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Consequential Damages: New Developments in New York Case Law Regarding an Insured's Right to Recover Extra Contractual Damages

One of the more significant developments of 2008 in New York insurance law came courtesy of two companion decisions by the state's highest court which held that, in addition to recovering policy proceeds, policyholders may recover consequential damages resulting from an insurer's breach of a policy, at least in certain circumstances where the insurer is found to have breached its duty of good faith and fair dealing and the damages were foreseeable and quantifiable; *Bi-Economy v. Harleysville Ins. Co. of N.Y.* and *Panasia Estates v. Hudson Ins. Co.*[1]

Consequential damages resulting from a breach of contract have previously been available to parties under traditional contract principles, to the extent they were a foreseeable result of the breach and "within the contemplation of the parties" at the time of contracting. Until recently, however, recovery of consequential damages was not a remedy generally available to policyholders for an insurer's breach of its policy under New York law.[2]

"The New York Court of Appeals set the stage for the pleading of consequential damages claims by insureds against insurers in its Bi-Economy decision."

With *Bi-Economy* and *Panasia*, insureds have gained strong grounds to recover – or at least plead – consequential damages in addition to policy proceeds where the insurer's denial of policy benefits allegedly breaches the covenant of good faith and fair dealing and the consequential damages were foreseeable at the time of contracting. The decisions are significant because New York does not recognize the independent tort of bad faith for an insurer's breach of the policy so as to support an award for extra-contractual damages, absent a pattern of egregious conduct warranting punitive damages.[3] These decisions provide a potential new avenue for recovery of extra-contractual damages from insurers.[4]

Setting The Stage: *Bi-Economy* and *Panasia*

The New York Court of Appeals set the stage for the pleading of consequential damages claims by insureds against insurers in its *Bi-Economy* decision. *Bi-Economy* dealt with an insurer's breach of the insured's right to prompt adjustment and payment of first party business interruption coverage under a commercial property insurance policy. In upholding the insured's right to assert a claim for consequential damages, the Court set forth specific requirements that an insured would need to meet in order to plead and prevail on such a claim.

The Court held that an essential factor of a consequential damages claim is that the risk was foreseen, or should have been foreseen, at the time of contracting. This does not mean the insurer has to foresee the breach or the particular way the loss occurred, but that loss from a breach was "foreseeable and probable." To satisfy this requirement, it must be determined whether consequential damages were "reasonably contemplated by the parties," and to do so "courts must look to the nature, purpose and particular circumstances of the contract known by the parties."[5]

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"Policyholders have been quick to assert the right to plead consequential damages in the wake of Bi-Economy and Panasia."

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The nature of the coverage in issue was a significant factor in *Bi-Economy*. The Court reasoned that the "very purpose" of business interruption coverage "would have made [the insurer] aware that if it breached its obligations under the contract to investigate in good faith and pay covered claims, it would have to respond in damages to Bi-Economy for the loss of its business as a result of the breach."[6] The Court further held that proof of consequential damages cannot be "speculative or conjectural," and must be proved with "reasonable certainty and be capable of measurement based upon known reliable factors without undue speculation."[7] While the plaintiff had asserted a cause of action for bad faith claims handling, the right to plead consequential damages was based on the Court's holding that implicit in a contract of insurance is a covenant of good faith and fair dealing that includes a promise to investigate in good faith and pay covered claims.

The majority opinion distinguished consequential damages from punitive damages, noting that the purpose of consequential damages was not a punishment to the insurer but "to give the insured its bargained-for-benefit," whereas punitive damages are intended to punish the breaching party.[8] The Court viewed the prompt payment of business interruption losses to be a bargained-for-benefit, as the purpose of business interruption coverage is to receive money promptly and avoid collapse of the business. Thus, failure to provide that benefit rendered additional damages foreseeable.

There was a strong dissent, which argued that the bargained-for-benefit of an insurance contract is coverage up to the policy limits, and that the parties to a policy generally do not contemplate consequential damages or, if they did, it would be rejected by the insurer.[9] The dissent considered the majority to be simply re-labeling punitive damages as consequential damages, and essentially allowing recovery of punitive damages without the requisite showing of a pattern of egregious conduct directed at the public.

In the companion case of *Panasia*, the Court relied on its opinion in *Bi-Economy* to uphold an insured's right to recover consequential damages for an insurer's alleged breach of the covenant of good faith and fair dealing in failing to promptly investigate, adjust and pay a claim made under builders risk coverage included in a commercial property insurance policy. However, the Court noted that the court below had failed to consider whether the consequential damages sought were foreseeable as the result of the insurer's breach, and thus remanded the case. *Panasia* confirmed that the question of whether a plaintiff's consequential damages were a reasonably foreseeable result of the breach and within the contemplation of the parties at the time of contracting is a question of fact, dependent on the circumstances and the nature and purpose of the insurance contract at issue.[10]

Application of *Bi-Economy* and *Panasia* by Lower Courts and the Extension to Third Party Liability Coverage

Policyholders have been quick to assert the right to plead consequential damages in the wake of *Bi-Economy* and *Panasia*. The subsequent caselaw suggests that the effect of these decisions may be more expansive than the Court of Appeals perhaps intended.

In *Hoffman v. Unionmutual Stock Life Ins. Co. of N.Y.*,[11] a New York appellate court relied on *Bi-Economy* to allow an insured's allegations of bad faith claims handling to be incorporated into its claim for wrongful denial to pay disability benefits, thereby opening the door for the insured to seek consequential damages. Significantly, while the court dismissed the tort cause of action for a breach of the duty of good faith, it held that allegations of breach of good faith were incorporated into the breach of contract claim, and that was a sufficient basis for seeking consequential damages.

An insured's right to seek consequential damages for the "distress, aggravation and inconvenience" purportedly caused by its insurer's alleged refusal to adjust, settle, compromise or pay a first party claim under a homeowner's policy was upheld in *Chaffee v. Farmers New Century Ins.*[12] There, the claim arose from an insurer's alleged failure to pay a claim for fire losses under a homeowner's policy. Although the court found that the insureds' claim for consequential damages is properly part of its breach of contract claim and not a separate cause of action, it also noted allegations that the insurer violated the implied covenant of good faith. Thus, the decision underscores that the right to seek consequential damages requires more than just ordinary breach of contract without associated improper conduct.

Courts have also relied upon *Bi-Economy* and *Panasia* to sustain an insured's right to seek consequential damages in the context of third party coverage.

In *Silverman v. State Farm Fire & Casualty Co.*,[13] the court sustained an insured's right to seek consequential damages based on the insurers' alleged improper failure to provide third party liability coverage for an assault claim under general, business owners and homeowners liability policies. The trial court dismissed plaintiffs' claim for punitive damages, but allowed them to amend their complaint to seek consequential damages, noting that such a claim is available if the failure to provide coverage flows from a breach of the covenant of good faith and fair dealing. The court also noted that defendants could still move to dismiss the claim after discovery.

In *Handy & Harman v. AIG*,[14] the insured sought consequential damages as part of its claim for breach of an environmental pollution liability policy, which provided coverage for cleanup costs and third party liability. The court noted that the nature of that policy was to ensure that the insured had the finances to

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conduct the remediation and pay third party claims, and that the insured had purchased the policy when it agreed to remediate its property in conjunction with its sale to avoid the financial pressure of remediation on its on-going business. Thus, the court found that "the particular circumstances" of the case and the nature and purpose of the policy supported the foreseeability of consequential damages. Significantly, the court required that there be allegations of breach of the covenant of good faith in plaintiff's breach of contract claim to support the request for consequential damages.

Conclusion

Bi-Economy and *Panasia* have provided insureds with a means to seek extra-contractual damage where there is foreseeable and quantifiable damage proximately resulting from an insurer's improper conduct.

To date, decisions have focused on an insured's right to plead consequential damages, rather than on upholding a recovery. It remains to be seen whether courts will continue to limit the right to plead consequential damages to those situations in which there are allegations of improper insurer conduct beyond simple breach of contact, and whether they will limit the right to recover by enforcing the burden of proof on insureds to demonstrate that such damages are quantifiable rather than speculative, and were foreseeable at the time the insurance was placed.

1 10 N.Y.3d 187 (2008) and 10 N.Y.3d 200 (2008), respectively.
2 The 2001 decision by an intermediate appellate court in *Acquista v. N.Y. Life Ins. Co.,* 285 A.D.2d 73 (1st Dept. 2001) opened the door for policyholders to seek consequential damages apart from policy proceeds as a result of an insurer's breach of an insurance contract, at least in the first party disability insurance context. The court (with a strong dissent) rejected the traditional view of New York courts up to that point that the remedy for an insurer's breach of contract was limited to recovery of policy proceeds. The court's reference to consequential damages being available was in the context of the insurer's denial or dilatory payment being without a reasonable basis. The ruling in *Acquista*, however, was generally rebuffed by New York courts. *See, Eurospark Indus. v. Mass. Bay Ins. Co.,* 288 B.R. 177, 186 (E.D.N.Y. 2003) (acknowledging that "[t]he *Acquista* decision has been met with disapproval").
3 *See Rocanova v. Equitable Life Assur. Soc.,* 83 N.Y.2d 603, 615 (1994) (holding that insured may recover contractual damages for insurer's breach, but not punitive damages unless insured could show "egregious tortious conduct" directed at the insured demonstrating a "pattern of similar conduct directed at the public generally."); *see also New York Univ. v. Continental Ins. Co.,* 87 N.Y.2d 308, 316 (1995).
4 This article does not address the issue of an insured's right to recover excess of policy limits when its liability insurer improperly fails to settle a claim within policy limits in gross disregard of the insured's interests. *See, e.g., Pavia v. State Farm Mut. Ins. Co.,* 82 N.Y. 2d 445 (1993).
5 *Bi-Economy*, 10 N.Y. 3d 187, 193 (2008).
6 *Id*. at 195.
7 *Id*. at 193 (citations and quotations omitted).
8 *Id*. at 195.
9 *Id*. at 198.
10 In both *Bi-Economy* and *Panasia*, and in a recent decision by the Fourth Department in *Stern v. Charter Oak Fire Ins. Co.,* 2009 NY Slip. Op. 00729 (N.Y. App. Div. Feb. 6, 2009) (reversing its prior holding issued before the Court of Appeals decided *Bi-Economy*), the courts also rejected the insurers' attempt to rely on a policy's "consequential loss" exclusion to bar an insured's "consequential damages" claim against its insurer. *Bi-Economy* determined that the term "consequential loss" as used in the exclusion refers to loss stemming from the conduct of the insured or third parties, while "consequential damages" concerns damages incurred by the insured as a result of the insurer's misconduct. *Bi-Economy*, 10 N.Y. 3d 187, 195.
11 857 N.Y.S.2d 680 (App. Div., 2nd Dep't 2008).
12 2008 WL 4426620 (N.D.N.Y. 2008).
13 867 N.Y.S.2d 881 (N.Y. Sup. Ct. 2008).
14 2008 NY Slip. Op. 32366 (N.Y. Sup. Ct. 2008).

