December 2008

Insurance/Reinsurance

HLB Kidsons v Lloyd's Underwriters & Others.

Getting Claims Notification Right – Fair, Comprehensive & Comprehensible

The Court of Appeal recently ruled on Gloster J.'s detailed analysis of the claims notification provisions in a claims made PII policy. At first instance, Gloster J. held that the information provided to underwriters was insufficient to trigger the "deeming" provision of the firm's PII policy save to the extent of a limited category of claims. This provision deemed that claims made after policy expiry were covered if they arose out of circumstances which had been validly notified within the policy period. Gloster J.'s test for a valid notification, that it was, "sufficiently clear and unambiguous to leave a reasonable recipient in no reasonable doubt", was rejected on appeal as being of no great assistance. The Court of Appeal instead held that any notification should be "fair, comprehensive and comprehensible". Where does this leave both insureds and insurers going forward? What constitutes effective notification?

Both Judgments provide essential guidance on the factors to be considered when making a notification. In summary:

- **What constitutes a circumstance which may give rise to a claim?** Here the policy provided that notice must be given "of any circumstances which may give rise to a claim". On appeal, Toulson LJ. held that this involved "a degree of crystal-ball gazing, an estimation of the likelihood of a claim". There does not need to be a certainty or even a probability or likelihood of a claim, only that the prospects of a claim emerging are real as opposed to false, fanciful or imaginary.
- **Who, in an insured organisation, is the knowledge holder for the purpose of a notification?** This is a two stage test. First, is the Insured **actually** aware of the relevant circumstances? The Kidsons case concerned a partnership. It was held that once the partnership secretary had been informed, as he had been given full authority to deal with insurance matters, his knowledge was imputed to the entire partnership. As to the second test, whose state of mind is relevant in deciding whether a circumstance should be notified, it was held that the subjective view of the Insured would only be relevant in exceptional circumstances. The question would usually be what would a reasonable person in the shoes of the Insured have recognised as a risk of a loss or claim?
- **What form should the notification take?** Unless the policy provides otherwise there is no specific form. In practice wording should be used that is fair, comprehensive and comprehensible and which leaves the recipient in no doubt that the purpose of the communication is to notify a circumstance.
- **To whom should the notification be made?** Again any requirements in the policy should be followed. Assuming the

policy is silent the test is whether an objectively reasonable recipient would consider the communication to constitute a notification. It is important to identify who exactly should receive the notification for it to be valid. Save where there are clear market agreements, the lead and all following underwriters should be notified.

- **Breadth of the notification?** A claim must be sufficiently casually related to the fact, event, happening or condition which comprises the notified circumstance, that it can be fairly said to have arisen out of it.

- **Conditions precedent and the effect of delay.** The Kidsons' policy provided that notice should have been given "as soon as practicable". Although it was accepted that this allowed the Insured a reasonable degree of latitude, it was held that a notification to underwriters further down the slip being both some months after the initial notification to the leading underwriters and post expiry of the policy was out of time. Here, although the giving of timely notice was not labelled a "condition precedent", it was held that the wording of the condition was such that timely notification must have been intended to be precedent to liability and the notice to the following market was therefore fatal to the claim (This final point has since been applied to a loss occurring wording in the case of *Aspen v Pectel [2008] EWHC 2804 (Comm)* where it was held that the Insureds failure to notify an occurrence promptly was a breach of a condition precedent).

HFW acted for HLB Kidsons. A small team, drawn from some of those involved in this case and others in the group would be delighted to present the issues, and advise on the implications of this. We are delighted to extend this offer to come and speak to your team, and to offer further guidance on this. Please let us know if you are interested in taking us up on this offer and the date and times convenient to you.

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Asbestos "Exposure" Trigger Confirmed

In the *Durham v BAI & Others (2008)* test case the Court endorsed the "inhalation/exposure" trigger which had traditionally been applied by the employer's liability (EL) insurance market to mesothelioma claims. The Court held that for the purpose of recovery under EL policies covering on an "injury sustained" or "disease contracted" basis, "injury is sustained or contracted when it is caused" and the policies would respond on the "inhalation/exposure" basis.

