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Eye on Insurance

A Look Back at 2013 and Forward to 2014

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Introduction

2013 was a year characterised by continued pressure on the financial sector, a new regulatory landscape and further challenges for the insurance industry branching into emerging risks and economies. This update is intended to review the key developments/trends for various classes of business during 2013, together with some commentary on what we can expect from 2014.

2013 saw continued scrutiny of the practices of banks and the wider financial industry. The FSA was de-commissioned, and the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) were established. The LIBOR scandal rumbles on, and UK litigation against Barclays and Deutsche Bank will proceed in 2014. With allegations of FOREX rate fixing emerging, and regulators increasingly calling for reviews of anti-money laundering practices, it will be interesting to see how/if companies make notifications for liabilities/costs incurred in relation to these activities.

Whilst few cyber claims have progressed beyond notification stage, new challenges for safeguarding the data of users in an increasingly cyber-dominated world are constantly emerging. During 2014 we can expect the cyber market to continue to work alongside insureds to ensure policies adequately meet their needs, and keep abreast of technological developments, how data is used and companies' responses to breaches.

In the professional indemnity sector, the Supreme Court clarified that legal advice privilege can be invoked in respect of legal advice obtained from legal professionals only. This means that non-lawyers providing advice of a legal context should be mindful that it could come under scrutiny by a third party/court at a later stage.

For liability insurers, there were Supreme Court and Court of Appeal decisions on the issues of payment of losses across an insurance tower, and when the obligation to indemnify arises under a liability policy, respectively. The debate regarding apportionment of mesothelioma claims between insurers continues, and we await the Supreme Court's decision in *IEG-v-Zurich* later in 2014.

2013 was also the year of "food fraud", and the meat industry was gripped by the horsemeat scandal. It is doubtful we have heard the last of it, and insurers face new challenges when writing risks, particularly where insureds source their products outside of the EU/ EEC countries. The debate on "damage to property" will no doubt receive renewed attention as food fraud-related claims emerge.

As we go to press, the UK is gripped by another flooding crisis and the "Flood Re" initiative cannot come soon enough for consumers and small businesses. However, it remains to be seen whether property insurers will be able to provide sufficient cover within their property book to meet the compulsory quotas of flood insurance proposed. In 2014, the Court of Appeal will consider whether the Riot Damages Act (RDA) provides compensation for both physical damage and business interruption, an issue of particular significance to property insurers, with no immediate sign of compensation available under the RDA being capped (despite recent recommendations).

Latin America continues to be the focal point for growth and all eyes remain focused on Brazil, although Chile continues to lead the way on the regulatory side. With the emergence of the MINT countries (Mexico, Indonesia, Nigeria and Turkey) in addition to the BRIC nations, 2014 will see further opportunity for expansion coupled with new cultural and regulatory challenges.

Finally, on the civil procedure side, the implementation of the Jackson Costs Reforms took centre stage in 2013 with the arrival of Damage Based Agreements. The recent Court of Appeal decision in *Mitchell* has shown that insureds and insurers alike must be mindful of court deadlines, and ensuring reasonable costs budgets. No doubt we will see more litigation in this area during 2014.

We hope you find this update useful. Best wishes for 2014!

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Financial Institutions

- Guardian Care Homes and Unitech were given permission by the English Courts to proceed with claims regarding the alleged manipulation of LIBOR.
- The first collective shareholder action in the English Courts has been commenced against a bank and its directors in respect of allegedly misleading statements made in a listing prospectus.
- Proposed amendments to the UK's Banking Reform Bill include a new criminal offence of "reckless misconduct in the management of a bank".

The Court of Appeal has determined that allegations that the LIBOR (London Inter Bank Offered Rate) was manipulated can also be included in Graiseley Investments' (Guardian Care Homes) claim against Barclays and Unitech's claim against Deutsche Bank[1], which were initially centered on allegations regarding the mis-selling of interest rate swaps alongside loan facilities. The cases are due to go to trial in 2014, and the High Court will now also consider the allegations that Barclays and Deutsche Bank allowed implied misrepresentations to be made regarding the basis on which the LIBOR was set. The fact the Court of Appeal did not dismiss these allegations does not necessarily mean that the LIBOR allegations will succeed at trial. If, however, the banks are found liable, then it could lead to a flood of new claims in the UK and the US, as LIBOR is used as the reference rate in, or forms the basis of, countless financial contracts.