Bermuda Regulation Review of 2008

In January 2008, the Bermuda Monetary Authority (BMA) published its 2008 Business Plan highlighting the BMA's goal to become internationally recognised as a leading risk-based regulator. In this article, we look back at 2008 and the BMA's focuses for the year and review what steps the BMA took to meet its goal, particularly in light of the challenging market conditions resulting from the global financial crisis.


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Mutual Recognition

In order to achieve continued growth in an increasingly globalised market, the BMA identified that full mutual recognition, being treated as having equivalent regulatory standards to those in the European Union, was crucial as this had the potential to simplify access by (re)insurers in each market to the other market.

Following the EU's proposal in 2007 for the introduction of the Solvency II Directive, in 2008 the BMA took a major stride towards mutual recognition by announcing significant changes to Bermuda's solvency and disclosure regulations.

Insurance Amendment Act 2008

Prior to the passing of the Insurance Amendment Act 2008, the Insurance Act 1978 in Bermuda required (re)insurers to meet a margin of solvency which had been calibrated based on the scale and class of the (re)insurer's business, with higher premium and/or reserving levels requiring more statutory capital and surplus. No account was taken of the fact that certain lines of business were inherently riskier than others. In July 2008, with the passing of the Insurance Amendment Act 2008, the Bermuda Solvency Capital Requirements (BSCR) were introduced to apply to Bermuda's Class 4 (re)insurers

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Insurance & Reinsurance Department (IRD) Highlights

- **Laurie Kamaiko** (New York) moderated and spoke at Lorman's Insurance Bad Faith Claims seminar in New York in December 2008.
- **Jack Dearie** (New York) and **Machua Millett** (Boston) presented a webinar entitled *"(Re)emerging Mercados: Significant Recent Developments in the Latin American Insurance and Reinsurance Markets"* on 21 January 2009. This webinar is available to view through the 'Newsstand' pages of our website, which can be accessed at: www.eapdlaw.com/newsstand.
- **Vivien Tyrell** (London) spoke at the International Association of Insurance Receivers 2009 Post Inaugural Insolvency Conference in Florida on 23-24 January.
- **David Kendall** (London) and **John Hughes** (Boston) spoke at a seminar co-hosted with the Association of Bermuda Insurers and Reinsurers on *"Credit Crisis Claims: Auction Rate Securities and Other Issues of Concern for D&O and E&O Insurers"* in Bermuda on 2 February 2009.
- **Mark Everiss** (London), **Peter Fidler** (London) and **Vivien Tyrell** (London) attended the Association of Run-Off Companies' Congress and Convention Dinner in London on 24-25 February.

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and was intended to establish risk based capital adequacy standards for high impact (re)insurers. Unlike the earlier fixed minimum solvency margin requirements, the BSCR take into account the relative underwriting risks of different lines of insurance as well as a broad range of other risk factors including credit risk, equity risk, liquidity risk, reserving risk and catastrophe risk. (Re)insurers are allowed (subject to the BMA's approval) to use their own internal capital models where they can establish that those models better reflect the inherent risks of their business. This approach owes much to the influence of the UK Financial Services Authority in the BMA's thinking.

This legislation also provides for the reclassification of the Class 3 insurance sector, which included firms ranging from captives writing a limited amount of third party business to large commercial (re)insurers. The reclassification focused on the respective risk profiles of the Class 3 companies and introduced a new Class 3A (small commercial insurers) and Class 3B (large commercial insurers) and a new category for insurance special purpose vehicles to be known as "Special Purpose Insurers". This allows the BMA to undertake a more detailed analysis in identifying the regulatory needs in relation to the different types of (re)insurers using its risk-based regulatory approach.

The changes to the Insurance Act 1978 have been supplemented with the following amendments:

Insurance Accounts Amendment Regulations 2008

These Insurance Accounts Amendment Regulations, which came into effect on 31 December 2008, amend the Insurance Accounts Regulations 1980 and set out the statutory financial accounting requirements for the purposes of BSCR for Class 4 (re)insurers. The amended statutory financial accounting requirements are more onerous and involve the submission of more detailed balance sheets (including detailed information about specific assets and distinguishing assets that are attributable to affiliates) and income statements to the BMA.

Insurance Returns and Solvency Amendment Regulations 2008

These Insurance Returns and Solvency Amendment Regulations, which also came into effect on 31 December 2008, amended the Insurance Returns and Solvency Amendment Regulations 1980. They made a general amendment to include references to Class 3A and Class 3B (re)insurers and a minimum margin of solvency for the new class of Special Purpose Insurers, and introduced a requirement for Special Purpose Insurers to submit a special purpose solvency certificate. These regulations were accompanied by the issuance of the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order 2008. The Order sets out the prudential standards that Class 3 (re)insurers must comply with when submitting a Capital and Solvency Return.

Response to the Global Financial Crisis

The Bermuda market has carefully monitored the situation since the onset of the crisis and, in particular, has focused on investment funds, banks and the insurance market, the areas most affected by the crisis. In the insurance sector, the BMA has taken a proactive role and has undertaken surveys to assess the companies' exposure in both investment portfolios and underwriting. The result of this was a focus on the financial guaranty firms who were the most affected. Some success has been achieved in helping these companies recover. However, the BMA has recognised that there is still work to do.

In 2008, the BMA collaborated with the New York State Insurance Department (NYSID) in relation to a number of firms within the financial guaranty sector impacted by sub-prime and matters related to AIG. This collaboration underscored the need to ensure that regulators could co-operate quickly and efficiently in the global insurance market and, as a result, the BMA and the NYSID signed a memorandum of understanding (MoU) on 29 September 2008. According to paragraph 2 of the MoU, its purpose is to facilitate a formal basis for consultation, co-operation and co-ordination between the two regulatory bodies. The MoU allows for the exchange of information relevant to each authority's supervisory, regulatory and examination responsibilities. Each authority can assist the other in investigative work regarding companies and persons engaged in insurance business, including questioning, taking testimony and conducting inspections and investigations.

The Year Ahead

On 15 January 2009, the BMA published its Business Plan for 2009. This year, the BMA will:

- continue to focus on the management of the financial crisis (in the same manner as in 2008, using soft tactics such as market surveys, stress tests and on-site reviews to identify firms for close monitoring)
- continue progress towards international mutual recognition for Bermuda (with a focus on EU and US markets)
- implement new money laundering standards (with a focus on on-site reviews and taking enforcement action as necessary)
- continue the improvement of operational efficiency within the market (by publishing service standards with regard to particular types of regulatory transactions rather than generally across the market).

The BMA also proposes to publish guidance on the regulatory standards for Special Purpose Insurers and to start a longer term project to review parts of the Insurance Act 1978 which require updating.

As the global financial system continues to dislocate, the BMA is taking steps to prepare for the next phase of the financial crisis. The Business Plan for 2009 is designed to chart a course to ensure that Bermuda succeeds as a leading financial market supported by a leading risk-based financial regulator.

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Complying with Corruption and Bribery Laws

Investigating and punishing companies for paying bribes to win public business is an increasing priority of law enforcement agencies around the world. There is no reason to expect that the insurance industry is immune from corrupt activities: in January 2009, the Financial Services Authority fined Aon Limited £5.25 million following an investigation into compliance systems failures causing possible breaches of anti-bribery laws.

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In the United States corruption investigations and enforcement actions are at an all time high, and the Aon and other cases suggest that the United Kingdom authorities are now intent on achieving similar results. This will be given impetus if Parliament accepts Law Commission proposals to overhaul bribery laws.

This article outlines the US legislation, the Law Commission's proposals in the UK, and the *Aon* case.

" The proposed bill, or something akin to it, could be passed in late 2009 or early 2010."

The United States: the FCPA

The Foreign Corrupt Practices Act (FCPA) criminalizes the corruption of foreign public officials to win or keep business. Representatives of state-owned companies could be public officials under the Act.

The FCPA also requires companies whose shares are traded in the US to maintain books and records that accurately and fairly reflect their transactions, and to maintain an adequate system of internal accounting controls.

Infringement of the FCPA can lead to civil or criminal penalties. Individuals can be jailed for up to five years. Fines in criminal proceedings can be up to twice the benefit sought by paying the bribe, and civil penalties can equal the gross amount of the benefit gained by the defendant.

The defences to prosecution include the legality of the payment in issue under the written laws of the country in which it is made. Reasonable expenditure incurred to demonstrate a product or to perform a contractual obligation is also permitted.

