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The Bermuda Form – a fresh perspective?

by Nathan Hull[1]

A review of David Scorey, Richard Geddes and Chris Harris, *The Bermuda Form, interpretation and dispute resolution of excess liability insurance*[2]

Introduction

This is an extended review of a new book on the Bermuda Form (details are given above – "Scorey et al."). In my review I also compare the analysis in this new work with another textbook on the same subject, *Liability Insurance in International Arbitration, the Bermuda Form*. The authors of this earlier work, now in its second edition[3], are Richard Jacobs QC, Lorelie S. Masters and Paul Stanley QC ("Jacobs et al.")[4].

Background

The Bermuda Form is a type of excess liability insurance purchased by large corporate policyholders requiring high limits of cover, particularly those exposed to liabilities in the U.S.A. The Form is an "occurrence first reported" policy – fixing coverage to the policy period to which notice of an occurrence or an "integrated occurrence" is first given. It is governed by a modified form of New York law and is subject to English arbitration.

In part due to the Form's origins in the 1980s when the US casualty market collapsed under long tail pollution and asbestos liabilities, it has some unique features (two of which are referred to above) that even now may not be familiar to many in the industry. This is mainly due to the lack of reported decisions on the operation of the Form – a consequence of subjecting the Form to English arbitration, which is generally confidential. As a result, it is only a relatively small pool of participants that have the knowledge and experience of the operation of the Form's unique and often complex provisions and how issues concerning those provisions have been decided by arbitration tribunals.

Given that, Bermuda Form Market participants should welcome attempts to explain the operation of the Form and the nature of arbitrations concerning it. Until recently, the only attempt at a comprehensive explanation was by Jacobs et al. However, although Jacobs et al. say that they have attempted to be evenhanded, they also concede that: "it has sometimes been gently hinted (by those who represent insurers) that our conclusions may be unduly generous to the insured"[5].

It is against this background that Scorey et al. have published their book. The authors say that their effort is to expand the body of knowledge available regarding the Form and the arbitral process to a broader universe of interested parties[6]. In reviewing certain aspects of their book[7], this article will comment on the extent to which the authors diverge from the views expressed by Jacobs et al.

Overview

Scorey et al's *The Bermuda Form* is split into three sections. The first and by far the shortest introduces the Bermuda Market and the Bermuda Form. There is no attempt to set out in detail the origins of the modern Bermuda Market or the Bermuda Form. The authors acknowledge that this story was told at length in the book by Jacobs et al. The second addresses the Form itself, in particular the construction of the Form and the applicable New York and English law. Certain aspects of this section (including the proper law clause, the "Expected or Intended" definition and the attachment point of the Form) are discussed below. The third focuses on dispute resolution under the Bermuda Form. It includes practical advice on the conduct of the arbitration itself, which will be of use to parties new to Bermuda Form disputes. The parts of this section dealing with disclosure will be discussed below.

The proper law clause

It would be a rare Bermuda Form dispute that did not involve any issues over the meaning of certain provisions of the Form. Therefore, the law governing the construction and interpretation of the provisions of the Bermuda Form (Article VI.O of the XL004 Form (referred to in this article as the "proper law clause")) is critical in setting the parameters within which arguments on construction must be made.

The proper law clause provides that any dispute, controversy or claim arising out of or relating to the Policy shall be governed by and construed in accordance with New York law. However, there are certain important exceptions to that (ie when New York law is not applied), including where such laws are "inconsistent" with any provision in the Policy[8].

The proper law clause also provides that the provisions of the Policy are to be construed in an "evenhanded fashion" as between the insured and insurer. In the view of Scorey et al. the principle of evenhanded construction is intended to be a "real departure" from the approach in the US when dealing with insurance contracts[9]. Instead, the principle is akin to that adopted by English law, although it would be too simplistic to label this as a "black letter law" approach, to the extent that the relevant commercial background is ignored[10].

The relevance of the English law approach and move away from the "protectionist approach of unmodified and unrestricted New York law"[11], the authors say, is underscored by the final sentence of the proper law clause. That provides that: "To the extent that New York law is inapplicable by virtue of any exception or proviso enumerated above or otherwise… the internal laws of England and Wales shall apply". Scorey et al. explain that:

> "… this merely makes express that which is otherwise implied, namely that the modifications to New York law effected by the [proper law clause] result in a system of law that has much more in common with the approach of the

> Commercial Court in London applying rules of construction under English law than undiluted New York law. This transatlantic shift possibly explains why the parties frequently engage English lawyers and advocates to argue points of New York law in Bermuda Form disputes: in effect, they are often merely applying English law under a different guise."[12].

