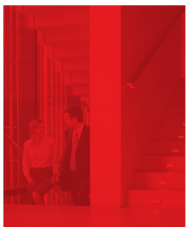
Insurance/
Reinsurance

September
2014

INSURANCE BULLETIN



Using a follow clause? Beware...

San Evans Maritime Inc & Ors v Aigaion Insurance Co SA (the ST EFREM)[1]

In this case, which involved the determination of a number of preliminary issues, the Court considered the application of a follow clause under which an insurer of a vessel agreed to follow the lead (C) and one other Lloyd's syndicate (B) *"in claims excluding ex gratia payments"*. In particular, the Court had to consider whether the effect of the follow clause was displaced by a separate clause in a settlement agreement between B, C and the assured, which expressly stated that B and C were entering into that settlement for their own participations only and were not purporting to bind any other insurer providing hull and machinery cover in respect of the vessel.

The first question for the Court was whether the effect of the follow clause was (i) to require the insurer to follow any settlement made by B and C; or (ii) merely to authorise C and B to act on the insurer's behalf. There is some uncertainty in the case law as to the basis upon which follow clauses operate, and in particular whether or not they create a relationship of agency. In this case, on a construction of the particular clause in question, the Court preferred the view that no agency was created and that the clause operated by way of a simple agreement that the insurer would follow C and B in claims matters. Therefore, the fact that C and B were not purporting to act for the insurer in settling the claim did not absolve the insurer from liability by reason of any suspension of agency.

The next question was whether the insurer could rely upon the contracts (Rights of Third Parties Act 1999) to enforce the term in the agreement between the assured, C and B. The Court held that the insurer could not do so because in agreeing the term in question, those parties were not purporting to confer a benefit on the insurer, but were instead seeking to protect C and B from any possible liability to the insurer in circumstances where they knew the insurer's

1 [2014] EWHC 163 (Comm)

policy contained a follow clause. The Court further held that even if it were wrong on this point, this would not assist the insurer, because whatever C, B and the assured may have agreed between themselves, this did not amount to a promise on the part of the assured not to rely upon the follow clause against the insurer.

Finally, the Court rejected an argument that the follow clause does not apply to a settlement which is expressly agreed not to be binding upon the insurer. The effect of the follow clause was to oblige the insurer to follow any settlement made by C and B, whether or not they purported to act as agent for the insured. This being the case, C and B were unable to countermand the effect of the clause by purporting not to bind the insurer.

As the Court recognised, follow clauses can be a useful tool in simplifying claims settlement and reducing the costs thereof. However, this case illustrates the extent to which an insurer may be bound by such a clause, even in circumstances in which it may not have imagined this to be the case. Insurers should therefore consider carefully whether or not the benefits of such clauses are outweighed by the risks and seek advice as to the appropriate wording of such clauses, if they are to be utilised. The case also highlights the fact that important issues remain unresolved as to the extent to which follow clauses create (i) a relationship of agency; and (ii) a duty of care on the part of the lead underwriter.

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UK Insurance Bill introduced into Parliament

On 17 July 2014, the Insurance Bill (the Bill) was introduced into Parliament.

This marked a significant step towards completion of the second stage of the joint review of insurance contract law by the Law Commission and the Scottish Law Commission (the Commissions), the first stage of which resulted in the Consumer Insurance (Disclosure and Representations) Act 2012.

The Bill contains proposals for reforms in areas such as disclosure in business insurance, warranties and an insurer's remedies for fraudulent claims. The Bill will introduce new law (replacing the existing common law) and will also amend parts of the Marine Insurance Act 1906 (the MIA 1906). However, certain proposals, such as reform of section 53 of the MIA 1906 (a broker's liability for marine insurance premium) and a statutory definition of insurable interest, proved controversial amongst stakeholders and were not included in the Bill. To enable the Bill to complete its passage through Parliament before the general election in May 2015, a simplified Parliamentary procedure for non-controversial Bills will be used, which is available only for Bills that attract a broad consensus of support.

The Commissions and HM Treasury, the sponsor of the Bill, consulted briefly on a draft version of the Bill in June and July 2014 (the Draft Bill). HFW published a briefing on the Draft Bill which explains some of the proposals in detail. The Briefing can be found at: http://www.hfw.com/The-Insurance-Contracts-Bill-July-2014.

With the exception of three major changes, the Bill is basically identical to the Draft Bill. The three major changes are that:

1. The clauses on terms relevant to particular types of loss (clause 11 of the Draft Bill) and damages for late payment (clause 14 of the Draft Bill) have been deleted. The Government's report on the responses to the Draft Bill explains that the responses showed that there was no consensus on these clauses. In a joint response, the LMA and IUA were of the view that clause 11 was unworkable and that clause 14 should operate only where the insurer refused to pay a claim in the knowledge that it was valid, or was reckless as to whether it was valid.

