HAPPY NEW YEAR!

First of all, I and your co-chairs would like to wish you all a very happy and prosperous 2014. The winter meeting in Marco Island is approaching and, having endured the winds and rain of England in December and January, I for one am very much looking forward to some sun, sea and sand with Federation friends. I hope you are too – it promises to be a great meeting.

As is appropriate in the New Year, this letter will look back at the past year and forward to the next. The newly formatted Section Meeting at Broadmoor was a great success and all enjoyed the informal round the table (literally) discussion of issues and developments that affect us all. It is different from any other Section Meeting. It was something of an experiment, but the unanimous view of all present was that we retain that format for Marco Island. Accordingly, that is what we are doing and we urge all of you who will be at Marco Island to attend on the Friday morning.

The following Newsletter also looks at important recent developments and cases in the world of Reinsurance, Excess and Surplus Lines.

With best wishes from London,

Stephen Carter (Chair)

Vice Chairs : Michael Aylward (Boston, MA)
Russell Allison (Birmingham, AL)
Charles D Henderson (Philadelphia, PA)
Barbara O'Donnell (Boston, MA)

Section Meeting – Marco Island

Friday 7 March 2014

This is the go-to event for all section members at Marco Island. It will build on the great success of our round table discussion in Broadmoor, with a similarly informal, but informed, event. At Broadmoor, John Intondi of AXIS Insurance led discussion on the *USF&G v American Re* case and its application in real life situations affecting us. Many thanks John. Also, thanks to Jean Lawler and her trusty IPad, we were also able to bring into the discussions a case reported that very morning!

Since then, the industry has seen two important reports, which probably have not received the attention that they deserve. They will impact on the insurance and reinsurance industry and on those who practise law in the field. The Federal Insurance Office report ***"How to modernise and improve the system of insurance regulation in the United States"*** advocated closer coordination between States and harmonisation of State insurance laws – in particular calling for further federal action in relation to credit for reinsurance and surplus lines. The American Law Institute's draft ***"Principles of Liability Insurance"*** is also gathering steam—albeit with remarkably little awareness on he part of insurers and outside counsel despite the profound implications that these proposed "best practices" for courts may have on the future shape of coverage litigation in the U.S.. These are the subject of the featured analysis below and will be the subject of discussion at the Section Meeting. Michael Aylward's presentation to DRI on these subjects gave rise to much comment and discussion. He will lead our discussion.

There will also be an opportunity to raise, share and discuss other issues that are prominent in our business, including (but certainly not limited to) issues arising from the cases and developments reported below.

This is cutting edge and important stuff – we look forward to as many of you as possible attending.

Fellowship Dinner - **On Wednesday 5th March**, there is a Fellowship Dinner arranged for the International, Reinsurance, Premises and Security Sections. This is an opportunity to meet and get to know not only our fellow Section Members, but also those in the International Section, with whom we share many interests, and the Premises and Security Sections. The venue is to be confirmed, but you can be sure it will be good and it will be fun!

Could you please sign up for the Dinner when you register, or, if you have registered without signing up, rectify that glaring omission by signing up now!

Section Call – Tuesday 4 February 12 noon Eastern Time/5pm London Time : Details of the dial – in for our section conference call will be circulated separately in the usual way. However, this is your opportunity to put it in the diary. It is a great opportunity for those not attending the Marco Island meeting (hopefully not to many fall in that category!) to discuss section business, as well as for those who will be in Marco. This is also a great opportunity to raise any current issues for discussion at our Marco round table meeting, ahead of time.

Member News

Again, I would ask that anybody with newsworthy activities, achievements, cases won or awards received, let me know on stephen.carter@cpblaw.com, and at the same time copy them to Susan J. Coone (scoone@thefederation.org) so that they can be used in the Federation flyer and/or the website as appropriate. Don't be shy about about blowing your own trumpet!

First of all, congratulations to former Section Chair **Meloney Perry** who, at the time of the Marco Island meeting, will be celebrating the first anniversary of her own niche insurance law firm in Dallas, **Perry Law PC.**

In England, it is the fifth anniversary of niche insurance/reinsurance law firm **Carter Perry Bailey LLP** ("CPB"), set up by current Section Chair **Stephen Carter**. 2013 has been a terrific year for Stephen and for CPB. Stephen, his partner Bill Perry (who, to the best of our knowledge, is unrelated to Meloney Perry!) and CPB are all ranked for insurance and reinsurance in Chambers Guide to the Legal Profession and Legal 500. Stephen was also commended and CPB was ranked among the "*overall leaders",* in Intelligent Insurer's *"UK Legal Elite".* CPB was also voted *UK Insurance and Reinsurance Law Firm of the Year 2013* in the Lawyers World Awards, the Corporate International Awards, the Acquisition International Awards and the Deal Makers Awards.

Featured Analysis

The American Law Institute, famed for its influential "Restatements" of the law, has embarked on an ambitious effort to codify a set of best practices for handling liability insurance coverage disputes. Despite the wide-ranging scope of the project and its broad potential implications, this ALI *Principles of Liability Insurance* project has drawn little notice from insurers and outside counsel.

