

In the present case, the wave conditions may well have been foreseeable but the Court of Appeal considered that they were not so benign at to create, on their own, an inference of inherent vice. On the evidence, metal fatigue was not the sole cause of the loss of the legs. Rather it was a "*leg breaking wave*" that had caused the starboard leg to break off, something that was "*not bound to occur in the way it did on any normal voyage round the Cape*". The loss of the starboard leg led to the others being at greater risk and so they, in turn, also broke off. Though with hindsight this may have been a "*highly probable*" chain of events that was not enough to render the proximate cause something other than the perils of the sea, a risk for which the assured was covered under the policy.

Result: Judgment for the assured.

Reinsurance

Wasa v. Lexington: The Final Word

Lexington Insurance Co v. Wasa International Insurance Co Ltd & Anor [2009][11]
House of Lords, 30 July 2009

To understand the significance of this case, one needs to go back to the seminal decision in *Vesta v. Butcher* [1989][12] some 20 years earlier. In that case, a Norwegian insurer of a fish farm reinsured the risk in the London market on terms by which reinsurers followed the terms and conditions of the direct policy. The court held that the follow clause did not have the effect of importing the choice of law of the direct policy, Norwegian law, into the reinsurance. However, in applying the governing law of the reinsurance contract, that is English law, and as a matter of construction of the reinsurance contract, the clear intention was that the reinsurance be "back-to-back" with the underlying policy. In other words, if the governing law of the insurance policy (in this case, Norwegian law) imposed a liability on the reinsured to pay the claim, then the governing law of the reinsurance contract (English law) imposed upon the reinsurer an obligation to indemnify the reinsured in turn. At the time of contracting, reinsurers could see from the terms of the direct policy that any liabilities under it would be determined by reference to Norwegian law. At any time they could have reached for their Norwegian "legal dictionary", from which they would have been able to see exactly what it was they were agreeing to follow. Accordingly, reinsurers could not treat themselves as discharged from liability on account of the insured's non-causative breach of warranty, as such a remedy was unknown under Norwegian law.

That principle, which in *Vesta v. Butcher* survived two unsuccessful appeal attempts to the Court of Appeal and the House of Lords, has remained good ever since, and has been applied (arguably extended) in many subsequent cases.

The Commercial Court Decision

In April 2007, however, the Commercial Court distinguished the Vesta line of authorities in the decision of *Wasa v. Lexington* [2007][13]. In this case, the underlying insurance, issued by Lexington, covered the risk of physical loss and damage occurring to property operated by the Aluminium Company of America (Alcoa) for a three year period, namely 1 July 1977 to 30 June 1980.

In the early 1990s, Alcoa was required by the US Environmental Protection Agency to clean up pollution that had accumulated at a number of its industrial sites over a 44 year period, from 1942 to 1986. Having expended the cost of that clean up operation, Alcoa then sought in turn to recover the cost from those insurers whose policies had been in place at the relevant time. There is, however, a long running debate in US jurisprudence about how such long-term damage or liabilities should be allocated between insurer interests. Some states apply a pro-rata basis of allocation (so a loss or liability of $100m accumulating over 10 years equates to a claim of $10m against each policy year). Others impose joint and several liability between the insurance periods (a development of the so-called "continuous" or "triple trigger" principle, which first emerged in the context of asbestosis claims) with the result that any one year's insurer may be sued for the full amount of the liability, in this case covering a period of more than 40 years. The latter concept is quite alien to English law.

In the event, Alcoa's claim against Lexington was determined by the Washington State Court, which determined the policy to be subject to Pennsylvania law. It held Lexington to be liable for the entire period of loss, on a triple trigger basis. Lexington paid the claim and in turn sought an indemnity under its facultative reinsurance.

The reinsurance was written in the London market. The slip described the Form and Interest as "*as original*", and the Period as "*36 months [from] 1/7/77*". It was common ground that the reinsurance was an English law contract. Relying upon Vesta and subsequent cases. However, Lexington argued that the reinsurance was intended to be back-to-back, and that reinsurers were therefore bound to indemnify in accordance with the decision of the US court on the underlying policy, however repugnant that decision may appear from an English legal perspective.

11 [2009] UKHL 40
12 [1989] 2 AC 852
13 [2007] EWHC 896 (Com)

The trial Judge, Simon J. disagreed. Noting the Judgment of *Hobhouse LJ in Municipal Mutual v. Sea Insurance* [1998][14], namely that reinsurance is to be seen as distinct and independent from the underlying contract, the Judge's starting point was to look at the terms of the reinsurance contract, construed in accordance with its governing law (English law). If the loss objectively fell outside the period clause of the reinsurance, as construed under English law, there could be no indemnity, and that would be the end of the matter. The Judge added that it was in any case not obvious to the reinsurer that disputes under the policy would in fact be determined in the Washington State Court and/or in accordance with Pennsylvania law; neither were nominated expressly in the underlying policy. The matter might have gone before a different state court and/or by reference to a different state's law, with very different results. Moreover, in 1977 Pennsylvania law was still undeveloped in so far as concerns the question of allocation of long-term liabilities. At the time of entering into the contract the reinsurers could not have known which legal dictionary to reach for, and even if they had it would not have given them the answer. Accordingly, the Judge said, reinsurers must be taken to have contracted with the intention that such matters could only be determined by reference to English law, being the governing law of the reinsurance contract. Applying English law, there could be no liability for any losses other than those actually shown to have been incurred between 1977 and 1980.

The Court of Appeal Decision

The Commercial Court Judgment was overturned by the Court of Appeal in a decision handed down on 29 February 2008. The Judges in the Court of Appeal posed a different starting question: did the parties intend the period clause in the reinsurance to have the same meaning as that in the direct policy? Having concluded that they did, the reinsurers were bound by its legal effect, as determined by the Washington court. A contract of reinsurance was not a second contract on the same underlying subject matter; rather it was an agreement to indemnify the reinsured, Lexington, for its liability under the direct policy.

It was also irrelevant, said the Court of Appeal, that Pennsylvania law had not been expressly nominated as the governing law in the underlying policy; on the facts it was not unreasonable to suppose that Pennsylvania law *would* indeed be applicable, and it mattered not that Pennsylvania law had yet to crystallise its attitude to the whole question of long term liabilities by 1977. Ultimately, the law is what it is, whether it was revealed to be so by reported decisions before 1977, or subsequently. Indeed, even if it could be said that Pennsylvania law had actually changed between the date of the policy and the date of the claim, this was but a risk that insurers and reinsurers alike had agreed to accept. Accordingly, reinsurers were bound by the legal consequences of the contract contained in the direct policy, by reference to the governing law now found to be applicable to it, that is Pennsylvania law.

