Published in issue 134 (2021) of the Journal of the British Insurance Law Association

Reinsurance under the Insurance Act 2015

Robert Merkin QC[*] *and Kyriaki P Noussia*[**]

1. Background to the Insurance Act 2015 (IA 2015)[1]

The IA 2015 is the single most wide-ranging statutory reform in the history of English insurance contract law. Earlier measures were either pure codification (Marine Insurance Act 1906) or piecemeal and designed to deal with specific issues such as gambling by life policies (Life Assurance Act 1774), the need for compulsory liability insurance for accidents on the road or at the workplace (Road Traffic Act 1988, Employers Liability (Compulsory Insurance) Act 1969), the protection of third party claimants against insolvent policyholders (Third Parties (Rights against Insurers) Act 2010) and the abolition of pre-contract disclosure obligations for consumers (Consumer Insurance (Disclosure and Representations) Act 2012). The IA 2015 amended a number of key provisions of the 1906 Act, overturning principles dating back at least to Lord Mansfield in the second half of the eighteenth century, although the 1906 Act otherwise remains in place.[2]

The most significant changes for business insurance contracts are as follows. First, there is a new duty of "fair presentation of risk" for business policyholders in place of the duty of disclosure, clarifying what needs to be disclosed, specifying when information is known for disclosure purposes and introducing flexible remedies for breach. Secondly, the familiar declaration made by the applicant, which deems all information given to the insurer to be the "basis of contract", thereby converting statements into warranties, breach of which terminates the risk, is banned. Thirdly, an insurer cannot rely upon a breach of a condition or warranty unless it has some causal relationship to the loss suffered. Fourthly, an insurer who fails to pay a claim within a reasonable time is in breach of contract and liable to pay damages. Fifthly, a fraudulent claim by the assured is given prospective effect only. Finally, utmost good faith is restated as a pervasive principle.

Insurers have responded in different ways to the measure. All have found it necessary to alter their policy wordings to reflect the reforms. Some insurers have taken advantage of ss 16 and 17 of the Act, which confer the ability respecting non-consumer policies to contract out of the IA 2015 by any term which satisfies the requirement of transparency in that it is both drawn to the policyholder's attention and is clear and unambiguous in its effect.[3] Other insurers have been content do nothing and await developments. As yet there are no reported cases offering guidance on the new statutory provisions, and the last five years disputes have been resolved by settlement or

---

*LLD; Professor of Law, University of Reading; Distinguished Professor, School of International Law, China University of Political Science and Law; Professor of Commercial Law, University of Exeter; Special Counsel, Duncan Cotterill.
** PhD, Senior Lecturer in Law, University of Exeter, School of Law, k.noussia@exeter.ac.uk

[1] The general commentaries on the IA 2015 deal with reinsurance only in passing. See: Clarke and Soyer (eds), *The Insurance Act 2015: A New Regime for Commercial and Marine Insurance Law* (2016); Wright, *A Practical Guide to the Insurance Act 2015* (2017); Merkin and Gürses, "Insurance Act 2015", 78 MLR 1004 (2015); Clyde & Co, "Insurance Act 2015: Shaking Up A Century of Insurance Law", 2016, https://www.clydeco.com/uploads/Files/Admin/CC010256_Insurance_Act_2015_26-07-16-web.pdf

[2] The 1906 Act has been adopted in some 80 countries, albeit in some disapplied from non-marine policies, but

[3] The Law Commission and The Scottish Law Commission (LAW COM No 353) (SCOT LAW COM No 238), *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* Chapter 29, para. 29.3, p. 316, & para. 29.16, p. 330, & Explanatory Notes A.8, p. 389, July 2014, Cm 8898 SG/2014/131, OCL, Crown Copyright 2014, https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/11/Report-Insurance-contract-law.pdf

arbitration, both designed to preclude the possibility of – depending on one's point of view – a damaging precedent.

