Legal briefing

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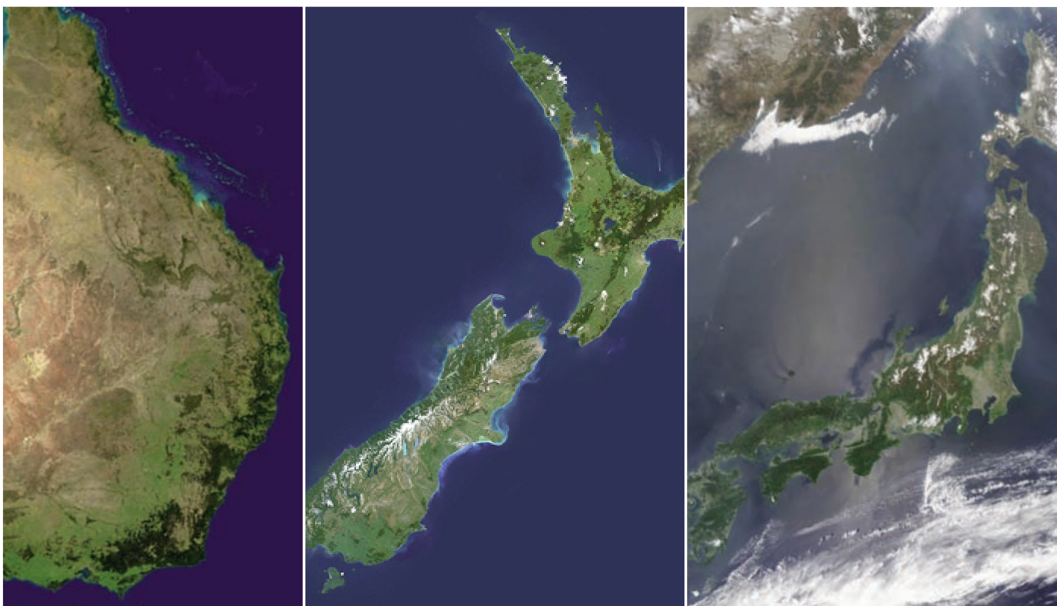
Catastrophe losses
Legal issues under contracts of reinsurance



Introduction

This briefing note addresses some of the potential reinsurance issues under English law, which might arise when a reinsured seeks payment of or a reinsurer is asked to pay claims relating to catastrophe losses. It is important to emphasise that reinsurance wordings are not uniform. Detailed examination of each reinsurance contract wording is to be advised when considering claims coverage.

Does your reinsurance wording cover the losses being claimed?

Cedants and Reinsurers will both need to consider carefully the full wording of their policies to establish not only that the claim falls within the risks covered by the reinsurance but also that the losses claimed are not otherwise expressly excluded. There will inevitably be issues as to the nature of losses being claimed within certain classes of business eg to what extent will a cedant be entitled to recover non-marine losses under a marine reinsurance contract. Cedants will need to ensure their claims presentations fall within the terms of coverage and that they are fully aware of and comply with any loss notification provisions, and claims co-operation or control clauses or other procedural requirements.

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‘Back to back’ cover

In certain cases, a reinsurer will write reinsurance on identical terms to the underlying insurance and the contract will incorporate a full reinsurance and ‘follow the settlements’ clause. Where a reinsurance contains such wording, it is not generally open to one of the parties to argue that a different meaning should be attributed to any of the clauses in the reinsurance so that the reinsurer’s liability under the reinsurance will differ to the reinsured’s liability under the underlying insurance. A court will look to see whether the parties intended the same wording to have the same meaning. If so, the meaning of the clause in the underlying will be applied to the similar clause in the reinsurance, even where the contracts might be governed by different systems of law.[1] Some “fundamental” clauses – such as a period clause in the reinsurance – will be strictly interpreted as a matter of English law, even if the effect is to remove back to back cover. Whether the governing laws of the insurance and reinsurance contracts are clear will be important in this interpretation.

What is the cause of the loss being claimed?

The underlying cause of losses being claimed under reinsurance programmes will be particularly relevant to some types of reinsurance depending on whether or not they contain a ‘follow the settlements’ clause and, if so, which type of clause (see below). The purpose of a ‘follow the settlements’ provision is primarily to relieve the reinsured of an evidential burden to prove that a loss was covered under the original insurance.