I. What Is A Principles?

Unlike the more familiar ALI "Restatements," which seek to codify areas of the law for which there is already a general consensus, a "Principles" is a declaration of what the American Law Institute thinks the law *ought* to be. There is an on-going discussion as to whether there will be an effort at some point to transform this project into a "Restatement."

II. History

A proposal to create a *Principles of the Law of Liability Insurance* was approved by the ALI in May 2010. Thomas Baker of the University of Pennsylvania Law School and Kyle Logue of the University of Michigan Law School were appointed as the Reporters, working with a team of three dozen "Adviser" members drawn from academia, industry and law firms that represent both insurers and policyholders. There is also a large "Members Consultative Group" that has offered comments and advice as the project progressed.

III. Scope of the Principles Project

The ALI contemplates that there will be four chapters. focus of Chapter One is on three topics: policy interpretation, waiver and estoppel and the effect of insured misrepresentations. Chapter Two will focus on the obligation of insured's to defend, the duty to settle and cooperation issues. Still to come are Chapter Three, which will address the scope of insured risks and topics such as trigger, allocation, and issues related to high profile exclusions and conditions and Chapter Four that will focus on advanced insurance contract issues like choice of law, remedies, bad faith, and enforceability.

Chapter One has now been approved by the ALI Council and its membership. Sections 16-23 in Chapter Two have been approved by the Council but do not yet have membership approval. A new Council Draft No. 4, promulgated in September 2013, sets forth new Sections 24-34 will be considered by the Council in the Spring of 2014. These new sections deal with thorny issues such as whether insurers have a right to recoup defense costs, the duty to settle and cooperation obligations.

IV. Summary

The following is a very brief overview of the main provisions that have been adopted to date:

Chapter One: Basic Liability Insurance Contract Principles

Following an opening definitional section, Chapter One consists of three topics: (1) Interpretation (Section 2-4); (2) Waiver and Estoppel (Sections 5-6) and (3) Misrepresentations (Section 7-11).

3. *Policy Interpretation;* A policy term shall be interpreted in accordance with their "plain meaning" and presumes that a reasonable policyholder would share that plain meaning unless the other side presents "highly persuasive evidence demonstrating that a reasonable person in this policyholder's position would give the term a different meaning under the circumstances." This Section would allow consideration of extrinsic evidence to find ambiguity with respect to terms that are clear on their face, a principle that many, if not most, courts have rejected.

4. *Ambiguity:* A term will be deemed ambiguous if it has "at least two objectively reasonable interpretations that could be applied to a given set of circumstances." It also states that, "a term that has a plain meaning that can be applied to one claim may not have a plain meaning in relation to another claim." Insurers may find some comfort in Comment (j) in which the Reporters choose not to adopt the standard "tie breaker" rule followed in many jurisdictions but instead declare that coverage will only be found if a court is otherwise unable to determine the meaning of an insurance policy term "using all other permissible sources of meaning, including extrinsic evidence." Policyholders may prefer Comment (k) which eliminates the rule that some jurisdictions have adopted eliminating the principle of *contra*

proferentem in cases involving so-called "sophisticated insureds." The reporters observe that, "Because *contra proferentem* is a doctrine of last resort. . .the doctrine should be applied irrespective of the sophistication of the parties."

5/6: *Waiver and Estoppel:* An insurer can "waive into coverage" by its actions.

7. *Rescission;* Rescission is only appropriate where material facts are misrepresented intentionally or recklessly and is not allowed in cases of so-called "innocent misrepresentation. An insurer must establish a misrepresentation by the same standard of evidence applicable to claims of fraudulent misrepresentation under applicable state tort law.

11. *Negligent Misrepresentation:* If the insurer would have issued the same policy but at a higher premium, the insurer must pay the claim that has been tendered to it but may collect from the policyholder or deduct from the claim payment the additional premium that would have been charged. If the insurer would not have issued the policy for any premium, the insurer must pay the claim at issue but may collect a reasonable additional premium for the increased risk and may cancel the policy prospectively.

Chapter Two: Management of Potentially Insured Liability Claims

Chapter Two discusses diverse aspects of the insurer's right and duty to defend. Among its more controversial provisions:

14. *Vicarious Liability:* In contrast to the rule in most states, Section 14 proposes that insurers be held vicariously liable for any misconduct by appointed defense counsel.

15. *Measuring the Duty to Defend:* An insurer's duty to defend shall be measured using a "four corners plus" approach whereby the duty to defend may be triggered either by an allegation or legal theory "complained in the complaint or comparable document stating the claim or that is identified in the course of the investigation or defense of the claim or inferable from the complaint or comparable document, that a reasonable insurer would regard as an actual or potential basis for all or part of the claim." Extrinsic facts may not be relied upon to justify a refusal to defend except where they relate to (a) whether the claimant is an entity "insured" under the policy and (b) whether the events in question took place during the policy period ("trigger").

Section 16 provides that where an insurer has a duty to defend it must do so in a professional manner protecting the insured from all risks including risks not covered by the liability insurance policy. Subsection two states that an insurer may carry out its obligation to defend by using staff counsel except where independent counsel is required as per Section 18.