2. The nature of reinsurance[4]

Legal principles applicable to reinsurance contracts were late in coming. For reasons never fully explained,[5] marine reinsurance was banned by s 4 of the Marine Insurance Act 1745[6] in cases other than the death or insolvency of the insurer. The repeal of the prohibition in 1867[7] saw the development of – or at least the removal of the cloak of secrecy from[8] – reinsurance practice and law. It is now settled that reinsurance whether in facultative (one-off) or treaty (multiple) form is, for contractual and regulatory purposes, regarded as insurance,[9] although the extent to which reinsurance can be properly so categorised depends upon the nature of contract. Reinsurances have their own unique wordings, and the law is based upon common law principles applied to these wordings.[10] The nature of reinsurance remained a matter of debate for a long while, but the matter was In *Wasa International Insurance Co v Lexington Insurance Co*[11] it was stated that it was widely agreed in legal theory that reinsurance is not liability insurance, and that there is much to be said for the view that in commercial reality reinsurance is liability insurance which provides cover for the reinsured in the event that the reinsured is liable to pay the original insured, and that the use of liability insurance language correctly emphasises the true commercial nature of reinsurance. This view was recently applied in *Re Society of Lloyd's and Lloyd's Insurance Co SA*,[12] where Snowden J regarded the notion that reinsurance is a further insurance on the original subject matter, the only difference being that the reinsured's insurable interest was its liability to pay the claim, as orthodox.

Facultative reinsurance policies fit relatively easily into a regime governing contracts of insurance. They are single risk covers of an agreed proportion of the insurer's liability, incorporating the terms and conditions of the insurance wording, agreeing to follow the reinsured's settlements and imposing a measure of control over the negotiations undertaken by the reinsured with the assured.

Reinsurance treaties – multi-policy covers – are more problematic. Excess of loss (non-proportional) treaties apply to all policies of a given class written by an insurer, and are triggered when the reinsured's aggregate losses under

[4] For reinsurance generally, see: O'Neill and Woloniecki, *The Law of Reinsurance* 5th ed 2019; *Butler and Merkin's Law of Reinsurance* 1985, looseleaf, updated.

[5] The implication from *Andree v Fletcher* (1787) 2 TR 161, *Edgar v Fowler* (1803) 3 East 222 and *Delver v Barnes* (1807) 1 Taunt 58 was that reinsurance had been perverted into a means of speculating on the rise and fall of premiums and was no more than a wager.

[6] 9 Geo. 2 c.37.

[7] Statute Law Repeal Act 1867, 30 & 31 Vict, c 59, completing the partial repeal in the Stamp Duties Act 1864, 27 & 28 Vict, c 56.

[8] "Honour" reinsurance contracts were nevertheless written, but not always paid. See Duntze, *State of a Reinsurance Underwritten by Sir John Baring* (1782).

[9] *China Traders Insurance v Royal Exchange* [1898] 2 QB 187; *Australian Widows Fund v National Mutual Life* [1914] AC 634; *British Dominions General Insurance Co Ltd v Duder* [1915] 2 KB 394; *Re London County Commercial Reinsurance Office* [1922] Ch 67; *Forsikringaktieselskapet National of Copenhagen v Attorney General* [1925] AC 639; *Toomey v Eagle Star Insurance Co Ltd* [1994] 1 Lloyd's Rep 516; *Wasa International Insurance Co v Lexington Insurance Co* [2009] Lloyd's Rep. IR 675.

[10] The first decision on a facultative policy appears to be *Union Marine Insurance Co Ltd v Martin* (1866) 35 LJCP 181. The first treaty decision was *Stephens v Australasian Insurance Co* (1872-73) LR 8 CP 18.

[11] *Wasa v Lexington*, [2009] UKHL 40, at para. 114.

[12] [2020] EWHC 3266 (Ch).

those policies reach the agreed "ultimate net loss" figure. By way of example, a property excess of loss treaty will, following a natural catastrophe such as flood, provide indemnity when the insurer's total flood losses reach the agreed trigger figure. Such a treaty can fairly be described as a contract of insurance, albeit one with an aggregate deductible and terms suited to the purpose.