TThe first collective action in the English Courts under section 90 of the Financial Services and Markets Act 2000 has been brought by investors and shareholders against Royal Bank of Scotland ("RBS") and four of its former directors. Investors and shareholders allege they suffered a loss as a result of investments made in reliance on allegedly misleading statements regarding RBS's financial strength, which were included in the prospectus for RBS's £12 billion rights issues (issued in April 2008). This case will be watched closely in order to see whether it leads to an increase in the number of shareholder actions against banks and other financial institutions in the UK and leads to a litigation environment closer to that of the US.

The UK Government's proposed amendments to the Banking Reform Bill include a new individual criminal offence of "reckless misconduct in the management of a bank", which, if enacted, could lead to senior bankers facing jail terms of up to seven years if their bank fails and they are subsequently found guilty of reckless misconduct. This is likely to effect the terms on which banks are able to obtain insurance. It could also increase the circumstances in which senior bankers are entitled to an indemnity in respect of the costs incurred in responding to regulatory investigations, subject to amendments being made to the standard wordings currently used.

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Directors & Officers

- In a rare decision in this area, the application of the professional services exclusion in a Directors & Officers (D&O) Liability policy to a professional liability claim was upheld by the High Court.
- UK Government's proposals to increase the accountability of directors for wrongful or fraudulent trading.
- US Securities and Exchange Commission's requirement for admissions of wrongdoing as a condition of settling enforcement actions.

In the case of *Rathbone Brothers-v-Novae*[2], the High Court had to consider the interplay between a trustee professional liability policy and a D&O policy in a liability claim against a trustee, when assessing a clause in the trustee liability policy which stated it operated in excess of any insurance or indemnification available from any other source. One among a number of issues was whether the D&O policy, which provided "outside entity" coverage, would be such an alternative available source, which meant the trustee liability policy only operated as an excess policy. The D&O policy contained a "professional services" exclusion which the Court held would prevent the D&O policy from providing cover for the claim. It also suggested that the "outside entity" coverage applied to management "wrongful acts" and not to professional services provided to a client, as alleged in this case.

The Court also found that the "other insurance and indemnification" clause in the trustee policy could not apply to indemnification provided by the trustee's own employer, the policyholder. To do so would remove the purpose of the cover provided to the policyholder. By implication, it held however the clause would apply to indemnification from some other source. In passing the Court also commented it was well established that where a contract of indemnity and a contract of insurance come into conflict the indemnification is the primary source of indemnity and the insurance is the last resort.

The decision provides some useful guidance as to the interaction between the professional liability and D&O policies taken out by a professional trustee company, and the operation of a fairly standard "other insurance and indemnification" clause. It is also the first time an English Court has assessed how a contract of indemnity may operate in conjunction with a financial services insurance policy (the previous cases all being in the context of other classes of insurance).

The UK Government has published a discussion paper which includes proposals in relation to enhancing transparency and increasing trust in the ownership and control of companies. The proposals include increasing the time limit for a disqualification period following an insolvency case from two years to five years or more, granting liquidators the statutory right to sell or assign fraudulent and wrongful trading actions to creditors or third parties and giving administrators the right to bring civil claims for fraudulent or wrongful trading. If these proposals become the basis of legislation, they could lead to a significant increase in the number of claims brought against directors and an increase in the period in which insurers remain on risk for the costs of providing an indemnity to directors who are the subject of disqualification proceedings, whether by means of run-off insurance, discovery periods or notified circumstances.

The US Securities and Exchange Commission has adopted a policy of no longer agreeing to settlements without any admission of liability in cases concerning serious misconduct that harm a large number of investors, or cases involving intentional misconduct on the part of defendants. This policy was applied in JP Morgan's settlement of several enforcement actions arising out of the activities of two traders in its London office (referred to as the "London Whale" traders). Settlements of this nature are likely to be reviewed carefully by insurers in order to see whether they are sufficient to trigger the conduct exclusions in their policies, which have been difficult to rely upon due to the requirement that they often require an admission or final adjudication.

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Cyber

- Bank Muscat was hacked by a group of organised criminals who created bogus prepaid cards with the stolen details, causing a multimillion-dollar loss direct to the bank.
- PR Newswire announced it had been hacked in February 2013, but that it was not aware that it had been compromised until October 2013, leading to fears that false press releases may have been made.
- Looking ahead, Microsoft will cease issuing security updates for Windows XP on 8 April 2014, which is predicted to leave any users of Windows XP especially vulnerable.