This EL Trigger Litigation arose from certain insurers' declining to pay EL mesothelioma claims on the traditional exposure basis, following the Court of Appeal's 2006 public liability (PL) decision in *Bolton MBC v Municipal Mutual*, where "injury" under this PL policy was held to have occurred (and coverage thereby triggered) not when exposure to asbestos fibres occurred, but 40 or so years afterwards, when a victim's tumour started to develop.

The Court held it was not bound by *Bolton* since that case concerned a Public Liability policy. Much weight has been given in the judgment to Parliament's and the Higher Courts' special approach in mesothelioma cases, to causation and the liability of successive employers/insurers. The matter is not finally resolved however, permission to appeal has been granted to the insurers. Watch this space.

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FSA - Treating Customers Fairly

By the end of December 2008, the FSA expects all firms involved in retail business to be able to demonstrate, through the use of management information, that they consistently treat their customers fairly in compliance with Principle 6 of the FSA's Principles for Business.

The FSA has made it clear that firms meeting its TCF deadlines will receive less regulatory scrutiny of their TCF arrangements. However, failure to meet the FSA's deadlines will result in increased FSA intervention.

It is worth noting that some market commentators have criticised the regulator's use of internal management information as a point of reference in measuring good customer treatment noting that there is little or no evidence to link the two.

However, TCF continues as a high priority in the eyes of the regulator and they have made it clear that the increased financial pressure on firms resulting from the current adverse economic conditions is no excuse for firms to focus more on immediate problems and not on conduct of business requirements.

A reminder of what is required from December can be found at: http://www.fsa.gov.uk/pubs/other/tcf_deadline.pdf

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FSA – General Insurance Aggregator Companies

Following the publication earlier this year of a report on general insurance comparison websites which welcomed the competition that they would bring, the FSA have now, in a second stage review the results of which have just been published, called for the industry to take prompt action to provide consumers with clear information on excesses and assumptions.

The FSA have stated that aggregator companies must:

- ensure that any assumptions about the customer used to generate quotes are clearly and prominently displayed on the website and at all stages of the consumer's online 'journey' so that the customer is aware of these assumptions;
- provide clear and accurate details about policy excesses;
- ensure that any statements in their advertising and communications material are factually correct, accurate and up-to-date;
- avoid creating adverts that give consumers an unrealistic perception of the market coverage of the aggregator;
- ensure any price/savings claims in their advertising are meaningful to the target audience and a fair representation of what they can be expected to receive.

One of the key examples the FSA have cited as bad practice is *"Using price as the sole basis for "comparison", but not advising consumers that they should consider other factors, and that the difference in price is likely to reflect the different levels of protection offered by the policies."* This has been a complaint of BIBA members from an early stage.

The FSA's examples of 'good' and 'poor' practice in comparison websites can be found at:

http://www.fsa.gov.uk/pages/Doing/Regulated/Promo/thematic/practice_gi_comparison.shtml

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New Regime for Change of Control of Insurance Companies

The Acquisitions Directive (2007/44/EC) (the "Directive") applies to persons seeking to gain influence/control over authorised firms in the insurance, banking and securities sectors. Concerns have been expressed about integration and perhaps a reluctance to effect cross-border mergers and acquisitions as a result of differing approaches across the EU. Implementation must take place across Member States by 21 March 2009.

The change of control regime in the United Kingdom

The change of control regime under the Financial Services and Markets Act 2000 is well established but has not been without its critics. For example, it is often not clear to parties when an application has started and the fact of the application itself means building in a potential 3 month delay to any proposed change of control, in effect stalling the M&A process.

Whilst in our experience this problem is generally mitigated by the FSA coming back with a decision well within the 3 month timeframe, an expedited process is not guaranteed.

The Directive

This particular issue is dealt with head-on in the Directive with a 60 working day deadline for the relevant supervisory authority to make its assessment. This 60 working days period can only be interrupted once for the regulator to ask for additional information, and such interruption may last for no more than 20 days. Further requests for information can be made by the regulator but these will not "stop the clock".

An exhaustive list of assessment criteria is also set out within the Directive. The criteria include consideration of the reputation of the potential acquirer, the reputation and experience of those who will direct the business of the target post acquisition, the financial position of the acquirer and any potential increase of money laundering or terrorist financing.

