Insurance/
Reinsurance

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INSURANCE/ REINSURANCE BULLETIN

Court of Appeal rules Judge correct to exercise his discretion to refuse stay of proceedings

Amlin v Oriental Assurance

Oriental Assurance provided cargo liability insurance to the owners of the ill-fated vessel, "Princess of the Stars", which capsized near the Philippines in the midst of typhoon "Frank". The casualty resulted in loss of life and a series of claims by cargo interests, which were brought in the Philippines against the shipowners and against Oriental.

Oriental was reinsured in the London market on an excess of loss basis. Both the original policy and the reinsurance contained a "Typhoon Warranty", which provided that the policy would be void if the vessel sailed when there was a typhoon warning. The reinsurance also contained a full "follow the settlements" clause. However, the governing laws of the original policy and the reinsurance were different (Philippine and English law respectively).

The Philippine proceedings are expected to take many years to resolve, but reinsurers sought a declaration in England that the reinsurance policy was void due to breach of warranty. Oriental therefore found itself in the invidious position of having to run precisely the opposite argument in the English proceedings (i.e. that the typhoon warranty did not apply) as it was bound to do in the Philippine actions. Oriental therefore sought a stay of the English proceedings on the grounds that they should be stayed pending the outcome of the claims in the Philippines. They argued that the intention of the reinsurance contract was that the reinsurance claim would be resolved after the underlying claims had been determined and that reinsurers should be bound (pursuant to the "follow the settlements" clause) by any factual findings made by the Philippine courts.

The judge at first instance rejected the stay application because a stay should only be granted in *"rare and compelling circumstances"*, which in his view were not present. Oriental appealed. Longmore LJ

gave the leading judgment in the appeal, stating that he did not *"think that reinsurance constitutes any general exception to the normal rule"*. Rimer LJ and Tomlinson LJ agreed, reluctantly - saying that *"By pressing ahead with their claim for negative declaratory relief, these giants of the London insurance market have placed their reinsured Philippine minnow in a hopeless and invidious position"*. The judge noted in passing that *"if this were proportional reinsurance it would not be immediately apparent that reinsurers were following the fortunes of the reinsured"*. Despite their misgivings, however, none of the judges thought that the judge at first instance had wrongly exercised his discretion as to whether to grant a stay and the appeal by Oriental was therefore dismissed.

It is worth noting that the invidious predicament that Oriental found itself in would have been much less likely to have arisen if the governing law and jurisdiction of the original policy and the reinsurance were the same because it is quite unlikely that two courts in the same jurisdiction, applying the same law, would reach inconsistent decisions. Obviously this is not always practical, but it is something that reinsurers, reinsureds and reinsurance brokers should all bear in mind.

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Broker's obligations to disclose commission from insurer

The case of *Hobbins v Royal Skandia Life Assurance Limited*[1] is a noteworthy decision of the Hong Kong Court of First Instance. It is a decision helpful to insurance brokers who operate in that jurisdiction and whilst only illustrative for those who operate within the England and Wales jurisdiction, it is a timely reminder of the benefit of good practice on disclosure and guidance on the extent to which a broker is required to disclose commissions to an insured.

The case concerns whether payments of commission by an insurer to an insurance broker were evidence that the broker was an agent of the insurer. In addition, the Court was asked to consider whether the extent of the disclosure by the broker to the insured of those payments was sufficient. On the facts, the insurance broker, Clearwater, had on numerous occasions disclosed to Mr Hobbins that it was receiving its commission/ fee from insurers, although it never informed Mr Hobbins precisely how much commission it was receiving.

The Court held the fact that Clearwater disclosed it was being remunerated by way of commissions/ other fees received from insurers should be regarded as a minimum good practice for insurance brokers and that, in line with long established common law, this did not mean it was the agent of insurers. To establish agency it had to be shown that as a result of the payment Clearwater had been expressly or impliedly authorised to enter into transactions on Skandia's behalf. However, as to whether Clearwater was obliged to disclose how much it was receiving from the insurers the Court stated *"to go beyond that and say that Clearwater should have disclosed more (specifically the quantum of commission it expected to receive) would be to impose a standard which would be at odds with case law on the prevailing commercial practice among insurance brokers".*

