

Insurance/Reinsurance

Brokers and Limited Liability Partnerships

Conversion to LLP status is something that is growing in popularity and we are working with several brokers keen to investigate the advantages it may confer.

LLP status was introduced in the UK in 2001 and has been popular with those businesses using the traditional partnership model, for instance, lawyers and accountants. Brokers, perhaps using a more traditional company structure, are now alive to the benefits that LLP status may afford.

LLP status brings with it a number of benefits:

1. LLP members are taxed as if they are self-employed, meaning that the LLP pays less in National Insurance.
2. Members of the LLP do not have shares or employment contracts; they are signatories to the membership agreement, which is a confidential document (unlike, say, articles of association).
3. The membership agreement can provide for profit share in a number of different ways with a level of flexibility that is not possible in a private company structure, when board and shareholder majority votes at meetings are required. This makes incentivisation, a huge current issue for brokers, more flexible.
4. The LLP structure is less hierarchical than the private company structure, arguably encouraging a greater sense of cohesion or camaraderie between members.
5. The LLP is tax transparent and is not charged corporation tax – each individual member is individually taxed on their share of profits.

Brokers should weigh the obvious potential benefits against the costs of conversion. Conversion to LLP status can be labour intensive; this is after all the incorporation of a new entity meaning a transfer of all existing business of the company to the LLP. For example:

- Regulatory authorisation will have to be in place for the new business.
- Any existing terms of engagement with clients or suppliers will need revision in order to provide that the services will be given to the client by the successor LLP.
- Bank accounts, client monies and facilities including leases will need to be transferred.
- An LLP agreement governing the operation of the LLP and the interaction between the members will need to be drafted.

However, the enormous advantages set out above may well be deemed to mitigate those expenses.

For new broker start-ups, however, the position is simpler (including the delivery of an application form and fee to Companies House and the drafting of a members' agreement) and certainly one that we believe will increase in popularity. The basics for incorporating an LLP can be seen in further detail on the Companies House website at <http://www.companieshouse.gov.uk/about/gbhtml/gbllp1.shtml>.

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Australia: APRA¹ Prudential Standards Alert

The revised Australian Prudential Standards (GPS 230 and 114) have important implications for non-APRA authorised reinsurers wishing to continue and/or enter business in the Australian reinsurance market and for Australian insurers who have claims which potentially have a long tail. This includes, for example, BI claims with a 24 month indemnity period, long tail IBNR claims and, for “claims made” policies, claims which are not resolved within 12 months of being notified.

One of the effects of the changes is that Australian insurers who reinsure with non-APRA authorised reinsurers now face an increased investment risk capital charge unless their reinsurer is able to provide appropriate collateral/security to the insurer in Australia.

Furthermore, stringent new requirements on when reinsurance recoveries must be paid by reinsurers potentially creates problems for those Australian insurers who have outstanding claims. In particular, Australian insurers who have claims which may take more than 12 months to resolve may be caught by a greater investment risk capital charge in certain circumstances.

Revised APRA standards

Increased Investment Capital Factors

Recent amendments to Australian prudential standard GPS 114 mean that all reinsurance placed with non-APRA authorised reinsurers will now attract an increased investment risk capital charge unless the non-APRA authorised reinsurers provides certain types of collateral² in Australia to the Australian insurer against reinsurance recoverables.

Furthermore, the investment risk capital charge will be significantly increased if:

1. There is a recoverable that is due and payable (“the receivable”);
2. The receivable is overdue for more than six months since a request for payment has been made to the reinsurer; and,
3. There is no formal dispute between the insurer and reinsurer in relation to that receivable.

The above changes apply to all reinsurances incepting on or after 1 July 2008.

In addition, for reinsurances incepting on or after 31 December 2008, insurers who have claims which have the potential to remain outstanding for a period past the second balance date of when the claim occurs (or, in the case of a claims made policy, is notified) also face a significantly increased investment risk capital charge for those claims. Again, this may be avoided if the reinsurance recoverables are supported by collateral, guarantee or letter of credit.