Supervisory authorities cannot use any other criteria. This is designed to meet head-on the charge that some Member States might use a change of control regime in a political manner to reject applications that are not viewed as being in their national interest. In our view, however, the criteria set out in the Directive are not specific enough to limit the charge that the rejection has been made on spurious grounds against the spirit of the Directive.

Implementation in the UK

A consultation paper issued in September 2008 gave an indication of how the Directive will be implemented in the United Kingdom. Please follow the following link to the consultation paper:

http://www.fsa.gov.uk/pubs/cp/acquisitions_directive.pdf

The following points should be noted:

- The current 33% approval threshold will be reduced to 30%.
- The change of control regime will apply to any natural or legal person or such persons acting in concert.
- Decisions to oppose acquisitions will have to be conformed to the acquirer in writing within two days of the decision being made.
- The penalty for non-compliance is likely to be increased to an unlimited fine after conviction on indictment.
- The FSA may make orders in respect of the entire holding of shares in the target, not just the excess over the relevant threshold.

Practical implications

Our view is that the new regime will not be materially different from the existing. Clients will still have to build in a change of control "delay" into their transaction structure, however the levelling of cross-border regulation could in theory be significant and the intention of the Directive is therefore very welcome

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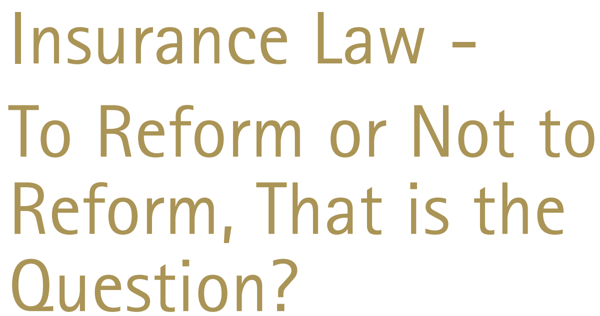

Insurance Law - To Reform or Not to Reform, That is the Question?

The Law Commission recently published a summary of responses to business insurance reform. There is going to be a further consultation on this in winter 2008/09. The Commission asked for views on a default regime with the option for the contracting parties to contract out. There were mixed reactions to the proposals as they impact on the freedom of contract and provide commercial assureds with further safeguards when dealing with insurers' standard terms. The assureds and brokers broadly favoured change.

Warranties

Currently, if a warranty in an insurance policy is breached, the cover automatically terminates as of the date of the breach despite the fact that the warranty may cover only minor issues and there is no related causation of the loss. The proposals introduce the need for a "causal connection" with the insurer being only able to avoid the claim to the extent that the breach caused or contributed to all or part of the loss. 73% supported this and 78% also supported an end to “basis of the contract” clauses transforming statements made by the assured to warranties.

The Duty to Disclose

Businesses would continue to have to disclose material information when applying for insurance. However, it was proposed that the materiality test should change from whether the information would have influenced a “prudent insurer” to whether the information was something a “reasonable assured” would have appreciated the insurer would wish to know. 52% of consultees approved the new “reasonable assured test”. The proposal was welcomed for its flexibility but criticised for introducing uncertainty. 59% agreed that where a business assured has provided inaccurate/misleading information negligently, the insurer should have a range of remedies depending on the degree of fault. Insurers would only be able to avoid the policy altogether in cases of deliberate/reckless conduct.

Intermediaries

There was also strong opposition to the Commission’s attempt to reform the law so that a broker is treated as acting for the insurer when it receives pre-contract information except when he is clearly acting for the assured and is independent of the insurer. The issue determines whether the insurer or the assured takes on the risk of the broker not communicating the correct information to the insurer in which case the latter can avoid the policy even if the assured is innocent. Currently even if in practice the broker is acting as the insurer’s agent, he is legally considered to be the assured’s agent when completing the proposal form on its behalf. 70% opposed the suggestion that a broker not searching the whole market is not independent and should be treated as the insurer’s. 80% thought the issue should be determined on common law principles.

Standard Terms

The proposals highlighted the concern to protect smaller businesses, who may not be better informed than consumers. The Law Commission proposed a mandatory rule that would prevent insurers contracting on standard written terms from giving themselves greater rights to avoid claims than under the default regime if this substantially changes the assured’s expectations of cover. Only 28% supported this. Those against were concerned about what constituted standard terms in a market using combinations of wordings.