17. *Reservation of Rights* Letters: An insurer may only contest coverage if it gives notice to its policyholder before agreeing to defend of the grounds on which it intends to contest coverage. The most controversial aspect of Section 17 is its provision of an opportunity to consult with appointed defense counsel concerning the scope and significance of a reservation of rights letter. Comment (f) explains that lawyers retained by insurance companies should at least have a general understanding of the forms of insurance pursuant to which companies pay their fees and assumes that "such lawyers are better prepared to read and interpret a liability insurance policy and a reservation of rights letter than an ordinary consumer or small business insured." While this is likely true, it is not necessarily true that excellent defense counsel with respect to tort claims have a working knowledge of more complex insurance coverage issues as would a lawyer specializing in insurance matters.

18. *Independent Counsel:* An insured should be allowed to select its own defense counsel if "there are common facts at issue in the claim and the coverage defense such that the claim could be defended in

a manner that would advantage the insurer at the expense of the insured," the insurer must agree to provide independent counsel. Independent counsel is not required merely because the underlying suit seeks damages in excess of the applicable limits. This is more or less the California "*Cumis*" approach.

19. *Fees:* If independent counsel is justified pursuant to Section 18, the insured may select defense counsel whose reasonable fees must be paid by the insurer in a timely manner Where fees are in dispute, the insurer must nonetheless pay the entire amount demanded subject to its right to bring an action against defense counsel to recoup the allegedly excessive amount.

20. *Terminating the Duty to Defend:* An insurer's obligation to defend will only end following an explicit waiver by the insured of its right to the defense or final adjudication of the claim or as the result of a partial adjudication that eliminates the original basis for coverage or a settlement or partial settlement that eliminates those claimed bases. Comment (f) states that an insurer may terminate its defense obligation by entering into a partial settlement that resolves the basis for its policy being triggered. However, the insurer may only enter into such a partial settlement with the informed consent of the insured.

21. *Consequences of Breach of the Duty to Defend:* If an insurer wrongly fails to defend a claim, it not only loses the right to control the defense or settlement of the claim but also the right to contest coverage for its claimed indemnity duties. In the event of breach, damages that the insured may recover include not only the amount of any settlement entered into in the underlying action or the reasonable portion of a settlement entered into by or on behalf of the insured after breach, but the reasonable defense costs incurred by or on behalf of the insured.

22. Multiple Carriers Defending: Where more than one insurer has a duty to defend, that duty is joint and several notwithstanding any term in any policy that purports to establish a priority of responsibility for the defense among the carriers except as provided in Section 23. Where multiple carriers have a duty to defend, the insured may choose one, which may then seek contribution from any non-selected insurers for the costs of defense and any judgment rendered. Comment (e) states that defense costs should be allocated on the same basis as indemnity. It does not discuss whether that means that policyholders must contribute to defense costs in states that have adopted "time on the risk" or other non-"all sums" approach to allocation issues.

Featured Cases

Our featured cases this time round feature a recent English reinsurance case in the Court of Appeal, dealing with insurance and reinsurance claims under a Bermuda form policy insuring a US risk (the first instance decision having been reported on in our previous newsletter) and another in the Commercial Court, which reviews the law applicable to brokers duties in respect of funds collected for clients (reklevant to both insureds and reinsureds). Both cases are of particular interest to US and International insurance and reinsurance markets.

1. **AstraZeneca Insurance Co Ltd ("AZICO") v XL Insurance (Bermuda) Ltd and ACE Bermuda Insurance Ltd - Court of Appeal – 20 December 2013**

This is the appeal from the judgment covered in the last newsletter. It upholds the first instance decision.

AstraZeneca settled a number of personal injury actions in North American proceedings, relating to its anti-psychotic drug "Seroquel". By October 2012, the total amount paid out by its captive, AZICO, to indemnify AstraZeneca in respect of defence costs and settlements, was some £448m. By contrast, only one claim had gone to a full trial and in that case judgment had been given for the defence. AZICO sought to recover

under a reinsurance placed with XL for aggregate losses of some £83m, excess of the policy deductible of £365m.

The insurance and reinsurance contracts were on a form based on XL004, a Bermuda form liability insurance. Although disputes arising under Bermuda form policies were usually governed by New York law and resolved by London arbitration, the parties to the reinsurance had waived the arbitration clause and the contract was expressed to be subject to English law.

XL denied liability on the basis that coverage was limited to situations of actual liability and there was no coverage where liability was merely alleged. XL argued that defence costs were similarly only recoverable in cases of actual liability.

The Commercial Court, and recently the Court of Appeal, rejected AZICO's arguments on these two issues, holding that the insurance and reinsurance only responded to claims where there was actual liability.

The courts' reasoning was that, under English law, a liability policy, in the absence of wording to the contrary, indemnifies the insured in respect of actual liability. That means that, in order to recover from his insurer, the insured must show that, on the balance of probabilities, he was liable to the person who claimed against him.

Nor was it necessarily sufficient for the insured to show that he had been held liable to a claimant by a court or tribunal. In the event of a dispute, the existence of actual liability had to be established to the satisfaction of the reinsurer or, failing that, by a judge or arbitrator who had jurisdiction to decide such a dispute.