However, the same cannot be said of the two most important classes of proportional treaty, surplus and quota share.[13] These have the common feature that they are in essence framework agreements under which the insurer cedes policies or risks of a given class and the reinsurers then pay the agreed proportion of any claim against the insurer. The main difference is that a quota share is a straightforward proportional sharing agreement whereas under a surplus treaty the insurer determines for each risk the maximum sum for which it is willing to retain liability and then cedes the remaining proportion to the reinsurers, with each loss being shared in the agreed proportions. Proportional treaties are for the most part written on an obligatory basis, whereby any risk accepted by the insurer and falling within the terms of the treaty is automatically ceded to the treaty.[14] An obligatory proportional treaty is a single contract, and although it has no content until risks are ceded – so that it is best described as a "contract for insurance" – it probably becomes a "contract of insurance" in respect of each individual cession. Some treaties are non-obligatory and confer upon the reinsured the right to determine what risks to cede and the reinsurer the right to accept or reject what has been proffered. The hybrid possibility of "facultative-obligatory" – under which the reinsured can decide what to cede but the reinsurer has no right to refuse a cession – have largely fallen into disuse, as the cherry-picking exercisable by the reinsured has obvious adverse implications for the reinsurer.

3. The IA 2015 and reinsurance

Insurance legislation is traditionally coy when it comes to reinsurance. The 1906 Act has only a somewhat unhelpful partial definition of insurable interest in s 9, and the 2010 Act by s 15 excludes reinsurance in order to avoid the complexities of direct claims against reinsurers by the policyholders of insolvent insurers.

The IA 2015 applies, by s 1, to any "contract of insurance". The question whether this phrase covered reinsurance was raised in the December 2014 analysis by the House of Lords Special Public Bills Committee,[15] and the Committee was satisfied by the Law Commissions' evidence that there was no need to actually say so. Parliamentary Counsel had expressed the view that any reference to reinsurance could cause problems for other pieces of legislation which do not so specify but which simply assume that insurance includes reinsurance. The Law Commissions also suggested that if contracts of reinsurance had been included in the definition there would

[13] As to which, see Carter, Lucas and Ralph, *Carter on Reinsurance* 5th ed 2013, ch 8.
[14] A small number are non-obligatory, so that the insurer can decide which risks to cede and the reinsurer can in turn decide whether or not to accept them. An even smaller number are "facultative/obligatory" so that the insurer can decide which risks to cede and the reinsurer is then bound to accept the cession: this type of business has largely fallen out of use, as it permits the reinsured to "cherry-pick" by ceding only the least favourable risks, thereby stripping the reinsurers of the benefit of a balanced portfolio. The problems are demonstrated in *Glencore International AG v Alpina Insurance Co Ltd* [2004] 1 Lloyd's Rep 111, *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins* [1998] 1 Lloyd's Rep 565 and *AXA Versicherung v Arab Insurance Group* [2017] EWCA Civ 96.
[15] House of Lords, Special Public Bill Committee, Insurance Bill [HL], HL Paper 81, December 2014 https://publications.parliament.uk/pa/ld201415/ldselect/ldinsur/81/81.pdf

have been uncertainty as to whether the Act extended to reinsurances of reinsurance (retrocession) and other contracts analogous to reinsurance under which insurers seek to spread the risks faced by them.[16] There is singularly little on reinsurance in the Law Commissions' voluminous documents on the reform of insurance law.[17]

The approach taken by the IA 2015 was, therefore, to make a single reference to reinsurance, in s 4(5)(b) concerning knowledge for pre-contractual disclosure purposes, discussed below.[18] That was thought sufficient to allay doubts as to the application of the Act to reinsurance and the same time sidestepped any need for detailed provision on exactly how the Act was to apply to the various contract forms constituting reinsurance. The matter has been delegated to the courts and (overwhelmingly in practice) to arbitral tribunals.