The House of Lords Decision

The House of Lords delivered its Judgment on 30 July 2009, unanimously reversing the decision of the Court of Appeal and reinstating the finding of the Commercial Court. The House of Lords held that the period clause in the reinsurance contract had to be given its ordinary meaning under English law, such that only loss and damage actually occurring during the specified three year period could be recovered. Accordingly, any claim paid, as here, merely on the basis of loss or damage spanning a period of 44 years, could not be recovered under the reinsurance.

Like the Commercial Court, the House of Lords was heavily influenced by the fact that the direct policy was silent as to its governing law. Contrary to the view of the Court of Appeal, it held that parties to the reinsurance contract could not have predicted, on the face of the direct policy, that Pennsylvania law would apply to it. Indeed, the decision of the Washington court in favour of Pennsylvania law had had little to do with this particular insurance contract at all; rather Pennsylvania was merely identified as the most common denominator across *all* of the policies spanning the relevant 44 period. It was "fanciful" to suppose that an American lawyer, asked in 1977 to identify the governing law of the Lexington policy in isolation, would have nominated Pennsylvania law. For its part, an English court would in fact have chosen the law of Massachusetts as being applicable. At any rate, at the time of the conclusion of the reinsurance contract there was "*no identifiable legal dictionary… still less a Pennsylvania legal dictionary*", and thus no basis for construing the contract of reinsurance "*in a manner different from its ordinary meaning in the London insurance market*". In this crucial respect, the case differed from the situation in *Vesta v. Butcher*.

14 [1998] Lloyd's Rep IR 421

This case is one with profound implications for the London and worldwide insurance markets. Following *Vesta v. Butcher*, and more recently *Groupama v. Catatumbo* [2001][15], many practitioners in the market had come to treat reinsurance contracts such as these in practical terms in much the same way as liability insurance (an approach endorsed expressly by Lord Justice Sedley in the Court of Appeal, if not by Lord Justice Longmore). Thus, where the reinsured was found liable to pay the direct claim by any court of competent jurisdiction, the reinsurer would be obliged to indemnify in turn. This litigation arose because that approach yielded such an extreme result, although even then it is notable that only 2.5% of the subscribing reinsurance market took the dispute to litigation. While acknowledging that there is "*much to be said for the view that in commercial reality reinsurance is liability insurance*", the House of Lords declined to embrace the idea, and has instead reaffirmed the traditional view. From the point of view of reinsureds, some careful re-drafting of reinsurance contract wordings may be in order.

Result: Judgment for reinsurers.

Actuarial modelling as proof of loss

Equitas Ltd v. R&Q Reinsurance Co (UK) Ltd
Equitas Ltd v. Ace European Group Ltd [2009]
Commercial Court, 11 November 2009

These actions concerned claims by Equitas (as assignee of the rights of 1992 and prior year Lloyd's underwriters) under various contracts of excess of loss retrocession written by the Defendants within the London Market Excess of Loss ("LMX") spiral.

The background to the dispute went back some 20 years, to the grounding of the "*Exxon Valdez*" in March 1989, and to the Iraqi invasion of Kuwait in August 1990, leading to the seizure of 15 aircraft belonging to Kuwait Airways, together with spares for the fleet, and the subsequent loss of a BA aircraft. The latter aircraft was destroyed, not in the course of the initial invasion, but rather during the later liberation of Kuwait by coalition forces in February 1991.

Initially, the Kuwait Airways and BA losses were presented to and paid by insurers and reinsurers within the LMX spiral as one event, with the date of loss being the date of the Iraqi invasion. The initial losses involved sums of approximately US$300 million, all of which were claimed and paid on an aggregated basis under a single cat code. The market continued to operate on this basis in relation to inwards and outwards claims for a period of about five years. However, from 1996 onwards the correctness of this approach came to be challenged by certain retrocessionnaires within the LMX spiral, at which point various participants stopped paying claims. The matter was eventually settled by the court in *Scott v. Copenhagen Re Co (UK) Ltd* [2003][16], in which the Court of Appeal held that the Kuwait Airways and BA losses in fact ought not to have been aggregated, as they arose from separate events.

In the meantime, matters were also unravelling in relation to the "*Exxon Valdez*" loss. Various losses having been paid by the market in the years immediately following the disaster, certain reinsurers began to challenge liability in the mid to late 1990s, most significantly in relation to a settlement of losses presented under Exxon's Global Corporate Excess ("GCE") Policy. Again the matters in dispute went to litigation, leading to a judgment of the Court of Appeal in *Commercial Union v. NRG* [1998][17] and subsequently in *King v. Brandywine Reinsurance Co.* [2005][18]. The net effect was that significant sums paid under the GCE Policy were subsequently found by the court not to be recoverable, and so ought not to have been included amongst the losses entering the LMX spiral.

15 [2001] LRLR 142
16 [2003] Lloyd's Rep IR 696
17 [1998] 2 Lloyd's Rep 600
18 [2005] 1 Lloyd's Rep 655

It was common ground in the present litigation that the LMX spiral was incapable of being reconstructed retrospectively, stripping out the irrecoverable or wrongly aggregated sums attributable to Exxon Valdez and the Iraq invasion respectively; the nature of the spiral was simply too complex to achieve that. So what was to be done?

Equitas sought to employ actuarial modelling techniques, to achieve what it believed to be the best approximation of the position as it would have been in the absence of the erroneous claims. In essence, the models employed discounts intended to eradicate the exaggeration in the UNLs. The Defendants for their part contended that this was simply not good enough; they referred in particular to the terms of the Loss Settlements Clause in the contracts of retrocession, by which settlements were to be binding upon them but only:

> "*providing such settlements are within the terms and conditions of the original policies and/or contracts ... and within the terms and conditions of this Reinsurance.*"

Relying upon the decision of the House of Lords in *Hill v. Mercantile & General Reinsurance Co Plc* [1996][19], they argued that the onus lay with Equitas actually to prove that the sums claimed were properly due, contract by contract, and by reference to the various attachment points and limits of each of the relevant reinsured syndicates. Since this could not now be done, there could be no liability.