Broad Application

The Act applies to corrupt activities within or outside the US, and companies are liable for the activities of their officers, directors, employees or agents. The Act also extends to foreign individuals or companies who take steps in the US as part of a scheme to bribe a foreign public official. This could include the use of a bank account in the US, wire transfers through the US or lesser links such as travel or communications through the US.

The accounting provisions apply both to issuers of US securities, and to their domestic and foreign subsidiaries. That may include companies in which an issuer has only a minority interest.

The UK position: Proposed Reform of Anti-bribery Laws

The law of bribery in England and Wales is outdated and uncertain. On 30 November 2008, the Law Commission published a detailed review of the existing law, and proposed a draft bill intended *"to make the law of bribery simpler and more appropriate to modern times and consistent with our international obligations".* The proposed bill, or something akin to it, could be passed in late 2009 or early 2010. It proposes the following broad offences:

- requesting or receiving a bribe
- offering or giving a bribe
- bribery of a foreign public official
- a corporate offence of negligently failing to prevent bribery.

The proposed bill does not distinguish between bribery in the public and private sectors, save for the specific offence of bribery of a foreign public official. That offence would be committed if the defendant offers or pays a bribe with the intention of influencing a foreign public official in his or her official capacity to obtain or retain business, or an advantage in business. Again, representatives of state-owned companies could be foreign public officials under the proposals. It would be a defence to show that the payments were 'legitimately due', or that the defendant reasonably believed that this was the position.

The corporate offence of failure to prevent bribery is perhaps the most significant proposed change. It would apply to companies and limited liability partnerships whose registered office is located in England and Wales. The offence would be committed if:

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IRD Highlights

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- Various UK and US EAPD partners attended the 2009 Professional Liability Underwriting Society International Conference in New York on 24-26 February.
- **Scott Casher** (Stamford), **John McCarrick** (New York) and **Mark Meyer** (London) spoke at an EAPD-hosted seminar entitled *"Directors and Officers Liability: An International Perspective"* at EAPD's New York office on 27 February 2009.
- **Antony Woodhouse** (London) attended and **Craig Stewart** (Boston) moderated a panel on *"Settling Complex Claims While Avoiding Bad Faith Liability to Everyone"* at the ABA-TIPS 17th Annual Insurance Coverage Litigation Committee Mid-Year Program at the Millennium Biltmore Hotel in Los Angeles on 26-28 February 2009.

For further details on any of these past events please contact Kalai Raj at KRaj@eapdlaw.com.

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The International Who's Who of Insurance & Reinsurance Lawyers (2008)

EAPD are delighted to be represented in this esteemed directory of the world's leading insurance and reinsurance lawyers.

EAPD partner **Vincent Vitkowsky** (Boston) and **David Kendall** (London) are listed as being 'Most highly regarded individuals' in this publication, and EAPD partners **Alan Levin** (Hartford), **Nick Pearson** (New York) and **John Rosenquest** (Hartford) are also identified as having leading practices. To quote directly from the commentary, EAPD is noted as having *"great lawyers on either side of the Atlantic"*.

This publication is the fruit of months of independent research on the part of Who's Who Legal, whose researchers and editorial team extensively canvass and subsequently analyse the opinions of law firm clients and insurance and reinsurance lawyers from around the world.

- any person performing services for or on behalf of a company or partnership paid a bribe (whether an employee, agent or subsidiary)
- the bribe was in connection with the defendant's business
- any person with responsibility for preventing bribery negligently failed to prevent the payment of the bribe.

It would be a defence to show that adequate procedures had been implemented intended to prevent bribery by the person paying the bribe, unless the act complained of is that of a director or other senior company representative.

It is proposed that criminalisation will extend to bribes paid overseas by British citizens, UK residents and companies or partnerships incorporated in the United Kingdom, even where no steps in relation to the bribes are taken in the UK. Individuals found guilty of an offence would face a maximum of ten years imprisonment or a fine, or both. The maximum penalty for a company would be an unlimited fine.

The *Aon* Case

On 6 January 2009, Aon Limited was fined £5.25 million by the Financial Services Authority for failing to take reasonable care to establish and maintain effective systems and controls for countering the risks of bribery and corruption by overseas third parties (OTPs) in a way that assisted it to win reinsurance business. That failure was a breach of Principle 3 of the FSA's Principles for Business which state that *"[a] firm must take reasonable care to organise and control its affairs responsively and effectively, with adequate risk management systems"*.

Aon's energy and aviation business used OTPs to win business in overseas jurisdictions. For example, payments were made to co-brokers who assisted in the placement of insurance or reinsurance, or to consultants helping to introduce clients or who provided market information.

Some of the customers were state owned entities, in whole or part, or otherwise had government connections. This created a significant risk that payments made by Aon to third parties dealing with those customers would be used for bribes, or other inappropriate purposes, in particular in certain high risk jurisdictions in which Aon undertook business.

Between 14 January 2005 and 30 September 2007, Aon made 66 'potentially inappropriate' payments to OTPs, totalling about US$2.5 million and Euros 3.4 million. The FSA identified the following failings in Aon's systems and controls:

- weak due diligence when entering into relationships with OTPs, or before payments were made
- Aon did not take into account the potential risks in the countries in which it operated, particularly where it had regular dealings with clients with political or state connections
- Aon failed routinely to review and monitor its relationships with OTPs in respect of bribery risks
- Aon did not provide staff dealing with OTPs with sufficient guidance or training on the bribery and corruption risks involved in such dealings
- the absence of compliance monitoring
- oversight committees were not provided with relevant management information, nor did they routinely assess whether bribery and corruption risks were being managed effectively.

In assessing the level of the fine, mitigating factors were taken into account: suspicious payments in Bahrain and Indonesia were reported promptly to the authorities; Aon appointed external advisers to conduct a thorough review of its systems and controls in relation to payments to OTPs; those external advisers were also asked to conduct a robust review to identify suspicious payments; lawyers were instructed to carry out detailed investigations into the suspicious payments; disciplinary action was taken against staff involved in the making of the suspicious payments. The FSA recognised that in taking these steps Aon had incurred considerable costs.

Further, Aon introduced new and enhanced systems and controls to combat bribery and corruption – these measures included a global anti-corruption policy, robust risk-based procedures to review existing and future third party relationships, and enhanced training. The FSA did not conclude that the failures were deliberate or reckless, otherwise the fine would have been significantly higher. Aon also received a 30% discount for early settlement.

However, the fine remained substantial, both in itself and compared to the profit that Aon made as a result of the suspicious transactions. The FSA has said that the fine was intended to provide a *"clear message to the UK financial services industry that it is completely unacceptable for firms to conduct business overseas without having in place appropriate anti-bribery and corruption systems and controls"*.

Conclusion

Enhanced scrutiny and investigation of publicly awarded contracts means that evidence of bribery and other corrupt practices will increasingly be uncovered. Those caught paying bribes are at risk of very substantial fines, imprisonment for individuals, payment of the profits made on contracts obtained by corruption, debarment from public contracts and potential law-suits from competitors and shareholders.

Robust and effective anti-corruption and anti-bribery policies, systems and controls are, in effect, a requirement of the proposed UK bribery legislation. Vigorous enforcement of the US FCPA already make this essential for any company trading internationally.

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Non-Party Discovery in Reinsurance Arbitrations


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A reinsurance transaction often involves many individuals or entities who are not parties to the reinsurance contract itself. Brokers, intermediaries, managing general agents or underwriters, third-party administrators and former employees of parties have often played vital roles in the transactions in dispute, and pertinent information concerning those transactions is often in their possession and control. Therefore, parties to reinsurance arbitrations often seek discovery from non-parties prior to the ultimate hearing in a matter. Many times, non-parties are willing to produce documents or provide testimony without conflict, due to their business interests. However, when the non-party from whom pre-hearing discovery is sought refuses to comply, issues arise as to the power of the arbitrators to compel such discovery under the Federal Arbitration Act ("FAA").

Non-Party Discovery under the FAA

Section 7 of the FAA empowers arbitrators to compel certain forms of discovery. It provides, among other things, that "arbitrators... or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in proper case to bring with him or them any book, record, document or paper which may be deemed material as evidence in this case."[1] While this language is clear with respect to an arbitrator's authority to require non-parties to appear and produce documents at an arbitration hearing, it does not address whether such power extends to pre-hearing discovery. Thus, courts have struggled to balance the discovery powers available to arbitrators under the FAA with one of the goals of arbitration - avoiding the burden, expenses, harassment, and lack of efficiency commonly associated with discovery in litigation.[2]

Pre-Hearing Depositions of Non-Parties

Recent case law illustrates judicial resistance towards permitting arbitrators to compel non-parties to attend depositions prior to the ultimate hearing. [3] Nonetheless, a jurisdictional split remains on this issue.

Federal district courts in the Seventh and Eleventh Circuits have held that an arbitrator has the authority to compel non-party depositions prior to the arbitration.[4] For example, in *Stanton v. Paine Webber Jackson & Curtis*, the Southern District of Florida held that Section 7 of the FAA empowers arbitrators to compel pre-hearing discovery, including the power to compel non-parties to appear for depositions prior to the hearing.[5] Similarly, several decisions originating from the Northern District of Illinois have held that an arbitration panel has the authority to order pre-hearing non-party depositions,[6] although a recent decision by that court held the contrary. *See Matria Healthcare, LLC, et al. v. Duthie, et al.*, No. 08-C-5090 (N.D. Ill. Oct. 6, 2008). In *Matria Healthcare*, the court rejected the Northern District of Illinois's decision in *Amgen Inc*. and held that "[b]y its own terms, the [FAA's] subpoena authority is defined as the power to compel non-parties to appear before them; that is, to compel testimony by non-parties at the arbitration hearing. A deposition simply does not fall within those terms."