Although there is not the same emphasis on the English law approach as in Scorey et al's book (if any emphasis), Jacobs et al in their book seem to have the same basic approach to construction under the proper law clause, namely that it includes the relevant commercial background to the policy. They say that the approach is to give effect to the parties' mutual intentions as expressed in the words used, when read in the context of the policy as a whole, the purposes sought to be accomplished, and the relevant surrounding circumstances[13].

The question, however, in many Bermuda Form disputes is what are the "surrounding circumstances" that can be taken into account? Jacobs et al set out a non-exhaustive list, which includes the legal background against which the Bermuda Form was originally drafted, and the legal system within which tort claims against which policyholders seek coverage are made against manufacturers in the US[14]. Scorey et al are less prescriptive, explaining that the debate is whether the "admissible 'surrounding circumstances' that can be considered include, for example, records of negotiations, preliminary drafts of contracts, prior agreements, the knowledge of both parties at the time of contracting and the relation of the parties at the time of contracting"[15].

The Expected or Intended definition

Under the Bermuda Form, the loss must be "encompassed" by an occurrence[16]. There are two types of occurrence provided for in the Form: (1) an event or conditions which cause actual or alleged personal injury, property damage or advertising liability; and (2) actual or alleged personal injury or property damage arising from the insured's products[17]. An occurrence can be included in an "integrated occurrence" where there is an occurrence encompassing personal injury, property damage or advertising liability to two or more persons or properties commencing over a period longer than 30 consecutive days attributable to the same event, condition, cause, defect, hazard and/or failure to warn of such[18].

However, any actual or alleged personal injury, property damage or advertising liability which is "Expected or Intended" by an insured at the times provided for in the Form (including at the time of sale of any insured's products and at the "inception date") shall not be included in an occurrence (or integrated occurrence)[19]. Scorey et al comment that this requires an examination of "*perhaps the most complex and difficult area of the policy*"[20], namely that of the definition of Expected or Intended set out in Article III.L of the XL004 Form.

The Expected or Intended definition provides, among other things, that personal injury and property damage shall be "Expected or Intended" where the Insured experiences or

expects a level or rate of personal injury or property damage. Scorey et al comment that the relevant enquiry, being in respect of a "level or rate" of personal injury etc, may be an instance where the "evenhanded approach" called for by the proper law clause may be relevant, rather than applying New York law, which has not considered an expectation of a "level or rate" of personal injury or property damage[21].

Expected or Intended under New York law

Insofar as New York law does apply, Scorey et al do address the well rehearsed debate of whether the insured's expectation is to be assessed on an objective or subjective basis and on which party the burden of proof rests.

As regards the objective or subjective standard, it may be more difficult to prove that a company (or the relevant individuals within that company) *actually* expected a particular result, than to prove that they *ought* to have expected that result. Scorey et al conclude that there is support for both the objective and subjective view in the body of New York law without commenting on which is the correct or preferred view[22]. In contrast, Jacobs et al suggest that "as a matter of construction and logic", "intention" and "expectation" are subjective, not objective concepts. They also say that the subjective standard is the predominant view from the New York law cases[23].

The authors of the two works also do not agree in relation to where the burden of proof lies. This debate concerns whether the wording "neither expected or intended by the insured" operates as part of the coverage afforded to the insured (in which case, under New York law, the burden would be on the insured) or as an exclusion (in which case, the burden would be on the insurer)[24].

Scorey et al, relying on the New York Court of Appeals decision in *Consolidated Edison Co v. Certain Underwriters at Lloyd's (Con Ed)*[25], say that the burden lies on the *insured* to show that it did not expect or intend personal injury or property damage. In support of that the authors note that the insured will always be far more able to address questions of its own actions, expectations and intent, than would be the insurer[26]. In contrast, Jacobs et al suggest that the burden is on the *insurer* to show that the insured expected or intended personal injury or property damage.They distinguish *Con Ed* on the basis that the wording at issue in that case did not contain the exclusionary wording in the occurrence "neither expected or intend by the Insured" and that the insured had to argue (unsuccessfully) that the requirement of an "accident" or an "occurrence" on its own operated as an exclusion, so that the burden to establish that would be on the insurer[27].

Commercial Risk

The Expected or Intended definition also provides, under the sub-heading "Commercial Risk", that actual or alleged personal injury arising out of sales of the insured's products after the date of the notice of integrated occurrence shall be deemed Expected or

Intended. The Commercial Risk provision is relevant where, for example, the personal injury caused by a product does not cause the insured to stop selling its products after it has given notice of integrated occurrence. Under this provision, personal injury included in the integrated occurrence arising out of post-notice sales would not be covered.