Meanwhile, the wording in this case described the coverage as being "to indemnify the Insured for Ultimate Net Loss the Insured pays by reason of liability … imposed by law" on account of various types of injury or damage "encompassed by an Occurrence". The courts considered that the wording, taken as a whole and on a natural reading, related to actual liability. The courts then construed the wording as requiring that, whilst there had to be an occurrence of the required type, and this could be in respect of either actual or alleged injury, this was merely the gateway to establishing coverage. The insured and reinsured could only recover in cases of actual liability. References in the wording to alleged damage or injury merely permitted the insured to notify circumstances where the damage or injury was merely alleged and not yet confirmed, but were not apt to convert the basis of coverage in the policy.

The Court of Appeal pointed out that there are ways of circumventing such difficulties. Instead of being drafted to respond to actual liability, the wording might have been drafted to provide coverage for claims made, or judgments given, or for loss arising from specified occurrences. Alternatively, the reinsurance might have contained a follow settlements clause, binding the reinsurer to follow the settlements of the reinsured, in which case the reinsurer would be bound if the reinsured had made a settlement in a reasonable and business-like manner. Alternatively, the wording might have contained a QC clause, or provisions whereby actual liability, as between the insurer and the insured, would be taken to have been established if certain conditions were met. Finally, the reinsured could seek the consent of his reinsurer to the settlement.

The Court of Appeal pointed out, however, that it would be "heretical" to construe the insurance as providing coverage for liability established by a reasonable and bona fide settlement or by a judgment, irrespective of whether there was an actual legal liability. (The position would be different in an insurance governed by New York law because of a substantive principle of law whereby an insurer who is bound to defend a claim of which he is notified, but who declines to do so, is bound by a reasonable settlement made in good faith or by a judgment against the insured.)

Turning to defence costs, the courts pointed out that, under English law, there is, in respect of non-marine liability insurance, no right to recover defence costs. Meanwhile the wording in this case stated expressly that the insurer had no duty to defend and that defence costs covered by the policy were included within, and not in addition to, the limits of liability of the policy. The Court of Appeal held that any entitlement to recover defence costs therefore had to depend on a freestanding entitlement under the policy.

The Court of Appeal also pointed out that, on a literal reading of the wording, defence costs could never be recovered. This was because defence costs would never be incurred (as the policy provided) by reason of a liability imposed by law and were not sums which the insured would be obliged to pay by reason of a judgment or settlement: defence costs are sums which become due pursuant to a contract between the insured and its lawyers.

Accordingly, the courts had to determine the parties' intention in relation to when defence costs should be recoverable. The only way to do this, consistent with the policy wording, was to treat the entitlement as dependent on the entitlement to damages. Here again, therefore, there had to be an actual liability before defence costs could be recovered.

The Court of Appeal accepted that this was clearly an unsatisfactory result from AZICO's point of view, but considered that the policy wording could not be treated as intended to be favourable to the insured.

Judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWCA/Civ/2013/1660.html&query=X+and+L+and+Insurance&method=boolean

2. **Equitas Limited v Walsham Bros, Commercial Court – Males J – 28 October 2013, [2013] EWHC 3264**

Full judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Comm/2013/3264.html&query=walsham&method=boolean

Equitas, the successor to Lloyd's syndicates writing non-life business for 1992 and all prior years of account, claimed that the defendant broker, Walsham, had received substantial sums which it ought to have remitted, either to the syndicates themselves before September 1996, or to Equitas thereafter. Equitas claimed that it had lost substantial investment income. Walsham acknowledged a duty to remit such sums, but contended that any claim was now time-barred.

Background - During the late 1980s and early 1990s there was turmoil in the Lloyd's market, arising out of syndicates' exposure to crushing long-tail liabilities, including in relation to asbestos and pollution claims from the USA, and also a series of catastrophes. Equitas argued that, during this period, Walsham had failed to remit to syndicates substantial funds which it had received. Such funds fell broadly into two categories, (1) claims received from outward protections placed with reinsurers or retrocessionaires and (2) reinstatement premium due on inwards business.

In cases where Walsham had paid over the funds received after substantial delay, Equitas claimed for loss of investment income. In cases where Walsham still had not paid over the funds received, Equitas claimed both the principal sum and lost investment income.

Nature of the proceedings - The court was requested to determine a number of issues of principle as a step along the way in resolving the dispute. The action proceeded on the basis that Equitas would, in due course, be able to make good its claim that at least some payments were not made reasonably promptly upon receipt and that other payments were not made at all. Equitas asserted that it was entitled to bring a claim as assignee of the syndicates and that duties were also owed directly to Equitas following a settlement agreement in 1996 entered into by market participants as part of a package of agreements giving effect to reconstruction and renewal at Lloyd's.

In summary, Equitas argued that it was entitled to recover damages for Walsham's breach of duties to remit funds reasonably promptly upon receipt, such duties arising as a matter of contract, tort and restitution. Walsham's failure had first occurred more than six years before the commencement of the proceedings. Equitas framed its case in tort as well as contract in order to take advantage of the later-expiring limitation period that often characterises a claim in tort, particularly if ss.14 A and B Limitation Act 1980 apply. Equitas also sought to avoid any defence of time-bar by arguing that the duties owed by Walsham were continuing duties, such that a fresh cause of action arose every day that Walsham failed to make a remittance. Alternatively, Equitas argued that there had been deliberate concealment by Walsham, such that the running of the limitation period had been postponed.