Other courts have reached the same conclusion as the Northern District of Illinois in *Matria Healthcare.* Federal district courts in the Second, Fourth, Fifth, and Eighth Circuits have rejected the notion that Section 7 of the FAA empowers arbitrators to order pre-hearing depositions of non-parties. [7] In *Atmel Corp.,* the Southern District of New York held that "the weight of judicial authority favors the view that the Federal Arbitration Act, 9 U.S.C. § 7, does not authorize arbitrators to issue subpoenas for discovery depositions against third parties." [8]

Moreover, the Second, Third and Fourth Circuits have found, at least implicitly, that an arbitration panel lacked the authority to order non-parties to appear for pre-hearing depositions.[9] Indeed, the Third Circuit stated in *Hay Group v. E.B.S. Acquisition Corp.* that, pursuant to the "unambiguous" language of Section 7 of the FAA, an arbitrator's subpoena power is limited to "situations in which a non-party has been called to appear in the physical presence of the arbitrator and to hand over the documents at that time."[10] Recently, the U.S. Court of Appeals for the Second Circuit characterized *Hay Group* as the "emerging rule," finding that "the arbitrator's subpoena authority under FAA § 7 does not include the authority to subpoena non-parties or third parties for pre-hearing discovery even if a special need or hardship is shown."[11]

Thus, while the majority of case law favors the view that arbitrators do not have the authority to order pre-hearing depositions of non-parties, several federal district courts have held to the contrary.

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EAPD appointed to the Committee on the Judicial Performance Evaluation Program

Michael Thompson (Stamford) has been appointed as a member of the Committee on the Judicial Performance Evaluation Program by Chase T. Rogers, Chief Justice of the Connecticut Supreme Court.

The Committee has been formed to examine the existing judicial evaluation program for Connecticut judges and to explore ways to enhance its effectiveness and to ensure its continued integrity.

Michael currently serves as Chairperson of the Connecticut Judicial Selection Commission.

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Pre-Hearing Document Production

Arbitrators have greater latitude with respect to ordering pre-hearing non-party document production. The majority of jurisdictions that have addressed the issue permit arbitrators to compel non-party document discovery prior to the hearing.

The Sixth and Eighth Circuits, as well as federal district courts in the Fifth, Seventh and Eleventh Circuits, have held that the FAA empowers arbitrators to compel pre-hearing document discovery from non-parties.[12]

By contrast, the Second and Third Circuits, as well as a federal district court in the First Circuit, have held that Section 7 of the FAA does not provide arbitrators with the authority to compel pre-hearing document discovery from non-parties to the arbitration proceeding.[13] For example, in *Life Receivables Trust*, the Second Circuit held that an arbitrator lacks authority under Section 7 of the FAA to compel pre-hearing document discovery from non-parties, essentially overruling prior decisions by federal district courts in that circuit that held the contrary.[14]

Similarly, in *COMSAT Corp.,* the Fourth Circuit held that an arbitrator lacks the authority to compel pre-hearing discovery "absent a showing of special need or hardship."[15]

Moving forward, it is likely that courts will continue to determine this issue on a case-by-case basis, guided where applicable by controlling appellate precedent. Nonetheless, it remains clear that courts are more willing to permit non-party document discovery prior to the hearing than they are depositions.

The Power to Compel Witness Testimony before an Arbitrator prior to the Final Hearing on the Merits

As noted, Section 7 of the FAA authorizes arbitrators to "summon in writing any person" to appear "before them or any of them as a witness" and bring documents that may be relevant to the case.[16] Citing this provision, a few recent cases have recognized that arbitrators have the authority to compel a non-party to provide documentary and testimonial evidence before them prior to the ultimate hearing.[17]

In *Stolt-Nielsen SA v. Celanese AG*, the Second Circuit examined whether Section 7 authorizes arbitrators to summon non-party witnesses to give testimony and provide evidence at a pre-merits hearing before an arbitration panel.[18] The non-parties objected to the subpoenas on the grounds that Section 7 does not provide arbitrators with the power to summon non-parties for the purpose of compelling testimonial and documentary evidence in advance of the ultimate hearing.[19] The Second Circuit held that based on the above language of Section 7, arbitrators have the authority to require non-parties to appear before them with documents and provide testimony on relevant issues prior to the final hearing. This case was recently cited with approval by the Second Circuit, as well as by a federal district court in Connecticut.[20]

Moreover, Section 7 of the FAA states that an arbitral subpoena "shall be served in the same manner as subpoenas to appear and testify before the court." Thus, the Second and Third Circuits, as well as a federal district court in the First Circuit, have held that the 100-mile jurisdictional limits of Rule 45 of the Federal Rules of Civil Procedure ("FRCP") applies to the service and enforcement of arbitral subpoenas.[21] In those jurisdictions, an arbitral subpoena may be quashed unless it is served on a non-party within 100 miles of the location where the non-party resides, is employed or regularly transacts business in person. However, the *Stolt-Nielsen* procedure may provide parties and arbitrators with an end-run around the jurisdictional limits of FRCP 45, as an arbitrator could simply decide to "sit" in a location within the judicial district, or within 100 miles, of the non-party from whom discovery is sought for the sole purpose of obtaining discovery.[22]

Conclusion

Non-parties to the reinsurance agreement are often in a unique position to provide important information to cedents and reinsurers engaged in arbitration. However, except in the rare circumstance when a non-party has a contractual obligation to provide pre-hearing discovery, parties to arbitration may not be able to obtain it. Given the current state of uncertainty on this issue, entities and individuals involved in a reinsurance transaction should be aware of the law in the applicable jurisdiction when deciding whether to seek or oppose non-party discovery in a related arbitration.

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1 9 U.S.C. § 7 (West 2008).
2 Graydon S. Staring, *Law of Reinsurance*, §22.2 (1998).
3 *See, e.g., Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, No. 07-cv-1197 (2d Cir.Nov. 25, 2008); Hay Group v. E.B.S. Acquisition Group, 360 F.3d 404, 407 (2d Cir. 2004); *Matria Healthcare, LLC, et al. v. Duthie, et al.*, No. 08-C-5090 (N.D. Ill. Oct. 6, 2008); *Atmel Corp. v. LM Ericsson Telefon*, 371 F. Supp. 2d 402 (S.D.N.Y. 2005); *Odfjell ASA v. Celanese AG,* 328 F. Supp. 2d 505 (S.D.N.Y. 2004); *In re Arbitration Between Hawaiian Elec. Industries, Inc.* and *HEI Power Corp.,* No. M-82, 2004 WL 1542254, (S.D.N.Y. July 9, 2004); *In re Arbitration Between The Procter and Gamble Co. and Allianz Ins. Co.,* 2003 U.S. Dist. LEXIS 26025, at *5 (S.D.N.Y. Dec. 3, 2003).
4 *Amgen Inc. v. Kidney Center of Del. County, Ltd.,* 879 F. Supp. 878, 879-80 (N.D. Ill. 1995); *Stanton v. Paine Webber Jackson & Curtis, Inc.,* 685 F. Supp. 1241, 1242-43 (S.D. Fla. 1988).
5 *Stanton,* 685 F. Supp. at 1242-43.
6 *In re Arbitration Between Scandinavian Reinsurance Co. Ltd. and Continental Cas. Co.,* No. 04-C-7020 (N.D. Ill. Dec. 10, 2004); *Amgen, Inc.,* 879 F. Supp. at 879-80.
7 *Atmel Corp.,* 371 F. Supp. 2d 402; *Odfjell* ASA, 328 F. Supp. 2d at 505; *In re Arbitration Between Hawaiian Elec. Industries, Inc. and HEI Power Corp.,* No. M-82; *Gresham v. Norris*, 304 F. Supp. 2d 795, 797 (E.D. Va. 2004); *SchlumbergerSema, Inc. v. Xcel Energy, Inc.*, No. Civ. 02-4304PAMJSM, 2004 WL 67647 (D. Minn. Jan. 9, 2004); *In re Meridian Bulk Carriers, Ltd.,* No. 03-2011, 2003 WL 23181011, at **1-2 (E.D. La. July 17, 2003); *In re Arbitration Between The Procter and Gamble Co. and Allianz Ins. Co.,* 2003 U.S. Dist. LEXIS 26025, at *5; *Integrity Ins. Co. v. Amer. Centennial Ins. Co.,* 885 F. Supp. 69, 71 (S.D.N.Y. 1995).
8 *Atmel Corp.,* 371 F. Supp. 2d at 403.
9 *Life Receivables Trust,* No. 07-cv-1197, at 10; *Hay Group,* 360 F.3d at 407; *COMSAT Corp. v. National Science Foundation,* 190 F.3d 269, 276, 278 (4th Cir. 1999).
10 360 F.3d at 407.
11 *See Life Receivables Trust,* No. 07-cv-1197, at 10.
12 *See, e.g., In re Sec. Life Insur. Co. of Am.,* 228 F.3d 865, 870-71 (8th Cir. 2000); *Am. Fed'n of Television and Radio Artists, AFL-CIO v. WJBK-TV,* 164 F.3d 1004, 1009 (6th Cir. 1999); *Festus & Helen Stacy Foundation v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 432 F. Supp. 2d 1375, 1379 (N.D. Ga. 2006); *SchlumbergerSema, Inc.*, No. Civ. 02-4304PAMJSM, 2004 WL 67647, at *2; *In the Matter of Meridian Bulk Carriers, Ltd.*, No. 03-2011, 2003 WL 23181011, at **1-2; *Amgen Inc.*, 879 F. Supp. at 882-83; *Meadows Indem. Co. v. Nutmeg Ins. Co.*, 157 F.R.D. 42, 44 (M.D. Tenn. 1994); *Stanton,* 685 F. Supp. at 1242.
13 *See, e.g., Life Receivables Trust,* No. 07-cv-1197; *Hay Group, Inc.*, 360 F.3d at 408, 410-11; *Liberty Mut. Ins. Co. v. White Mountains Ins. Group Ltd.*, No. 06-11901 (D. Mass. Feb. 26, 2007), reported in Mealey's Litigation Reporter: Reinsurance, Volume 17, Issue 22, March 22, 2007.
14 *Life Receivables Trust*, No. 07-cv-1197, at 8-10.
15 *COMSAT Corp.*, 190 F.3d at 275-76, 278.
16 9 U.S.C. § 7.
17 *Life Receivables Trust,* No. 07-cv-1197, at 13-14; *Stolt-Nielsen SA v. Celanese AG*, 430 F.3d 567, 578-79 (2d Cir. 2005); *Hay Group, Inc.*, 360 F.3d at 410-11; *Guyden v. Aetna, Inc.*, 2006 WL 2772695, at *7 (D. Conn., Sept. 25, 2006).
18 *Stolt-Nielsen,* 430 F.3d at 578-79.
19 *Id.* at 577.
20 *Life Receivables Trust,* No. 07-cv-1197, at 13-14; *Guyden*, 2006 WL 2772695, at *7.
21 Compare *Dynegy Midstream Services, LP v. Trammochem,* 451 F.3d 89, 94-95 (2d Cir. 2006), *Legion Ins. Co. v. John Hancock Mut. Life Ins. Co.* 33 Fed. Appx. 26, 27-28 (3d Cir. 2002) and *Liberty Mut. Ins. Co.,* No. 06-11901 with *Festus & Helen Stacy Foundation,* 432 F.Supp.2d at 1378.
22 While courts have yet to specifically address the precise meaning of "sit," there is arguably precedent from several federal courts that a panel is "sitting" in the location where the underlying arbitration is actually taking place. *See Gresham*, 304 F. Supp. 2d at 796 ("[A] district court maintains jurisdiction over such a petition [to enforce a subpoena under 9 U.S.C. § 7] if the situs of the pending arbitration is within its jurisdiction."); *Thompson v. Zavin*, 607 F. Supp. 780, 783 n.5 (D.C. Cal. 1984) (noting that the only federal court that has the power to enforce or issue a non-party subpoena under the FAA is the district court in which the arbitrators were "sitting").