In early 2013, an international group of hackers breached the security on servers operated by a third party on behalf of Bank Muscat. Whilst there, the hackers compromised 12 accounts for prepaid foreign currency cards by removing their daily limits and disabling the antifraud measure on accounts. The hackers recoded iTunes gift cards and other readily available magnetic strip cards to create 200-plus physical copies of the compromised accounts. The cards were distributed around the world to organised groups. Then, on 20 February 2013, the groups struck, and within 24 hours had withdrawn from ATMs or purchased goods in excess of US$40 million. The hack shows that even cautious institutions can be vulnerable through their systems being connected to, or reliant on, third-party systems. The vulnerability of a business to lax security of a third party is set to rise as more businesses outsource their information technology requirements.

On 13 October 2013, PR Newswire announced that its security measures had been compromised, allowing for unauthorised persons to publish to its news services. PR Newswire later discovered that its systems had been compromised since February 2013. PR Newswire then commenced an investigation into whether there had been any false reports published on its service in the eight months that its systems had been compromised. The situation was discovered by Cision AB, a Swedish prerelease distributor, which also in October 2013 announced that a fake article had been published on its service. This led to the rising of share prices for two biometric companies. An open question remains as to the duty of care owed to general investors by newswire services, but nonetheless these attacks show that cyber-criminals are open to manipulating sophisticated information portals.

Microsoft currently issues security patches for Windows XP via its update service. These updates address the security loopholes found in the popular operating system, and are applied across multiple versions of Windows. However, Microsoft will cease updates for Windows XP on 8 April 2014. On that same day, Microsoft will cease providing its anti-virus software, Microsoft Security Essentials, for free download to Windows XP users. There is concern that hackers will reverse engineer the updates for other Windows systems, such as Windows 7, to identify the vulnerabilities being addressed and then target those vulnerabilities in Windows XP computers (which will no longer receive updates to their Security Essential software either). Whilst some may not consider this an issue for businesses in Western markets, many of which have updated their desktops and servers, this is not the case. The Bank Muscat hack showed how secured networks can be exploited where they rely in part on third-party servers; particularly in developing countries where there IT systems may not be as up to date. Windows XP operates as an embedded operating system in more devices than just desktop or laptop PCs. The risk is there and businesses should review their systems urgently in light of it.

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Professional Indemnity

- Legal advice privilege ("LAP") - strictly for the benefit of legal professionals.
- Where a conflict of interest between company and its executives exists, solicitors must properly identify who their client is and discharge their duty of care appropriately.
- Court of Appeal confirms blanket notifications are valid – insurers must take heed and wait for claims to be brought before determining coverage position.

In *R (on application of Prudential Plc & Anor)-v-Special Commissioner of Income Tax & Anor* [3], Prudential's claim that legal advice obtained from its tax advisers should be subject to LAP was dismissed by the Supreme Court. A majority decision emphasised that allowing Prudential's appeal would extend LAP beyond what is commonly understood to be its accepted scope. Extension to other professionals would create uncertainty as to whose advice qualified for protection, particularly when multiple advisers are involved in a matter. Accountants were disappointed that the decision maintains, in the view of some, an anti-competitive environment. Advice relating to, for example, tax mitigation schemes, may see lawyer involvement favoured over that of accountants. However, until Parliament steps in, the status quo on LAP remains.

In *Newcastle International Airport Ltd-v-Eversheds LLP* [4], the Court of Appeal considered the duties of solicitors acting for a company but receiving instructions from executive directors with respect to their own draft service contracts. The Court of Appeal reiterated that the duty of the solicitors was to ensure that the company itself was properly advised. Given the conflict of interests between the company and its directors, advice to the directors could not be considered advice to the company. The solicitors were therefore required to provide the company's remuneration committee with clear, written advice. The failure to do so was a breach of duty. The Court found, however, that the claimants had failed to establish causation: the chair of the remuneration committee would not have read an explanatory note and, even if she had, the proposed bonus scheme would still have been approved. The case reminds solicitors that where there is a conflict or potential conflict of interest between directors/executives and a company, the solicitor must ensure that the client company receives clear written advice. Tactically, the case also demonstrates the importance of obtaining costs protection, even in cases with strong causation defences. Newcastle Airport had rejected Eversheds' offer of £2 nominal damages (reflecting the risk of a finding of breach of duty) and so were ordered to pay both parties' costs of the litigation.