The possible implication of these changes is that an Australian insurer is effectively being penalised for reinsuring with a non-APRA authorised reinsurer. Potentially affected reinsurers should therefore give consideration to becoming APRA authorised or, alternatively, to making arrangements with their Australian reinsureds for acceptable collateral to be put in place.

Contract certainty of reinsurance arrangements

In addition, GPS 230 now provides for a “two month” and “six month” rule in respect of documentation relating to the reinsurance arrangements that must be complied by the insurer. These can be summarised as follows:

1. Within two months after the inception date(s) of the reinsurance arrangement, the insurer should have a placing slip(s) which has been signed and stamped by all participating reinsurers with no outstanding terms or conditions. If the insurer does not have a placing slip(s), the insurer must have a cover note(s) issued by the participating reinsurers and/or appointed reinsurance broker. The insurer also needs to have systems to verify that the content of the cover note(s) is the same as the placing slip(s) agreed between the insurer and the reinsurer(s).
2. Within six months after inception date(s) of the reinsurance arrangement, the insurer must have either complied with the requirements as provided under the “two month” rule, or have in its possession a full treaty contract wording (including any attachments) that has been signed and stamped by all contracting parties.

Law and jurisdiction of Australian reinsurance

Finally, all reinsurance for Australian reinsureds incepting on or after 31 December 2008 must be subject to Australian law and jurisdiction³.

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1. Australian Prudential Regulation Authority
2. This includes assets in Australia as part of a trust, deposits held by the insurers, etc. Further details of acceptable collateral can be provided on request.
3. GPS 230, paragraph 31.



Binders and Ownership of Business: right to conduct run-off after termination of agency agreement

Disputes concerning the ownership of records and the rights to business renewals are quite common between underwriters and their (erstwhile) underwriting agents, particularly where the agent starts underwriting for a competitor. A recent Court of Appeal case considered the right of an underwriting agent (in this case a broker) to continue to service the run-off of the business after the agency agreement was terminated by the underwriter, against the wishes of the underwriter, in circumstances where the agency agreement was not clearly worded on this issue. The court relied on the nature of the fiduciary's obligations to hold that while an agent's *obligation* to act may remain in force post-termination, its *rights* to continue to act, against the wishes of the underwriter, will cease, save in very limited circumstances, (and that would possibly be so even had the agency agreement contained a clear stipulation allowing the agent so to act.)

Temple Legal Protection Ltd v QBE Insurance (Europe) Ltd concerned a binder under which QBE granted Temple authority to write legal expenses insurance on its behalf. Shortly into the term of the binder, the relationship deteriorated and Temple sought to terminate the agreement. The effective date of termination was disputed, but the parties agreed it was no later than 2 December 2006. In January 2007, QBE wrote to Temple saying it would assume all claims handling responsibilities relating to the policies written. Temple disputed the authority of QBE to handle the run-off and the matter went to arbitration.

The arbitrator found that Temple's right to handle the run-off was terminated by QBE's January letter. Temple appealed but the first instance judge agreed with the arbitrator. The Court of Appeal were then petitioned and Moore-Bick LJ gave the leading judgment.

The parties' experts agreed that it would be usual for a broker to conduct the run-off in such circumstances, and that the termination provisions of the binder were drafted on the assumption this would be so, although there was no clear stipulation to this effect. However, the judge held that this was very different to granting a broker an entitlement to continue to act. The relationship between an agent and a principal is fiduciary in nature, and Moore-Bick said it would be "*unusual, and in my view uncommercial, for any principal... to be*

obliged to allow that agent to continue to act on his behalf once the necessary degree of trust and confidence had been lost". The majority in the Court of Appeal found that such an obligation could only be imposed by clear language in the binder or in very limited factual circumstances, which did not exist in this case. Rix LJ felt that such an obligation would in any event have been revocable by the underwriter, unless certain limited circumstances existed.