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Using European Companies to Restructure Operations

In the last issue of *Insurance and Reinsurance Review* we looked at how European legislation is tackling cross-border M&A transactions through the Cross-Border Mergers Directive, the Acquisitions Directive and the Takeovers Directive. This article looks at an alternative model: the formation of a European Company to consolidate the regulation of an insurer's European businesses in one European jurisdiction, and through it the capacity to move regulation of its operations between EU member states.

by Richard Spiller
and Stephen Ixer
London

What is a European Company?

A European Company, or Societas Europaea (SE), is a public limited company formed under the European Company Statute (Council Regulation (EC) No 2157/2001) (the Regulation). The creation of SEs was intended to give companies operating in more than one EU member state the option of being established as a single company under Community law and so able to operate throughout the EU with one set of rules and a unified management and reporting system. It was hoped that introducing SEs would offer European businesses significant savings in administration and legal costs.

However, national laws of the EU member states still apply in all matters that are not covered by the Regulation, such as regulatory supervision, tax, accounts and insolvency. This means an SE needs to comply with the domestic law of each jurisdiction in which it operates, thus reducing the scope for savings. As a result, the use of the SE entity has not been as successful as originally envisaged and fewer than a dozen SEs had been registered in the UK by the end of 2008 (although at least two more have been formed already this year).

Nonetheless, the potential advantages an SE offers can still make it an attractive option. In the case of insurers wishing to consolidate their operations into one company regulated in one jurisdiction, it is a realistic alternative to a cross-border insurance business transfer. Moreover, depending on how the transfer is effected, there may be no transfer involved of the company's business to another entity – so no court-approved insurance business transfer scheme is required, although a court approval with a much more limited procedure and cost may still be required.

How Does a Company Become an SE?

An SE can be set up in four ways:

- merger of two or more existing public limited companies in different EU member states
- formation of a holding company by two or more public or private limited liability companies in different EU member states
- formation of a subsidiary by two or more public or private limited companies in different EU member states, or
- transformation (conversion) of an existing public limited company with a subsidiary in a different EU member state.

Only public limited liability companies can become SEs and they must comply with a minimum capital requirement of €120,000. The SE must be registered in the same member state in which the administrative head office is located.

In the last three of the four scenarios described above, at least two of the companies setting up the SE must have had subsidiaries in another member state for at least two years. This requirement makes those options impractical for creating an SE, unless the parent company already possesses companies within its group with the necessary operating history. In these circumstances, the first option may be favoured; a new public company can be created and it or the existing public company then becomes an SE by merger, depending on which is selected to be the successor. In the UK establishing a new public company is a relatively swift and straightforward process.

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"...national laws of the EU member states still apply in all matters that are not covered by the Regulation, such as regulatory supervision, tax, accounts and insolvency."

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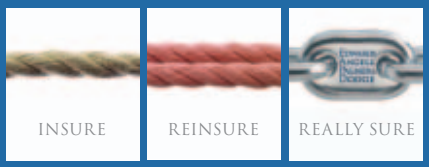

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Upcoming Events

- **David Kendall** (London) and **Martin Lister** (London/Hong Kong) will be speaking at the EAPD seminar *"Managing Insurer Solvency through the Economic Crisis"* at the City Garden Hotel in the Northpoint area of Hong Kong on 4 March 2009.
- **Charles Welsh** (Hartford) will attend the March 2009 meeting of the National Association of Insurance Commissioners in San Diego on 15-18 March 2009.
- **Mark Everiss** (London) will attend the Cavell Cologne Rendezvous in Cologne on 16-18 March 2009.
- **Michael Thompson** (Stamford) will be speaking at the BRMA's Committee Rendezvous on *"Electronic Discovery: What Reinsurance Brokers Need to Know"* in Naples, Florida on 22-24 March 2009.
- **David Kendall** (London) and **Jack Dearie** (New York) will be speaking at the EAPD March Annual Review on *"[Title to be confirmed tomorrow]"* at Trinity House in London on 25 March 2009.
- **James Shanman** (Stamford/New York) will be speaking at the American Conference Institute's 7th International Advanced Forum on Run-Off and Commutations on *"Ethical Considerations When Engaging in Run-Off and Commutations"* at the Helmsley Park Lane Hotel in New York on 25-26 March 2009.

(Continued on Page 13)

The different processes to be followed for SE creation are set out in the Regulation and will be subject to regulation by the authorities of the jurisdiction where the SE is formed. For an SE formed by merger, the procedure includes preparation of the draft merger terms, an expert's report, a meeting of shareholders, legal notices and a court certificate approving the legality of the merger. While this appears lengthy and complex, the time and costs involved are likely to be significantly less than an insurance business transfer scheme.

If the new SE is created by merger, the following consequences occur as soon as it has been formally registered:

- all the assets and liabilities of each company being acquired are transferred to the acquiring company
- the shareholders of the company being acquired become shareholders of the acquiring company
- the company being acquired ceases to exist
- the acquiring company adopts the form of an SE.

Redomiciling

Once an SE has been formed, Article 8 of the Regulation provides that its registered office may be transferred to another EU member state without such transfer resulting in either the winding up of the SE or the creation of a new legal person. The exact procedure for redomiciliation will be subject to the procedure in the jurisdiction where the SE was formed but this will in any event follow the Regulation.

A key requirement is that a management report is drawn up explaining and justifying the legal and economic aspects of the transfer and its implications for shareholders, creditors and employees. The basic details of the transfer, including the SE name and company statutes, the proposed timetable, an explanation of the implications for employees and any protection for shareholders or creditors must also be published in accordance with the rules of the member state where the SE has its registered office.

No decision on the transfer can be taken for two months after the proposal is published. The SE will then need a certificate from the competent authority (in England and Wales this is the High Court) attesting to the completion of the pre-transfer formalities.

The Regulation provides that a member state can stipulate that the transfer of the registered office of an SE registered in that member state shall not take effect if any of that member state's competent authorities oppose it. Such opposition may be based only on grounds of public interest. This right to oppose also applies to a national financial supervisory authority, such as the Financial Services Authority in the UK. The First Non Life Directive (73/239/EEC) requires that the head offices of insurance undertakings are situated in the same member state as their registered office. The Regulation contains a similar requirement. Regulators are therefore unlikely to object to a redomiciliation that unites the head offices and registered office under one regime. However, it should be noted that the regulator in the member state that the SE transfers into will need to be satisfied that the SE is compliant with local supervisory laws at the point the transfer occurs and the SE starts to carry on a regulated activity.

SEs in Practice

SEs are still far from common and the transfer procedure described above is rarer still. One notable insurer which has taken advantage of SE status is Swiss Re, which created an insurer SE by acquisition in the UK through the merger of a UK insurance company, SR International Business Insurance Company Plc, with Dutch insurance company Reassurantie Maatschaapij Nederland. The resulting SR International Business Insurance SE then redomiciled to Luxembourg, transferring from FSA regulation to Luxembourg regulation.

Chubb Reinsurance Company of Europe has also recently transferred its place of regulation from Belgium to the UK. Chubb created an SE through merger by acquisition as part of the process, but in Chubb's case the successor entity was a new UK public company so redomiciliation was not involved. Instead, Chubb used a cross-border merger and also effected a business transfer for its direct business under the applicable Belgian insurance business transfer legislation.