In *McManus-v-ERIC* [5], the Court of Appeal considered the validity of a blanket notification which solicitors had purported to make in non-specific terms following a spate of claims arising out of historic conveyancing matters. ERIC had rejected the blanket notification, saying that MSR had not *"[identified] the specific incident, occurrence, fact, matter, act of omission which would give rise to a claim on each individual file".*

The Court of Appeal agreed with the first instance decision that ERIC's rejection of the notification had been wrong. Blanket notifications can be valid for later claims, and the notifications do not have to be specific. However, it upheld the earlier decision not to grant a declaration that this particular notification was valid. The terms of the proposed declaration at first instance referred to various types of anticipated misconduct – and the Court noted that the form of wording sought had changed substantially even during the course of the appeal. Where the factual scenario was so complex that a declaration could only be worded ambiguously, the Court of Appeal was not prepared to grant a declaration. A response to the notification should instead be left until claims were made. The case reminds insurers to treat blanket notifications with care. Each will be fact specific, and they should weigh up the extent of evidence available against the scope of cover being sought. Insurers will typically have to wait for claims to arise before a coverage position can be determined. This may take place over an extended period of time and across several policy periods.

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Liability

- **Coverage for mesothelioma claims under employers' liability policies** - EL insurers cannot limit coverage to reflect their period on risk as proportion of the period of exposure to asbestos – they will be liable for an insured's entire liability.
- **Insurance towers** – payment of losses - the timing of an insured's loss is determined by the date on which the insured's liability crystallises, not when an underlying insurer agrees to pay.
- **Aggregation** – 9/11 attacks arose out of two events, not one. Four unities necessary for aggregation re-considered.

The Court of Appeal in *IEG-v-Zurich*[6] overturned the High Court's decision that for claims brought in Guernsey which were not subject to the Compensation Act 2006 (whereby tortfeasors are jointly and severally liable for mesothelioma claims), an employers' liability insurer should only be liable for a portion of an insured's liability, by reference to time on risk as against the period of exposure. The Court referred to the Supreme Court's decision in the EL trigger litigation *Durham-v-BAI*[7], which confirmed that "liability for mesothelioma following upon exposure to asbestos created during an insurance period involves a sufficient "weak" or "broad" causal link for the disease to be regarded as "caused" within the insurance period". Therefore, the insurance should respond to "all sums for which the Insured [was] liable", regardless of their proportion of the overall exposure period. It was not necessary for the Court of Appeal to consider whether Guernsey law would have viewed causation differently. The court was also mindful of circumstances where the employer no longer exists or was uninsured for part of the exposure, and claimants should not be left without recourse. The case is on appeal to the Supreme Court.

The Supreme Court in *Teal-v-WR Berkley*[8] unanimously ruled that layers of insurance will be eroded by reference to the date at which the insured became liable, not when claims were notified. The insured (Black & Veatch) was insured by Teal, its captive, via a primary layer insured by Lexington, three excess layers of worldwide PI cover, and a "top and drop" policy which excluded US and Canadian claims (reinsured by WR Berkley and Aspen). Once the primary layer was exhausted, Teal sought to allocate its US and Canadian losses before non-US losses, so as to maximise its recovery across the tower. The Supreme Court agreed with the Court of Appeal that liability under the insurance would be determined by reference to the date(s) on which the Insured became liable for losses, not the sequence of dates on which they were notified. If determined by date of notification, this would produce an "uncommercial" result, whereby an insured/reinsured could manipulate the order of claims.

Once again, the four unities of time, place, means and intention were considered in the High Court decision of *AIOI-v-Heraldglen*[9]. The insured sought to argue that the terrorist plot should render the destruction of the two towers one event, not two separate events as an arbitral panel had found. The four reinsurance policies defined "each and every loss" as "each and every loss or accident or occurrence or series thereof arising out of one event". The Court agreed with the arbitral panel that despite the proximity of the buildings and timings of their collapse, they stood and fell independently of each other. Moreover, there were two successful hijackings which caused separate loss and damage. As a result, on the facts, it was reasonable for the arbitral panel to conclude that two distinct events had taken place. Whilst the decision was in a reinsurance context, it is a useful re-cap on the law on aggregation which is relevant to all classes of business.

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Products

- EU food fraud notifications in 2013 are more than double 2012's total.
- In the absence of a health risk, product liability or recall coverage is unlikely.
- Possible coverage arguments may exist in relation to "damage" and "tamper".

This year has seen a great deal of media and government attention on "food fraud". Food fraud has existed for centuries in many forms, including dilution, substitution of one or more inferior ingredients, and mislabelling a whole product. Out of notifications to the European Union's Rapid Alert System for Food and Feed (RASFF), the number of cases of adulteration or fraud more than doubled from 2012 to 2013. Many of the 2013 issues related to the presence of undeclared horsemeat in other meat and meat products.

