

INSURANCE AND REINSURANCE ALERT

Follow the Settlements Clauses revisited.

BACKGROUND

In autumn 2011, Thailand suffered severe floods. Among the properties damaged were shops and distribution centres owned by a subsidiary of Tesco. Tesco was insured against property damage and BI losses in Thailand under a master global policy issued by ACE European Group Ltd and under a local policy issued in Thailand by ACE INA.

The master policy responded on a Difference in Conditions/Difference in Limits basis, which meant that it was only to the extent that the losses fell outside the scope of the local policy that they were covered by the master policy.

ACE was reinsured in the London market as to 55% of its exposure under the master policy and the local policies ("**Reinsurance**"). Tokio Marine Europe Insurance Limited ("**TMEI**") took a 12.5% line on the Reinsurance and in respect thereof placed excess of loss reinsurance with Novae ("**Retrocession Agreement**").

On 14 February 2012 Tesco made an offer to ACE of £82.5 million to settle its claim for property damage and BI losses, subject to receiving payment by 23 February 2012 so that it could be included within Tesco's 2011/2012 financial year. ACE wanted to accept the offer, as it was considerably less than the £120 million figure which the loss adjusters had advised ACE that Tesco's claim could exceed.

On 20 February, the claim was settled by ACE in the amount of £82.5 million. Approximately £58 million was allocated to the local policy in Thailand and £24.4 million was allocated to the master policy.

TMEI paid the claim under the Reinsurance. Novae resisted liability to TMEI under the follow the settlements clause in the Retrocession Agreement on the basis that ACE did not take all proper and business like steps in making the settlement with Tesco. TMEI applied for summary judgment against Novae on the basis that this defence had no real prospect of success. Summary judgment was granted against Novae.

FAILURE TO TAKE ALL PROPER AND BUSINESS LIKE STEPS IN MAKING THE SETTLEMENT

The Retrocession Agreement contained a follow settlements clause in these terms:

"This Contract is subject in all respects ... to the same terms, clauses and conditions as original and without prejudice to the generality of the foregoing, Reinsurers agree to follow all settlements (excluding without prejudice and ex gratia payments) made by original Insurers arising out of and in connection with the original insurance..."

Novae's defence was founded on Robert Goff LJ's "2nd proviso" set out in *Insurance Company of Africa v Scor (UK) Reinsurance* that for reinsurers to be bound by a follow the settlements clause, the insurers must have taken all proper and business-like steps in making the settlement. Novae argued that because ACE had not taken Thai law advice as to the coverage position under the local policy and had also failed to properly analyse and investigate various points under the master policy, ACE had failed to take all proper and business like steps in making the settlement. Novae also argued that it was not relevant to show that the Tesco settlement would have been better for reinsurers if the steps that Novae submitted ought to have been taken had been taken.

TMEI argued that even if additional advice had been sought and had been in favour of ACE as to the question of the number of deductibles applicable under the local policy and the master policy, a settlement figure of £82.5 million would still have been a good one (although note that TMEI do not appear to have made any submissions about whether this would have been a good settlement figure had favourable advice on coverage more generally been obtained).

The court agreed with TMEI and held that notwithstanding that ACE did not further investigate the coverage position afforded by the local policy and did not delve more deeply into questions concerning coverage under the master policy, Novae's defence that ACE, in failing to take these steps, failed to act properly or in a business-like manner had no prospect of success.

COMMENT

In order to obtain summary judgment, the claimant must establish that the defendant's defence has no real prospect of success and that there is no other compelling reason for a trial. This sets a high threshold for summary judgment applications. Nevertheless, in this case the court considered that this threshold had been met. This case demonstrates that the courts will be unimpressed by attempts by reinsurers to deny liability on the basis that

the insured failed to act in a proper and business-like way by not investigating or pursuing points which would not have affected the reasonableness of the settlement figure. In the court's view, ACE was entitled to conclude that the settlement offer was a good one on the basis that the figure was considerably less than the projected final figures for the adjusted loss. The case highlights that insurers must act in a proper and business-like way, but this does not extend to reaching a settlement that benefits excess of loss reinsurers. In the court's view, the settlement by ACE undoubtedly remained a good one from ACE's perspective and in the circumstances, ACE was entitled to conclude that there was nothing to be gained by pursuing other avenues of enquiry.

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