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D&O and the Environment

A vast amount has been written in the last year or so concerning the potential liabilities faced by directors and officers in the financial downturn and the importance of D&O insurance cover. An area which has been less well covered is directors' liabilities arising from environmental matters.

The introduction of the Companies Act 2006 (the Act) resulted in the codification of the existing common law duties for directors although one duty represented a departure from the common law - the director's duty to promote the success of the company. In meeting this duty the Act identifies six factors to which a director must have regard; one of which is the impact of the company's operations on the community and the environment.

Directors face both indirect and direct risks from the impact their decisions may have on the environment. Indirect risk, for example from shareholder derivative actions, as set out under the Act, arising not just from breaches of a director's duty to his company but also from his negligence in performing his job and any default. Shareholders awareness is heightened by the Act's requirement for extensive reporting. Companies are to produce an expanded business review which keep members informed of the company's operations and quoted companies must specifically include information on environmental matters. Direct risks are faced from statutes imposing liabilities on directors, for example the Environmental Protection Act 1990.

In a world where there is increasing global pressure on the implementation of carbon emission-reducing strategies as well as environmental legislation aimed at reducing pollution and environmental hazards, the duty imposed by the Act increases the pressure on directors to pay due regard to environmental matters in decisions in the boardroom. With this in mind the Environmental Liability Directive (the ELD) is scheduled to become part of UK law either at the end of this year or early 2009. There are potentially significant exposures to companies as the ELD looks to reinforce the "polluter pays" principle. The introduction of this directive comes on the back of such legislation as the Waste, Electrical and Electronic Equipment Directive which came into force in January 2007.

Directors should therefore pay more than lip service to the environmental impact their decisions and the strategies they agree upon may have and ensure that their D&O policies cover the potential risks they face.

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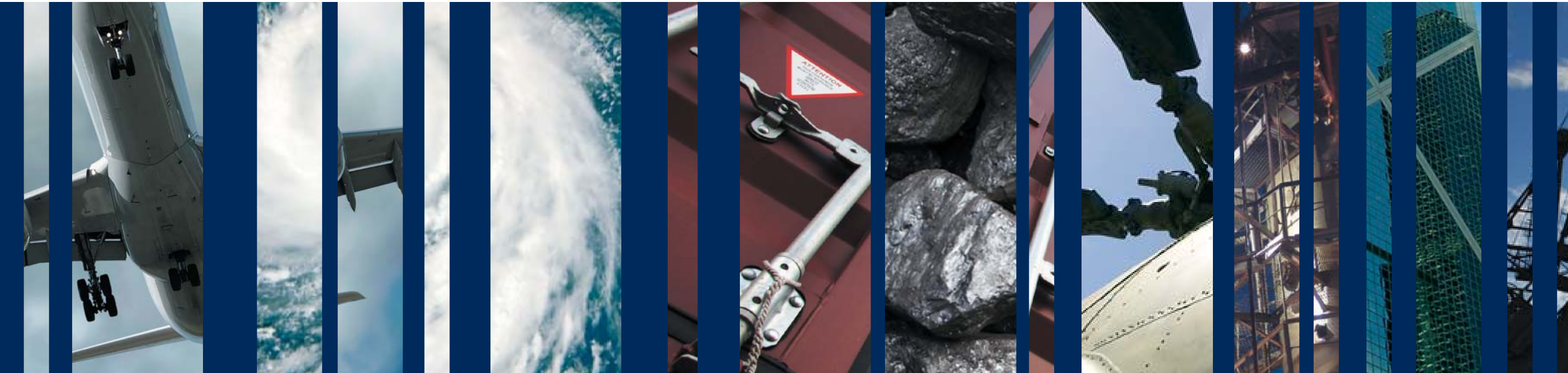
Misrepresentation: Limit No 2 Ltd v Axa Versicherung AG

The Court of Appeal's judgment in *Limit No. 2 Limited v AXA Versicherung* AG dismissed three grounds of appeal from the first instance decision. One ground of appeal was allowed, and it is of significance to all insurers, reinsurers and brokers - can a misrepresentation as to a reassureds' present intention at placing persist until and beyond renewal, or does it relate only to the time at which it was made?

