

## Insurance/Reinsurance

# Reinsurance Fraud Allegations are Justiciable

## *Korea National Insurance Corporation v Allianz Global*

**In this unusual case, the Court of Appeal ruled that reinsurer (Allianz) allegations of fraud against the North Korean state-owned insurer, KNIC, are “justiciable” (i.e. capable of being tried in England), and therefore capable of forming a defence to KNIC’s reinsurance claim, despite the potential of those allegations to cause diplomatic embarrassment between the UK and North Korea.**

Overcoming Allianz’ allegation of fraud, KNIC had obtained judgment in the North Korean court against Allianz, in accordance with the jurisdiction clause in the reinsurance contract, and sought to enforce the judgment in the UK. Allianz alleged the judgment had been procured by a fraud, instigated or approved by the North Korean Government with KNIC’s knowledge or participation, and that the judgment was unenforceable on public policy grounds since the North Korean judiciary, which gave the judgment, was controlled by the Government, which instigated or approved of the fraud.

The fraud allegations directly concerned the claim itself (which involved a helicopter crash and resulting damage to a warehouse and its contents), but also relied on fraud inferred from a breathtaking litany of past alleged criminality on the part of the North Korean state, including the involvement of North Korean diplomats in drugs trafficking, and state involvement in counterfeiting currency, cigarettes and pharmaceuticals.

These fraud issues will not now be decided by the court, because the case has been settled, nevertheless the Court of Appeal did rule that the fraud allegations were justiciable and should not be struck out. This

rested partly on the fact that the British Government, despite having been given the opportunity, had not indicated that a decision would embarrass diplomatic relations with North Korea, and partly on the fact that the relevant legal authorities did not support any proposition that, in a commercial context, when allegations are made against a state, not in relation to a sovereign act carried out in its own jurisdiction but in relation to acts which affect the rights of a party under a commercial contract, the court should exercise restraint. Waller LJ said *“If a foreign state were an insured under an insurance contract the insurers cannot be precluded from alleging a fraudulent claim simply because that might embarrass the foreign state. It cannot be any different if a state entity makes the claim and it is asserted that both the entity and the state owner were involved in the fraud.”*

The case is quite unusual and may be confined to its facts. Nevertheless it may provide some comfort to re/insurers of state-controlled entities in certain regimes which are starved of hard currency and where the independence of the judiciary and the state is, at best, questionable.

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## Drop Down Clauses in Umbrella Policies

Multi-national assureds often supplement local insurance cover (within a given single jurisdiction) with a worldwide master or umbrella insurance policy which responds in excess of the local policy limit. Sometimes, the umbrella policy will contain “drop down



clauses" – which operate so as to reinstate cover under a local policy which may otherwise have been exhausted. This can give rise to the question: on what terms is the local cover reinstated?

In *Flexsys America L.P. v XL Insurance Company Ltd*, Tomlinson J. had to consider a claim by Flexsys under its global umbrella liability policy (US\$25 million x/s US\$1 million) after a local US liability policy up for \$1 million had been exhausted in defending "advertising liability" claims. Aside from the different policy limits, the local policy provided cover against advertising liability on terms which were materially broader than those of the master policy. Flexsys tried to argue that the drop down clause in the umbrella policy not only reinstated the broader terms of the local cover, but sought to apply those broader terms up to the full policy limit of the master umbrella cover (\$25 million) rather than just the \$1 million limit of the local policy.

Tomlinson J. decided that Flexsys could not do so. His starting point, not surprisingly, was that the operation of a drop down clause would be dependent upon its wording, which in the present case was: "In the event of total exhaustion of a local policy this [master/umbrella] policy will continue in force as the underlying insurance, subject to the terms .... of the particular local policy". Whilst the facts giving rise to Flexsys' exposure, which could trigger the local policy but not the master policy, may have been the exception rather than the usual or paradigm case, there was no reason not to give effect to the terms of the umbrella policy in respect of the loss above the limit of the local policy. The court therefore applied the terms of the umbrella policy and refused Flexsys' claim for cover up to the limits of the master policy, as if it had been written on the terms of the broader local policy.

The case highlights the importance of policyholders and their insurers co-ordinating the terms on which local and umbrella cover are purchased.