Generally, coverage under product liability, product recall and contaminated products insurance policies depends on the occurrence, likelihood or risk of personal injury or property damage. However, food fraud is not generally associated with safety issues. As fraudsters are typically keen to avoid detection, it is likely they deliberately select substitute ingredients or products that do not carry any significant risk of injury.

Although the question of personal injury risk appears straightforward, the question of whether "property damage" has occurred is debatable. In 2002, in *Bacardi-Martini-v-Thomas Hardy Packaging Limited*[10], the Court of Appeal agreed that a defective ingredient (carbon dioxide containing benzene) had not caused damage to the end-product bottled drink that was recalled. It was argued that the carbon dioxide had instead caused damage to the other ingredients of the drink, but the court said "*the more natural view*" is that the other ingredients ceased to exist upon mixing. Even if there were "damage", it was "*artificial and wrong to try to separate out any particular loss as arising from*" it. Such damage to other ingredients did not cause the loss, which "*arose from the uselessness of the finished drinks, and the need for their recall*".

In apparent contrast, the High Court in *Omega Proteins-v-Aspen Insurance*[11] has since stated that a party supplied animal matter that could not be used without "*damaging, by rendering unusable, any ... product with which ... it was mixed*". On the basis of this, it might be argued that an insured victim of food fraud, who has innocently mixed the fraudulent ingredient with others, or distributed it for mixing by another, has caused property damage, triggering coverage. However, the better view may well be that this is an artificial point, and the Court of Appeal's opinion in *Bacardi-Martini* is to be preferred: even if there is "damage" to other ingredients, this is not the true cause of the loss.

Many product recall and contaminated products policies extend coverage to product tampering. Under the Public Order Act 1986, sections 38(1) and 38(2), it is a criminal offence to allege, threaten, or actually commit contamination of food products with the intent to cause injury, public alarm or anxiety, or with the intent to cause economic loss by reason of the goods being shunned. The language of these offences is similar to that used in many product tamper insuring provisions or definitions. It would appear that, in most cases of food fraud, where the fraudster intends to deceive, and avoid detection, such intent is unlikely to be present. In many cases it may not even be possible to identify the fraudsters, much less to prove their intent. It is, therefore, unlikely that malicious tamper coverage will respond to food fraud losses, subject, of course, to the precise wording involved.

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Property

- The government has proposed adding clauses to the Water Bill to address the availability and affordability of insurance for households with a high flood risk.
- High Court decides that the Riot (Damages) Act 1886 ("RDA") applies only to physical property damage and not business interruption loss ("BI").
- Independent review recommends changing the law so that businesses with annual turnover of £2 million or more – and their insurers – cannot recover under the RDA.

In November 2013, the government outlined its new flood insurance deal, Flood Re. It will replace the expired "Statement of Principles", whereby the Association of British Insurers (ABI) voluntarily agreed to provide comprehensive flood cover. Flood Re will be industry-managed and run as a not-for-profit fund to ensure that flood insurance is widely affordable and available to most high-risk households based on their council tax band. To fund Flood Re, all UK household insurers would pay a levy, equivalent to £10.50 for each UK household's premiums. Under the supervision of the Financial Conduct Authority, each insurer would be allocated an obligatory quota of higher-risk properties to cover (based on its market share). This means that in order to meet this new quota, insurers would have to compete with each other and offer more competitive deals. However, properties valued at £900,000 or more, properties built since 2009 and small business may be excluded from Flood Re. This could result in the costs of flood insurance rising considerably for non-eligible property owners in the future.

The 2013 case of *Mitsui & Others-v-The Mayor's Office for Policing and Crime*[12] concerned substantial damage to the Sony distribution centre in Enfield on 8 August 2011, during widespread civil unrest. The claimants insured, or suffered uninsured, property damage and BI, and claimed these losses from the defendant under the RDA. The sums claimed were approximately £63 million, including more than £11 million for consequential lost profit and lost rent. The Court had to decide whether the loss was caused by persons *"riotously and tumultuously assembled"*, as required by s.2(1) of the RDA. If not, the RDA did not apply. If the RDA did apply, the Court had to decide a second issue, namely whether the RDA covered BI, or only physical property damage. In summary, Flaux J reviewed the authorities and held that the RDA applied, but the claimants could recover only property loss, and not BI.