The area of broker practice and commissions has been the subject of many discussions over the years and reviews by the Law Commission and the Scottish Law Commission. In addition, The Consumer Insurance (Disclosure and Representations) Act 2012 received Royal Assent on 8 March 2012, although it is yet to come into force (it is hoped this will happen next year). The Act focuses on the relationship between consumer insureds, their broker and the insurers. Under the Act, a broker will usually be deemed to be acting as agent of the consumer unless:

1. It is the appointed representative of the insurer under section 39 of the Financial Services and Markets Act 2000.

"To establish agency it had to be shown that as a result of the payment Clearwater had been expressly or impliedly authorised to enter into transactions on Skandia's behalf."

1. [2012] HCCL No.15 of 2010.

2. It has express authority to collect information as agent of the insurer.

3. It has express authority to enter into the contract of insurance on the insurer's behalf.

4. Circumstances dictate otherwise.

Brokers and insurers focusing on consumer business as opposed to corporate insurance should be aware of the new Act and prepared for when it does come into force.

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When is an arbitration clause not an arbitration clause?

The decision in *Turville Health Inc v Chartis Insurance UK Ltd* illustrates the court's willingness to exercise its inherent jurisdiction to allow a stay of court proceedings, even where a dispute resolution process does not qualify as an arbitration for the purposes of a section 9 (Arbitration Act 1996) stay.

Following an insurance claim, quantum was disputed and the insurer invoked the complex policy procedure involving a mixed appraisal/arbitration process. Information was submitted to the appraisers, but progress was delayed, and the insured therefore issued court proceedings.

The insurer applied for a stay of the court proceedings under section 9 on the basis that the policy contained an arbitration clause. Alternatively, if the particular clause was found not to comply with the requirements of the Arbitration Act 1996, the insurer applied for a stay under the inherent jurisdiction of the court, to allow the parties to resolve the dispute by the agreed process.

The court held that the clause was not an arbitration clause within the meaning of the Arbitration Act, because it required the arbitrator to secure the agreement of an appraiser, who was not an arbitrator, and the decision could therefore not be treated as a decision of the arbitrator alone. Further, if neither appraiser would agree with the arbitrator's decision, it would not bind the parties. The section 9 application therefore failed. However, the court granted a stay under its inherent jurisdiction, on the basis that the parties had entered into the agreed dispute resolution process without protest and had invested considerable sums in that process, and which would deal with all disputed matters. The most significant factor considered by the court was whether it would be faster or more economic for the dispute to be dealt with by the court or by continuing with the procedure contained within the clause.

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S&P

The first instance decision of Justice Jagot in the Australian Federal Court in *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* is an important case for rating agencies, financial institutions (FIs) and, potentially, insurers. The decision has established that ratings agencies have a duty of care to investors in rated instruments with whom they have no contract. In addition, the judgment highlights the importance of financial institutions maintaining an arm's length relationship with the ratings agencies, and also understanding the ratings assigned to the products they market to investors. For more information, see our briefing at http://www.hfw.com/publications/client-briefings/alarm-bells-for-financial-institutions-and-their-insurers.

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> "The decision has established that ratings agencies have a duty of care to investors in rated instruments with whom they have no contract."

1. [2012] FCA 1200.

Measure of direct loss following physical damage

The recent case of *Coles v Hetherton* is a reminder that where property has been damaged, whether it is repaired or not, the diminution in value of the asset can be measured by the reasonable cost of repair; issues of mitigation cannot apply to the court's assessment of the direct loss.

The Claimant car owners (C) suffered damage to their vehicles following admitted negligence of the defendant drivers (H). C arranged for their vehicles to be repaired under a scheme provided by their insurers (R). R engaged MRNM (M) to carry out the repairs. M is within the same group of companies as R, and it then subcontracted work to other garages outside the group. The interposition of M between R and the repairing garage increased the repair costs by approximately 25%.

The defendants' insurers (P) claimed that the effect of the relationship between R and M was to increase the claims for repairs to be paid by the negligent drivers' insurer by as much as 25%, and submitted that the actual cost of repair represented the loss and that R had a duty to mitigate the loss, as agent of C, by using its bargaining power to achieve the lowest possible repair cost, whether or not that was achievable by the policyholder itself.