Scorey et al note that commentators have described this provision as "somewhat harsh" (referring to Jacobs et al's book) or as essentially requiring an insured to cease sale of its product (referring to Dolin and Posner "Understanding the Bermuda Excess Form"[28]).

However, in Scorey et al's view neither criticism is justified: The provision appears to say only that, if the Insured does continue sale of its product, it will, in most circumstances be self-insured for the liability consequences of the injuries and damage arising from its decision to continue those sales. The authors say that:

> "This is not a directive to withdraw a product from the market. To the contrary, it provides an additional source of business sense direction to the insured: if a product may only be sold profitably because the liabilities resulting from the injuries it causes are insured, it probably should not be sold; alternatively, if the insured decides to sell in those circumstances, it should bear that commercial risk rather than seek to impose it upon the insurer"[29].

Attachment point

The attachment point (the point in the insured's tower of excess insurance where the cover begins) of the Bermuda Form policy is determined by Article II.A. In short, it is the greater of: (1) the minimum per occurrence retention amount set out in the Declarations; and (2) the cover provided by underlying insurances (ie responding below and therefore before the Bermuda Form) listed or which should have been listed on the present or any prior "Schedule B" annexed to the policy.

The point of Article II.A is that the Bermuda Form will attach at a minimum of the per occurrence retention amount listed on the Declarations, but may increase depending on the extent of the underlying insurance.

Scorey et al explain that the principle of excess insurance in the Bermuda Form is applied quite differently compared with other excess policies. This difference, the authors say, arises from two features of the Bermuda Form: (1) the policy is typically extended by an annual renewal, rather than replaced by a subsequent policy; and (2) by giving notice of an integrated occurrence, under defined circumstances, injuries and property damages that take place over an extended period of time are treated together as arising from a single occurrence fixed to a single policy year.

Therefore, the individual injuries or instances of property damage included in an integrated occurrence to which the Bermuda Form responds, may well have taken place over many years, thereby implicating multiple years of underlying policies. That is critical

in light of the wording of Article II.A of the Form which provides that the Form responds in excess of *all* such applicable underlying policies, not only those whose policy period coincides with that of the relevant policy period of the Form[30].

The importance of this difference, Scorey et al explain, is that, it is often the case that some or all of the policies underlying the Bermuda Form have been written on a different basis – usually an occurrence basis[31]. Occurrence based policies respond on a different basis than the Bermuda Form policy. First, the policy is triggered based on the date of injury or the date of damage. Second, aggregation is typically not as broad as in the Bermuda Form[32]. Consequently, although an integrated occurrence reported to a Bermuda Form insurer including injuries or property damages over a number of years will impact only one year of coverage of the Bermuda Form policy, it will trigger each of the years of occurrence based underlying insurances when injury took place[33]. As the authors say:

> "The import of this section of Article II then is to specify that underlying coverage, in the meaning of Article II, is not limited to the policies whose annual periods coincide with the annual period of the Bermuda Form policy when the notice of occurrence was received. To the contrary, 'underlying insurance' in this sense means any responding insurance, of whatever form and in respect of whichever period, attaching at a layer lower than the attachment point of the Bermuda Form insurer"[34].

The authors explain that this does not mean that the Bermuda Form responds in excess of the *limits* of all applicable underlying insurances. Rather, only in excess of the loss which is *covered* by the underlying insurances[35]. Therefore, where a loss is covered by the Bermuda Form policy but is not covered by an underlying insurance, the presence of that policy (for example, on Schedule B) will be irrelevant to determining the attachment point of the Bermuda Form policy. However, where it is covered by the underlying insurance, the Bermuda Form will respond in excess of that covered amount[36].

Jacobs et al think it would be an unlikely situation where, because of the underlying insurance limits, the attachment point of the Bermuda Form was greater than the minimum attachment point, i.e. the minimum per occurrence retention amount set out in the Declarations. Jacobs et al do, however, accept that this may happen. They make the point that Article II.A may have particular relevance where the policyholder's programme of insurance includes a primary policy covering defence costs in addition to the limits (which are only exhausted by payments of indemnity). They say that in that circumstance, it is possible that the per occurrence retention would be exceeded, and therefore the attachment point increased[37].

Disclosure

The nature and scope of disclosure is often a hotly contested issue in Bermuda Form arbitrations. Insureds may argue for the adoption of the International Bar Association

(IBA) Rules on the Taking of Evidence in International Arbitration[38]. These Rules provide for requests of documents (or a narrow and specific category of documents) relevant to the dispute. The issue often for insurers, however, is that it is difficult and often impossible to know which documents or categories of documents in the insured's possession are relevant to the dispute. This makes it hard to formulate requests to capture all relevant documents – particularly those adverse to the insured's case, which may be essential where there is an extensive factual dispute. Insurers therefore may instead seek to adopt English "standard disclosure", which requires the production by both parties of all relevant documents, including those adverse to their case.