In what follows, the key issues posed by the application of the IA 2015 are considered. It should be said at the outset that the IA 2015 applies to a reinsurance agreement only if the applicable law is that of England and then only to the extent to which there has not been a contracting out from the legislation. However, that bare statement belies the true significance of the legislation internationally. Many international reinsurance contracts not underwritten in London adopt English law (and either arbitration or jurisdiction) for the purposes of neutrality. Leaving aside the US, English law provides the only comprehensive set of rules for reinsurance and many jurisdictions have no reinsurance law at all. It is very common for courts and tribunals in Europe in particular to treat English law as representative of international law and practice in the field.

In those jurisdictions where there is limited domestic insurance capacity, it is the practice for major risks to be placed with a local insurer and then reinsured into London on a facultative basis with reinsurers taking 100 per cent of the risk, a practice known as "fronting". Post-Brexit, and anticipating the loss of passporting rights, Lloyd's has established Lloyd's Insurance Company SA in Belgium to provide both insurance and reinsurance in the European market, and reinsurance will be available by fronting.

Added to the mix is the project for the drafting of Principles of Reinsurance Contract Law (PRICL).[19] This is an international project on which work began in 2016, funded by European reinsurers and drafted by leading practitioners and scholars. The objective is to provide reinsurance markets with uniform soft law rules in place of a national laws. PRICL has been modified to take account of the changes to English law by the IA 2015.

4. Utmost Good Faith and the Insurance Act 2015

By reference to the view of the Law Commissions that the IA 2015 applies, by s 1, to any "contract of insurance" the approach of the IA 2015 was that it was enough to make a single reference to reinsurance, in s 4(5)(b)

[16] Eg, by Catastrophe Bonds, whereby insurance risks are sold to the capital market.
[17] Ince Group, "The Insurance Act – The Final Countdown", 2015 https://incedadds.grouptreedev.net/file.axd?pointerid=59144c8103996f0de4f0248b.
[18] The Law Commission and The Scottish Law Commission (LAW COM No 353) (SCOT LAW COM No 238), *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* para. 6.4, p. 62, & para. 15.25, p. 199 July 2014, Cm 8898 SG/2014/131, OCL, Crown Copyright 2014, https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/11/Report-Insurance-contract-law.pdf.
[19] The PRICL Website is http://www.iversr.uni-frankfurt.de/forschung/pricl. The content of PRICL itself can be found at https://www.ius.uzh.ch/dam/jcr:c5e36159-2cbc-4686-83ce-1067bc4704a3/PRICL_1.0_2019.pdf. For commentary, see Heiss, "From Contract Certainty to Legal Certainty for Reinsurance Transactions: The Principles of Reinsurance Contract Law (PRICL)", Scandinavian Studies of Law, Vol. 64, 2018, 92-114, 101,105-106.

concerning knowledge for pre-contractual disclosure purposes, and this was taken as sufficient to imply the application of the Act to reinsurance. This is also in relation to good faith, as explained below.

4.1. Good faith duties owed to reinsurers

In *Eagle Star Insurance v Cresswell*[20] Rix LJ introduced some constraints which are not all one way. Reinsurance treaties of various types frequently contain "sole judge" clauses whereby the reinsured is given what is on its face an unfettered discretion over a particular matter. The phrase was used in *Brown v GIO Insurance*,[21] where an excess of loss treaty conferred upon the reinsured the right to be "sole judge" of the number of "events" that had taken place: the exercise of that discretion would inevitably have had a profound effect on the sum recoverable under the treaty, as the reinsured was free to determine how many losses were to be aggregated and treated as arising from one event for the purpose of a "per event" deductible (necessarily as many as possible, so that the minimum number of deductibles are borne by the insurer), and how many losses arising from one event were to be aggregated for the purposes of a per event policy limit (necessarily as few as possible, so that each loss has its own limit of indemnity).[22] It was common ground even on this strong wording that the discretion had to be exercised reasonably, although there was no discussion of how the standard was to be determined and the basis for any review of it.[23] Those questions appear to have been resolved by *Gan* and *Cresswell* in favour of an absence of arbitrary and capricious behaviour as the test (equivalent to the concept of rationality in judicial review cases), and a combination of implied term and good faith as the grounds for intervention.

