INSURANCE BULLETIN
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"The regulations are expected to be introduced into Parliament after the Houses return in early September and state that they will come into force later in the autumn."

1. REGULATION AND LEGISLATION

UK: HM Treasury publishes final version of insurance linked securities regulations

Following consultations in 2016 and 2017, on which we have previously reported[1], HM Treasury has published the final version of the regulations which will enact the UK's insurance linked securities (ILS) regime[2].

The proposed regime aims to establish the UK as an alternative location for ILS business which can compete with low tax and (comparatively) low regulation ILS domiciles such as Bermuda, the Cayman Islands and Guernsey.

During the consultation process, there was some concern over how the UK's regime would, in practice, be able to compete with these existing regimes. To some extent, the Government has addressed these concerns in the final regulations:

- On the tax side, the activities of UK ILS vehicles will be exempt from UK corporation tax if certain conditions are met, and debt/equity payments (e.g. dividends) made to a vehicle's investors will be exempt from withholding tax. Accordingly, UK investors will be taxed as normal, but overseas investors will be taxed based on their local regime.
- On the regulatory side, there remain concerns around how quickly investors will be able to establish new vehicles. The Government has adjusted its original position and, where a multi-transaction vehicle is used, the regulations now require only a notification to the FCA each time a new cell is created, and a notification to the PRA each time a risk is assumed on behalf of a cell. However, the PRA will still have up to six months to determine applications for the initial authorisation of a multi-transaction vehicle, although the Government has said that the PRA will try to determine applications within 6 to 8 weeks if the vehicle is non-complex and for a single transaction.

The regulations are expected to be introduced into Parliament after the Houses return in early September and state that they will come into force later in the autumn. However, the regulators have not, at the time of writing, published updated versions of the draft rules governing the regime which they published in November 2016, so it is possible that this date may slip.

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1 See: http://www.hfw.com/Insurance-Bulletin-8-December-2016 and http://www.hfw.com/Insurance-Bulletin-26-January-2017

2 The Risk Transformation Regulations 2017 (https://www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities) and the Risk Transformation (Tax) Regulations 2017 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630705/Risk_Transformation__Tax__Regulations_2017.pdf).

2. COURT CASES AND ARBITRATION

Australia: Insurer fails to establish breach of duty of disclosure

The decision in *Stealth Enterprises Pty Ltd T/as Gentlemen's Club v Calliden Insurance Ltd*[1] demonstrates the difficulty in proving and remedying a breach of the duty to disclose information relevant to an insurer's decision to renew a policy.

Background

The insured company owned and operated a brothel from premises in the ACT. The premises was insured against property damage and liability under an 'Adult Industry Insurance Policy' (Policy) which was renewed in the 2011/2012 year. On 1 January 2012, the premises was damaged by fire and the insured claimed under the renewed Policy.

The insurer denied the claim arguing that at the time or renewal, the insured did not comply with its duty of disclosure under s21 of the *Insurance Contracts Act 1984* (Cth) (ICA) by failing to disclose that:

- Its sole director and manager were members of the Comancheros bikie gang.
- The brothel's registration had lapsed.

The judge at first instance held that the insurer would not have renewed the Policy had the information been disclosed. Accordingly, as the insurer would not have been on risk at the time of the fire, its liability would be reduced to nil under s28(3) of the ICA.

Issues

On appeal, the NSW Court of Appeal considered the following:

- Whether a reasonable person in the circumstances of the insured could be expected to know that the association with the Comancheros was relevant to the insurer's decision to renew the Policy.
- Whether the insurer would have been on risk had either of the disclosures been made.

In upholding the appeal, the Court of Appeal found that the insured had not breached its duty to disclose and ordered the insurer to pay the claim plus interest and costs.

The Court of Appeal held that a reasonable person in these circumstances could not be expected to know that association with the bikie gang was relevant to the insurer's decision to renew the Policy. In reaching this conclusion, it was noted that the insurer specifically targeted brothels and other *"adult industries"* with its insurance scheme, and understood that people involved in such businesses often had criminal connections and were of *"dubious repute"*. Consequently, a reasonable person would not be expected to know that the bikie gang association would create a risk over and above the *"inherent risk in insuring a brothel"*.

Moreover, on the evidence before the Court, the insurer had not established that had it been made aware of the association, it would have declined the renewal. It was also inferred that, had the failure to renew the brothel registration been disclosed, the insurer would have remedied the problem itself and therefore remained on risk.

Since the handing down of the judgment, the insurer has successfully applied for a stay order pending determination of its application to appeal to the High Court[2]. Nonetheless, the decision highlights the difficulties faced by insurers in establishing the knowledge threshold in s21 of the ICA and proving that a policy would not have renewed if disclosure was made.

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"Since the handing down of the judgment, the insurer has successfully applied for a stay order pending determination of its application to appeal to the High Court"

1 [2017] NSWCA 71.