The main disadvantage of the SE model is that the Regulation only partially controls the operation of the SE and the national laws for each jurisdiction in which the company operates must still be considered. SEs may also differ markedly in terms of their structure: the management system may be either by a single board of directors or by a two-tier board made up of executive and supervisory organs; the choice is left to the SE founders. Employee involvement can also take two forms: employee representatives can be informed of key decisions and consulted on others; or they may have the power to recommend or oppose the appointment of some members of the management boards.

Conclusion

Use of the SE model by the large insurers mentioned above attests to its usefulness as a tool to restructure the pan-European operations of insurance groups. If Solvency II causes insurance groups to seek to rationalise their operations and consolidate their regulatory supervision to a single or smaller number of national authorities, it is likely that the use of SEs will increase. SEs are also likely to be bolstered by the proposed introduction of a sister regime, the European Private Company, or SPE, to enable small- and medium-sized enterprises to do business throughout the EU at a lower cost. The European Commission's SPE proposal (COM(2008) 396/3) is currently under review by member states.

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NAIC Paves the Way for the Modernization of U.S. Reinsurance Regulation

by Mohana Terry
New York

At its December 2008 Winter Meeting, the National Association of Insurance Commissioners ("NAIC") adopted, in plenary session, the reinsurance regulatory modernization proposal ("Proposal") drafted and previously adopted by the Reinsurance Task Force of the Financial Condition (E) Committee. If implemented, the Proposal would significantly reform existing state-based reinsurance regulation. Under current law, U.S. ceding insurers may only take full statutory statement credit if the assuming reinsurer is authorized or accredited in the ceding insurer's domiciliary state, or if it posts collateral sufficient to cover 100% of the policyholder liabilities assumed. The Proposal would modernize the existing regime by allowing ceding insurers to take credit for reinsurance assumed by unauthorized, unaccredited reinsurers without requiring as much, or in some cases, any collateral depending on a ratings-based system. This article summarizes some of the key aspects of the Proposal.

"...the Proposal contemplates creation of a new NAIC Reinsurance Supervision Review Department..."

Creation of New Classes of Reinsurers and a Single Regulator System

The Proposal contemplates establishment of a single U.S. regulator system with two new classes of reinsurers: (1) "national reinsurers" which are U.S. reinsurers licensed and domiciled in one state (known as the "home state") that are permitted to conduct business in that state and the entire domestic market, and (2) point of entry reinsurers ("POE reinsurers") which are non-U.S. reinsurers certified by a point of entry U.S. state ("POE state") to provide creditable reinsurance to the U.S. market. A single state would be responsible for regulating each national reinsurer and POE reinsurer - either the home state or the POE state.

With respect to national reinsurers, the home state supervisor would be responsible for, among other things, approving licensure, conducting solvency exams, ensuring compliance with applicable law, establishing and adjusting the reinsurer's rating for collateral purposes, responding to inquiries from other supervisors regarding national reinsurers domiciled in the home state, initiating enforcement actions against such national reinsurers, notifying the ceding insurers' domiciliary states (known as the "host state") of such actions, and receiving annual fees from each national reinsurer it supervises.

With respect to POE reinsurers, the POE state supervisor would be responsible for, among other things, entering into a supervisory recognition framework with supervisors in non-U.S. jurisdictions, certifying POE reinsurers, establishing and adjusting the reinsurer's rating for collateral purposes, responding to inquiries from other supervisors regarding any POE reinsurer under its supervision, consulting with non-U.S. regulators regarding any issues with POE reinsurers, advising all host states of such issues, and receiving annual fees from each POE reinsurer it supervises. Additionally, POE reinsurers must file certain reports with and make certain notifications to the POE state supervisors. These reports and certifications include, but are not limited to, a notification within 10 days of any ratings or license change, submission on an annual basis of audited financial statements (preferably prepared in accordance with U.S. GAAP), and submission on an annual basis of a list of all disputed and overdue reinsurance claims assumed from a U.S. ceding reinsurer.

Under the Proposal, reinsurers are not required to become national or POE reinsurers. Reinsurers that do not wish to become national or POE reinsurers may continue to conduct business under the existing regulatory framework in accordance with the current NAIC Model Credit for Reinsurance Law as adopted by the states.

Role of the RSRD

In order to qualify as a home state or POE supervisor, the Proposal contemplates creation of a new NAIC Reinsurance Supervision Review Department ("RSRD") to evaluate and establish standards for such supervisors. Additionally, the Proposal charges the RSRD with the responsibility to evaluate the regulatory framework of non-U.S. jurisdictions for the purpose of identifying a list of recognized jurisdictions from which non-U.S. reinsurers may apply for licensure as POE reinsurers. The RSRD is charged with, among other things, development of a sample mutual supervisory recognition agreement and a protocol for recognizing non-U.S. jurisdictions, and a sample information sharing and regulatory cooperation agreement between recognized non-U.S.

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RE 40 Under 40s Group, Inc.
The U.S. Reinsurance

Robert DiUbaldo (New York) and **Brian Green** (New York) are participating in the US Reinsurance Under 40s Group event *"It's Not Your Father's Reinsurance Anymore - Putting Reinsurance In Your Terms"*, which is to be hosted by QBE in New York on March 12, 2009.

Brian Green (New York), **Rob DiUbaldo** (New York)and the rest of the U.S. Reinsurance Under 40s Group will host the London-based Lloyd's Non-Marine Under 30's Group at an event in midtown New York on May 6, 2009.

Details will be posted on the Re Under 40s website: **www.reunder40s.org**

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"If adopted, the Proposal would ... potentially open up the domestic market to more non-U.S. reinsurers."

jurisdictions and the POE supervisor. It will also act as a repository for relevant data concerning reinsurers and the reinsurance marketplace.

To further clarify RSRD's operational structure, the NAIC adopted the following Statement of Principles for the Creation of the RSRD: (1) the RSRD should be created as a transparent, publicly accountable entity (contemplated to be part of the NAIC), with a governing board consisting of state or district insurance regulators, and with director eligibility open to all state or district insurance commissioners, directors and superintendents, and (2) RSRD criteria relating to ceded premium volume will not unfairly discriminate against otherwise qualified small jurisdictions from approval as a home state or a POE supervisor.

The Proposal recommends federal enabling legislation to provide the RSRD with sufficient authority to fulfill its functions.

Collateral Requirements

If implemented, the Proposal would reduce the amount of collateral an unauthorized, unaccredited reinsurer must post in order for an admitted, ceding insurer to take financial statement credit. Under the Proposal, the home state or POE supervisor is charged with rating national and POE reinsurers on a legal entity basis for the purpose of determining collateral requirements. The requirements depend on a sliding scale: tier 1 – 0% collateral; tier 2 – 10% collateral; tier 3 – 20% collateral; tier 4 – 75 % collateral; and tier 5 – 100% collateral. A reinsurer in the top tier would not need to post any collateral, whereas a reinsurer in the lowest tier would need to post collateral sufficient to cover 100% of policyholder liabilities in order for the ceding insurer to take financial statement credit. However, with respect to national reinsurers, as U.S. state law protects policyholders and ensures stability of the U.S. financial system, such reinsurers would not have to post collateral if they are rated in tier 3 or better by their home state supervisor.

In determining a reinsurer's rating, the home state or POE supervisor would review the reinsurer's financial strength rating, which the reinsurer must obtain from at least two rating agencies approved by the U.S. Securities and Exchange Commission. Failure to obtain or maintain such ratings would result in assignment of the lowest rating, which corresponds to a requirement that the reinsurer post 100% collateral in order for the ceding insurer to obtain financial statement credit. Additionally, the home state or POE supervisor would consider the following in determining the reinsurer's rating: (1) participation in any solvent scheme of arrangement involving U.S. cedents (if so, the reinsurer would be assigned a tier 5 rating); (2) the reinsurer's compliance with contractual terms and obligations (including certain clauses mandated by the Proposal); (3) the business practices of the reinsurer in dealing with its ceding insurers; (4) the reinsurer's reputation for prompt payment of claims; (5) regulatory actions against the reinsurer; (6) an independent audit opinion for the reinsurer; (7) the liquidation preference of obligations to a ceding insurer in the reinsurer's domiciliary jurisdiction; and (8) the most recent NAIC Filing Black Schedule F for property and casualty insurer or Schedule S for life, accident and health insurers, which detail liabilities assumed from U.S. ceding insurers. For POE reinsurers, the POE supervisors would also review audited financial statements, preferably completed in accordance with U.S. GAAP.

Implementation of the Proposal

The Proposal contemplates implementation through federal regulation in order to promote uniformity across the 50 states and the District of Columbia. Many industry groups support the Proposal and believe that its implementation would create a level playing field between domestic and foreign reinsurers resulting in lower costs for consumers, whereas others are concerned that given the current economic climate, it is not the right time to modify collateral rules and increase the uncertainty that U.S. insurers will receive prompt payments of amounts due under contracts with unauthorized, unaccredited reinsurers.

Conclusion

If adopted, the Proposal would significantly reform current state-based reinsurance regulation, and potentially open up the domestic market to more non-U.S. reinsurers. As of the date of this article, the NAIC has not promulgated a Model Law suggesting language to implement the Proposal. One state, New York, has proposed a rule similar to the Proposal and accepted comments with respect to that rule until February 6, 2009.

We will continue to monitor this topic, including the NAIC implementation process and the status of the New York rule, and we direct you to the EAPD website www.eapdlaw.com and the blog www.InsureReinure.com for further developments.