Walsham accepted that it was obliged to remit funds received reasonably promptly. It did not accept that it had failed to do so. However, Walsham contended, no doubt in view of the limitation issue, that its duty arose exclusively as an absolute obligation in contract and restitution, but not in tort. Males J made findings as follows:

Market understanding of the duties of Lloyd's brokers – The expert evidence was that the duties owed by Lloyd's brokers were (i) to collect reasonably promptly from the reinsured and pay reasonably promptly to the reinsurers all premiums, net of applicable brokerage and claim refunds, (ii) to notify the reinsurers reasonably promptly of any potential claims advised by the reinsured and to notify the reinsured reasonably promptly of any questions raised by the reinsurers, (iii) to collect reasonably promptly from the reinsurers all valid claims (and returns of premium) and pay these reasonably promptly to the reinsured and (iv) to administer the reinsurance contract in a professional and business-like manner, including the maintenance and preservation of proper and adequate records, and providing the relevant records, or copies thereof, to the reinsured and to the reinsurers, if requested.

Absolute duty – The judge held that the broker's contractual and restitutionary duty to remit funds reasonably promptly was to be regarded as an absolute duty, not merely a duty to exercise reasonable diligence. It was a general principle of the law of agency that an agent who held or received money for his principal was bound to pay it over or account for it.

The broker was at the same time performing a contract for the supply of a service, being the collection and remittance of funds on behalf of its client syndicates, with the result that a term was to be implied into the contract between the broker and its client that the broker would carry out that service with reasonable care and skill, pursuant to s.13 Supply of Goods and Services Act 1982. Further, it had been held in Equitas v Horace Holman (2007) that a broker owes a duty to take reasonable care to maintain proper and adequate records which would allow the syndicates, at any stage, to ascertain the true state of the account with them and what sums were owed to the syndicates by their reinsurers, as well as to preserve and produce such records on request. However, the fact that the broker was additionally under these duties did not derogate from the absolute nature of the obligation referred to above.

Duty in tort – Males J held that the syndicates relied on brokers to administer their reinsurance policies, and that responsibility was assumed and undertaken by brokers. Accordingly, brokers assumed a duty of

care towards such syndicates, unless this was inconsistent with, or excluded by, the terms of any contract between the parties.

Whether time bar was overcome by the broker owing a continuing obligation – Walsham was held to be under a continuing obligation to maintain accounts and administer the syndicates' reinsurance policies. In the circumstances, this was not a case where the broker was merely under a once-and-for-all obligation to provide payment on a due date. The broker owed continuing duties to Equitas (no distinction was to be made as to whether the duty arose in contract, tort or restitution). The Judge's decision meant that, in respect of funds held by Walsham, there was in principle a fresh cause of action accruing each day when those funds were not paid over. Therefore, Equitas was entitled to recover damages in respect of Walsham's breaches of its continuing duties in the six years preceding the commencement of the action. Any funds held by Walsham which had not been paid over would be recoverable.

Entitlement to compound interest – Males J approved an earlier authority to the effect that the law proceeds on the basis that the measure of the successful claimant's loss is the cost of borrowing to replace the money of which he has been deprived, regardless of whether the claimant actually did borrow. A conventional rate is used representing the cost to commercial entities similar to the claimant. Males J held that such interest should be compounded on a basis reflecting the commercial terms that would have been available, unless this would produce an unfair result in any specific case.

From when does interest run? – Lloyd's 1988 Code of Practice for Lloyd's Brokers provided that brokers were entitled to interest or investment income earned on funds held in their Insurance Broking Accounts ("IBAs"). However, Males J held that the broker was merely entitled to retain interest earned during the relatively short period until the broker was obliged to remit funds to its client. The action proceeded in accordance with Equitas's understanding that, pursuant to the usual procedures of the market, payment ought to have been remitted by at least the first day of the month, two months after the month in which funds were actually received by the broker.

Investment income – It had been foreseen and widely publicised at the time of reconstruction and renewal that Equitas, with its economy of scale and ability to invest on a longer term basis than syndicates with their 36 month period of account, should be able to obtain investment returns significantly better than those previously achieved by individual syndicates. Therefore Equitas, rather than claiming interest on funds not remitted after September 1996, claimed damages for lost investment income by reference to the actual investment returns it had achieved. Males J held that Equitas was entitled to recover on this basis.

However, the judge was at pains to emphasize that the issue had only been the subject of limited argument before him. The only reason advanced as to why Equitas should not, in principle, recover its lost investment income had been that the damages were too remote. Walsham had not, for example, argued that Equitas had failed to mitigate by borrowing in the market to make good the payments which Walsham had failed to remit, which would then have enabled Equitas to use the borrowed funds to achieve its investment return. Because that case had not been advanced, it had not been necessary to consider whether Equitas would have had a good answer, to the effect that failure to borrow funds to replace what it did not know was missing could hardly be regarded as a failure to mitigate. Walsham had also accepted that the improved investment return which Equitas was expected to achieve was within the parties' reasonable contemplation.