4.2. Utmost good faith and reinsurance before 2015

Section 17 of the Marine Insurance Act 1906 in its original form, based on the judgment of Lord Mansfield in *Carter v Boehm*,[24] provided that a contract of marine insurance is one of the utmost good faith and that 'if the utmost good faith be not observed by either party, the contract may be avoided by the other party.' Lord Mansfield referred only to "good faith" and the statement was made in the context of an alleged failure to disclose, although a verdict was given for the assured on the ground that the information withheld – the threat of French invasion of Sumatra from which place the insured business was being carried on – was common knowledge. The cases on the good faith principle were, in the 150 years after *Carter* leading up to the passing of the 1906 Act, all but confined to pre-contractual disclosure or misrepresentation by the assured. The extension from "good faith" to "utmost good faith" or "*uberrima fides*" in that context first occurred as late as 1845 in the judgment of Parke B *Elkin v*

---

[20] [2004] Lloyd's Rep IR 437.
[21] [1998] Lloyd's Rep IR 201.
[22] There are numerous decisions on the meaning of "event" and other formulations for aggregation purposes. For the most recent explanations, see: *Spire Healthcare Ltd v Royal & Sun Alliance Insurance Plc* [2018] EWCA Civ 317; *Bank of Queensland Ltd v AIG Australia Ltd* [2019] NSWCA 190. *Moore v IAG New Zealand Ltd* [2020] NZCA 319 appears to be irreconcilable with authority.
[23] "Sole judge" clauses are used also in property surplus treaties, where the insurer may cede a portfolio of buildings with and the sharing proportion is fixed by reference to the value of the top risk/location against an estimated maximum loss (EML) and the insurer is then "sole judge" of what constitute EML and what constitutes a risk/location.
[24] *Carter v Boehm* (1766) 3 Burr 1905.

Janson,[25] and was rapidly followed by equivalent formulations such as "the most perfect good faith",[26] "the most absolute good faith"[27] and "full and perfect good faith."[28]

All of that said, in the context of insurance and reinsurance, a combination of common law principles and utmost good faith in its unamended form has imposed important constraints on the conduct of the parties. Two matters in particular have become of significance.

First, the general recognition that contractual relationships may give rise to a "duty to speak", thereby precluding on the basis of estoppel by acquiescence one party from relying upon defences otherwise open to it not drawn to the attention of the other,[29] is enhanced in the insurance context.

In the Insurance Act 2015, the first element of a fair presentation is a duty of disclosure, (s.3(3)(a), s. 3(4)), provides two ways to satisfy the duty of disclosure. Section 3(4)(a) effectively replicates the disclosure duty in section 18(1) of the 1906 Act, by stating that the insured must disclose "every material circumstance" which the insured "knows or ought to know". Section 3(4)(b) sets out the second way to satisfy the duty of disclosure, which is intended to operate where the insured has failed to satisfy the strict duty in section 3(4)(a) but has nevertheless disclosed enough information to put the insurer on notice that it needs to ask for further information from the insured before it makes the underwriting decision. This reflects the approach already taken by the courts in some cases.[30]

In *Ted Baker Plc v Axa Insurance UK Plc (No 2)*[31] one of the defences taken by the insurers under a business interruption policy was that the assured had failed to provide documents requested by them, to which the assured's response was that it had been hoodwinked by the conduct of the insurers into the belief that production was not required. The Court of Appeal held that this particular defence could not succeed, Sir Christopher Clarke stating[32] that:

> "I would not regard this conclusion as dependent on the contract being, as it was, one *uberrimae fidei.* It is not, therefore, necessary to decide the extent to which, if at all, the fact that it is such a contract may enlarge the circumstances in which a duty to speak arises. It is however, clear that the fact that the contract is of such a nature will, if it does anything, increase the likelihood of a party having a duty to speak".