The message for underwriting agents is that, despite what they might believe to be market practice, any provision in a binder that they are entitled to continue to act after termination of an agency agreement with underwriters needs at the least to be very clearly expressed in order to be effective, and might even be revocable by underwriters, where the necessary trust and confidence in the agent have broken down.

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The Commercial Court considers the scope of the West Tankers / Front Comer decision

The *Commercial Court in National Navigation Co v Endesa Generacion SA* [2009] EWHC 196 (Comm) has recently reviewed and applied the ECJ ruling in the West Tankers case (see March 2009 Bulletin) (which held that an anti-suit injunction preventing proceedings first commenced in another EU member state from progressing because they conflicted with arbitration proceedings in another state was incompatible with EC regulations) - and on the basis of that decision, also dismissed the claimant's application for a similar anti-suit injunction in this case.

However, importantly, the English court also held that it was not required to recognise a Spanish court judgment that an arbitration clause was not incorporated, and consequently granted the claimant's application for a declaration that certain disputes between the parties were referable to London arbitration.

The Facts

Endesa, a Spanish electrical generating company, chartered the Wadi Sudr ("the Vessel") from Egyptian company, National

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Navigation Co (“NNC”) to transport coal to Ferrol in Spain, where it was to be used in Endesa’s generating facility.

The terms of the bill of lading included a term that “*all terms, liberties and exceptions of the charterparty dated as overleaf, including the law on arbitration clause are herewith incorporated*”. However, the Vessel was subject to various potentially relevant charters. The head charter contained an English law and London arbitration clause. The voyage charter also contained a London arbitration clause.

In January 2008, the vessel was damaged and the coal discharged before it reached Ferrol. Endesa claimed that, due to the difficulties it then encountered to transport the coal onwards to Ferrol, it was forced to purchase a second shipment of coal and incurred substantial costs in doing so. Endesa claimed that NNC was liable for that additional cost.

Endesa commenced arrest proceedings in Spain and on that same day, NNC commenced proceedings in the Commercial Court in England and claimed that the English courts were first seised. Endesa subsequently commenced substantive proceedings before the Spanish court, which, a few months later, found that it had jurisdiction to hear the claim and that the English arbitration clause had not been incorporated into the bill of lading. However, the Spanish proceedings were then stayed pending resolution of the English Court’s jurisdiction. NNC subsequently filed applications in the English court for a declaration that certain disputes between the parties were referable to London arbitration and for an anti-suit injunction against Endesa.

Justice Gloster, in the English Commercial Court, held that the relevant charterparties contained London arbitration clauses, and therefore the English court did not have jurisdiction pursuant to Article 23 of EC Regulation No 44/2001 (“Regulation”) to hear the claim. She also found, after application of the West Tankers case, that she did not have the jurisdiction to grant an anti-suit injunction – because a preliminary issue judgment, such as that handed down by the Spanish court, on whether an arbitration clause was incorporated, did not fall within the arbitration exclusion in the Regulation, where the substantive proceedings themselves fell within the Regulation, so the granting of an anti-suit injunction would be inconsistent with the Regulation.

However, importantly, Gloster J held that she was not obliged to recognise the Spanish court’s judgment on the grounds that the proceedings before the English court did not themselves come within the Regulation. Gloster J further held that she would in any event have found it contrary to UK public policy to recognise that judgment because, pursuant to English law, it had been obtained

in breach of an arbitration agreement. Accordingly, Gloster J granted NNC’s application for a declaration that the bill of lading incorporated a London arbitration clause.

As can be seen, this case demonstrates that, as in the present case, there may be conflicting decisions from English and European courts as to the incorporation of an arbitration clause into a contract, which in turn may result in two separate actions on the substantive issues, one in a European court and another in arbitration in London.

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Legless in Durban – “I don’t think that these legs were ever going to make it round the Cape” - Proximate cause & inherent vice

Global Process Systems Inc and another v Syarikat Takaful Malaysia Berhad [2009] EWHC 637 (Comm)

The claimant owned a ‘self elevating mat supported jack-up oil rig’. It was also the assured under a ‘Takaful’ policy of cargo insurance underwritten by the defendant. The policy covered ‘all risks’ subject to specified exclusions. It excluded loss or damage caused by ‘inherent vice’ – i.e. the nature of the subject matter covered.