In terms of how far back Equitas could go in claiming interest and damages for loss of investment income, the judge pointed out that this would not necessarily extend back to losses arising from breaches committed more than six years prior to commencement of the proceedings. This would depend on whether Equitas succeeded on any of its additional limitation arguments, such as deliberate concealment.

Implications - Subject to any appeal, this case should assist clients to obtain compensation from insurance and reinsurance brokers. The case clarifies that the broker's duty to remit funds reasonably promptly is absolute and not merely a duty to exercise reasonable diligence. Further, brokers are liable to pay compound interest on funds retained beyond the point at which such funds would normally be remitted. The decision also illustrates that funds can be recovered from brokers even when the broker first breached its duty to pass on funds more than six years prior to the commencement of proceedings. Finally, damages for lost investment income may be available in respect of funds remitted late.

USA Cases

1. Extrinsic Evidence Admitted in respect of Duty to Defend

BioChemics Inc v AXIS Reinsurance Co, 2013 US Dist LEXIS 111218 (D. Mass. Aug 7, 2013):

US District Court for the district of Massachusetts considered when an insurer is entitled to rely on extrinsic evidence for determining its duty to defend.

AXIS insured BioChemics under a claims made and reported directors and officers policy for the period November 13, 2011 to November 13, 2012. BioChemics sought a defense in connection with an SEC enforcement action filed during the period the policy was in effect. BioChemics also sought a defense for two SEC subpoenas issued by the SEC during the policy period. AXIS, however, took the position that BioChemics was not entitled to coverage for these matters because they related back to a series of subpoenas served by the SEC prior to the policy's date of inception, at a time when BioChemics was insured by a different carrier. In support of its position, AXIS relied on a provision in its policy's Limits of Liability section stating that:

All Claims, including all D&O Claims . . . arising from the same Wrongful Act . . . and all Interrelated Wrongful Acts shall be deemed one Claim and such Claim shall be deemed to be first made on the earlier date that: (1) any of the Claims is first made against an Insured under this Policy or any prior policy . . . .

Notably, the subpoenas served by the SEC both prior to and subsequent to the AXIS policy's date of inception all had the same SEC matter identification and number.

BioChemics filed a declaratory judgment action and subsequently moved for summary judgment on the duty to defend before the commencement of discovery, asserting that the duty to defend is based solely on the complaint and the policy, and that as such, discovery was not necessary. AXIS opposed the motion, asserting that at the very least, it was entitled to discovery into communications between BioChemics and the SEC so that it could confirm whether, in fact, the subpoenas served prior to its policy's inception were interrelated with the subsequent subpoenas and the enforcement action, thus comprising a "single, ongoing claim" first made prior to the policy period.

The court acknowledged a line of cases cited by BioChemics standing for the proposition that insurers cannot rely on extrinsic evidence for the purpose of determining a duty to defend. The court went on to note, however, that this line of cases does not apply to extrinsic facts that will not be litigated in the underlying matter. The court further observed that in the context of claims made and reported policies, the rule against consideration of extrinsic facts cannot be rigidly applied since coverage issues such as the timing of the claim are unlikely to be alleged in the underlying complaint. While the court acknowledged it a close question, it ultimately held that:

… an insurer may use extrinsic evidence to deny a duty to defend based on facts irrelevant to the merits of the underlying litigation, such as whether the claim was first made during the policy period, whether the insured party reported the claim to the insurer as required by the policy, or whether the underlying wrongful acts were related to prior wrongful acts.

As such, the court allowed AXIS to proceed with discovery into the interrelatedness issue, and denied BioChemics' motion for summary judgment without prejudice. The court further held that under Massachusetts law, AXIS was not required to provide BioChemics with a defense pending determination of the duty to defend issue.

Case note submitted by Section Member, Rich Traub and authored by his partner, Brian Margolies, of Traub Lieberman Straus & Shrewsberry LLP.

2. Jurisdiction over a London Market Placement

Instituto Nacional Seguros v Hemispheric Group and Howden Insurance Brokers (Case No. 10-33653 CA 04 (Fla. Cir. Ct. Apr. 10, 2013)).

Instituto Nacional Seguros (INS), a Costa Rican insurer, retained HRG, a Miami broker, to place reinsurance of a property account. HRG, in turn, retained Howden to place it in the London market, which Howden did. INS later brought proceedings in Florida against HRG and Howden. The assertions included claims in tort for negligence and breach of fiduciary duty. INS argued that the parties' relationship began in Florida and that the centre of their relationships remained Florida, through which the relevant funds flowed. On this basis, INS asserted that the law of Florida should apply to the claims for negligence and breach of fiduciary duty.

Howden argued that English law should apply to those claims, since Howden's conduct took place entirely in England. Howden argued there could be no "centre" of the relationship, as there was no direct relationship between itself and INS.

The Court found in favour of INS, holding that Florida law applies to INS' tort claims against Howden under Florida's *"most significant relationship"* test.