On the first issue, the judge set out guidance on the meaning of *"riotously and tumultuously assembled"*. The defendant had argued, amongst other things, that insufficient noise had been made at the warehouse to amount to *"tumult"*. The judge said that *"the persons assembled must be acting in an agitated, excited, volatile manner ... usually also making a noise ... there must be some "public" element to the behaviour ... to which the police could, notionally, have responded"*. The facts involved enough indication of riot – including the smashing of a door, the throwing of petrol bombs, and silent CCTV footage showing behaviour consistent with shouting – to trigger the police's responsibility under the RDA. On the second issue, the judge construed the RDA as a whole, as well as its repealed preamble, and decided that RDA compensation was clearly and unambiguously limited to physical damage to premises and any property there. This issue is reportedly the subject of an appeal.

November 2013 saw the publication of Neil Kinghan's report on an independent review of the RDA. One of its recommendations is to set a cap on RDA compensation for businesses – and their insurers – so that compensation is payable only to businesses with annual turnover less than £2 million. There is concern that, if such a limit is imposed, large businesses may avoid areas considered to have a greater risk of unrest. Furthermore, the ABI was disappointed that Kinghan recommended the RDA should not apply to BI. It remains to be seen whether the government proceeds to amend the RDA in line with Kinghan's recommendations. It will be some time before consultation is complete, and any change to legislation takes effect. In the meantime, police authorities will continue to foot the bill for buildings damaged by persons *"riotously and tumultuously assembled"*.

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Latin America

- The new insurance contract law underlines the Chilean market's position as the most sophisticated in Latin America.
- Flooding in Brazil poses a challenge in more ways than one.
- Colombia needs you – the liberalisation of the insurance market is aimed at attracting foreign insurers to support continued economic growth.

The Chilean insurance market continues to lead the way in Latin America, following the implementation of its new insurance contract law on 1 December 2013. Most of the provisions can be seen as shifting the interpretation of insurance policies further in favour of the insured. Although there is the option to contract out of most of these requirements for large risks, there are two mandatory provisions relating to reinsurance. First, an insurer cannot delay payment under the original policy until cover on the reinsurance has been confirmed. Secondly, despite establishing that the insured has no direct action against the reinsurer, it seems the insurer may cede its rights under the reinsurance to the insured. The new law introduces a basic definition of reinsurance, but provides no guidance on key reinsurance principles, such as "follow the settlements" or claims cooperation. Foreign reinsurers may take comfort from the statement that reinsurance contracts will be interpreted in accordance with "international custom". However, this is yet to be tested and we doubt how persuasive it would be when faced with a conflicting provision in Chilean law. It is important for foreign reinsurers to be mindful of how things are done locally, particularly following the changes introduced by the new law.

2013 saw rates being squeezed in the Brazilian reinsurance market as it felt the impact of the influx of foreign reinsurers setting up local operations. The softening of the market is likely to result in lower profits in the short term, but there is little doubt that the capacity will be needed if Brazil is to see continued economic growth. Reinsurers that have set up locally are best-placed to benefit from this growth, and flood insurance is just one area that is likely to contribute. The UK was not the only country to suffer from December flooding, as the worst floods in a decade struck southeast Brazil. In a country that suffers from relatively few natural disasters, the risk of flooding poses a challenge to much-needed construction and infrastructure projects. The recent floods follow similar events in 2012 and the problem looks set to worsen, unless steps are taken to address the risk of flooding at the planning stage. It is estimated that more than 40 million Brazilians will live in areas exposed to flooding by 2030. There are opportunities for foreign insurers and reinsurers to use their experience from other jurisdictions in helping to manage and protect against this risk.

In contrast to protectionist policies in neighbouring Venezuela, Colombia continues to look beyond its borders for investment. After a slow start to the year, the economy picked up in the second half of 2013 to more than 5% of GDP. The Colombian government has looked to sustain growth through international trade agreements and investment in infrastructure projects. This has led to a lack of capacity in the local insurance market and underinsurance, despite Colombia's position as one of the most attractive countries in Latin America for foreign insurers and reinsurers to invest. The liberalisation of the insurance market in 2013 is aimed at encouraging direct investment in specific lines of business: international maritime transport, international commercial aviation and space launch and transportation. The new law also makes it possible for Colombian nationals and companies (other than state entities) to seek insurance directly from the international market, save for insurance that is mandatory, or in relation to social security obligations. Foreign insurers must be careful not to market products in Colombia or solicit business outside of the specified classes of business. Those insurers looking to make the most of Colombian growth may wish to take advantage of the new rule allowing them to set up as a local insurer. Although subject to regulatory requirements, this option may be preferable to trying to take over a local company.