To enable the Bill to complete its passage through Parliament before the general election in May 2015, a simplified Parliamentary procedure for non-controversial Bills will be used, which is available only for Bills that attract a broad consensus of support.

WILL REDDIE, ASSOCIATE



2. The clause regarding the deemed knowledge of an individual acting as agent of the insurer (clause 6(3)(b) of the Draft Bill) has also been removed. This stated that confidential information held by such an individual would not be attributed to the insurer where the information was acquired through a business relationship with someone other than the insurer. The omission of this clause means that the common law position will continue to stand. A practical example is where a coverholder acts for two insurers and issues a policy on behalf of each insurer for similar risks. Information (confidential or otherwise) that is received by the coverholder for the purposes of the first insurer may (but will not necessarily) be attributed to the second insurer.
3. The Bill contains new provisions amending the Third Parties (Rights Against Insurers) Act 2010 so that it can be brought into force. An omission in the Act regarding the definition of insolvency events had previously prevented this.

If the Bill receives Royal Asset before the current Parliamentary session ends on or around 30 March 2015, we expect that the new Act will enter into force in early to mid-2016.

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Richard is Chairman of the Insurance Law Committee of the City of London Law Society and Will is its Secretary.

New regulatory regime for insurance brokers in the UAE

Insurance brokers in the UAE are subject to a new legal regime which requires an increase in minimum capital, financial guarantees and PI insurance. In order to obtain a licence, the broker must now appoint a "technical cadre" of specified professional experience and qualifications.

The new Insurance Brokers Regulation (Resolution No. 15 of 2013 of the Insurance Authority Board of Directors, Brokers Regulation) applies to insurance brokers in the UAE (including Free Zones).

The Brokers Regulation is complemented by Resolution No.58 of the Insurance Authority (the Supplementary Regulation), which provides further information relating to, among other things, the qualifications and experience required by members of the profession and the solvency requirements for brokers.

In this article, we identify some of the key features of the regulations.

Life and non-life separate; insurance and reinsurance separate

Insurance brokers can conduct both (i) life insurance and associated capital operations, and (ii) general insurance business, provided that the two are kept entirely separate.

The position remains that an insurance broker cannot be both the insurance and reinsurance broker in the same transaction for the same customer, although an insurance broker may provide reinsurance broking services.

The Brokers Regulation is complemented by Resolution No. 58 of the Insurance Authority (the Supplementary Regulation), which provides further information relating to, among other things, the qualifications and experience required by members of the profession and the solvency requirements for brokers.

The broker must also keep separate accounts for its own and its clients' funds.

Licensing requirements

Capital and solvency

The Brokers Regulation sets down the requirements for obtaining and maintaining a broking licence, including the requirement for paid up capital: AED3 million for UAE companies, and AED10 million for branches in a Free Zone or branches of a foreign company.

The Supplementary Regulation introduces a strict solvency margin on brokers that requires the broker to maintain "available capital" (the difference between the value of its assets over its liabilities) not less than "the required minimum" (i.e. the amounts set out above) at all times.

Qualifications for brokers

Licensing requirements in the regulations include the appointment of a technical and administrative cadre, with specific technical and professional skills/requirements and qualifications.

This means that brokers must have: (i) a Director General or CEO; (ii) an Operations Manager/Internal Controller; and (iii) a specialised employee for each licensed insurance type.

The Director General/CEO is required to have: (i) an academic degree or ACII certified by the Chartered Insurance Institute in London/or similar professional institute; (ii) passed at least three training courses in insurance or in insurance brokerage; and (iii) had 10 years (five years for UAE nationals) of practical insurance experience if they do not hold a "postgraduate qualification", or five years (two years for UAE nationals) of practical insurance experience if they do hold a higher education certificate.

The Operations Manager is required to have: (i) three years (one year for UAE nationals) experience if holding an academic degree or its equivalent (the academic degree must be in financial sciences, accountancy, administrative sciences, banking or law) or six years (two years for UAE nationals) experience if they do not hold an academic degree.

An Internal Controller must have: (i) an academic degree or its equivalent in finance, accounting or law or an accredited financial professional certificate approved by the Authority; and (ii) practical experience in external or internal audit and have participated in auditing the business of the insurance or insurance broker companies of not less than three years (two years for UAE nationals).

The Brokers Regulation obliges the broker, within three months of obtaining its licence, to draw up its byelaws and file them with the Insurance Authority.

A specialised employee for each insurance type is required to have: (i) an academic degree; and (ii) practical experience in the licensed insurance type or branch for five years (three years for UAE nationals). The academic requirements for a Branch Officer are more extensive than that of a specialised employee.