Secondly, the Supreme Court has confirmed that there is no such thing as an unfettered contractual discretion. The leading case is now the Supreme Court decision in *Braganza v BP Shipping Ltd*,[33] Lady Hale put the matter thus:

---

[25] (1845) 13 M & W 655.
[26] *Foley v Tabor* (1861) 2 F & F 663.
[27] *Clapham v Langton* (1864) 5 B & S 729.
[28] *Bates v Hewitt* (1867) LR 2 QB 595.
[29] *Starbev GP Ltd v Interbrew Central European Holdings BV* [2014] EWHC 1311 (Comm).
[30] *CTI v Oceanus* [1984] 1 Lloyd's LR 476; *Garnat Trading and Shipping v Baominh Insurance Corporation* [2011] EWCA Civ 773.
[31] [2017] EWCA Civ 4097.
[32] At para 89. See also *Cultural Foundation v Beazley Furlonge Ltd* [2018] EWHC 1083 (Comm).
[33] [2015] UKSC 17.

> "It is plain from these authorities that a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The concern is that the discretion should not be abused. So it works as an implied term."[34].

The Court of Appeal has addressed reinsurer discretion in two cases, *Gan Insurance Co v Tai Ping Insurance Co*[35] and *Eagle Star Insurance v Cresswell*.[36] In *Gan* a facultative policy contained the provision: "No settlement and/or compromise shall be made and liability admitted without the prior approval of Reinsurers." The Court of Appeal held that the clause was not absolute, Mance LJ stating[37] that by reason of implied term the right was one:

> "to be exercised in good faith after consideration of and on the basis of the facts giving rise to the particular claim, and not with reference to considerations wholly extraneous to the subject-matter of the particular reinsurance or arbitrarily. It is to be exercised by considering the claim as a whole. The court cannot substitute its own view of the reasonableness of a reinsurer's decision to withhold approval."

The Court of Appeal was thus reserving to itself the right to control the exercise of the discretion by a test akin to judicial review: the result could not be challenged, but the process – including the reasoning behind the reinsurers' decision – was open to judicial consideration. In *Eagle Star v Cresswell* the contract provided that: "the Underwriters hereon shall control the negotiations and settlements of any claims under this Policy. In this event the Underwriters hereon will not be liable to pay any claim not controlled as set out above." If reinsurers refused to control the claim, they faced no liability. Once again the discretion was held not to be unfettered, Rix LJ following *Gan* to hold that reinsurers were not permitted to act "in bad faith, capriciously or arbitrarily" by reason of an implied term or by reason of "the very essence of the reinsurers' mutual obligation of utmost good faith."[38]

The constraints suggested by Rix LJ, are not all one way. Reinsurance treaties of various types frequently contain "sole judge" clauses whereby the reinsured is given what is on its face an unfettered discretion over a particular matter. The phrase was used in *Brown v GIO Insurance*,[39] where an excess of loss treaty conferred upon the reinsured the right to be "sole judge" of the number of "events" that had taken place: the exercise of that discretion would inevitably have had a profound effect on the sum recoverable under the treaty, as the reinsured was free to determine how many losses were to be aggregated and treated as arising from one event for the purpose of a "per event" deductible (necessarily as many as possible, so that the minimum number of deductibles are borne by the insurer), and how many losses arising from one event were to be aggregated for the purposes of a per event policy limit (necessarily as few as possible, so that each loss has its own limit of indemnity).[40] It was common ground

[34] At para 22.
[35] [2001] Lloyd's Rep IR 667.
[36] [2004] Lloyd's Rep IR 437.
[37] At para 76. See also para 66.
[38] At para 54.
[39] [1998] Lloyd's Rep IR 201.
[40] There are numerous decisions on the meaning of "event" and other formulations for aggregation purposes. For the most recent explanations, see: *Spire Healthcare Ltd v Royal & Sun Alliance Insurance Plc* [2018] EWCA Civ 317; *Bank of Queensland Ltd v AIG Australia Ltd* [2019] NSWCA 190. *Moore v IAG New Zealand Ltd* [2020] NZCA 319 appears to be irreconcilable with authority.