If however, a reinsured is required to prove its original loss, the legal test for it doing so will depend on the law of the original insurance. The general principle which will apply in competent jurisdictions, including the US and England, is that the original insured is entitled to recover only the loss which is caused by an event covered by the terms of the original insurance contract. In English law the doctrine of ‘proximate cause’ applies, sometimes referred to as the ‘dominant or effective or operative cause’. There can be more than one ‘proximate cause’[2] and there has to be an element of inevitability in the insured peril causing the particular loss.[3,4]

Causation is likely to be an issue for original insurers in circumstances where it could be argued that losses were caused by more than one event eg earthquake damage, flood damage caused by tsunamis and damage caused by fires and explosions. The law of ‘proximate cause’ varies in different jurisdictions.

Reinsurers will wish to analyse the underlying cause(s) of loss in order to establish whether claims are properly covered by the original policies.

Does the reinsurer have to follow the settlements of its reinsured?

Where a reinsurance contract contains a ‘follow the settlements’ clause, the reinsurer will be obliged to meet claims arising from the reinsured’s settlements provided the following criteria are satisfied:

- First, the claim must fall within the particular risks covered by the policy of reinsurance as a matter of English law;
- Second, the reinsured must have acted honestly, and taken all proper and businesslike steps, in making its settlement of underlying claims.[5]

The second criterion will be satisfied where the reinsured can show that it genuinely believed it was liable for the claim (whether or not ultimately it was) and acted reasonably in reaching that conclusion. A failure by a reinsured to raise good defences available to it on an original claim can be evidence that a settlement of such claims was not carried out in a businesslike manner.

The first criterion depends upon whether the reinsurance is back-to-back with the original policy. Where it is not, a reinsurer will always be entitled to rely on the terms of the reinsurance in determining whether the claim is covered. However, where it is truly back to back with the original policy, the first criterion will be automatically satisfied where the second is satisfied, ie where the reinsured has settled a claim on the basis it falls within the original policy and has acted reasonably and taken all proper and business like steps in doing so.

In circumstances where the reinsurance contract is not back-to-back with the original policy, the reinsurer will also be entitled to question the factual basis of the underlying settlement in order to establish whether the loss fell within the terms of the reinsurance.[6]

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What effect does 'ex gratia' or 'to follow without question' wording have on the 'follow the settlements' clause?

Settlements of original claims, which do not fall within the terms of the original cover, are said to be 'ex gratia' settlements. They are commercial settlements, made in the absence of a legal liability to pay specific losses. "Ex gratia" payments which are knowingly made by a reinsured, are not recoverable under a reinsurance contract with a 'follow the settlements' clause unless there is specific wording.[7]

True 'ex gratia' payments should be distinguished from payments made which are said to be 'ex gratia' but, in fact, are agreed pursuant to a genuine risk of liability. The latter would be recoverable under a 'follow the settlements' clause provided liability under the original policy could be shown (or arguably shown) in respect of the claim so recognised in the settlement.

'Without question' wording in a 'follow the settlements' clause still requires the reinsured to make an honest, proper and businesslike settlement as a precondition to recovery under his reinsurance.[8]

What is the extent of the reinsured's obligation in the absence of a 'follow the settlements' clause?

In the absence of a 'follow the settlements' clause in a reinsurance contract, for a claim to be recoverable, the reinsured must show that the claim falls within both the terms of the original insurance and those of the reinsurance.[9] If a settlement of original claims has been made, it is open to reinsurers to challenge the reinsured's liability under the original policy (see comments on 'proximate cause' above). This can involve a detailed re-examination of the legal and factual arguments on which the reinsured based his original settlement including, where necessary, an assessment by the English court as to the application of foreign law.[10]

The standard terms and conditions under which the London Excess of Loss market commonly contracts are the Joint Excess of Loss Committee Clauses. These clauses do not contain a 'follow the settlements' clause but state that it is a condition precedent to liability under the reinsurance that any settlement of original claims must be within the terms and conditions of the original policy.

Other similar 'loss settlements' clauses expressly state the double obligation of the reinsured to show liability under both the terms of original policy and the reinsurance.[11] A wording which states the obligation of the reinsurer 'to pay as may be paid thereon' still obliges the reinsured to prove its liability under the original policy. However, it will not have to prove the quantum of that liability provided it has taken proper and businesslike steps to ascertain the amount fairly.[12]

Is a reinsurer obliged to follow a judgment entered against a reinsured?

English law implies a term into reinsurances that the reinsurer must treat the judgment of a foreign court on the reinsured's original liability as 'decisive and binding' for the purposes of recovery under a reinsurance, except in specific and limited circumstances.