Having reviewed the authorities, the Commercial Court found for Equitas. The Judge concluded that, while it was indeed a requirement of law that Equitas must satisfy both elements of the Loss Settlements Clause, a position made clear by the House of Lords in *Hill v. M&G*, it was not a requirement of law that this could only be done by actually proving each loss at each stage of the LMX spiral. Precisely how Equitas discharged its burden of proof was a matter of evidence, and the evidential standard it had to clear was the balance of probabilities. While accepting that actuarial modelling was complex and imperfect, and that in utilising upon such evidence it was "*plainly necessary to proceed with caution*", the Judge nevertheless held that this was still "*preferable to leaving the losses to lie crudely where they fall*". Having analysed the models used in some detail, he concluded that they offered an "*acceptable, soundly based route to establishing the properly recoverable minimum losses sustained by the syndicates, having regard to the applicable burden and standard of proof*". Accordingly, Equitas was entitled to declaratory relief in its favour.

Result: Judgement for the retrocecedants.

19 [1996] 1 WLR 1239

Excess Liability

Difference in conditions and "Drop Down"

Flexsys America LP v. XL Insurance Co Ltd [2009][20]
Commercial Court, 20 May 2009

The US claimant, Flexsys, was a manufacturer and distributor of various chemicals used in the rubber industry. It was insured for public and products liability under a local policy issued in Ohio by XL Select Insurance ("Select"). The local policy included coverage for "Personal and Advertising Injury", defined to include injury arising out of any publication of material which slanders or libels a person or organisation, or which disparages their products. The policy imposed a general aggregate $1m limit of liability for personal or advertising injury, and a sub-limit, again of $1m, in respect of such injury "sustained by any one person or organisation".

Above the prescribed local policy limits, Flexsys had recourse to a master policy protecting its Belgian parent company, Flexsys Holdings BV, and all group entities. The master policy was issued by the Defendant (XL) and was subject to a limit of indemnity of $25m any one event, and a sub-limit of $25m for product liability. The master policy also covered public and products liability in similar terms throughout, save that "Advertising Injury" appeared by way of a policy extension, and it was defined more narrowly than in the local policy, applying only to liability arising from the advertising of the insured's *own* products or services.

In April 2006, Flexsys and others were sued in California by Korea Kumo Petrochemical Company ("KKPC") alleging an unlawful conspiracy to monopolise the US market and to prevent KKPC competing against it. The litigation was successfully resisted by Flexsys at every stage, but in doing so it incurred some $2m in irrecoverable defence costs, for which it sought a policy indemnity. For its part, Select denied that the claim against Flexsys was one falling within the insuring clause of the local policy, but nevertheless entered into a without prejudice settlement of the policy claim, equivalent to the applicable limit of $1m.

Flexsys then sought to recover the balance of $1m from XL under the master policy, and at the same time it asked the English court for a declaration that XL must respond to any further potential liability to KKPC, up to its policy limit of $25m.

It was common ground that KKPC's claim against Flexsys fell outside the narrower definition of "Advertising Injury" as it appeared in the master policy. However, Flexsys sought to rely upon a drop down clause in the master policy, in the following form:

> "In the event of partial exhaustion of a local policy this Policy will pay in excess of the reduced underlying Limit of Indemnity. In the event of total exhaustion of a local Policy this Policy will continue in force as the underlying insurance subject to the terms Exceptions and Conditions of the particular local policy."

Flexsys argued that the master policy was obliged to drop down in accordance with the clause, and in doing so to assume all the terms and conditions of the local policy, even where these were in conflict with the master. So long as actual liability under the local policy could be shown, Flexsys argued, the master policy must follow.

The court held, firstly, that the reference to "partial exhaustion" in the first sentence of the drop down clause was designed to deal with the situation where the aggregate limit had been partially eroded by earlier claims. So, for example, two prior claims of $400,000 each would leave only $200,000 remaining on the underlying policy. In the event of a third loss, of say $10m, would the insured be expected to have suffered $1m (i.e. the local policy limit), of which $800,000 would be uninsured loss, before the master policy became engaged? The court held not. The concept of partial exhaustion was intended to bridge that gap.

However, the court also found that, whether the master policy became engaged upon partial or total exhaustion of the local cover, the fact remained that it could only be liable in accordance with its own terms and conditions. In this case, the wording of the master policy dealt specifically with the case where the insuring terms of the master were broader than those

20 [2009] EWHC 1115 (Comm)

in the local policy (the broader terms would prevail) but it said nothing about the reverse situation, as here. It was to be inferred that, ordinarily, the master policy would not respond in circumstances where a claim, although within the scope of the local policy, was outside the terms of the master.

In the present case, it having been accepted that the claim against Flexsys fell outside the definition of "Advertising Injury" in the master policy, the court held that the second sentence of the drop down clause did not change the position. The clause was not intended to bring about a "wholesale expansion of the cover" afforded by the master policy. To hold otherwise would be to render otiose the limitations appearing in the master policy, since the master policy would only ever be engaged when it was required to "drop down".

Having reached its decision in favour of XL on the meaning of the drop down provision, it became irrelevant whether KKPC's claim was one which actually fell within the wider terms of the local policy. Nevertheless, the court went on to consider the position as a matter of its own governing law (the law of Ohio) and concluded that there was in any event no such liability under the local policy.

Result: Judgment for the insurer.

Procedure

Joinder of insurers to proceedings between insured and brokers

Dunlop Haywards (DHL) Ltd & Ors v. Erinaceous Services Ltd & Ors [2009][21]
Court of Appeal, 28 April 2009
Commercial Court, 19 November 2009

The situation is not at all uncommon. An insured's policy claim is rejected, on the grounds that it falls outside the coverage terms arranged by the broker, in response to which the insured sues the broker for having failed to procure insurance on suitable terms. Frequently the broker will respond in its defence that the policy claim is in fact recoverable under the relevant terms, and that insurers' declinature is invalid. The result is that the insured may find himself litigating the merits of the policy claim with his own broker.

In this situation, the normal approach is to make the insurers a party to the litigation, either at the instigation of the insured or (less commonly) the broker, and thus all issues will be resolved between the interested parties in one set of proceedings. Furthermore, the loser in the litigation will usually be ordered to pay the costs of both of the other parties.