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Reinsurance

- Broker owes continuing duty to remit claims proceeds, premium, returns and premium refunds to its client and reinsurers, and which in theory cannot be time-barred.
- Claims Control Clauses don't prevent cedant from negotiating and making partial inwards settlements.
- Cedant can bind reinsurer merely by showing that the basis on which it settled a loss is arguably within a back-to-back reinsurance containing an unqualified follow the settlements clause.

In *Equitas-v-Walsham*[13], Walsham was the broker for Lloyd's names whose 1992 and prior outwards reinsurance was assigned to Equitas as part of "Reconstruction & Renewal". Equitas sought unpaid proceeds received by Walsham in performing its role, plus lost investment income. Walsham pleaded time bar and alternatively argued that the debts had been extinguished by set-off of cross-claims in respect of overpayments and broker funding. A broker owes a continuing duty of care (to its client and its client's reinsurers) in negligence to remit funds reasonably promptly which is breached afresh every day, with the result that claims for non-payment are never time-barred. Lost investment income on unpaid funds can be established by reference to a conventional commercial borrowing rate without evidence of the claimant's financial circumstances. Equitable set-off only applies where the relevant cross-claim has been asserted by the defendant, and even then does not extinguish or reduce the claim, so does not of itself prevent accrual of interest on the full principal amount.

In *Beazley-v-Al Ahleia*[14], multiple reinsurers on the same layer containing a Claims Control Clause ("CCC") disagreed about coverage. The CCC required each reinsurer be given control of negotiations *"in connection with . . . loss or losses . . . which may give rise to a claim"* against it and forbade settlements without consent. Although all initially agreed to treat a loss as excluded, one broke ranks and negotiated with the insured. The cedant's involvement in this process did not breach the CCC. An inwards loss breaching a layer of reinsurance on which multiple reinsurers participate may be cut, like a pizza, into slices. The cedant can freely dispose of one reinsurer's slice without giving rise to liability on the part of any other reinsurer. Consultation with other reinsurers about negotiations about that slice would be otiose and thus is not required by the CCC. Similarly, only the reinsurer to whom a slice is attributable need consent to its settlement.

The case of *TMEI-v-Novae*[15], concerned non-proportional retrocessional reinsurance purchased by TMEI (the Retrocession), attaching excess of £53 million each and every occurrence, of its 12.5 percent line on a facultative reinsurance of Tesco's global property programme insured with Ace. Novae wrote a 12.5 percent line on the Retrocession, which was on the same terms and conditions as the "Original Policy". Ace compromised a substantial dispute with Tesco in respect of Thai flood losses. TMEI paid its share; Novae disputed liability to TMEI on various grounds, several of which were selected by the parties as issues suitable for preliminary determination in Commercial Court proceedings. The issue of most general interest to the market concerned the standard of proof that TMEI must meet in establishing a claim under the Retrocession: was proof required on the balance of probability, or was it sufficient for TMEI to show that Ace's settlement was *arguably* within the Retrocession? Regarding himself bound by Court of Appeal precedent, about which he expressed reservations, the judge unwillingly concluded that TMEI need only merely show a loss arguably within the Retrocession. (Had he been free to do so, he observed, he would have held that proof must be on the balance of probability.) Novae was bound by Ace's settlement, including, in particular, its determination that underlying losses arose from one occurrence.

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Litigation, Costs & Procedures

- The Courts have strictly interpreted the Jackson Reforms of the Civil Procedure Rules ("CPR").
- High-profile new Part 36 "bonuses" for claimants who beat offers at trial not guaranteed.
- Damages Based Agreements ("DBAs") yet to find favour with lawyers.

The judgment handed down in May 2013 in *Venulum-v-Space Architecture*[16], was the first to strictly interpret the consequences of missed deadlines under the new CPR after the Jackson Reforms. The claimant applied for permission to serve its Particulars of Claim out of time, causing the claim to become time barred. Applying the amended CPR rule 3.9, the Court held that: *"…when the circumstances are considered as a whole, particularly in the light of the stricter approach … this is a case where the court should refuse permission .... the Claimant has taken quite long enough to bring these proceedings and enough is now enough".*

This approach was confirmed in November by the much-anticipated Court of Appeal judgment in the case of *Mitchell-v-News Group Newspapers*[17]. It dealt with one of the standout Jackson Reforms – the requirement for parties to file and exchange costs budgets. Having breached various directions, the Court at first instance dismissed the claimant's application for relief from sanctions and limited the claimant's recoverable costs to the court fees. The Court of Appeal, including Lord Justice Jackson, dismissed the claimant's appeal. In doing so, it gave some guidance on the application of the new rules to the wider legal community. Every effort should be made to comply with rules, orders and practice directions. The courts' starting point for ordering relief from sanction will be that the original sanction was properly imposed. Trivial breaches may be tolerated, but the substantial part of any order must be complied with. Good reason for default is likely only to be one outside of the party's control.