The circumstances under which the English court would look to re-open the decision of a foreign court which had decided the liability of the reinsured under its underlying contract are rare. The limits to the recognition of the foreign court's decision have been defined as follows:[13]

- That the foreign court should in the eyes of the English court be a court of competent jurisdiction;
- That the judgment should not have been obtained in the foreign court in breach of an exclusive jurisdiction clause or other clause by which the original insured was contractually excluded from proceeding in that court;
- That the reinsured took all proper defences;
- That the judgment was not manifestly perverse.

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Does the reinsured's underlying settlement of claims properly demonstrate his liability?

A reinsured must take care in settling claims and have in mind any relevant reinsurance protections when doing so. Reinsurers should look carefully at a reinsured's settlement with its insureds, if it purports to settle numerous claims and counterclaims which have not been individually quantified in the settlement agreement. Such 'global settlements' of claims can give rise to a dispute as to a reinsurer's liability to indemnify a reinsured in circumstances where the reinsured's liability to its insured has not been properly ascertained.[14]

What is the effect of a claims co-operation clause in reinsurance contracts?

Without a claims co-operation clause there is no specific entitlement of a reinsurer to be consulted in or be involved with the settlement of an original claim by a reinsured. In practice, however, prudence would dictate that a reinsured should keep his reinsurers informed at all stages of negotiation and settlement of large claims for which reinsurance recovery will be sought.

The nature of the reinsured's obligation under a claims co-operation clause depends on its precise wording. It is common for such clauses to be described as conditions precedent, the settlement of any claim being predicated upon the prior approval of reinsurers. Provided the wording is sufficiently clear to indicate that the clause is a condition precedent, a failure of a reinsured to obtain prior approval for settlement of claims can give reinsurers a defence to liability under a claims co-operation clause. This applies even if a reinsured can prove his underlying liability to his insured.[15]

A reinsured will usually be required to notify its reinsurers of a loss which may give rise to a claim under a claims co-operation clause. In the context of liability policies, the English courts have held that "loss" must be an actual loss for the purposes of notification.[16]

The requirement for a reinsured to obtain the reinsurer's prior consent under a claims co-operation clause is not generally subject to a requirement that that consent be given (or not given) reasonably (unless expressly stated).[17] However, a reinsurer has to exercise any decision to withhold approval of a settlement by the reinsured in good faith.[18]

If the reinsurer's approval of a settlement is not a condition precedent to liability then it remains open to the reinsured to prove its liability on the original policy and thereafter seek recovery under its reinsurance.

It is not necessary for the words 'condition precedent' to be used in a claims co-operation clause for the clause to be a condition precedent (although obviously express words will make the obligation clearer), so long as the words used are clear.[19]

Reinsurers must consider the extent to which they elect to give consent under a claims co-operation clause or to exercise claims control clauses (depending on the precise wording of the obligation). In some circumstances, a 'follow the settlements' clause can override the provisions of a claims control clause provided the original claim is valid.[20]

A reinsurer will not be taken to have waived its entitlement to exercise rights under a claims co-operation or control clause simply by its denial of a claim. The English courts have held that it is in the interests of justice for reinsurers to be entitled to deny liability for a claim whilst actively continuing to be involved in adjustment and settlement of the claim, without prejudice to the denial of liability.[21]

Similarly, a reinsurer will not, as a matter of course, be taken to have accepted liability for a claim in exercising rights under a claims co-operation or control clause.[22]

To what extent can claims be aggregated in reinsurance contracts?

The obvious answer remains that it depends on the precise wording of each contract.

'One event' wording

In the absence of specific clauses defining the limits of aggregation (see below) the aggregating words commonly found in excess of loss reinsurance contracts are 'arising out of one event' or 'arising from one event'.

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These phrases have been considered in the English court. The requirements for determining an 'event' are:

- A common factor which can properly be described as an event;
- Which event caused the losses in question;
- And which was not too remote.[23]

The link in causation between the event and the losses has to be significant.[24] In considering the characteristics of an event, rather than simply a state of affairs, consideration is given as to whether there was a unity in place, in time and in intent such that any losses can be described as arising out of a single unifying event.[25]

The words "event" and "occurrence" have been held to be synonymous.[26]

The New Zealand Earthquake Commission has recorded the two recent NZ quakes as separate events because they affected different faults at different depths: 10km and 5km respectively. Some seismologists consider the second quake was an aftershock of the first.

'Originating cause' wording

Other common aggregating words in reinsurance are 'originating cause' or 'original cause'. Such wording is considered to be wider in scope than 'one event' wording.[27]

A 'cause' can be a continuing state of affairs, such as an underwriter's negligent approach to underwriting giving rise to losses on a number of separate policies.[28] There still must be a causative link between the originating cause and the particular losses and in addition, the losses must not be too remote for aggregation to be possible.