even on this strong wording that the discretion had to be exercised reasonably.[41]

The real problem underlying wording such as that in *Brown* is that the way is left open for the insurer to seek to maximise its reinsurance recoveries. The English courts have taken the view that, with or without a sole judge clause, it is not open to an insurer to depart from the shared assumption that losses will be allocated on the agreed basis. In *Teal Assurance Co v Berkley*[42] the insurer, a "captive" – an insurer wholly owned by the assured – reinsured its coverage for professional indemnity claims under excess of loss treaties arranged in layers. The lower layers covered all claims, whereas the top layer excluded claims emanating from North America. The insurer was faced with a series of claims and ordered the claims so that those from North America came first and thus were allocated to the lower layer where there was coverage. The Supreme Court held that the insurer had no such discretion, and that losses were to be allocated in the order in which they actually occurred, i.e., the actual date on which the liability of the assured for any one claim was established and quantified by judgment, arbitration award or settlement. Lord Mance, commented that: "The freedom of choice which [the reinsured advocates] cannot in the present context readily be reconciled with the basic philosophy that insurance covers risks lying outside an insured's own deliberate control."[43]

The *Teal* case was straightforward in the sense that the date on which a loss occurs for the purposes of insurance coverage is the subject of clear rules: in first party insurance, the date of the casualty; and in liability insurance the date on which the liability of the assured to the third party was established and quantified. However, in the exceptional circumstances facing the Court of Appeal in *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd*[44] that was not the position.

4.4. The decision in Equitas

Equitas was the long-awaited and inevitable final instalment in the "Fairchild Enclave" saga. The complex background has been explored in detail elsewhere.[45] It suffices to say here that by a series of decisions the House of Lords and then the Supreme Court, coupled with statutory intervention, reached the following position. First, an employee exposed to asbestos and contracting mesothelioma could bring an action for full compensation against any employer responsible for any exposure no matter how short, free of the need to prove causation (*Fairchild v Glenhaven Funeral Services Ltd*[46] as modified by s 3 of the Compensation Act 2006). Secondly, employers' liability policies issued from the 1960's onwards responded to exposure to asbestos rather than the

---

[41] "Sole judge" clauses are used also in property surplus treaties, where the insurer may cede a portfolio of buildings with and the sharing proportion is fixed by reference to the value of the top risk/location against an estimated maximum loss (EML) and the insurer is then "sole judge" of what constitute EML and what constitutes a risk/location.

[42] [2013] UKSC 57.

[43] In subsequent proceedings, *WR Berkley Insurance (Europe) v Teal Assurance Co Ltd* [2017] EWCA Civ 25, it was held that the establishment of an escrow account by the assured, against which sums could be sought by claimants as and when they incurred expenditure to put right the defects in the assured's work, did not establish and quantify liability, and it was the later individual claims that had that effect.

[44] [2019] EWCA Civ 718. See Gurses, "The Fairchild Enclave and Allocation of Losses in Reinsurance" Ins LJ, 30, No 2, (2019), 124-130.

[45] Merkin "Insurance and reinsurance in the Fairchild enclave" (2016) 36 LS 302.

[46] [2002] UKHL 22.

onset of illness (*Durham v BAI (Run off) Ltd*[47]). Thirdly, and crucially for present purposes, given that every exposure gave rise to tort liability, and that every exposure was the trigger for insurance coverage, it was a short step to the holding that every exposure also gave rise to an insurance claim by an employer for the full amount of any liability incurred by the employer. That was the effect of *International Energy Group Ltd v Zurich Insurance Plc UK Branch*.[48]