The case of *Feltham-v-Bouskell*[18] considered the new high-profile Part 36 bonus payments introduced for claimants who secure an award at least as advantageous as any claimant Part 36 offer made on or after 1 April 2013. Unless it considers it unjust to do so, the court can now award not only additional interest and indemnity costs, but also a "bonus", calculated as a percentage of damages awarded, capped at £75,000. However, in *Feltham*, the court decided the bonus would be unjust, having regard to the way in which the claimant had conducted the litigation: making the successful Part 36 offer only at the last minute, failing to disclose key documents and introducing key allegations for the first time at trial.

No doubt we can expect further satellite litigation during 2014 – hopefully leading to further, helpful clarification on the application of the Rules post-Jackson. For the time being, however, the message from the courts appears clear. Non-compliance with the letter, or even the spirit, of the tougher CPRs will only be tolerated in exceptional circumstances and is certainly unlikely to be rewarded.

For the first time, in England and Wales, DBAs allow lawyers to conduct litigation in return for a share of the winnings. Uncertainty as to whether lawyers may use "hybrid" DBAs (which would include lower hourly rates in exchange for a contingency success fee) have had limited their popularity so far. However, we can expect the Ministry of Justice to seriously consider amending the regulations in 2014, in support of the DBA concept. Confirming that "hybrid" arrangements are in fact permitted should provide firms with greater confidence to trial them.

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Case Citations

[1] *Graiseley Properties Limited-v-Barclays Bank PLC and Deutsche Bank AG v Unitech Global Limited* [2013] EWCA Civ 1372

[2] *Rathbone Brothers Plc-v-Novae Corporate Underwriting* [2013] EWHC 2734 (Comm)

[3] *R (on the application of Prudential plc and another)-v-Special Commissioner of Income Tax and another* [2013] UKSC 1

[4] *Newcastle International Airport Limited-v-Eversheds LLP* [2013] EWCA Civ 1514

[5] *McManus Seddon Runhams-v-European Risk Insurance Company* [2013] EWHC 18 (Ch)

[6] *International Energy Group-v-Zurich PLC UK Branch* [2013] EWCA Civ 39

[7] *BAI (Run Off) Limited (In Scheme of Arrangement) (Appellant)-v-Durham (Respondent)* [2012] UKSC 14

[8] *Teal Assurance Company Ltd-v-WR Berkley Insurance (Europe) Ltd* [2013] UKSC

[9] *Aioi Nissay Dowa Insurance Company Limited-v-Heraldglen Limited and Another* [2013] EWHC 154 (Comm)

[10] *Bacardi-Martini-v-Thomas Hardy Packaging Limited and others* [2002] EWCA Civ 549

[11] *Omega Proteins-v-Aspen Insurance* [2010] EWHC 2280 (Comm)

[12] *Mitsui & Others-v-The Mayor's Office for Policing and Crime* [2013] EWHC 2734 (Comm)

[13] E*quitas Ltd-v-Walsham Brothers & Co. Ltd* [2013] EWHC 3264 (Comm)

[14] *Beazley Underwriting Limited and others-v-Al Ahleia Insurance Company and others* [2013] EWHC 677 (Comm)

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

[16] *Venulum Property Investments Ltd-v-Space Architecture Limited and others* [2013] EWHC 1242 (TCC)

[17] *Andrew Mitchell MP-v-News Group Newspapers Limited* [2013] EWCA Civ 1537

[18] *Lorraine Studholm Feltham-v-Freer Bouskell* [2013] EWHC 3086 (Ch)

About Sedgwick, Detert, Moran & Arnold LLP

Sedgwick, Detert, Moran & Arnold LLP (SDMA) (established in 1985) is a London based insurance and disputes resolution practice. It is a subsidiary of Sedgwick LLP, a California Limited Liability Partnership, and has been working closely with the London and international insurance markets for over 25 years. Our London EC3 based team is comprised of specialist insurance business and liability lawyers with a wealth of experience in financial lines and casualty insurance and reinsurance.

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