What is the effect of an 'hours clause' in a reinsurance contract?

Property excess of loss reinsurances commonly contain an hours clause. The purpose of this clause is to define the basis on which the reinsured is entitled to aggregate losses arising from one event or occurrence. This clause defines the aggregating event by a period of time, usually 72 hours in the case of hurricanes or windstorm.

Losses occurring outside the relevant time period cannot generally be aggregated. The precise wording of any hours clauses will need to be considered because in some cases a reinsured will be entitled to start the clock running at its discretion so that a single event, such as an earthquake, hurricane or windstorm, which lasts for a long period of time, can actually form the basis of two separate loss occurrences giving rise to two or more separate aggregations.

In circumstances where the cause of loss is arguable, and where more than one occurrence occurred in a relatively short space of time (eg an earthquake followed by several aftershocks), difficulties may arise in establishing how the hours clause is intended to operate. Therefore, aggregation of claims where there is an hours clause will need to be reviewed carefully.

What is the law of the contract and in which jurisdiction will disputes be fought?

Disputes as to the proper law of a reinsurance contract, or the jurisdiction in which any dispute will be heard, are invariably complex and detailed advice should be sought when such disputes arise. Some general points which reinsurers should consider are addressed here. Reinsurance contracts are subject to the Contract (Applicable Law) Act 1990, which incorporates the Rome Convention on applicable law in contracts.[29]

A court will look to ascertain the governing law of a reinsurance contract by establishing whether there is an express choice of law stated or whether there is an implied choice of law by the parties by reference to the terms of the contract itself. Reinsurance contracts placed in the London market and issued in London on London market wording, do not automatically carry an inference that they will be governed by English law, especially if there is an arbitration clause in the policy which expressly provides for arbitration to take place in a different jurisdiction.[30]

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'As original' wording in reinsurance contracts is generally not sufficient to carry an imputation that the parties to the reinsurance intended the law of the original contract to apply also to the reinsurance.[31]

If a court cannot ascertain an express or an implied choice of law from the terms of the reinsurance, it will decide the applicable law by reference to the system of law, which has the closest connection to the contract.

The fact that a contract is governed by English law does not necessarily mean that England is the appropriate forum in which to hear disputes.[32] A court will consider many matters including the facts surrounding the nature of the contract, the dispute concerned and the position of the parties. However, as a general rule, in the case of business placed and underwritten in the London reinsurance market there will be strong grounds for a party to advance England as the appropriate forum to hear disputes arising from such business.

What documents is a reinsurer entitled to see from a reinsured?

The extent of the documentation which the reinsurer is entitled to see in settling reinsurance claims will depend on the terms of the particular contract.

Where the reinsurance contract contains a right to inspect a reinsured's records, the reinsurer can request to see claims documentation but should do so in a timely fashion. The reinsurer can refuse to meet claims payments pending the exercise of his right to inspect provided he does so in good faith, the request is not excessive in scope[33] and inspection is not being requested solely to prevent a summary judgment being made against the reinsurer.[34]

In the absence of an express right of inspection, such a right will generally be implied,[35] irrespective of whether the contract contains a 'follow the settlements' clause.[36]

The reinsurer is entitled to see the documents, which form the basis on which the reinsured has settled his underlying claims, including adjusters' reports and legal advices. The reinsurer can assert his right to do so because he has a common interest in such advices. However, no common interest will arise where a reinsurer has purported to exercise a right to avoid the reinsurance contract in question.[37]

In respect of placing or claims files held by a Lloyd's broker there is an implied term in the reinsurance contract that such documents should be available to reinsurers where they have previously been seen by underwriters but only in cases of reasonable necessity. [38]

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[1] *Wasa International Insurance Company Ltd v Lexington Insurance Company* [2009] UKHL 40; [2009] 3 WLR 575

[2] *Midland Mainline v Eagle Star* [2004] 2 Lloyd's Rep 604

[3] *Mardorf v Accident Insurance Co.* [1903] 2 Lloyd's Rep 604 (CA)

[4] See also Orient Express Hotels Ltd v Assicurazioni Generali SA [2010] EWHC 1186 (Comm)

[5] *ICA v Scor (UK) Reinsurance Co. Ltd* [1985] 1 Lloyd's Rep. 312 (CA) and *Assicurazione Generali v CGU International Insurance* [2004] 1 Lloyd's Rep. IR 457