2 *Stealth Enterprises Pty Ltd (T/as Gentlemen's Club) v Calliden Insurance Ltd* [2017] NSWCA 129.

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"The Court of Appeal upheld the lower court's rejection of the claim, but the most interesting aspect of the decision is the finding that the insurers were estopped from relying on breach of a policy condition precedent, due to the insurers' failure to comply with a "duty to speak", which arose during the claims adjustment process."

England & Wales: Insurers partially win jurisdiction battle over reclaimed settlement monies[1]

Readers will recall from our Bulletin of 21 October 2016 that the "Atlantik Confidence" was found to have been scuttled in 2013 with the privity of its owners, enabling cargo underwriters (represented by HFW) to defeat owners' claim for a limitation of their liability under the Convention on Limitation of Liability for Maritime Claims 1976.

Well before that judgment, hull underwriters had, pursuant to a settlement agreement, paid the hull loss of $22 million or so, and so, fortified by the judgment, hull underwriters now reclaim their outlay from the mortgagee bank, which was assignee and loss payee of the hull claim, on the basis that the bank allegedly adopted the insured's misrepresentation that the vessel was lost by an insured peril and/or for unilateral mistake.

The bank is domiciled in the Netherlands and so it must be sued there unless an alternative is supplied by the Brussels Regulation. Underwriters issued proceedings in England, and the bank challenged the Court's jurisdiction.

Underwriters relied on an exclusive English jurisdiction clause in the insurance settlement agreement between themselves and the owners, but the bank was not a party to this, nor had it subscribed to the jurisdiction clause, and so underwriters could not rely on Article 25 of the Brussels Regulation, which recognises certain exclusive jurisdiction agreements, to sidestep the domicile rule.

Underwriters then sought to rely on Article 7(2) of the Brussels Regulation, which allows parties to sue in tort in the courts where the harmful event occurred, provided that the claim is not a "matter relating to insurance" (in relation to which, under Article 14, a policyholder, insured or beneficiary of an insurance policy must be sued in their domicile.) The Court held that the nature of underwriters' claim for rescission of the settlement agreement was so closely connected with the question of liability under the hull policy that the claim did in fact relate to insurance. However, since the purpose of the special insurance regime in the Regulation was to favour the interests of the "weaker party" (usually the insured), and since the bank could not be described as the weaker party, the bank could not benefit from Article 14.

This paved the way for the Judge to find that underwriters' claim for damages for misrepresentation was a tort claim, and since the damage suffered by underwriters occurred in England (where the settlement agreement was signed, the settlement monies were paid to the broker, the misrepresentation was allegedly made and underwriters were allegedly induced), the English Court has jurisdiction over that claim. However, there is no jurisdiction over underwriters' claim for restitution based on mistake, since that is not tort claim (because a claim for mistake does not require a harmful event.)

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1 Aspen Underwriting Ltd v Kairos Shipping Ltd [2017] EWHC 1904 (Comm)

England & Wales: Clarification on application of 1930 and 2010 third party rights against insurers regimes[1]

This case clarifies that the Third Parties (Rights Against Insurers) Act 2010 (the 2010 Act) does not apply retrospectively, such that the Third Parties (Rights Against Insurers) Act 1930 (the 1930 Act), and only the 1930 Act, will continue to apply in circumstances in which both (i) the insured's insolvency occurred; and (ii) the insured's liability was incurred, prior to 1 August 2016.

Under the 2010 Act, a third party with a claim against an insured insolvent party is entitled to pursue the claim against the insolvent party's insurers

1 *Shirley Anne Redman (suing as widow and administratix of the estate of Peter Redman) v (1) Zurich Insurance Plc (2) ESJS1 Limited* [2017] EWHC 1919 (QB)

directly, without first having to establish the insolvent party's liability. The 2010 Act is more advantageous to such a claimant than the 1930 Act, which requires the insolvent party's liability to have been established separately, prior to proceedings being brought against insurers, a task rendered procedurally more convoluted, if not impossible, where the insolvent party has ceased to exist as a corporate entity.

In this case, the claim was brought by Mrs R, whose husband (Mr R) had in 2013 died of lung cancer allegedly caused by asbestos exposure during the course of his employment (from 1952 – 1982) with a firm, (E). After Mr R's death, E was the subject of a voluntary winding up, being dissolved in June 2016.

Mrs R brought a claim against E's Insurers under the 2010 Act. The Insurers objected, arguing that the 2010 Act had no application in this case, on a proper interpretation of its transitional provisions.

The 2010 Act came into force on 1 August 2016, but provides that the 1930 Act shall continue to apply in cases in which both the insolvency and the "incurring of the liability" happened before that date.

