Insurance/
Reinsurance

10 December 2014

INSURANCE BULLETIN

Welcome to HFW's Insurance Bulletin, which is a summary of the key insurance and reinsurance regulatory announcements, market developments, court cases and legislative developments of the week.

In this week's Bulletin:

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

Graham Denny, Partner, graham.denny@hfw.com

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1. Regulation and legislation

1.1. Insurance Bill – Law Commission Revisions (UK)

The Law Commission published a revised draft Clause 11 to the Insurance Bill, which the Law Commission hopes will be agreed in time to be included in the Insurance Bill currently before the House of Lords. The new draft Clause 11, together with a note, relates to breaches of terms and warranties of an insurance contract that are irrelevant to the actual loss.

The original draft Clause 11 was not included in the Insurance Bill introduced to Parliament in July 2014, as there were some concerns from stakeholders that the Clause was uncertain. The concern related to the fact that the Clause may be interpreted to apply to terms that described the risk as a whole.

The revised Clause 11 applies to terms which could affect the risk of a specific type of loss occurring, or the risk that a particular type of loss would be more extensive. The Clause does not apply to terms which reduce the risk profile as a whole and provides that the insurer should only have to pay if the insured can show that the breach was totally irrelevant and could not have affected the actual loss suffered.

The Law Commission believes that the draft new Clause 11 captures its policy aims, and gives insurers and insureds more clarity with respect to the application of the statutory benefit.

To view the revised draft Clause 11, please see: http://lawcommission.justice.gov.uk/docs/insurance-clause_terms_not_relevant_to_actual_loss.pdf

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NAZIM ALOM, ASSOCIATE

To view the accompanying note to the revised Clause 11, please see:

http://lawcommission.justice.gov.uk/docs/insurance-clause_terms_not_relevant_to_actual_loss_note.pdf

To view the Law Commission's explanatory note relating to the Third Parties (Rights Against Insurers) Act 2010, referred to in the Insurance Bill, please see: http://lawcommission.justice.gov.uk/docs/Third_Parties_and_Insurance_Bill_2014.pdf

For more information, please contact Nazim Alom, Associate, on +44 (0) 20 7264 8760, or nazim.alom@hfw.com, or your usual contact at HFW.

1.2. FCA – Brokers' Conflicts (UK)

The UK Financial Conduct Authority (FCA) has recently reviewed the potential conflict of interest that may arise amongst brokers that use "integrated models", including managing general agency (MGA) agreements, as a means to increase income.

The FCA is particularly interested in brokers whose internal systems for managing potential conflicts the FCA deems to be unsatisfactory. The consequences can be severe for those brokers whose systems the FCA considers to be inadequate. This includes expensive Section 166 Reviews (at the brokers' expense) and potentially large fines. It would be prudent for affected brokers to take early action in order to avoid later problems and financial implications.

This follows the FCA Thematic Review of brokers that arrange cover for SMEs. The FCA was highly critical of what it considers to be a systematic conflict of interest at the centre of business models used by the brokers. The FCA was particularly critical of The FCA "integrated models", where brokers undertake broking activities as agent for insureds, in addition to acting as agent of insurers. The FCA perceives there to be a conflict of interest between the broker's fiduciary duties to its client insured and to the insurer, given the broker's own financial interest.

Unfortunately, there is no detailed guidance as to what amounts to an "effective control framework". In light of this, brokers may well think it advisable to obtain advice on their structures and procedures, or otherwise risk the implications of a Section 166 report.

For more information, please contact Nazim Alom, Associate, on +44 (0) 20 7264 8760, or nazim.alom@hfw.com, or your usual contact at HFW.

2. Court cases and arbitration

2.1. Meaning of "estimated cost of repair" (New Zealand)

This was an appeal by Islington Park against a judgment holding that Islington Park was not entitled to recover for damage to its buildings on the basis of total loss. Islington Park was a complex of 31 industrial buildings in Christchurch. The Agreed Value of the complex for the purposes of the buildings policy was NZ$9 million. The policy provided cover on an "old for old" basis for the buildings. The policy also contained a basis of settlement clause, which provided that the basis of settlement is the Agreed Value in the event of a total loss and that the buildings would be deemed a total loss if the estimated cost of repair exceeds 80% of the Agreed Value.

The effect of the clause was that if the "estimated cost of repairs" exceeded NZ$7.2 million, the buildings were deemed to be a total loss and the full sum insured was recoverable.

Seven of the buildings were damaged in earthquakes in September 2010 and February 2011. Islington Park asserted that the cost of repairing the buildings to a standard meeting current building regulations exceeded NZ$7.2 million and that there was a total loss. Insurers contended that the standard of repair was "old for old" and on that basis the cost of repairs was less than NZ$7.2 million.

The New Zealand Court of Appeal dismissed Islington Park's appeal. The primary basis of indemnity was "old for old". Insurers may commission the repair work, which must meet current building regulations, but that does not alter the indemnity; the clause specifies that insurers need only pay on an "old for old" basis. Where repairs are commissioned, the insured must contribute to the extent of any necessary regulatory upgrade costs or betterment. If Islington Park were correct, the policy would have the effect of providing a degree of reinstatement cover where, as in the present example, repairs are estimated to cost more than NZ$7.2 million on a "new for old" basis but less than that sum on an "old for old" basis. The basis of settlement clause called for comparison between the cost of repairs and the amount of a deemed total loss, and the cost of repairs had to be estimated in the same way under the basis of settlement clause. The case is a useful guide to the principles that the courts will apply in deciding such questions.