It is of note that Scorey et al in their book say that standard disclosure is, in their experience, frequently adopted, and that it is often perceived to be the usual starting point for determining the parameters for document disclosure in an arbitration with its seat in England, unless there are factors that indicate the practice should be varied[39]. That is in contrast, somewhat, to Jacobs et al, who say that it is now increasingly common for tribunals in international arbitrations to adopt the IBA Rules[40].

Scorey et al say that the particular justification for standard disclosure arises where there is a perceived information imbalance between the policyholder and insurer in any case involving an extensive factual dispute[41]. As they explain:

> "… a Bermuda Form dispute will concern a contract of insurance or reinsurance relating to liabilities to third parties, which will very probably mean that there is an inequality of information between the parties to the arbitration. At least at the start of proceedings, the policyholder will presumptively have an informational advantage over the insurer with regard to facts concerning the third party liabilities and the relevant knowledge held by the policyholder."[42].

For that reason, the authors say, it is a fundamental purpose of document disclosure in arbitration to facilitate the aim of giving the parties equality of arms[43].

Comment

In light of the limited information available to those utilising the Bermuda Form, Scorey et al's *The Bermuda Form* is a welcome addition to the existing literature. The book of course only sets out the authors' own views and experiences in relation to the Bermuda Form and Bermuda Form arbitrations, and they may differ from those of others concerned with the Form, including those of Jacobs et al, as is evident at least in some respects from the discussion above.

Whilst it may be said that these differences of opinion are a reflection of the different perspectives of the authors of each of the books, the reality may be that they can be explained by the difficulty of the issues concerning the Bermuda Form and the conduct of the arbitrations in which the authors were involved.

In any case, like its rival, Scorey et al's *The Bermuda Form* will be essential reading for any participant and practitioner in the Bermuda Form market, and is likely to be the subject of extensive debate in Bermuda Form arbitrations to come.

Endnotes

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[2] 2011. Oxford University Press. 512 pages. £130. ISBN-10: 0199583617 ISBN-13: 978-0199583614

[3] 2011.

[4] A further description, by Richard Jacobs, of the Form and discussion of how it is used, appeared in issue 120 of the BILA Journal, page 3.

[5] Page viii of the Preface.

[6] Page ix of the Preface.

[7] A full analysis is not possible given the various subjects covered by the book.

[8] Article VI.O(3) of the XL004 Form.

[9] Paragraph 4.34, page 65.

[10] Paragraph 4.36, page 65.

[11] Paragraph 4.37, page 66.

[12] Paragraph 4.38, page 66.

[13] Paragraphs 4.12 – 4.18, pages 49 – 52.

[14] Paragraph 4.26, page 55.

[15] Paragraph 4.65, page 77.

[16] Article I of the XL004 Form.

[17] Article III.V(1) of the XL004 Form. Note that there is also a temporal requirement for the event or conditions for the first type of Occurrence and for the actual or alleged Personal Injury for the second type.

[18] Article III.R of the XL004 Form.

[19] Article III.V(2) of the XL004 Form.

[20] Paragraph 7.32, page 118.

[21] Paragraphs 7.48-50, pages 122-123, and paragraph 7.82, page 134.

[22] Paragraph 7.72, page 129.

[23] Paragraph 7.19-7.20, pages 105-106.

[24] Paragraphs 11.10 – 11.11, pages 190 – 191, of Scorey et al's book.

[25] 98 NY2d 208 (2002).

[26] Paragraph 7.73-74, pages 129 – 130.

[27] Paragraphs 7.15-17, pages 104-105.

[28] 1(4) Journal of Insurance Coverage 68 at 75-6.

[29] Paragraph 7.61, page 125.

[30] Paragraph 10.05, page 178.

[31] Paragraph 10.08, page 179.

[32] Paragraph 10.09, page 179.

[33] Paragraph 10.09, page 179.

[34] Paragraph 10.10, page 180.

[35] Paragraph 10.10, page 180. As the authors point out, that may of course be the same if the underlying insurance is exhausted.

[36] Paragraph 10.10, page 180.

[37] Paragraph 9.08 – 9, page 138.

[38] 2010.

[39] Paragraph 19.63, page 353.

[40] Paragraph 16.06, page 311.

[41] Paragraphs 19.62-63, pages 352-353.

[42] Paragraph 19.70, page 354.

[43] Paragraph 19.70, page 354. Although the authors say that disclosure should not be an unfair burden on either party.