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## Credit Where Credit is Due

On 1 May 2009 the Department for Business, Enterprise and Regulatory Reform ("BERR") announced the launch of the government trade credit insurance top-up scheme. See the following for full details:

<http://www.businesslink.gov.uk/bdotg/action/detail?r.lc=en&ty.pe=ONEOFFPAGE&itemId=1082435828&r.s=s1>

The scheme will run until 31 December 2009. It is hoped that the scheme will be of use to businesses who are at the limits of

their trade credit insurance availability. The suppliers will be able to purchase government-backed trade credit insurance. The value is determined by the level of cover provided by the existing underlying trade credit insurance policy. The minimum amount of cover is £20k and a maximum £5bn is available under the scheme.

### ABI Statement

Just prior to the BERR announcement, ABI published a statement of principles for trade credit insurance. The statement may be found at:

[http://www.abi.org.uk/Document\\_Vault/Trade\\_Credit\\_Statement\\_of\\_Principles.pdf](http://www.abi.org.uk/Document_Vault/Trade_Credit_Statement_of_Principles.pdf)

The principles set out how trade credit insurers operate and what their clients can expect from them. The ABI notes that many credit insurers already follow those minimum standards, and indeed some go beyond them. The ABI has also published advice to businesses on trade credit insurance to assist clients of credit insurers in understanding the information expected from them. The link to that advice is:

<http://www.abi.org.uk/Members/circulars/viewAttachment.asp?EID=22610&DID=17616>

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## Credit Insurance in the Economic Downturn

Credit insurance plays a vital role in companies' trading activities and financial stability. The sectors heavily reliant upon credit insurance include the construction, electronics and retail sectors and these are areas which have been badly hit in the current economic downturn.

Since the end of last year a number of countries have taken steps to shore up the availability of credit insurance to safeguard trading activity. At the end of last year France introduced CAP, an initiative intended to supplement the credit insurance already provided to companies. In the last month France has announced a further initiative, CAP+, intended to provide credit insurance cover for risks that are considered uninsurable. In Canada the government have offered up to C\$1 billion in funding to the country's six private credit insurers. Portugal has expressed an interest in purchasing a local credit insurer to secure additional support for the country's exporters. In the UK too, Alistair Darling has announced a credit insurance initiative.

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HFW has recently advised a number of parties on their obligations under credit insurance policies. The prevalent issues focus on the pre-qualifying requirements for a covered loss and policyholders' adherence to their ongoing claims obligations under the policy.

There can be many pre-qualifying requirements. These include ensuring that the transaction from which the loss has flowed is in accordance with the requirements of the policy. Examples include requirements for retention of title clauses to be included in trade agreements; the transaction too must fall within the credit limit provided for that particular buyer; a policy may exclude trade with particular countries and so where a buyer's business is registered may be significant. In addition to these, there are normally ongoing reporting requirements for potential losses and disclosure of adverse information in relation to buyers.

Once the policyholder has suffered a loss, which is a covered loss as defined under the policy, there are ongoing claims conditions which must be adhered to. These can include ongoing reporting obligations and obligations to take reasonable steps to minimise losses. In relation to the latter, consideration should be given to whether such steps have been undertaken soon enough or whether the mechanics of any deals done to minimise losses breach any policy conditions such as maintaining rights against buyers and third parties for insurers. If trading on a global basis, what is reasonable may depend upon the debt recovery options available in a buyer's country.

Whilst adhering to policy terms sounds straightforward, difficulties in securing cover can come where companies, now notifying losses, in boom years have not needed to rely upon their credit insurance and so have not abided by the pre-qualifying policy obligations in their transactions. Companies trading on a global basis from business units worldwide face the logistical difficulty of ensuring their business units comply with policy conditions. In those cases it is important that trading and reporting protocols are in place for those business units that reflect the company's credit insurance obligations.

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## D&O Update

There have been a number of noteworthy events recently:

1. In recent weeks the Financial Services Authority (FSA) has signalled that it intends to take a far more aggressive approach to regulatory breaches. Their focus is not just on the companies themselves but also on the individuals at the helm

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of the companies. Any increase in enforcement action is likely to have a knock-on effect on D&O notifications/claims.