[6] *Aegis Electrical v Continental* [2008] Lloyd's Rep IR 17

[7] *Assicurazione Generali v CGU International Insurance* (supra)

[8] See note 5 above

[9] *Commercial Union v NRG Victory Re* [1998] Lloyd's Rep IR 439 and *Hill v M&G Re* [1996] 1 WLR 1239

[10] *King v Brandywine Reinsurance Co.* [2005] 2 All ER (Comm) 1; [2005] 1 Lloyd's Rep 655

[11] *Hill v M&G Re* (supra), considered in *Assicurazione Generali v CGU International Insurance* (supra)

[12] *Western Assurance Co. of Toronto v Poole* [1903] 1 KB 376

[13] *Commercial Union v NRG Victory Re* (supra)

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[14] *Lumbermens Mutual Casualty v Bovis LendLease Ltd* [2005] 2 All ER (Comm) 669; [2005] 1 Lloyd's Rep 494, the reasoning in this decision has been criticised in *Enterprise Oil Ltd v Strand Insurance Company Ltd* [2006] 1 Lloyd's Rep 500 and more recently in *Omega Proteins Ltd v Aspen Insurance UK Ltd* [2011] 1 All ER (Comm) 313

[15] *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] 2 All ER (Comm) 299

[16] *AIG Europe (Ireland) Limited v Faraday Capital Limited* [2008] 2 All ER (Comm) 362; [2008] Lloyd's Rep IR 454

[17] See note 13 above

[18] Mance LJ in *Gan Insurance v Tai Ping Insurance Co Ltd (No. 2)* [2001] 2 All ER (Comm) 299

[19] *Eagle Star v JN Cresswell* [2004] Lloyd's Rep IR 537 – the clear words used were *"reinsurers will not be liable to pay any claim not controlled [by them]"*

[20] *Vesta v Butcher* [1989] 1 Lloyd's Rep 331 (HL)

[21] *Lexington Insurance Company v Multinacional De Seguros* [2009] 1 All ER (Comm) 35; [2009] Lloyd's Rep IR 1

[22] *Kosmar Villa Holidays v Syndicate 1243* [2008] 2 All ER (Comm) 14; [2008] Lloyd's Rep IR 489

[23] *Caudle v Sharp* [1995] LRLR 433

[24] *Scott v Copenhagen Reinsurance Co (UK) Ltd* [2003] Lloyd's Rep IR 696 and *Lloyd's TSB General Insurance Holdings Ltd v Lloyd Bank Group Insurance Company Ltd* [2003] UKHL 48; [2003] 4 All ER 43

[25] Kerr QC in *Dawson's Field Arbitration Award* (29 March 1972)

[26] Per Rix J in *KAC v KIC* [1996] 1 Lloyd's Rep 664

[27] *Axa v Field* [1996] 1 WLR 1026

[28] *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437

[29] The Rome Convention applies to contracts entered into after April 1992 and does not have retrospective effect.

[30] See *Waller LJ in King v Brandywine* (supra) in which a New York arbitration clause and a New York Service of Suit clause pointed to New York as being the proper law, and *Norske Atlas Insurance v London General Insurance Co Ltd* (1927) 28 Lloyd's Rep. 104 in which there was a Norwegian arbitration clause.

[31] *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.1)* [2001] 2 All ER (Comm) 299

[32] *Amin Rasheed Shipping v Kuwait Insurance* [1984] AC 50 and *Trade Indemnity plc v Forsaringsaktibolaget Njord* [1995] LRLR 367

[33] *Re A Company Nos 008725/91 ex p Pritchard* [1992] LRLR 288

[34] See Rix J's analysis in *Pacific & General Insurance Co Ltd v Baltica Insurance Co (UK) Ltd* [1996] LRLR 8

[35] *Phoenix Insurance Co of Greece v Halvanon Insurance Co Ltd* [1985] 2 Lloyd's Rep 599

[36] *Charman v Guardian Royal Exchange* [1992] 2 Lloyd's Rep 607

[37] *Commercial Union v Mander* [1996] 2 Lloyd's Rep 640

[38] *Goshawk v Tyser & Co Ltd* [2006] 1 Lloyd's Rep 566

This briefing has been prepared by the Insurance and Reinsurance Group at Lawrence Graham LLP. It is not a comprehensive statement of the law relating to reinsurance claims but it is a reference document which can be used as guidance in reinsurance claims' assessment. Detailed legal advice should be sought on legal issues arising in the assessment of reinsurance claims.

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