The claimant attempted to transport its jack-up rig on a barge from Texas to Malaysia. Its intention was to transport the rig with its legs still attached and sticking up. Prior to departure, technical advisers told the claimant that it was highly likely the stress limits of the legs would be exceeded during the voyage. In an effort to mitigate this problem, repairs were undertaken half way through the journey, at Saldanha Bay near Cape Town. Despite the repairs, the barge only got as far as Durban before the legs fell off into the sea.

The court heard from experts on both sides who agreed that the loss occurred because of metal fatigue caused by the motion of the barge as it was towed through the sea.

The defendant contended that the loss was excluded under the policy because the proximate cause of the loss was an ‘inherent vice’ in the legs – namely, their inability to withstand the voyage. It also said that the loss was inevitable and therefore not an ‘accident’.

The claimant argued that the proximate cause of the loss was inadequate repairs undertaken at Saldanha Bay.

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The court decided that although the failure of the legs as the rig was towed around the Cape of Good Hope was very probable, it was not inevitable. Nevertheless, the judge did find that the proximate cause of the loss was inherent vice; it happened despite the repairs, not because of them. The judge was persuaded by one of the defendant's experts, Jeremy Colman, who said that "I don't think that these legs were ever going to make it round the Cape".

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Further boardroom liability? A watching brief

HM Revenue and Customs have announced the introduction of a new responsibility for "senior accounting officers" of large companies and large groups of companies (effectively companies other than those defined as "small" and "medium size" in the Companies Act 2006). The rationale behind the proposals is to achieve greater corporate tax transparency.

The provisions incorporating the new responsibility will be introduced by the Finance Bill 2009 (the Bill). Budget Note 62 explains that the Bill 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. Those in such positions are required to certify annually that the accounting systems in operation are adequate for the purposes of accurate tax reporting or, if they are unable to so certify, 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 the senior accounting officers personally as well as on 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 currently unclear.

The Budget Note explains that these obligations will apply only to returns due to be made for accounting reference periods beginning on or after the date on which the Bill receives Royal Assent and as such it will be important to keep a watching brief. There is certainly a hint of the US Sarbanes-Oxley Act 2002 about it by the requirement of executives to demonstrate rigorous internal controls against fraud and other commercial risks.

Apart from the level of penalties which may be imposed upon the company or senior accounting officer there is a further potential issue. It is likely that the duties imposed will fall upon the finance directors in the relevant companies and therefore consideration needs to be given as to what effect these new duties may have on a financial director's exposures to shareholder action under the Companies Act 2006 for any loss suffered by the company as a result of his carelessness or failure to meet the duties imposed by this Bill. Companies that may be affected will need to give serious consideration to the new legislation once it receives Royal Assent to assess the additional exposures it places upon the relevant individuals charged with overseeing such internal controls in addition to satisfying themselves that their internal accounting systems enable them to meet the obligations imposed.

This new approach is unhelpful, dubious and entirely unnecessary. Whether it will increase tax revenue is questionable. No doubt the professional bodies will be lobbying strongly against its introduction.

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Conferences and Events

HFW Insurance Brokers Seminar

Friary Court, London (12 May 2009)

[Kapil Dhir](#), [Paul Wordley](#), [Andrew Bandurka](#),
[Nicholas Hutton](#)

BIBA conference

Manchester (13-15 May 2009)

[Kapil Dhir](#)

Lloyds Rugby 7s Tournament

Richmond Athletic Ground (14 May 2009)

[HFW Insurance/Reinsurance team members](#)

The 10 Big Issues for Insurers and Brokers in the Current Market - Stephen Ross, Deloitte

Friary Court, London (6 June 2009)

D&O Litigation (To what extent will the recent Companies Act reform lead to increased litigation?)

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

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