The representation that caused the dispute was in a broker's fax. It was sent to reinsurers before the 1996 inception of a 12 month energy excess of loss reinsurance treaty. The fax said that *"as a matter of principle [the reassureds] maintain high standards and would not normally write construction unless the original deductible were at least £500,000 ($745,000), preferably £1m"*. The broker thereby represented that the reassureds intended only to underwrite energy risks with high deductibles. This was inaccurate because high deductible energy business was no longer available due the prevailing market conditions. Reinsurers were therefore entitled to avoid the 1996 treaty for misrepresentation.

The 1996 treaty was extended by endorsement for 7 months. Despite the reassureds' arguments to the contrary, the endorsement was held to be an amendment to the 1996 treaty rather than a separate contract, so reinsurers avoided 19 months of cover.

The treaty was renewed in 1998. This was a new contract. The Court of Appeal considered whether the representation made by the brokers in 1996 continued to be effective, or whether the



reassured was obliged to inform reinsurers that its policy on deductibles was not as previously advertised.

Longmore L.J noted that a 'representation of intention' was an elusive concept because a person's intentions are always subject to change. He held that *"A representation of intention cannot last for ever; it only relates to the time when it is made; there must come a time when it is spent, and to my mind, that is well before the passage of 19 months"*. Accordingly, reinsurers were entitled to avoid the extended 1996 treaty but not the 1998 renewal.

This case has clarified the effect of misrepresentations of intent when it comes to renewal but it does not say how much time must pass before a representation of intention becomes 'spent'. This will no doubt depend on the circumstances, but one may infer from the judgment that the potential harshness of the remedy of avoidance was a factor which affected the weight that Longmore L.J. was willing to put on a representation of intent that was made 19 months earlier. This judgment applies to annual treaties. Where a continuous treaty is concerned, the same considerations may not apply.

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Knowledge and Claims Co-operation Clauses

Claims Co-operation Clauses ("CCC") aim to provide reinsurers with a greater degree of control in order to manage risks. These clauses can typically require that when the reinsured is in possession of information relating to circumstances that may give rise to a claim, it should notify the reinsurer of this. It is common practice for the CCC to be made a condition precedent to liability, rendering failure to comply within a stated period fatal to a resulting claim.

In *Markel Capital Ltd v Gothaer Allgemeine Versicherung AG, Continantale Sachversicherung AG and Bolemers & Partners Ltd [2008]* the operation of a CCC in a facultative excess of loss reinsurance contract was considered. The central issue was whether or not knowledge of a relevant circumstance which was held by the general agent for an insurance pool ("VOV") could be imputed to its principals the reinsured and thus trigger the obligation to notify under the CCC.

The slip described the reinsured as *"Gothaer and Continentale as per VOV"*. The crucial point was whether VOV, in their general capacity as agents for the pool, had sufficient wider authority to receive information on the reinsured's behalf.

The court concluded that VOV's knowledge did not matter in relation to the "condition precedent" aspect of the CCC. It was the knowledge of reinsured which was relevant for the purposes of notification under the CCC.

In *Markel*, on a summary judgment application the court was unwilling to impute knowledge of agents to the reinsured for the purposes of notifications as it did not seem fair and just to do so under the particular circumstances of that case. The question of whether VOV in fact had relevant knowledge, in the capacity of the defendants' agent, may be one which arises at the full trial.

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FSA - Credit Write-backs

The FSA has published an "articulation" paper on this topic, which makes clear that proper systems and evidential trails need to be in place. Please follow this link to our full client briefing:

http://www.hfw.com/articledetails.aspx?pnl=6&ctid=14&pid=117

Lloyd's claims reserves - Pre-budget Report

In the Pre-Budget Report delivered on 24 November, the Government announced its intention to align the tax treatment of Lloyd's claims equalisation reserves with that of other general insurers. Please see paragraph 4.33 of the Report at the following link:

http://www.hm-treasury.gov.uk/d/pbr08_completereport_1721.pdf

This newsletter is designed to provide a summary of recent legal developments.
It does not purport to be comprehensive or to offer legal advice.