In the present case the insured (DH) carried on business as a property consultant, in which it undertook commercial property management, surveying and valuations. The brokers procured on behalf of DH a primary professional liability policy with a limit of £10m covering all of DH's activities, together with an excess policy providing coverage of £10m excess of £10m. The latter policy, however, was expressed to be limited to the "*assured's commercial property management activities only*".

DH faced a number of claims from clients alleging negligent and/or fraudulent valuations by an employee, which were duly notified to the primary and excess policies. The excess insurers denied liability on the grounds that the claims arose out of valuation work, not commercial property management. In response, DH sued its brokers for having failed to procure excess insurance on terms suitable to its business.

In this case, it was the defendant broker who wished to have excess insurers joined to the proceedings, but this could not be achieved by means of a Part 20 Notice because the brokers had no claim in their own right against the insurers. Instead, the brokers sought to have the excess insurers added under CPR 19.2(2), which permits any party to be added to litigation "*if it is desirable to add the new party so that the court can resolve all the matters in dispute in the proceedings*".

In the Commercial Court, Mr Justice Field rejected the broker's application under CPR 19.2(2) in a judgment delivered In April 2008. On the basis of the clear policy terms, he concluded that the merits of any claim against excess insurers were "so weak" that the insurers ought not to be put to the inconvenience and expense of becoming parties to the litigation at all. It was, in other words, not "desirable" to add the excess insurers as a party to this litigation, and if the holder of the right to those claims wished to do so, it could pursue them by way of separate proceedings.

In a decision handed down on 28 April 2009, the decision of the Commercial Court was overturned by the Court of Appeal. The Court of Appeal said the Judge was wrong to dismiss the merits of the policy claim on a summary basis, as he had done. There was at least a good arguable case that the policy terms were a mistake; that in fact the market had not intended to restrict coverage in the manner expressed in the excess policy, and that the wording required rectification. Even where one agreement, such as is expressed in a "held covered" endorsement or in the terms of a "firm order" was superseded by another, such as a slip, there could still be rectification of the later slip and policy to reflect the earlier agreement if in fact that remained the intention of the parties. In the present case, the Court of Appeal held that the case for rectification was not so weak as to render it not "desirable" to join the excess insurers under CPR 19.2(2). Accordingly, the excess insurers were to be joined.

The proceedings then returned to the Commercial Court for trial on the merits, upon which judgment was handed down on 19 November 2009. In the event, the Commercial Court rejected the rectification claim, finding that there was indeed no claim against the excess insurers under the terms of the policy. Accordingly, the brokers were at fault in having failed to

21 [2009] EWCA Civ 354; [2009] EWHC 2900 (Comm)

procure cover in accordance with their principals' requirements, and for which the court apportioned liability between the producing and placing brokers in the respective amounts of 80:20.

Result: Judgment for the insured against the brokers, and for the excess insurers on the policy claim.

Meaning of "Defendant" under the CMR

Emmerich Hatzl & Anor v. XL Insurance Co Ltd [2009][22]
Court of Appeal, 19 March 2009

Under article 31(1) of the Convention on the Contract for the International Carriage of Goods by Road (aka the "CMR") any legal proceedings arising out of a contract of carriage under the Convention may be brought in the courts of any contracting country by agreement between the parties or "in the courts or tribunals of a country within whose territory the defendant is ordinarily resident, or has his principal place of business".

This case concerned goods sent by an Austrian consignor ("TA") to its sister company in Italy, both insured by XL. The goods were entrusted to Hatzl, an Austrian road haulage company, but were stolen whilst their driver was asleep at a roadside parking place in northern Italy.

XL paid the policy claim in the normal way, and took an assignment from TA of its rights against Hatzl. When XL sought payment from Hatzl, however, the latter responded by issuing proceedings in the English court against XL for a declaration that it was not liable for the loss. In seeking to found the jurisdiction of the English court, Hatzl relied upon the fact that XL (not TA) was the Defendant to the claim it had issued. Since XL was ordinarily resident or had its principal place of business in England, the English court had jurisdiction to hear the matter, notwithstanding that the original parties to the contract of carriage had no connection with England at all. The trial Judge agreed, a decision from which XL appealed.

The Court of Appeal issued its judgment on 19 March 2009, reversing the Judge's decision. Applying a purposive approach to the language of the Convention, the Court of Appeal agreed with XL that Article 31(1) was not intended to apply to a defendant against whom a declaration of non-liability was sought simply in its capacity as an assignee of the rights of one of the original parties to the contract of carriage. The word "Defendant" in the Article was not to be understood in simply the procedural sense. It was intended to extend to the parties to the contract and probably also to others to whom the Convention had ascribed rights and duties, but not to an assignee, even if that assignee also happened to be one of the parties' insurers.

Result: Judgment on jurisdiction for the defendant insurers.

22 [1996] 1 WLR 1239

Law and Jurisdiction

Governing Law and Jurisdiction in reinsurance – revisited

Gard Marine & Energy v. (1) Lloyd Tunnicliffe; (2) Glacier Re & Anor [2009][23] Commercial Court, 9 October 2009

The Background

This was a case giving rise to issues of both jurisdiction and governing law under a contract (or contracts) of excess of loss reinsurance issued by the Defendants, to the Claimant ("Gard"), a reinsured domiciled in Bermuda.

The reinsurance was arranged under two separate placements. An order for 7.5% of the whole was placed by way of a London market slip, to which various Lloyd's syndicates subscribed. A separate slip, for 5% of whole, was placed with the second Defendant, Glacier Re ("Glacier") a company domiciled in Switzerland.

A dispute emerged under the reinsurance between Gard and certain of the subscribing reinsurers, specifically under the Sum Insured clause and the application of the policy deductible. Glacier paid a proportion of the amount claimed against it, on the basis of its own calculation of how the deductible should apply, although it subsequently developed its case to argue that no sums were in fact due at all, and accordingly sought to recover the sum it had paid.

In March 2007, Gard issued the English proceedings against the reinsurers then in dispute, namely three Lloyd's syndicates and Glacier. The proceedings were served on Glacier in June 2007, by which time Glacier had itself issued competing proceedings against Gard in the Swiss court, for recovery of the amount it had already paid. Subsequently the Swiss court declined jurisdiction over those proceedings, on the ground that the Defendant, Gard, was not domiciled in Switzerland. At that point, the English court was asked to rule upon its own jurisdiction and as to issues of governing law.