Case note submitted by Stephen Carter, Carter Perry Bailey LLP.

3. Excess Insurance

3.1. Equitable Subrogation

Steadfast Ins Co v Agricultural Ins Co (No. 10-5113 (10th Cir. December 10, 2013))

Having received a certified opinion from the Oklahoma Supreme Court declaring that a second level excess insurer can pursue a claim for equitable subrogation against an umbrella carrier, the Tenth Circuit ruled that Great American can challenge Steadfast's purported exhaustion of its underlying insurance by placing nine years worth of flooding losses into a single policy year. However, the Court of Appeals also ruled that the higher level excess carrier could not recover for a claimed breach of the implied obligation of good faith and fair dealing, as the carriers were not in contractual privity.

3.2 Exhaustion

Quellos Group v Federal Ins Co (No. 68478-7-I (Wash. App. November 12, 2013))

The Washington Court of Appeals has joined the growing body of courts that have adopted the *Qualcomm* view of exhaustion. In this case, Division One ruled that D&O policies that respectively provided that their excess coverage "shall attach only after the insurers of the Underlying Insurance shall have paid in legal currency the full amount of the Underlying Limit" or "will attach only after all of the Underlying Insurance has been exhausted by the actual payment of loss by the applicable insurers thereunder" did not cover

large securities claims where the insured had entered into settlements with the underlying insurers for less than full limits. The Court of Appeals distinguished the Second Circuit's venerable *Zeig* opinion and declined to set aside clear requirements to coverage based on the public policy favoring settlements.

3.3 Allocation

Cleaver Brooks Inc v AIU Ins Co (2013AP203 (Wis. App. October 29, 2013)).

In a case where a trial judge had ruled in an earlier law suit among the parties that certain excess policies issued by AIG companies were jointly and severally liable for indemnity payments arising out of the asbestos liabilities of a former boiler manufacturing subsidiary of Coca Cola, the Wisconsin Court of Appeals has ruled that Wisconsin case law gave the insured the option of choosing more than one of the Insurers at a time to indemnify it for a given claim, such that the Insurers' payments are proportional to their liability and will exhaust at the same time. In this case, District I rejected the insurers' effort to fund the insured's liabilities entirely through the excess policies issued by AIU and National Union and not under a Lexington policy that did not provide for the payment of defense costs and which would ultimately have deprived the insured of coverage for defense costs upon the exhaustion of the AIU and National Union limits.

4. **<u>Reinsurance</u>**

4.1 Cut Through Clauses

Trenwick American Re v Unionamerica Ins Co (2013 US Dist. LEXIS 97518 (D. Conn July 12, 2013)).

A federal district court in Connecticut has ruled that a party to a reinsurance assumption agreement has the right to compel arbitration of its dispute pursuant to a cut through clause with the reinsurer even though the assumption agreement itself did not contain an arbitration clause. In this case, Judge Arterton emphasized the fact that the assumption agreements were physically attached to and referenced within the terms of the facultative reinsurance agreements. Further, the court held that a signatory to an agreement containing an arbitration clause is estopped from avoiding arbitration with the non-signatory when the issues the non-signatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed. Finally, the court refused to allow the reinsurer to carve out a statute of limitations defense independently of the arbitration proceedings.

4.2 Coverage Denial Upheld

Public Risk Management of Florida v One Beacon Ins Co (2013 WL5705575 (M.D. Fla Oct 18, 2013))

This was a Florida law case in which the Federal Court upheld a reinsurers' denial of coverage to the reinsured, for its claim arising from an underlying lawsuit that sought relief based solely on the insured's failure to pay under a construction contract. The Court found that there was no alleged *"wrongful act"* and the policy contained an exclusion for intentional breaches of contract. Although the insurer had funded the defence of the claim, the reinsurer had refused to provide coverage because it argued that the litigation was not actually covered under insurers' policy in the first instance. The Court agreed that there was no coverage under the policy, because there was no allegation of any purported *"wrongful act"* by the insured in the underlying claim, and, even if there were such allegations, the contract exclusion would bar such coverage. The insurers' argument that a reservation of rights letter from the reinsurer conceded coverage was also rejected.

Submitted by Stephen Carter, Carter Perry Bailey LLP

5. **<u>Insolvency</u>**

Farmers Mut. Fire Ins. Co. of Salem v. New Jersey Property-Liability Insurance Guaranty Assoc., (A-42-11 (N.J. September 24, 2013)).