In its judgment, the Court of Appeal confirmed by reference to previous authorities that a liability is "incurred" for these purposes when the cause of action is complete (when negligence and damage collide[2]) and not when a judgment, settlement or award establishing such liability is made.

The Court of Appeal further held that the legislative intention was not for both regimes to operate in parallel, in the case of claims to which the 1930 continues to apply. Either the 1930 regime applies or it does not. Where it does continue to apply then the 2010 regime has no application.

Although the Court of Appeal's conclusions are perhaps unsurprising, this case provides important clarification on a point on which, as the judgment itself makes plain, is of significant wider interest. It also makes clear that, at least for the time being, the 1930 and 2010 regimes will continue to operate alongside one another, with the circumstances of each case determining which will apply.

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2 *Per Lord Denning MR in Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 Q.B. 363 at page 375

England & Wales: Insurers' "duty to speak" on insured's breach of policy condition[1]

This long-running case has finally been decided in favour of insurers, since the insured failed to show that its individual business interruption losses exceeded the relevant policy deductible. Importantly, it illustrates circumstances where an insurer may have a duty to speak up about an insured's breach of contract, if the insurer is later to be allowed to rely on that breach in order to deny liability.

The insured Ted Baker's employee had engaged in multiple thefts of its stock, amounting to £millions in total. In the hearing on preliminary issues in 2012[2], the Commercial Court had decided that the resulting loss and business interruption was potentially covered by the insured's combined commercial policy, despite the insurers' argument that the policy did not extend to fidelity risks.

The Court of Appeal upheld the lower court's rejection of the claim, but the most interesting aspect of the decision is the finding that the insurers were estopped from relying on breach of a policy condition precedent (regarding the supply of information), due to the insurers' failure to comply with a "duty to speak" (i.e. to point out the insured's breach to it), which arose during the claims adjustment process.

In general, of course, the insurer has no duty to warn an insured that it must comply with policy conditions (particularly when the insured retains an experienced broker), and the Court reaffirmed this.

However, on the particular facts of this case, such a duty did arise. During the claims investigation phase, the insurer's adjuster had requested a shopping list of information pursuant to policy claims conditions. These encompassed the insured's existing management accounts, which were readily available to the insured and easy to produce, and other categories of financial information which were more difficult to produce, and which, the insured maintained, would require professional assistance, at insurer's cost, pursuant to a policy Professional Accountants Clause (PAC). Since liability was in dispute, the insured expressed unwillingness to produce this information until the insurer had admitted liability. The insurer's adjuster agreed to take instructions on these issues and to revert to the insured, but it never did so. In the meantime the insured believed the whole shopping list request was "parked", pending communications of the insurers' position. In several subsequent communications the adjusters, despite appreciating this was the insured's belief, did nothing to dispel it. The insurer's Defence later distinguished between the more difficult items of information, which had been "parked" pending instructions, and the straightforward supply of management accounts, to which the PAC undoubtedly did not apply, in order to deny liability.

An argument that insurers had deliberately kept quiet about the insured's obligation to provide the management accounts (in order to avoid the insured waking up to the need to do so before it was too late) was rejected. So too was an argument that an express agreement had been reached and a representation had been made, to "park" the request for management accounts.

However, applying established case law regarding commercial contracts generally (rather than case law regarding "good faith" insurance contracts), the Court held that a reasonable person in the position of this insured would have expected these insurers, acting honestly

1 *Ted Baker v AXA Insurance UK Limited* [2017] EWCA 4097

2 [2012] EWHC 1406 (Comm)

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"It is expected to be the most expensive natural disaster in US history, with some estimates of the total damage reaching as high as US$200 billion.

and responsibly, to have made the position clear with regard to the ongoing breach. In upholding a "duty to speak" on the facts of the case, the Court ruled that the insurer should not have remained silent about the insured's breach, and should have made this clear if they required the management accounts before the adjuster reported back, "particularly if the failure to provide these was to be said to be fatal to the claim…It would have been the simplest thing to confirm they still wanted the management accounts, notwithstanding the waiting for instructions." The insurers were therefore estopped by acquiescence from relying on the breach.

Although fact-specific, this decision illustrates that situations may sometimes arise in which an insurer will be estopped from relying on the insured's breach of duty if it has not insisted on compliance with that duty at an earlier stage, and this may be so notwithstanding insurer's continuing reservation of rights.

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3. MARKET DEVELOPMENTS

US: Insurers hit hard by Hurricane Harvey

Insurers and reinsurers are bracing themselves for enormous losses in the wake of Hurricane Harvey. The category 4 hurricane, the most powerful to hit Texas in half a century, has so far caused 44 deaths, damaged 48,700 homes and forced 32,000 people into temporary shelter. The hurricane has also hit the Texas oil industry, forcing companies such as Exxon Mobil to shut down their facilities. It is expected to be the most expensive natural disaster in US history, with some estimates of the total damage reaching as high as US$200 billion.