Applicable Law

Dealing with applicable law first, the English court noted that it was obliged to apply the principles of the Rome Convention[24]. Article 3 of the Convention provides that a contract is to be governed by the law chosen by the parties. Such a choice may be express or it may be "*demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case.*" The 1980 report of Professors Giuliano & Lagarde, a guiding text which accompanies the Convention, offers examples of where this may be so, including where the contract is in a standard form known to be governed by a particular system of law "*such as a Lloyd's policy of marine insurance...*"

If no choice can be discerned at all, either expressly or by implication as above, then generally the contract will be subject to the law of the place of business of the "characteristic" performer of the contract (Art 4(2)), which in the case of reinsurance is taken to be that of the reinsurer[25].

23 [2009] EWHC 2388 (Comm)

24 Recently superseded by the Rome I Regulation, to which see later

25 *Dornoch v. Mauritius Union Assurance* [2006] 1 Lloyd's IR 786

In the present case, the court concluded that there was a good arguable case in favour of English law, in preference to Swiss, on four grounds:

(1) The contract with Glacier was not, in truth, a Swiss market placement. It was a London market placement in which Glacier had merely been invited to participate. The risk was placed by London brokers who had offered Glacier a share of an existing reinsurance programme, expressly to make up for capacity constraints faced by the existing participants. The fact that the Glacier participation was recorded under a separate order did not detract from this fact;

(2) The use of a Lloyd's slip and policy pointed towards English law, applying the reasoning in Giuliano & Lagarde;

(3) The slip specifically incorporated a number of London market wordings, such as LSW196A, CL 356A, CL 365 and LSW 1001. This had previously been held persuasive in favour of an implied choice of English law.[26]

(4) The slip adopted a number of formulations and turns of phrase recognisable to English law, such as the form of Notice of Cancellation or the provision "*Subject to all terms, clauses, conditions as Original and to follow the original in every respect...*". In the Aegis case the judge had considered this to be "*terminology which associates it with the law of England*".

Accordingly, the "characteristic performer" test under Art 4(2) of the Convention (which in this case would have pointed to Swiss law) did not come into play.

Jurisdiction

Matters of jurisdiction as between England and Switzerland are subject to the Lugano Convention. The default position under the Lugano Convention (Art 2) is that a defendant should be sued only in his own domicile, such that in this case Glacier could only be sued in Switzerland.

There are, however, a number of specific derogations from this position, and in this case Gard relied upon two of them, in the alternative.

The Article 5(1) Argument

Under Art 5(1) of the Convention, which deals with contractual obligations, a party in a Contracting State (e.g. Switzerland) may be sued in another Contracting State (e.g.. England), if the latter is "*the place of performance of the obligation in question*".

As a matter of English law, however, the actual place of performance of an obligation to pay money is taken to be the place where the creditor (i.e. Gard) resides, in this case Bermuda. On this basis, there would be no "place of performance" within a Contracting State, since the required place of performance was actually Bermuda. Accordingly, so argued Glacier, Art 5(1) could not apply. The court agreed. It dismissed Gard's argument that, as a matter of practice, the debtor's obligation here was to pay money to the brokers in London, rather than (on the orthodox analysis) to seek out its creditor in Bermuda. Thus, Gard's argument in favour of English jurisdiction under Art 5(1) failed.

The Article 6(1) Argument

Under Art 6(1), the Lugano Convention also provides that where (as here) the Defendant is one of a number of defendants, he may be sued "*in the courts for the place where any one of them is domiciled*".

The purpose of Art 6(1) is of course to avoid the risk of contradictory judgments in different jurisdictions, but it will only apply where the claims against the various defendants are so closely connected that it is expedient to hear and determine them together in the interests of avoiding irreconcilable judgments.[27] Such irreconcilability may arise from potential conflicting findings of fact or from potential conflicting decisions on questions of law[28].

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26 *Gan v. Tai Ping* [1999] Lloyd's Rep IR 229 (CA); *Aegis v. Continental Casualty* (11 May 2006)

27 *Kalfelis v. Schroeder, Muenchmeyer, Hengst & Co* [1988] ECR 5565

28 *Gascoine v. Pyrah* [1994] IL Pr 82

Glacier contended that there was no such risk in this case. Although the two slips shared common provisions, they were separate and contained distinct annotations. The claims also concerned different facts, in that exchanges were relied upon between the brokers and the London market reinsurers that were not relevant to Glacier's position.

On this point, the court agreed with Gard and rejected the position of Glacier. There was a good arguable case that, by declining English jurisdiction over the claim against Glacier (and so forcing Gard to sue Glacier in Switzerland) irreconcilable judgments would be reached between the English litigation and that in Switzerland. Both claims turned on the proper construction of the Sum Insured clause in the reinsurances. That clause was in precisely the same terms in both contracts, which contracts were placed as part of a common reinsurance programme. Further, the issue of construction fell to be determined under English law. There was no material difference between the terms of the two contracts, so the court held, and so the legal issue to be determined in both cases was the same.

The court also noted that Gard was pursuing an alternative claim in the same litigation against its broker, a claim contingent upon the outcome of the claim on the reinsurance. This made the consequence of differing judgments particularly serious. If, for example, Gard's claim against Glacier failed in Switzerland but its contingent claim against the broker was being pursued in England, what would happen if the English Court reached a different conclusion on the issue of construction? The claim against the broker might then fail, leaving Gard to "fall between two jurisdictional stools".

Accordingly, the English court confirmed jurisdiction over Gard's claims against both the London market syndicates and Glacier, as well as the contingent claim against the broker.

European anti-suit injunctions – the door closes

Allianz SpA & Ors v. West Tankers Inc (the "FRONT CONNOR") [2009][29]
Court of Justice of the European Communities, 10 February 2009

Anti-suit injunctions are a commonly used tool in re/insurance litigation. The paradigm example sees a London re/insurer sued by an insured or reinsured in the courts of (say) Texas, in defiance of an exclusive English jurisdiction clause, to which the re/insurer will respond with an application for an injunction from the English court.

The legal effect of the anti-suit injunction is frequently misunderstood; the order is intended to injunct the litigant, not the foreign court. Nevertheless, anti-suit injunctions are often viewed with suspicion by foreign courts, who consider them an improper invasion into their administration of justice by the English court. Some jurisdictions, most notably France, have never granted anti-suit relief.