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A Practitioner's Guide to the FSA Regulation of Insurance

EAPD is pleased to announce the publication of the 3rd edition of 'A Practitioner's Guide to the FSA Regulation of Insurance'. EAPD partner **Ambereen Salamat** has authored the chapter covering 'Special rules relating to certain categories of general insurance business and the Reinsurance Directive' in this comprehensive guide to regulation in the insurance industry.

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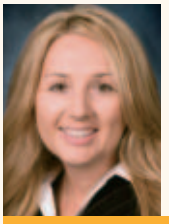
When Actions Speak Louder than Words: Procedural Bad Faith in the Absence of Coverage



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Certain states have recognized a common law tort often referred to as procedural (as opposed to substantive) bad faith. Unlike substantive bad faith, which is, in basic terms, the failure by an insurer to pay a *meritorious* claim[1], procedural bad faith is a vehicle for an insured to seek damages based on an insurer's bad faith handling of *any* claim, meritorious or otherwise. Simply stated, an insurer can be required to pay bad faith damages for a claim for which the insurer has no coverage obligations under an insurance policy, if the insurer handled the investigation or denial of the non-covered claim in an unfair manner.

Recently, the viability of procedural bad faith was reviewed, and upheld, by the Washington Supreme Court in *St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.*, 196 P.3d 664 (Wash. 2008) (*en banc*). The plaintiff/insured involved in the *Onvia* case was served with a lawsuit which it tendered to its liability insurer. The insured reportedly resubmitted its tender letter six months later and, shortly thereafter, submitted to its insurer an amended version of the complaint. Approximately nine months after the original tender, the insurer responded for the first time, denying coverage and defense. Subsequently, in a bad faith and breach of contract lawsuit against the insurer, a federal district court found that the insurer's coverage determination was correct.[2]

Nonetheless, the Washington Supreme Court, reviewing the issue on certification from the district court,[3] held that, in the third-party context, an insured has available to it a cause of action for bad faith claims handling that is not dependent on the duty to indemnify, settle, or defend. The court reasoned that, under Washington law, insurers have not only a general duty of good faith, but also a specific duty to act with reasonable promptness in investigation and communication with their insureds following notice of a claim and tender of defense. The court further reasoned that the duty of good faith is broad and all-encompassing, and is not limited to an insurer's duty to pay, settle, or defend.[4]

Previously, the Washington Supreme Court had already adopted the tort in the first-party context in *Coventry Associates v. American States Ins. Co.*, 136 Wash.2d 269, 961 P.2d 933 (1998), in which case the court held "[t]he implied covenant of good faith and fair dealing in the policy should necessarily require the insurer to conduct any necessary investigation in a timely fashion and to conduct a reasonable investigation before denying coverage. In the event the insurer fails in either regard, it will have breached the covenant and, therefore, the policy." [5]

Washington is by no means the first state to adopt the tort of procedural bad faith and, although the Connecticut Supreme Court has not yet spoken on the issue, the district court in that state has predicted a similar outcome. In *United Technologies Corp. v. Am. Home Assurance Co.*, 118 F.Supp.2d 181, 188-89 (D.Conn. 2000), *mod. after recon. on other grounds*, 237 F.Supp.2d 168 (D.Conn. 2001), the district court was asked to determine whether the Connecticut Supreme Court would likely recognize a common law action for procedural bad faith not involving wrongful withholding of payment due under an insurance policy. Although the defendant insurer argued that a claim for bad faith is not actionable without a showing of a failure to pay a meritorious claim (substantive bad faith), the court concluded, after carefully analyzing existing state court precedent, that the Connecticut Supreme Court would not limit the tort of bad faith to claims of unreasonable or wrongful denial of claims. The court reasoned that an insurer's duty of good faith can be breached not only when coverage is unquesionted, but also when there is no coverage. [6]

The tort of procedural bad faith has similarly been reviewed and adopted by the Wyoming Supreme Court. The issue was first considered by that court in the first-party context, when it considered whether the investigatory procedures utilized by an insurer can amount to bad faith when the insurer is entitled to debate the underlying merits of the insured's claim. *See Hatch v. State Farm Fire and Cas. Co.*, 842 P.2d 1089 (Wyo. 1992). The court recognized the tort of procedural bad faith where the insurer (under circumstances later described as "rather egregious")[7] required the insured, who sought coverage after a house fire, to file a detailed inventory of items in the house at the time of the fire, including how many cornflakes were left in the cereal box before the fire and how much salt was in the salt shaker. The Wyoming Supreme Court later recognized procedural bad faith where the

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Upcoming Events

(Continued from Page 10)

- **Antony Woodhouse** (London) will be speaking on *"The Impact of ABA Rules on Attorneys as Arbitrators and Related Ethical Considerations"* and **Nick Pearson** (New York) will be speaking on *"Capital Markets Components: Impact of Collateralized Debt Obligations on Reinsurance"* at the Harris Martin Reinsurance, Arbitration & Mediation Conference at the Fontainebleau Miami Beach Hotel in Florida on 26-27 March 2009.
- **David Kendall** (London) will be speaking at the ARC 101 Asbestos Seminar on *"UK Follow Settlements"* in London on 7 May 2009.

For further details on any of these upcoming events please contact Kalai Raj at: KRaj@eapdlaw.com.

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claim was not only debatable, but was ultimately determined to be outside the scope of coverage. *State Farm Mut. Auto Ins. v. Shrader,* 882 P.2d 813 (Wyo. 1994) ("while an insured may state causes of action for breach of contract and breach of the duty of good faith and fair dealing, the insured does not need to prevail on the contract claim to prevail on the claim for breach of the duty of good faith and fair dealing."). That rationale was adopted from the Arizona Supreme Court, which also recognized procedural bad faith in the absence of coverage. *Deese v. State Farm Mut. Auto. Ins. Co.,* 172 Ariz. 504, 509 (1992) ("breach of an express covenant is not a necessary prerequisite to an action for bad faith ... a plaintiff may simultaneously bring an action both for breach of contract and for bad faith, and need not prevail on the contract claim in order to prevail on the bad faith claim, provided plaintiff proves a breach of the implied covenant of good faith and fair dealing.").

It should be noted that, even in California, where it has been determined that "a bad faith claim cannot be maintained unless policy benefits are due,"[8] courts have acknowledged the validity of a procedural bad faith claim under unusual or "highly extraordinary" circumstances when benefits are not due under the policy. *See Avery Dennison Corp. v. Allendale Mutual Ins. Co.,* 310 F.3d 1114, 1117 (9th Cir. 2002) (*"[e]xcept perhaps in highly extraordinary circumstances*, California does not permit recovery on a bad faith claim unless insurance benefits are due under the policy") (emphasis added); *see also Murray v. State Farm Fire & Cas. Co.,* 219 Cal.App.3d 58, 268 Cal.Rptr. 33, 37 (1990) (*"[w]hile there may be unusual circumstances in which an insurance company could be liable to its insured for tortious bad faith despite the fact that the insurance contract did not provide for coverage,* no such circumstances are presented here.") (emphasis added).

Despite the fact that procedural bad faith in the absence of coverage has only been recognized by a handful of states,[9] insurers across the board should be mindful of its existence and cautious to avoid falling prey to such a claim. A bad faith action can be filed in, or litigated under, the laws of any number of different jurisdictions, regardless of the venue of the underlying claim for which coverage is sought or the location of the insured to whom the policy was issued. What may start out as an ordinary insurance claim in an insurer-friendly state could eventually result in a bad faith lawsuit in a state recognizing the tort.

Moreover, insurers should be cognizant that the common law tort of procedural bad faith opens the door to the possibility of much greater liability to the insurer than seemingly-similar statutory protections. Although several states offer statutory protections against unfair claims handling,[10] certain states do not allow individual insureds to bring a claim for a violation of the statute,[11] while others do not allow the statutory protections to be invoked for a single violation.[12] In those states recognizing the tort of procedural bad faith, however, insurers can be liable to individual insureds for isolated instances of unfair claims handling.

Additionally, insurers should be mindful of seemingly innocent setbacks in the handling of claims. Although an insured will often have to prove "extraordinary" or "egregious" conduct to prevail on a procedural bad faith claim,[13] it can also be found as a result of something as innocuous as a delayed notification of a proper denial of coverage, as demonstrated by *St. Paul v. Onvia*. Even non-meritorious procedural bad faith claims based on nothing more than sloppy claims handling can result in lengthy and expensive litigation until a conclusion regarding the insurer's good faith can be reached.

Given the appealing nature of this tort to insureds who are otherwise unable to prove breach of contract or violations of unfair claims handling statutes, and the recent attention paid to the tort by the Washington Supreme Court, insurers face the possibility that similar claims will soon emerge in states currently silent on the issue. Insurers should always be mindful of the tort of procedural bad faith, regardless of the merits of the underlying claim and the confidence with which the insurer denies coverage. This topic should be monitored as courts continue to render decisions on this issue.

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1 *See United Technologies Corp. v. Am. Home Assurance Co.,* 118 F.Supp.2d 181, 188-89 (D.Conn. 2000), *mod. after recon. on other grounds*, 237 F.Supp.2d 168 (D.Conn. 2001).

2 *See St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.,* 2007 WL 2005536, *2 (W.D.Wash. 2007).

3 The United States District Court for the Western District of Washington certified the following question to the Washington Supreme Court: "Under Washington law, does an insured have a cause of action against its liability insurer for common law procedural bad faith[,] for violation of the Washington Administrative Code and/or for violation of the Washington Consumer Protection Act, even though a court has held that the insurer had no contractual duty to defend, settle, or indemnify the insured?" *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.,* 2007 WL 2005536, 1 (W.D.Wash. 2007).

4 The court concluded, however, that no rebuttable presumption of harm can arise in this context, and declined to recognize coverage by estoppel. The court held that an insured must prove actual harm, and its damages are limited to the amounts its has incurred as a result of the bad faith, as well as general tort damages.