R maintained that the figures charged by M were no more than what a policyholder would have had to pay to a garage on the open market and in the majority of cases were somewhat less owing to discounts obtained from the volume of work that R gave to M.

The court ruled in favour of C. The actual cost of repair does not represent the loss. The law is clear in that where a person's asset is damaged by negligence of another, the loss suffered is the diminution in value of the asset. This is a direct loss, ordinarily measured by the reasonable cost of remedying the damage. This is judged by what C, not R, would pay on the open market. Whilst issues of mitigation could arise, for example, in relation to the cost of a courtesy car, they could not apply to the court's assessment of direct loss when it used the reasonable cost of repair to measure the diminution in market value of the car.

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FSA's consultation on the client money rules for insurance intermediaries

The proposals contained in the FSA's consultation (CP12/20) on the client money rules (CASS) for insurance intermediaries (which ended on 30 November 2012) proposed several practical changes to the current regime, which are intended to improve governance and protection of client money.

Some of the main changes proposed include:

1. Increasing the frequency of client money calculations and the frequency that client money balances are reconciled to bank records for firms that operate Non Statutory Trust client accounts (NSTs).

2. The imposition of maximum periods for extending credit from NSTs after which the client money must be replaced by the firm (being 45 days where debt is due from the client, e.g. premium, and 90 days where debt is due from the insurer, e.g. claims and premium refunds).

3. A prohibition on the grant of conditional risk transfer by insurers to intermediaries as an alternative to the insurer accepting unconditional risk transfer or the intermediary holding client money permissions.

4. Enabling intermediaries to obtain pre-consent from clients in Terms of Business Arrangements (TOBAs) to the transfer of client money held on their behalf as part of the sale of books of business - there will be a parallel obligation to notify the FSA of the intention to transfer the client money at least seven days in advance of the transfer.

5. Provisions to deal with unallocated client money, including a limited period of 13 months during which firms may take credit write backs in relation to certain balances and the ability to remove unclaimed client money balances held for a minimum of six years where the client cannot be contacted. This

would be dealt with through a payment to charity (but subject to an unconditional undertaking to make good any future valid claims in respect of the money).

The FSA has proposed a delayed commencement of the new rules for 12 months from their publication (save in respect of certain provisions on unclaimed client money which will be introduced earlier) and implementation will be by way of a new CASS 5A chapter to replace CASS 5.

When the changes to the client money rules are adopted, firms will need to review their current systems to assess whether they are adequate, in particular, ensuring that appropriate changes are made to TOBAs to provide for the time periods on funding, consents to transfer of client money, the removal of conditional risk transfer, as well as other consequential changes.

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Superstorm Sandy - insurance and reinsurance issues

Severe flooding, rampaging fires, explosions and downed power lines were just some of the consequences left in the wake of Superstorm Sandy, the post-tropical cyclone which battered more than 20 US States in early November. Once again, the insurance market will be faced with complex factual and legal analyses to ascertain the nature and extent of coverage. HFW published a briefing considering the issues at http://www.hfw.com/publications/client-briefings/superstorm-sandy-insurance-and-reinsurance-issues.

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News

Insurance Law Committee of the City of London Law Society

Richard Spiller has been appointed Chairman of the Insurance Law Committee of the City of London Law Society.

John Barlow

We are delighted that John Barlow has been elected to join the Partnership, effective 1 December 2012. John, who joined the firm as a Consultant in October 2012, advises insurers and reinsurers of financial institutions in connection with their fidelity, computer crime, D&O, PI/civil liability and cyber liability programmes, and on claims that arise under these products. He has handled and settled many of the most significant claims to find their way into the London insurance and reinsurance market over the last two decades.

Conferences & Events

FiscalReps' 7th Annual Indirect Tax Forum
Trinity House, Tower Hill, London
(23 November 2012)
John Barlow and Costas Frangeskides

C5 Forum on Defending and Managing Financial Institution Litigation
Crowne Plaza London
(28-29 November 2012)
John Barlow

HFW Mining Claims Seminar
HFW Friary Court, London
(22 January 2013)
Paul Wordley, Rebecca Hopkirk, Nigel Wick, Peter Schwartz, Toby Savage and Rupert Warren

If you are interested in receiving more information about any of these events, please contact events@hfw.com

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