Within Europe in particular, the anti-suit injunction has increasingly been seen as an affront to the idea that the courts of each European state are equally well-equipped to apply what have become largely harmonised rules on the allocation of jurisdiction between them. Consequently, under the terms of EU Regulation 44/2001, the courts of member states of the European Union are now prohibited from issuing injunctions to restrain proceedings already commenced in the courts of another member state. In the case of *Gasser GmbH v. MISAT Srl* [2003][30], the European Court of Justice held that this would be true even where the first proceedings had been brought in defiance of an exclusive jurisdiction clause, and similarly even where a litigant had deliberately (i.e. in bad faith) issued proceedings in a member state court other than that stipulated (*Turner v. Grovit* [2004])[31].

What remained unclear until recently was the position of arbitration clauses, because arbitration is excluded from the scope of the Regulation. Could an English court still issue an injunction restraining a party from pursuing a claim in Italy in defiance of a contractual provision referring the matter to arbitration in England? That was the question for consideration in the case of *Allianz v. West Tankers*.Body

29 Case C-185/07; [2009] WLR (D) 44

30 Case C-116/02; [2004] 3 WLR 1070

31 Case C-159/02; [2002] 1 WLR 107

In a provisional opinion issued in February 2007, the House of Lords took the view that the court still retained the power to order injunctions in support of arbitration; Lord Hoffman noted that arbitration fell outside the system of allocation of court jurisdiction created by the Regulation and that there was nothing inconsistent with the Regulation for a party to protect, by force of an injunction, its express contractual right to have a dispute determined by way of arbitration. Nevertheless, the House of Lords conceded that the point was one upon which judges and academics in various States had expressed conflicting views, and so it referred the matter for determination by the European Court of Justice.

On 4 September 2008, the Advocate-General Kokott delivered her opinion on the matter. Contrary to the position taken by the House of Lords, her view was that the Regulation does indeed preclude the courts of a member state from issuing an anti-suit injunction in support of arbitration, in much the same way as court jurisdiction. The crucial question, she said, was whether the proceedings sought to be injuncted themselves fell within the Regulation. If they did, then it was for the court seised of those proceedings (in this case the Italian court) to determine if they should be stayed in favour of some other forum, whether that be arbitration or court litigation, in another member state. The court delivered its judgment on 10 February 2009, adopting the opinion of the Advocate General, and formally confirming that the Regulation does indeed prohibit member state courts from issuing anti-suit injunctions in favour of arbitration.

The decision is a controversial one, particularly among commentators in England, where the anti-suit concept is most developed. While the ECJ ruling does not affect the ability of the English court to issue anti-suit injunctions in restraint of proceedings brought outside Europe, it closes the door on anti-suit as a tool against competing litigation in other EU jurisdictions. To that extent, it threatens to put England at a disadvantage relative to common law jurisdictions outside the European Union, notably New York and Bermuda, where the courts remain unaffected by the Regulation.

Rome I Regulation comes into force

Regulation 593/2008 on the Law Applicable to Contractual Obligations (the "Rome I Regulation")

In force: 17 December 2009

Contracts of insurance and reinsurance entered into prior to 17 December 2009, were subject to two separate choice of law regimes[32]. On the one hand, direct insurance contracts covering risks situated outside the EU, together with all reinsurance contracts (whether inside or outside the EU) were governed by the Rome Convention of 1980, as implemented in England by the Contracts (Applicable Law) Act 1990. By contrast, choice of law issues in direct insurance covering risks situated within the EU were governed by a series of EU Directives, latterly made part of English law by regulations under the Financial Services and Markets Act 2000.

As a broad rule of thumb, the Rome Convention preserved the right of party choice, as had been the position under the prior common law, whereas governing law was more heavily regulated under the Directives, the primary intention being to offer protection to consumers. Nevertheless, there was much criticism of the existing regime, not only because of the inherent inconvenience of having to refer to two separate sources of law, but also because, in the case of direct insurance, the crucial question was where the risk was "situated", a test that was not always easy to apply. In particular, questions would arise in the case of an EU risk underwritten by a non-EU insurer, or where a risk was partly inside and partly outside the EU.

The Rome I Regulation, which came into force in respect of all contracts entered into from 17 December 2009, represents an attempt to resolve some of these issues, while at the same time bringing the two separate choice of law regimes back under one roof.

32 That is, in the English courts and those of other EU member states

Direct Insurance

The default provisions under the Regulation appear at Article 3, essentially replicating the freedom of party choice previously enshrined in the Rome Convention. However, the Regulation then goes on to make specific provision for various different types of contract. In the case of insurance these appear at Article 7, which applies to most insurance contracts "*whether or not the risk covered is situated within a Member State*". On the face of if, therefore, the previous distinction between risks inside and those outside the EU has been removed. In its place, the Regulation draws a distinction between "large" risks and the rest. So long as a risk qualifies as "large", whether situated within the EU or not, it will be subject to the default regime at Article 3, that is to say freedom of party choice. For these purposes, all insurance covering aircraft, railway stock, ships and goods in transit are considered "large", whatever the actual values involved. In other cases, a risk will be large where the insured's balance sheet or turnover exceeds a certain level, or if it satisfies a minimum employee headcount.

In practice, most commercial insurance contracts will qualify as "large" risks, and as such the parties will be left free to choose the governing law. In these cases, it is no longer necessary to enquire into the location of the risk. To this extent, therefore, the Rome I Regulation represents a welcome simplification of the former position.

However, if a risk fails to qualify as "large", then the question of location of the risk comes back into play. Non-large risks situated *outside* the EU are subject to the Article 3 regime, as with large risks. By contrast, non-large risks situated *within* the EU are subject to more restrictive provisions. In such cases, the parties remain free to choose the governing law by virtue of their contract, but they are limited to a menu of available governing laws. They may, for example, choose the law of the Member State where the risk is situated, or the law of the policyholder's residence. They may not, however, choose the law of the place of business of the insurer. If they fail to make a choice at all, then once again it is the "*law of the Member state in which the risk is situated*" that governs.

In what appears to be an attempt to overcome some of the problems identified with the former regime, the Regulation provides that, where a contract of insurance covers more than one risk, including a risk within a Member state and a risk in a third country, the special provisions on insurance apply only to the particular risk(s) located within the Member State and not to the whole contract[33]; in other words, insurance contracts are to be treated as severable between the EU located risk and that located outside the EU. This still does not assist, however, in the situation where a single risk spans more than one jurisdiction, one or more of which is outside the EU.