5 *Id., citing* 1 Allan D. Windt, Insurance Claims & Disputes: Representation of Insurance Companies and Insureds § 2.05, at 38 (3d ed.1995).

6 The *United Technologies* holding has been acknowledged numerous times in Connecticut since that decision, including at the state trial court level. *See Joseph Fortin et al. v. Hartford Underwriters Ins. Co. et al.,* 2006 WL 3524562, 42 Conn. L. Rptr. 353 (Conn. Super. 2006) (insurer claimed that tort was only available when insurer breached its contract; court noted that such expansive reading of case law does not withstand scrutiny in light of *United Technologies* careful review of Connecticut case law and conclusion that Connecticut courts have recognized an independent common law tort for such conduct.)

7 *International Surplus Lines Ins. Co. v. University of Wyoming Research Corp.,* 850 F. Supp. 1509, 1527 n. 20 (D. Wyoming 1994), *aff'd,* 52 F.3d 901 (10th Cir. 1995), *citing Hatch, supra,* 842 P.2d at 1098.

8 *Love v. Fire Ins. Exchange,* 221 Cal. App. 3d 1136 (1990); *see also Young v. Illinois Union Ins. Co.,* 2008 WL 5234052, 2 (N.D.Cal. 2008), *citing Love, supra,* 221 Cal. App. 3d at 1153 ("[i]n the absence of any underlying coverage, there is no conceivable liability that Young could allege against [the insurer] on any theory of 'bad faith;'" *see also Brown v. State Farm Mut. Auto. Ins. Co.,* 2008 WL 5234255, 13 (N.D.Cal. 2008), citing *Love*, supra ("[a]bsent an entitlement to policy benefits, a plaintiff may not recover on a bad faith claim, as a matter of law.")

9 Certain states have explicitly held that they do not recognize the tort of procedural bad faith in circumstances where there is no coverage owed under the policy. *See, e.g., Zurich Ins. Co. v. Texasgulf, Inc.,* 233 A.D.2d 180, 181 649 N.Y.S.2d 153, 154 (N.Y. App. Div. 1996) (granting insurer's motion to dismiss insured's bad faith claim because the claim was not covered upon the insurance policy); *Republic Ins. Co. v. Stoker,* 903 S.W.2d 338, 341 (Tex. 1995) (finding that as a general rule, a claim for bad faith cannot exist without first establishing that a claim is covered); *Love v. Fire Ins. Exchange,* 221 Cal. App. 3d 1136 (1990) ("a bad faith claim cannot be maintained unless policy benefits are due"). *But see Avery Dennison Corp. v. Allendale Mutual Ins. Co.,* 310 F.3d 1114 (9th Cir. 2002) and *Murray v. State Farm Fire & Cas. Co.,* 219 Cal.App.3d 58, 268 Cal.Rptr. 33, 37 (1990), discussed above.

10 *See, e.g.*, the Connecticut Unfair Insurance Practices Act, which includes a section specifically regarding "unfair claim settlement practices." Conn. Gen. Stat. Section 38a-816(6).

11 The Supreme Court of California, for example, has held that section 790.03 of the California Insurance Code, addressing unfair claim settlement practices, was not intended to create a private civil cause of action against an insurer that commits one of the various acts listed in that section. *Moradi-Shalal v. Fireman's Fund Ins. Cos.,* 46 Cal.3d 287, 304, 758 P.2d 58, 250 Cal.Rptr. 116 (1988) (*en banc*).

12 For example, in Connecticut, unfair claim settlement practices must be committed or performed "with such frequency as to indicate a general business practice." Conn. Gen. Stat. Section 38a-816(6).

13 *See, e.g., Avery Dennison Corp. v. Allendale Mutual Ins. Co., supra,* 310 F.3d 1117; *International Surplus Lines Ins. Co. v. University of Wyoming Research Corp., supra,* 850 F. Supp. at 1527 n. 20.

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Misrepresentation of Intention: Two Treaties and an Endorsement


by Antony Woodhouse
and Paolo Cerroni
London

In *Limit No. 2 Limited v AXA* ([2008] EWCA Civ 1231) the Court of Appeal provided guidance on a number of important issues relevant to the placement of insurance and reinsurance, specifically: the effect of comments made by a broker at placement with regard to the reinsured's underwriting principles and whether those comments could be viewed as representations of fact or mere matters of expectation or belief; the effect of an endorsement extending the period of a contract of reinsurance; and the willingness to view two representations which were made at placement as 'continuing' for the purposes of a subsequent renewal.

The Treaties

This case involved two treaties. One was written on 1 July 1996, originally lasting 12 months, but later extended by endorsement dated 20 June 1997 for a further 7 months to 31 January 1998. The other was a 12 month treaty written in February 1998. AXA, who had taken over the original reinsurers on both treaties, sought to avoid the treaties as a result of a misrepresentation by the brokers for the reinsured, Limit No.2 Limited, a syndicate at Lloyd's.

The Representation

The representation at the heart of the dispute was contained within a fax sent by the reinsured's brokers, Newman Martin and Buchan Ltd (NMB). Prior to agreeing the 1996 treaty NMB attached a front cover to the draft slip and information sheet provided by the syndicates for the purpose of placing the reinsurances. On 4 July 1996 NMB faxed a bundle including the front cover to the reinsurers stating 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"*. This statement was not however repeated when the 1997 endorsement was made, nor when the 1998 treaty was agreed. NMB had represented that the reinsureds intended only to underwrite energy risks with the defined high deductibles, but this was arguably inaccurate because in the prevailing market conditions high deductible energy business was no longer available. Whilst the reinsured had written reinsurance with the stated deductibles before July 1996, the intention to continue to write such reinsurance had evaporated by July 1996 when the treaty was written. Moreover, it became apparent that most of the risks that were underwritten by Limit No. 2 had deductibles of £100,000 to £200,000.

First Instance Decision

In the High Court, Jonathan Hirst QC held that the broker's statement within the fax sheet was a misrepresentation of intention and therefore the 1996 treaty could be avoided. As a consequence of the avoidance of the 1996 treaty, the 1997 endorsement, which was an extension of the 1996 treaty, could also be avoided.

With regard to the 1998 treaty, the judge held that the representation was a continuing one and that the reinsurers were entitled to assume that the policy regarding deductibles remained for the 1998 year in the absence of any evidence to the contrary. The reinsurers were therefore entitled to avoid the 1996 treaty, the 1997 endorsement and the 1998 treaty.

Misrepresentation

The Court of Appeal outlined the requirements for a finding of actionable misrepresentation: (1) there must have been a representation, in this case the statement by the syndicate that they intended to write business with the stated deductibles; (2) the

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Martin Lister of EAPD Ranked in Band One by Chambers Asia (2009) for Insurance

EAPD is delighted to note that **Martin Lister**, who divides his time between EAPD's London office and EAPD's associated office in Hong Kong (Lister Swartz), was ranked in the top band as a 'Leading Individual' under the category Insurance: Non-contentious. Chambers goes on to describe Martin as *"...an esteemed and towering presence with a well-defined focus in this area"*.

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representation must have been untrue when the relevant contract was written and (3) the misrepresentation must have been material, however materiality was not a point on appeal. The court held that it was an *'inexorable conclusion'* on a fair reading of the evidence, that the representation was untrue; on examination it transpired that it was only the broker that had made the representation and it was contrary to the intention of his client, Mr O'Farrell. The Court of Appeal was satisfied that the statement was a misrepresentation and for this reason it held that the first contract had fallen away. For judicial consideration on the test for misrepresentation where there are allegations of non-disclosure see the recent decision of the Commercial Court, *Crane v Hannover Ruckversicherungs AG* ([2008] EWHC 3165 (Comm)).

Representation of Intention

The court then considered whether the representation of intention was continuing such that it was still in effect when the 1997 endorsement was made and when the 1998 treaty was agreed. In his consideration of a *'representation of intention'*, Lord Justice Longmore suggested that it was an elusive concept primarily because a person's intentions were always subject to change. The court viewed the endorsement as part of the 1996 contract and suggested it would be *'artificial'* to view it as a new contract because it was an agreement between the parties to amend the period clause in the 1996 contract. At the time the 1998 treaty was made the representation was not repeated and Longmore LJ commented that *"[a] representation of intention cannot last for ever; it only relates to the time when it is made"*. Moreover, Longmore LJ refused to put such *"weight on a representation of intention … to say that it must be taken to be still operative after a lapse of 19 months"*. Accordingly the endorsement fell away with the 1996 Treaty, but the 1998 treaty could not be avoided and so the syndicate's appeal was successful on this point at least.

There has been much criticism and discussion about the draconian nature of the right to avoid an insurance or reinsurance contract. Perhaps mindful of just how powerful the remedy of avoidance can be in the hands of an insurer or reinsurer, Longmore LJ concluded that *"a court should not struggle to hold that everything said at inception is to be impliedly repeated on renewal"*.

Comment

This case has to some degree clarified the effect of a misrepresentation of intention in the context of a renewal, and it provides some guidance on how much time must pass before a representation of intention will lapse. Clearly this will vary depending on the specific circumstances of the case, but it seems that the potential harshness of the remedy of avoidance was a factor which affected the weight that Longmore LJ was prepared to put on a representation of intent that had been made 19 months prior to the writing of the 1998 treaty.

The decision also acts as a warning to brokers to ensure that they have authority to include information in the presentation. Great care must be taken when making any statement on behalf of the reinsured. Clearly any losses suffered by its principal as a result of any shortfall in cover could well find their way back to the broker.

Clearly not all representations will continue at renewal, but extension endorsements are likely to be set aside if they are procured by non-disclosure or misrepresentation or if the contracts they extend are so procured.

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