The ultimate losses to the insurance and reinsurance industry are difficult to predict in view of a highly complicated and challenging claims situation, but initial estimates put industry losses in the range of US$10 billion to US$20 billion[1]. The catastrophe is being considered predominantly as a commercial flood event, with insurers preparing themselves to be faced with many property damage and business interruption claims.

Hurricane Harvey has also affected HFW's own offices in west Houston with staff unable to access the office for several days due to flooding. We ourselves are therefore facing potential property damage and business interruption issues. The hurricane is also causing significant damage to the Texas oil industry. Inventory is unable to be brought to refineries and plants, so those refineries and plants remain closed waiting on product to refine. The Houston Ship Channel has only recently re-opened and therefore crude oil and other products have only just begun to be unloaded.

Policyholders should act quickly and diligently to maximise their chances of insurance recovery. They should carefully review all their insurance policies to find those areas for which they are covered. Insurance cover will most commonly be provided under a policyholder's first party property and business interruption covers, but others might be relevant too (e.g. extra expenses, service interruption, civil authority coverage, contingent business interruption, ingress/egress coverage). They should carefully check the applicable sub-limits to each cover and time limits for claims to be made, in particular the sub-limit for flood damage. Policyholders should also keep complete and accurate records of all losses and prepare detailed records of all property and income losses, with as much supporting evidence as possible.

Coverage disputes are likely to arise as a result of Hurricane Harvey. In particular, we expect to see disputes around the following issues:

- Issues are likely to arise around the definition of "flood", particularly in policies which contain high full coverage issues but lower flood sublimits. What is genuine flooding caused by rivers and reservoirs overflowing (which

1 Source: JPMorgan Chase & Co.

might limit an insured's claim to a lower flood sub-limit) and what is simply large accumulation of rainfall in surface water (which might entitle an insured to claim a full policy limit)?

- Concurrent causation issues are likely to arise in both commercial and homeowner coverage. Many homes and businesses sustained damage caused by two concurrent factors: Firstly, rising surface water. Secondly, damage from water entering the building through holes caused by high winds (e.g. holes in roofs or lost windows). In that situation, if the insured cannot prove which water damage came from surface water and which came from wind damage, all of the water loss will be excluded under most policies, unless the insured also purchased flood coverage. If the insured did purchase flood cover, concurrent causation would still be an issue if there is a flood sublimit.
- Aggregation issues are likely to be contentious. In particular, not all losses arising out of the disaster will necessarily be aggregated as a single catastrophe for reinsurance purposes. This will depend on the wording of the relevant reinsurance contracts and the governing law and jurisdiction clause may affect how such wording is interpreted.

It is not yet clear what proportion of losses will ultimately be covered by insurance. In 2005, Hurricane Katrina caused US$176 billion of damage, of which US$82 billion was insured. Then in 2012, Hurricane Sandy caused US$75 billion of losses, of which US$31 billion was insured (source: Swiss Re). Insurance Day reported that in relation to Hurricane Harvey, economic losses are likely to reach beyond US$100 billion, of which around US$20 billion would be insured.

There are particular concerns about homeowners, because standard home insurance policies cover losses from fire, theft and wind damage, but not flood damage. This is because private flood cover is very expensive for the consumer, as adding flood coverage can increase the premium by five times over basic home cover. To address this problem, homeowners can purchase subsidised cover from the federally-run National Flood Insurance Program, but it appears only around 15% of homes in Houston have purchased this.

For details of HFW's Houston office, please see http://www.hfw.com/Houston.

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4. HFW PUBLICATIONS AND EVENTS

UK: HFW to attend IRLA Breakfast Briefing on Part VII transfers

Richard Spiller (Partner, London) and Will Reddie (Senior Associate, London) will be attending the IRLA Breakfast Briefing on Part VII transfers on 8 September.

Monaco: HFW to attend Monte Carlo Reinsurance Rendez-Vous

Richard Spiller (Partner, London) and Ashwani Kochhar (Partner, London) are attending the Reinsurance Rendez-Vous in Monte Carlo from 10-13 September. During the trip, they will be attending the 9th annual ILS round table hosted by Munich Re on 11 September.

UK: HFW to give presentation on Hanjin insolvency to London Insurance and Reinsurance Group

On Tuesday 26 September, HFW London will host the London Insurance and Reinsurance Group quarterly meeting. Partner Costas Frangeskides and Senior Associate Matthew Wilmshurst will give a presentation on the Hanjin Insolvency and Costas Frangeskides will give an update on legal decisions of interest to the London Market. Enquiries to antonia.munro@hfw.com.

HFW has over 500 lawyers working in offices across Australia, Asia, the Middle East, Europe and the Americas. For further information about our Insurance/reinsurance capabilities, please visit http://www.hfw.com/Insurance-Reinsurance-Sectors

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