The New Jersey Supreme Court ruled that 2004 amendments to the PLIGA Act stating that "[e]xhaustion occurs only after a 'credit for the maximum limits under all other coverages, primary and excess, if applicable, issued in all other years has been applied'" requires that an insured exhaust all available insurance in other years before the state Guaranty Fund must contribute to the cost of cleaning up an oil spill. The court rejected Farmers' contention that the state guarantee fund should pay shares of clean-up costs attributable to the now-insolvent Newark Insurance Company, declaring that the 2004 amendments to Section 17:30A-5 trumped any allocation otherwise provided for under *Owens-Illinois*. The court found that the PLIGA Act was passed in order to mitigate the financial distress to insureds and claimants resulting from an insurer's insolvency and was not intended to benefit insurers and that the 2004 amendments were partially in response to the Appellate Division's opinion in *Sayre v. INA*, 306 N.J. Super. 209 (App. 1997) which had required the guarantee fund to pay orphan shares attributable to insolvencies. The court ruled that such statutory amendments take precedence over the common law pro-ration scheme that the court had adopted in *Owens-Illinois*. Further, it found that these amendments did not unconstitutionally impair Farmers' contractual relationship with its policyholder since, in the context of a highly regulated industry such as insurance, there could be no "contractual expectation" that a regulatory scheme will forever remain unalterably fixed. The court concluded that insurers have been on notice since *Owens-Illinois* that its opinion was not the last work in long-tail continuous trigger cases and that the PLIGA Act, being motivated by legitimate public policy bills, imposed reasonable conditions to meet appropriate governmental objectives. Accordingly, it affirmed the opinion of the Appellate Division.

Above US case notes submitted by Section Vice Chair, Mike Aylward, unless otherwise stated.

…And More Cases from London

1. **Reinsurance Allocation**

Teal Assurance Co Ltd v W R Berkley Insurance (Europe) Ltd and another [2013] UKSC 57

This was the case that came out on the day of the Section Meeting at The Broadmoor, and which formed part of that discussion.

Teal, a captive insurer, provided its parent with a US$60m tower of professional indemnity insurance. Teal also provided excess insurance to its parent, in the form of a top and drop cover. This contained a limit of £10m sterling and excluded American claims (which the underlying tower did not). This excess policy was reinsured by WR Berkley and others.

Claims arose such that if non-American claims were allocated to the tower first, American claims would fall under the top and drop, but as they were excluded would not recoverable from reinsurers. Teal therefore argued that the American claims should be allocated first; it had chosen to discharge them first and the policy wording required the insured to have "paid" prior to the insurer indemnifying the insured.

The Court of Appeal found against Teal. The Court relied on the proposition that, in the case of liability cover, the obligation of the insurer and the reinsurer arises at the point that the liability of the insured is established (not discharged) and the amount of the liability has been ascertained, whether by litigation, arbitration or settlement. The Court rejected the proposition that the reinsured had freedom of choice in

the ordering of losses because this could not readily "be reconciled with the basic philosophy that insurance covers risks lying outside an insured's own deliberate control". It was held that the claims became due in the order that Teal became liable by way of judgment or admission and not in the order in which it decided to discharge them.

Judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Comm/2011/91.html&query=teal&method=boolean

2. Follow The Settlements

Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd [2013] EWHC 3362 (Comm)

Under a *"follow the settlements"* clause, the reinsured only has to establish that the claim arguably falls under the reinsurance, not that it does on the balance of probabilities.

Judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Comm/2013/3362.html&query=tokio+and+marine&method=boolean

3. Policy Construction

British American Insurance (Kenya) Ltd V (1) Matelec Sal (2) Thika Power Ltd [2013] EWHC 3278 (Comm)

Unusually, a single document constituted both the insurance and reinsurance contracts. The original policy document contained a law and jurisdiction clause that stated only the word *"Kenya"*. By endorsement, this was changed so as to identify English law, the jurisdiction of the Kenyan Court and London arbitration. In finding that the English law and London arbitration provisions applied to both the insurance and the reinsurance, the Court decided that where the language of the parties can be construed in two different ways:

- The Court should generally adopt the interpretation that would make more commercial sense.
- The Court should do its best to reconcile the provisions, going to the margins of what can conscientiously and fairly be done, but no further.

Judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Comm/2013/3278.html&query=thika&method=boolean

4. Breach of Warranty

Amlin Corporate Member Ltd & Ors v Oriental Assurance Corp [2013] EWHC 2380 (Comm)

A warranty not to sail when there is a storm warning had been breached when the vessel sailed into the eye of Typhoon Frank, thereby, in accordance with its terms, avoiding the contract of reinsurance.

Judgment:

http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Comm/2013/2380.html&query=amlin&method=boolean

UK cases submitted by Stephen Carter, Carter Perry Bailey LLP

… And From Ireland

Rhatigan v Eagle Star Life Assurance Company of Ireland Ltd [2013] IEHC 139 (High Court, Cooke J, 15 March 2013)

Eagle Star was not required to provide discovery of documents prepared in anticipation of repudiation of a life insurance policy, as these documents were protected by litigation privilege. A decision to repudiate is so likely to provoke litigation, that the steps taken by an insurer towards making such a decision must necessarily be characterised as steps taken in contemplation of litigation. Communications between the insurer and reinsurer were also protected by privilege.

Judgment:
http://www.bailii.org/cgi-bin/markup.cgi?doc=/ie/cases/IEHC/2013/H139.html&query=rhatigan&method=boolean

Submitted by Section member Kieran Cowhey, Dillan Eustace, Ireland

… And Finally….. in Myanmar

A new market opens up? Myanmar, currently closed to foreign insurers, expects to open its market up in 1-2 years. They are also considering establishing a state owned reinsurer to take a proportion of all risks written by local companies, with the rest being reinsured in overseas markets. Watch this space!