The broker's byelaws

The Brokers Regulation obliges the broker, within three months of obtaining its licence, to draw up its byelaws and file them with the Insurance Authority. These byelaws must include provisions for the management of documents between the insurer and its customer, including systems for: correspondence, record keeping and complaints; risk management manuals; and professional conduct for the broker's staff.

Broker's obligations to the insurer

The broker must sign an "insurance brokerage agreement" (TOBA) with each insurance company. The TOBA must be in Arabic, notarised, and include certain provisions which are specified by the Brokers Regulation.

Broker's obligations to the customer

The Brokers Regulation also codifies a broker's duties to its customers and the broker must obtain written confirmation (in a specified form) before acting for a customer. The broker must also set out the importance of disclosure, notify the customer of the details of the policy including the scope of cover and exclusions, notify its customer 20 days before the expiry of a policy and ask whether the customer requires the policy to be renewed.

Summary

The regulations clearly set out the broker's obligations to the Insurance Authority, the insurers and its customers. They also provide the requirements for obtaining and maintaining a licence, and the merger and consolidation of brokers.

Together with the Insurance Authority's Directive to insurance companies (see our February 2013 Briefing http://www.hfw.com/Re-Insurance-Clauses-UAE-Law-Feb-13), these new regulations form a significant development in regulation of the insurance sector in the UAE, one which brokers in the UAE will need to carefully consider.

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The disclosure of documents and the waiver of privilege

Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Limited[1]

Care should always be taken by an insured when disclosing privileged material to an insurer lest they inadvertently waive privilege over the document. The recent Federal Court decision of *Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Limited* found that the insured had waived privilege as between themselves and a defendant whom they were making a claim against when a confidential report produced by their solicitors was disclosed to their insurer.

This case is important as it highlights the risks associated with policy holders providing legally privileged information to insurers without first ensuring that adequate steps are taken to preserve legal professional privilege.

The key facts

Independent Liquor (NZ) Limited (ILNZ), as nominee for Asahi Holdings (Australia) Pty Ltd (insureds), purchased shares of a business operated by Flavoured Beverages Group Holdings Limited (FGB). The insureds took out policies of Warranty and Indemnity Insurance (Policy) against any loss associated with breaches of warranties provided by the sellers in accordance with the share sale agreement.

The insureds subsequently initiated legal proceedings against the sellers on the basis they had misrepresented the financial position of FGB. Anticipating litigation, the insureds' solicitors produced a report (the Report) which particularised the items of adjustment said to be necessary to reflect the true financial position of FGB at the relevant time.

In addition, the insureds had made a claim for loss occasioned by the breach on the Warranties and Indemnity insurer (insurer) and provided a complete version of the Report marked "Privileged and Confidential" to the insurer. A redacted copy of the Report was provided to the respondent sellers in the course of discovery during the legal proceedings.

The respondent sellers sought a full unredacted copy of the Report on the basis that privilege had been waived by the insureds upon disclosing the complete copy to the insurer.

Anticipating litigation, the Insureds' solicitors produced a report which particularised the items of adjustment said to be necessary to reflect the true financial position of FBGL at the relevant time.

RICHARD JOWETT, PARTNER

The decision

The central issue was whether the disclosure of the Report to the insurer was inconsistent with the confidentiality purpose which would thereby amount to a waiver of litigation privilege. The confidentiality purpose which litigation privilege serves to protect is to keep hidden from one's opponents or adversaries material that may prejudice the privilege holder.

The insured argued that there had not been a waiver of privilege and relied upon three primary matters:

- The Report was marked 'privileged and confidential'.
- Disclosure occurred pursuant to the Policy and that from the insurer's duty of utmost good faith, an obligation of confidence should be implied.
- Commonality of interest that existed between the insurer and insured.

The Court rejected these submissions and found that privilege in the Report had been waived.

The Court also held that there was no common interest privilege extant between insured and insurer – it found that the insurer and insured's interests were potentially adverse to each other due to the claim being advanced by the insured against the insurer under the relevant insurance policy. There was no evidence that the insurer was likely to provide indemnity and indeed the interests of insured and insurer were disparate for a number of reasons. The Court found that this was a case where, on the facts, privileged information was voluntarily disclosed to a potential opponent.

1 [2014] FCA 481

The judgment provides a valuable summary of key principles which a court will take into account in determining a waiver of privilege and include:

- A client acting inconsistently with the maintenance of the confidentiality in the communication can amount to a waiver of privilege.
- That the test to determine when the client has acted inconsistently is an objective one, so that implied waiver may be found notwithstanding that it may not reflect the actual subjective intention of the privilege holder.

Applying these principles to the facts, Justice Bromberg concluded that objectively:

- Upon assessment of the claim, the insurer may want to evaluate it by disclosing the information to others including persons who would not be under any restriction to its further disclosure.
- The insurer could use the information in open court should any legal proceeding be brought against it by the insured, if for example the insurer rejected the insureds claim.
- In pursuit of the purpose for which the information was disclosed, its contents may pass into the public domain.