2. Banco Santander has agreed a \$235m settlement with Irving Picard, trustee for the liquidation of Bernard Madoff Investment Securities over its Madoff losses. A legal claim was brought against two funds run by Santander's investment management arm. It is anticipated that the bank's D&O insurers will face a potential payout following the settlement.
3. In our last bulletin we wrote about the intended introduction of a new responsibility for "senior accounting officers" of large companies as explained in Budget Note 62. The provisions are expected to be incorporated in the new Finance Bill 2009. This will require senior accounting officers of the relevant companies and large groups of companies to take reasonable steps to establish and monitor accounting systems within their companies to ensure such systems are adequate for the purpose of accurate tax reporting. Annual certification that the accounting systems in operation are adequate for the purposes of accurate tax reporting is required or, if they are unable to do so, they are required to specify the nature of any inadequacies and confirm that those inadequacies have been notified to the company auditors. Penalties will be levied against them personally as well as the company where the obligations have not been met through careless or deliberate failure and for giving, whether carelessly or deliberately, an incorrect certificate or notification. The level of such penalties is unclear. It is likely that this will have an impact on financial directors' duties. It is anticipated that the Finance Bill will receive formal assent at some stage this summer.
4. Lord Justice Jackson's preliminary report on civil litigation costs was published on 8 May 2009. Whether this review on costs will accelerate discussion for changes in legal processes permitting contingency fees and greater access to collective redress is something which needs to be followed closely given the potential effect it could have on claims across the board.
5. Finally, the prosecution of Cotswold Geotechnical Holdings, on which proceedings commence on 17 June 2009, is the UK's first prosecution for corporate manslaughter under the Corporate Manslaughter and Corporate Homicide Act 2007, which came into force on 6 April 2008. The fact that a director of the firm has been charged with gross negligence manslaughter is a stark reminder for all directors to check their D&O insurance policies to ensure they have adequate cover.

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## Block Exemption: European Commission to focus more on Insurance & Reinsurance

On 24 March the European Commission ("Commission") published its preliminary views on renewal of the Insurance Block Exemption Regulation (BER). The BER, which will expire on 31 March 2010, exempts certain agreements between insurance companies from the EC competition rules which ban restrictive business practices. The Commission thinks that two of the four categories of agreements currently exempted by the BER could be renewed: exchange of statistical information for the calculation of risks and the creation of co-insurance and reinsurance pools. But the Commission thinks that it is unnecessary to renew the exemption for non-binding standard policy conditions (SPC) for direct insurance, non-binding models on profits, or technical specifications for security devices and their installation and maintenance.

Without a BER, relevant agreements are not illegal automatically, but insurers would have to self-assess whether their agreements fall within the scope of competition law and, if so, whether they could be considered "exempt".

On the formation of pools, contrary to the position with SPCs, the Commission accepts that there is a special need for co-operation, because without pools certain types of risk might not be insured adequately or at all. The Commission plans to tighten BER rules for pools, for example on market share, and by emphasising the need for a careful legal assessment.

The Commission believes that the insurance/reinsurance sector has not been examined as closely as other financial services and that this *"is likely gradually to change"*. In particular, the Commission quotes many cases where businesses mistakenly believe that their practices comply with competition law. The Commission also remains concerned that the subscription market is not compatible with competition law, as it *"almost always results in an alignment of premiums and other conditions of coverage."*

The Commission would welcome feedback on its proposals, and the industry should focus more on compliance with competition law.

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## News: JLT Commtech Forum

HFW participated in the 6th JLT Global Communications, Technology and Media Annual Forum in Salzburg last month. A panel of experts and senior representatives from the insurance industry led a series of sessions over this three day event, presenting to multi-national insureds, brokers and insurers from the international communications, technology and media sector. Paul Wordley, Nigel Wick and Alison Proctor from HFW attended. We have been a supporter of the JLT Annual Forum from its inception and have presented papers across the world.

This Forum focussed on the topical issue of Global Insurance and Risk Finance in Times of Turmoil. The recent global economic slowdown and financial crisis are forcing policyholders to carefully review risk assumption, risk management and risk transfer. HFW's popular workshop, headed up by Paul Wordley, dealt with risk management in credit crunch times and provoked a lively debate addressing risk assumption, supplier contract review, supplier stability, counterparty risk and political and trade sanction risk on the risk assumption side and broker engagement terms, service provider contracts, captive management arrangements and claims handling and management on the risk transfer side.

## News: Lloyd's Rugby 7s

On 14 May 2009 HFW participated in this year's Lloyd's Rugby 7s tournament in Richmond, fielding another strong team. A large number of our clients and friends from across the London insurance market joined us in supporting this successful event.

## Conferences and Events

### **The Thirteenth Annual Cavell Rendez-Vous & InTap Technical Meeting**

St Andrew's Hall, Norwich (8-10 June 2009)

[Andrew Bandurka](#), [Costas Frangeskides](#)

### **C5 D&O Litigation Conference**

Grange City Hotel, London (16-17 June 2009)

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