Reinsurance

Article 7 expressly does not apply to reinsurance. Instead, reinsurance falls within the default provisions of Article 3, again preserving the freedom of choice found under the Rome Convention. While some of the terminology used in the Convention has been amended slightly in the Regulation, the changes are unlikely to be significant. Where, for example, the Convention previously looked for an express choice of law, failing which a choice "*demonstrated with reasonable certainty*", the Regulation now calls for a choice to be "*clearly demonstrated*". Whether there is much to be made of this distinction remains to be seen, but either way the same default rules apply; in the absence of choice the contract will be governed by the law of the place of the "service provider", which the English courts are likely to continue to treat as that of the reinsurer[34].

33 Recital 33

34 Having held previously that the reinsurer is the "characteristic" performer of a reinsurance contract (*Dornoch v. Mauritius Union* [2006] 1 Lloyd's IR 786)

Other Developments

D&O Insurance in Germany – The New Legislation Arrives

Unlike in many jurisdictions, directors and officers' liability insurance is not compulsory under German law. Nevertheless, D&O coverage is expected as a matter of good practice, as set out in the German "Corporate Governance Kodex" ("the Code"). Furthermore, the Code has for some time recommended that listed companies agree in their D&O policies upon an "adequate" deductible to be borne personally by the directors protected by the policy. By imposing a personal interest on the part of the directors concerned, it was sought to motivate them to avoid claims arising, although the question of what constituted an "adequate" deductible has remained vague.

In practice, many German companies has circumvented the requirements altogether, relying upon a standard form of derogation from the Code in their annual filings, with a statement that a deductible "*would not improve the consciousness of responsibility*" of their directors, or otherwise motivate them to avoid damage arising.

The German Legislature has now acted to put a stop to this practice for directors of German stock corporations. Following a period of debate in the *Bundestag* the new Act on the Adequacy of Managerial Salaries (*Gesetz zur Angemessenheit der Vorstandsvergütung - VorstAG*) was passed on 18 June 2009. The new provisions came into force on 10 July 2009.

The Act amends section 93 II 3 of the German Stock Corporation Act (*Aktiengesetz – AktG*), and requires that listed companies purchasing D&O insurance for their executives must impose a personal deductible to be borne by the directors of at least 10% of a loss up to an annual maximum deductible calculated by reference to the fixed remuneration of the director from time to time. Practical guidance is to be found in the accompanying Reasons (*Begründung, BT-Drs 16/13433*) issued by the legislator, which states that the required personal deductible shall consist of at least 10% of *each loss*, subject to an absolute annual cap which must be set at not less than one and a half times the annual fixed remuneration of the director. The aggregate cap is to be reviewed annually to reflect movements in the fixed element of the director's remuneration.

The requirements are applicable to all stock corporations, whether in fact listed or privately owned, although, under Germany's two tier system of corporate governance for such companies, only members of the board of directors (*Vorstandsmitglied*) are affected, and not supervisory board members (*Aufsichtsratsmitglied*).

The provisions were applied with immediate effect to all newly concluded D&O insurance contracts, while those already in existence were amended with effect from 1 July 2010. There is a transitional exception in the case of those companies already obliged under existing service contracts to provide D&O insurance cover to the director without deductible. In those cases, the policy terms may remain unchanged until the appointment of the director and the underlying service agreement expire. The statutory maximum appointment term of a board member is five years.

Interestingly, the legislation does not prohibit directors from insuring their deductible exposure separately, leading to speculation that the reforms will simply give birth to a new class of business in D&O deductible insurance. While responsibility for the premiums for such a product would have to be borne privately by the directors, there is nothing to prevent them seeking a commensurate uplift in their remuneration to cover the outlay. Furthermore, any obligation to disclose such an arrangement in corporate filings would require an amendment to the Code as it stands.

At the same time, the new Act on the Adequacy of Managerial Salaries also brings about an amendment to section 87 I AktG, which will now oblige the supervisory board members to ensure that the total remuneration of members of the board of directors is in adequate relationship to their tasks and performance, and the performance of the relevant company. It requires that the usual ("*üblich*") remuneration of a director is not to be exceeded without specific reasons. Furthermore, in the case of listed stock corporations, the directors' remuneration has to be consistent with the sustained ("*nachhaltig*") development of the company, and performance elements of directors' remuneration are to be assessed on the basis of several years, up to the entire term of appointment. Short term performance measures are no longer acceptable. The new provisions also stipulate that the responsibilities of the supervisory board with respect to directors' remuneration may not be delegated to the general meeting.

The new remuneration and D&O provisions expressly *do not* apply to a private Limited Liability Company (*GmbH*).

ECJ Decision on (Re)Insurance Portfolio Transfers Subject to VAT

Swiss Re Germany Holding v. Finanzamt München für Körperschaften [2009] Court of Justice of the European Communities, 22 October 2009

On 22 October 2009 the European Court of Justice (ECJ) delivered judgment in the above case, concerning the VAT treatment of portfolio transfers of both primary and reinsurance business[35], a case that came before the ECJ upon referral from the German Federal Tax Court (BFH).

The background to the case was this: in 2002, the former Swiss Re Germany Holding GmbH transferred 195 reinsurance contracts to an affiliated company within the Swiss Re group situated in Zurich, Switzerland, and received in return the payment of a single purchase price. Of the transferred reinsurance contracts, some 18 were assessed as having a negative value, thereby reducing the net agreed purchase price.

This being reinsurance business, the policy holders of the transferred contracts were themselves insurance companies, all of them located outside Germany, both in other EU member states and in non-member countries. They each gave their consent to the transfer. Upon execution of the transfer, however, the local Munich tax authorities determined the transfer to constitute a taxable supply of goods, applying a former decision of the BFH. Having appealed against the decision unsuccessfully to the Munich local tax court, Swiss Re filed an action with the BFH.