In reinforcing His Honour's position that the waiver of privilege was complete and not merely limited to the insurer, he referred to Gordon J's reasoning in *Cadbury Schweppes Pty Ltd v Amcor Limited (2008)* whereby Her Honour stated:

"Once privilege holder provides the privileged information to another person and cannot control its further dissemination by that person, the privilege is destroyed."

The insureds were thereby ordered to produce an un-redacted copy of the Report to the respondents.

Comment

Irrespective of the insureds having an obligation to disclose information to the insurer under the policy, it was not contended that the duty extended to providing information which was protected by privilege.

Despite privilege being waived in this instance, policy holders should understand that where a privileged document is provided to an insurer in circumstances where that insurer might become an adversary, it is advisable for the insured and insurer to enter into a confidentiality agreement. By doing so, the chances of defeating a waiver argument are improved.

An express agreement which sets out the basis upon which the disclosure is made and the limitations upon its further use is accordingly recommended when providing insurers with legally privileged information, particularly in instances where common interest privilege might not arise immediately.

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European Commission consults on the functioning and future of Insurance Block Exemption Regulation

On 5 August 2014, the European Commission issued a questionnaire to seek views on the functioning and future of the Insurance Block Exemption Regulation (Regulation 267/2010). The current block exemption expires on 31 March 2017. The Commission must report to the Council and European Parliament by March 2016. The Commission has invited views, information and evidence on relevant market developments, the extent of use of the block exemption and on the impact of the block exemption. In particular, it seeks views on the policy options of renewing, partially renewing or not renewing the current block exemption. Responses are invited by 4 November 2014.

The block exemption provides an automatic exemption from the prohibition of cartels and anti-competitive agreements under Article 101 of the Treaty on the Functioning of the European Union for agreements and arrangements which comply with the terms of the block exemption.

As was the case when the Commission reviewed the previous incarnation of the Insurance Block Exemption Regulation, the Commission's starting point will be that the block exemption should not be renewed. This is because the Commission takes the view that sector specific block exemptions are generally unnecessary, and that all industry sectors should rely on the general guidelines and block exemptions which the Commission has adopted for all industry sectors.



The current block exemption expires on 31 March 2017. The Commission must report to the Council and European Parliament by March 2016.

Therefore, in order to preserve the benefits of legal certainty conferred by the block exemption, it will be important for the industry to explain again what is special and unique about the insurance sector that it requires a specific block exemption.

The current block exemption covers joint compilations, tables and studies, so enabling the exchange of statistical information (calculations, tables and studies) subject to the specified conditions; and common coverage of certain types of risks (co(re)-insurance "pools"), subject to market share thresholds and other specified conditions.

Regarding "pools", the Commission has taken the view that this covers all forms of co(re)-insurance other than ad hoc subscription, for example line slips, consortia and binding authorities. If the block exemption is continued, it is likely to be clarified that "pools" covers arrangements initiated by the broker as well as those initiated by the insurer.

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Rioting our way to a change in the law

In the recent case of *Mitsui Sumitomo Insurance Co (Europe) Ltd & Ors. v Mayor's Office for Policing and Crime*[1], the English Court of Appeal considered the question of whether or not the Mayor of London's Office for Policing and Crime (MOPC) was liable under the Riot Damages Act 1886 for losses suffered by the victims and their insurers as a result of a fire deliberately caused at a warehouse during the 2011 London riots by a gang of approximately 20-25 people. For the full article, please visit www.hfw.com/rioting-our-way-to-a-change-in-the-law.

Amendments to the Australian Insurance Contracts Regulations 1985 – duty of disclosure

A duty is imposed on insureds to disclose to the insurer matters that are relevant to the insured's decision to accept the risk and, if so, on what terms. The duty is imposed up to the time that the contract incepts. If the insured fails to disclose relevant matters to the insurer as required, the insurer then has the opportunity to deny or reduce indemnity or cancel the policy completely, depending on the circumstances of the non-disclosure. For the full article, please visit www.hfw.com/amendments-to-the-australian-insurance-contracts-regulations-1985.

1 [2013] EWHC 2734 (Comm)

News

HFW is delighted to announce that Mikaela Stafrace has joined the Melbourne office as Special Counsel, specialising in regulatory compliance and risk management in the insurance sector.

Conferences and events

49th Houston Marine Insurance Seminar
Houston, USA
21–23 September 2014
Attending: Geoffrey Conlin

Asia Offshore Energy Insurance Conference
Indonesia
24–26 September 2014
Presenting: Andrew Dunn and Paul Wordley

New insurance industry regulation: what the reforms mean for you
Dubai
29 September 2014
Presenting: Sam Wakerley, Luke Hacker and Hari Krishna

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