The full judgment can be found here: http://www.i-law.com/ilaw/doc/view.htm?id=349840

For more information, please contact Alison Proctor, Associate, on +44 (0)20 7264 8292, or alison.proctor@hfw.com, or your usual contact at HFW.

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ALISON PROCTOR, ASSOCIATE

2.2. Cover in France – misrepresentation (France)

Under French Law, underwriters are entitled to decline cover for an insured's intentional misrepresentation (article L.113-8 of the French insurance Code). If the insured contests the insurers' position, the dispute will be ruled upon by the courts in the ordinary manner. However, many years may pass before a final decision is obtained.

During this period, the insured will receive no indemnity and will thus be deprived of the funds he may require, for instance, to rebuild his premises and to reduce economic losses.

In these circumstances, can the insured obtain damages corresponding to the loss resulting from the absence of payment within a reasonable time, which is not covered by the insurance policy?

A recent judgment of the French *Cour de Cassation* (Supreme Court), dated 12 June 2014, holds that the insured is entitled to damages based on principles of contractual liability (article 1147 of the French civil code) provided he can establish insurers' bad faith in refusing to pay the claim.

This decision is unusual, as the French *Cour de Cassation* has added a condition of "bad faith", which is not mentioned expressly in article 1147 of the French civil code.

For more information, please contact Ghislain Lepoutre, Senior Associate, on +33 1 44 94 40 50, or ghislain.lepoutre@hfw.com, or Louis Cornut Gentille, Associate, on +33 1 44 94 40 50, or louis.cornutgentille@hfw.com, or your usual contact at HFW.

2.3. The burden of proof in indemnity disputes (Australia)

In its recent decision of *McLennan v Insurance Australia Ltd*[1], the NSW Court of Appeal was asked to consider whether an insured under a contract of insurance, which covered the risk of fire, had the burden of proving that the fire which damaged her home was not deliberately started by her or someone who had entered her home with consent.

In determining the above, the Court was required to distinguish between the operation of limiting provisions that qualify the entire coverage clause (e.g "we cover loss caused by fire") and provisions that specifically exclude particular cases of cover (e.g "we cover loss caused by fire, except when intentionally caused").

At first instance, the trial judge found that the qualifications made were not exclusionary, and so the insured had the burden of proving that the fire was not deliberately started.

The Court of Appeal disagreed and found that the qualification relied on by the insurer was a 'specific exception' to the promise to indemnify and thus the burden rested with the Insurer to prove the fire was caused intentionally.

The implications of the decision on insurers are that policies can include express provisions setting out which party bears the onus of proving the existence or non-existence of a particular fact. Insurers can take advantage of this allowance.

For more information, please contact Hugh Gyles, Associate, on +61 (0) 3 8601 4528, or hugh.gyles@hfw.com, or your usual contact at HFW.

1 [2014] NSWCA 3000

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HUGH GYLES, ASSOCIATE

2.4. Court orders that insurer be given access to documents belonging to the Plaintiff in order to make a meaningful settlement offer (Australia)

In *Fortescue Metals Group Ltd v Underwriting Members of XL Syndicate 1209 at Lloyd's for the 2004 and 2005 Underwriting Years of Account*[1], Fortescue Metals Group Ltd and one of its Directors sued their directors' and officers' liability insurer, seeking costs incurred as a result of defending earlier proceedings. The earlier action had been brought against them by the Australian Securities and Investment Commission (ASIC). ASIC alleged that the Directors had made misleading statements to the Australian Stock Exchange.

The plaintiffs sought an order that the action proceed to trial on all of the issues in dispute, other than, in effect, the issue of quantum.

The Western Australian Supreme Court made this order on the condition that:

- The trial of the liability issues should not take place until the parties had participated in a mediation conference.
- The defendants had been given access to unredacted invoices of the costs that the plaintiffs incurred in defending the proceedings brought by ASIC.

The Court held that it would have been unfair to require the defendants to proceed to a trial on liability without being in a position to:

- Make a meaningful commercial offer to settle the matter.
- Meaningfully participate in a mediation conference.

For more information, please contact Mikaela Stafrace, Special Counsel, on +61 (0) 3 8601 4513, or mikaela.stafrace@hfw.com, or your usual contact at HFW. Research by Brendan Donohue, Paralegal.

1 [2014] WASC 422



3. HFW publications and events

3.1. HFW publishes Briefing on the provisions of the Counter-Terrorism and Security Bill that relate to insurance (UK)

Following HFW's previous Briefing on the Counter-Terrorism and Security Bill, HFW has published a Briefing which analyses in more detail how the Bill would, if enacted, affect insurers.

Further information can be found here: http://www.hfw.com/UK-Counter-Terrorism-and-Security-Bill-ransom-payments-2-November-2014

For more information, please contact James Gosling, Partner, on +44 (0)20 7264 8382, or james.gosling@hfw.com, or your usual contact at HFW.

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