For its part, the BFH also took the view that a reinsurance portfolio transfer was a taxable supply, albeit a supply of services (not goods), and in the present case it held that the place of supply was Germany, the place of business of the transferor. Since no VAT exemption applied, it considered that, as a matter of German law, VAT should be charged in Germany. However, the BFH also wished to clarify whether this interpretation would violate the Sixth EU Council Directive 77/388/EEC (Sixth Council Directive) and accordingly it submitted a preliminary reference to the ECJ seeking its ruling on the following main points:

- Are such portfolio transfers to be regarded as a "supply of services" or a "supply of goods", (since a different VAT regime applies to each)?
- If a portfolio transfer is to be regarded as a supply of services, does it constitute a "banking financial or insurance transaction" (if so, the service would be exempt from VAT under Art 13B of the Directive)?
- Is the transferee to be regarded as a service *supplier* in relation to the acquisition of those reinsurance contracts carrying a negative value and if so what difference (if any) does this make in respect of VAT obligations?

In considering the above matters, the ECJ held firstly that portfolio transfers of insurance and reinsurance business constituted a taxable supply of services, not goods, since the latter required the transfer of tangible property. The court also declined to classify the transfer as a "banking financial or insurance transaction" and hence it held that the transaction could not, in principle, enjoy the attendant VAT exemptions under Art 13B. Whether or not the relevant VAT will be deductible or refunded as input VAT depends on the particular circumstances of the case.

The ECJ also refused to qualify the portfolio transfer as two separate transactions (i.e. the first concerning the obligations assumed by the transferee to policy holders and the second concerning the transferee's right to collect future reinsurance premiums from the policy holders). The separation of a single transaction into two separate service elements to which different VAT treatments would apply was, in the court's view, an artificial construction.

Finally, on the question of the 18 contracts with a negative value, the ECJ declined to segregate those contracts from the remainder of the portfolio. While it may be true that, commercially, the transferor was paying the transferee an agreed sum of money to assume those particular contracts, the fact remained that the parties had agreed upon a total purchase price for the transfer of a single portfolio. Accordingly, the transferor was the supplier of all of the contracts for VAT purposes, and the attendant VAT was payable upon the overall net price agreed.

35 Case C-242/08

This ECJ ruling will have major consequences for insurance and reinsurance portfolio transfers in the future. The court confirmed that insurance and reinsurance portfolio transfers are in general subject to VAT. This should not only apply to future transactions, but also to past transfers that have not yet been finally assessed by the competent national tax authorities. Furthermore, if the transferee performs only VAT-exempt insurance services, it will not be eligible for VAT input deduction or VAT refund, with the result that the VAT imposed on portfolio transfers will effectively increase the purchase price of the portfolio.

As an aside from the ECJ ruling, it should also be noted that changes to the VAT system within EU member states are due to come into force in 2010. Those changes may well lead to a reverse charge of VAT (that is, the transferee becoming liable for VAT in its home country). Whether or not the VAT charge is deductible would then depend on the individual VAT status of the transferee, rather than the transferor. This may well give rise to structuring opportunities to avoid a VAT charge, particularly with intra-group transactions. Clearly, as the VAT solution will determine the deal structure this should be analysed at a very early stage.

As a final word of warning, manipulation of the purchase price for tax reasons (to reduce or mitigate the VAT basis) should not be considered a suitable solution. As a rule of thumb, the agreed purchase price must be one reached at arm's length. In cases of intra group transactions especially, the agreed purchase price will come under the close scrutiny of the relevant tax authorities to ensure it represents the fair market value.

Court sanctions transfer of insurance business from Lloyd's names

In Re Equitas
In the Matter of Names at Lloyd's for the 1992 and Prior Years of Account [2002][36]
Chancery Division, 7 July 2009

This matter concerned an application by Equitas Ltd, and others, for an order of the court approving a Part VII transfer of the insurance business of Lloyd's names for the 1992 and prior years of account to Equitas Insurance Ltd.

As the Judge noted, the proposal was intended to bring finality to the Reconstruction and Renewal process implemented by Lloyd's 1996, in the wake of huge losses suffered, principally, in connection with asbestos and pollution liabilities. Essentially R&R separated the 1992 and prior year business from the continuing business conducted at Lloyd's, and it provided names with reinsurance to close (RITC) in respect of their liabilities for the 1992 and prior business, thereby enabling names with no other open years of account remaining to resign their membership of Lloyd's. The RITC protection was underwritten by Equitas Reinsurance Ltd, either directly or (in the case of certain business and/or certain syndicates) via retrocession. In each case, the liabilities were in turn retroceded to Equitas Ltd.

In November 2006, following a corporate acquisition by Berkshire Hathaway Inc, the liabilities of Equitas Ltd were further retroceded to National Indemnity Company of Nebraska, a Berkshire Hathaway entity. Meanwhile, the operational functions of Equitas were delegated to Equitas Management Services Ltd, soon to be renamed Resolute Management Services Ltd.

While in practical terms this scheme was intended to create economic finality for names with respect to their pre-1993 liabilities, what it did not achieve was a transfer (that is, a novation) of the names' liability to policyholders under the original contracts. At the time that the R&R process was implemented, no statutory mechanism existed to bring this about, with the result that the names retained contractual liability to policyholders, and hence the residual exposure should the assets of Equitas Ltd be insufficient to meet its RITC liabilities.

Such a scheme is, however, now possible under Part VII of the Act, with the approval of the court. Accordingly, the application in this case sought finally to transfer the underlying business, with the end of substituting Equitas Insurance Ltd as the insurer (or reinsurer) under the original policies in place of the names.

36 [2009] EWHC 1595 (Ch)

While the proposal was opposed, the Judge granted the application, having been satisfied upon a report of an FSA approved expert that it would not operate to the disadvantage of any interested parties.

Interestingly, one of the grounds of objection was raised by Mr Stephen Merrett, former active underwriter of the eponymous syndicates 418 and 421, and a former Deputy Chairman of Lloyd's. He argued that various statements emanating from Lloyd's over the years had encouraged him, and others, in the belief that RITC in fact operated to absolve names from further liability to policyholders, in that the liability was novated to the reinsurers. The present scheme, he argued, was founded on the assumption that this was not so but that, on the contrary, the names in question had remained liable in law all along. Unless the true status of RITC was definitively established, there could be no certainty that the proposed scheme would work as intended.

The court rejected this objection, noting that the same argument had in effect been raised and dismissed by the Commercial Court in the previous case of *Harris v. Society of Lloyd's* [2008][37]. The court affirmed once again that RITC is, as its name suggests, a contract of reinsurance and nothing more. Moreover, nothing had ever been said by Lloyd's to cause names to believe otherwise.

Result: Application granted.

37 [2008] EWHC 1433 (Comm)

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