In this case Zurich had been on risk for six of the twenty-seven years of exposure by the employer. Speaking for the majority, Lord Mance applied the logic of *Fairchild* and ruled that every exposure triggered an insurance claim for 100% of the liability incurred by the employer, and that any unfairness to the paying insurer was mitigated by contribution rights against other insurers. Lord Sumption, speaking for the minority, refused to extend the *Fairchild* fiction to the insurance level and held that Zurich could be liable for only 6/27 of the total loss. The majority in *IEG* felt that they had been driven to that conclusion in order to complete the work started by *Fairchild*. Proportional recovery from any one insurer would have deprived the employer (and thus, in practice, the victim) of insurance proceeds for that part of the exposure period where an insurer was untraced or no longer in business. The minority was not prepared to distort ordinary insurance principles to reach that result. The judgment of Lord Mance is a classic demonstration of the inevitable fact that if the starting point of an analysis is novel, the knock-on effects are likely to create intractable distortions. So it proved, and Lord Mance was forced to make increasingly unprincipled adjustments to the operation of the Third Parties (Rights against Insurers) Act 1930[49] and to contribution between insurers,[50] and it was also necessary to rediscover the equitable right of recoupment in order to allow an insurer to recover from its own policyholder a contribution for any period of exposure during which there was no insurance coverage.[51]

4.4.1. Equitas and the reinsurance spiking problem

And so, to *Equitas v MMI* and the reinsurance "spiking" problem. Assume that an employer has exposed an employee to asbestos for a period of ten years, during which time a single insurer provided EL cover. Assume also that in each of the ten years, the insurer had excess of loss reinsurance coverage, but with some variation between years, e.g., to the ultimate net loss figure triggering coverage, to the maximum sum recoverable or to the makeup or respective contributions of the subscribing reinsurers. The employee's action against the employer does not need to identify the year of exposure (*Fairchild*) and the employer's action against the insurer does not need to identify the year of exposure (*IEG*). However, does that mean that the insurer is free to place its reinsurance claim into whichever of the ten years of reinsurance coverage that maximises its recovery? The excess of loss

[47] [2012] UKSC 14.
[48] [2015] UKSC 33.
[49] Now 2010.
[50] The usual rule of independent liability, whereby the contribution of each insurer to a loss is apportioned by reference to the sum for which it faced liability, would have led to the conclusion that an insurer on risk for 25 years would be able to claim a 50% contribution from an insurer on risk for one year. Lord Mance sidestepped the issue by creating a "time on risk" exception for the present context.
[51] Krishnaprasad, "Unjust enrichment in the 'Fairchild enclave': International Energy Group Ltd v Zurich Insurance Plc" (2017) 80 MLR 1150; Stevens, "The Unjust Enrichment Disaster" (2018) 134 LQR 574. The notion that insurer and assured can share liability in proportion to insured and uninsured loss is unknown in the absence of average: *Standard Life Assurance Ltd v Ace European Group* [2012] EWCA Civ 1713.

reinsurances in *MMI* covered the period January 1950 to December 1981, with the ultimate net loss figure and excess layers varying as between years. The parties, wishing to keep the resolution confidential, adopted the highly unusual course of securing permission to appoint a judge-arbitrator.[52] Flaux LJ duly delivered a confidential award in April 2018 holding that *Fairchild* extended to the reinsurance level, that MMI was entitled to spike its losses into any year of its choice and that there were no good faith or other constraints on the exercise of its contractual rights. The Court of Appeal gave permission to appeal[53] on the ground that these rulings were open to serious doubt, and a differently constituted Court of Appeal overturned the principal rulings in the award.

The Court of Appeal rejected the suggestion that MMI had settled the claims against it on a "time on risk", thereby defeating the argument that its reinsurance claims should automatically be determined in the same way. The issue thus became whether MMI, with a contractual right to bring a claim against the reinsurers in any of the years of cover, was restrained from doing so. The Court of Appeal unanimously concluded that there was such a restraint. Males LJ based his decision on the contracts themselves, holding that spiking was inconsistent with the "presumed intentions and reasonable expectations of the parties", and that it was necessary to imply a term in the very specific *Fairchild* enclave contest to the effect that: "the insurer's right to present its reinsurance claims must be exercised in a manner which is not arbitrary, irrational or capricious, and that in that context rationality requires that they be presented by reference to each year's contribution to the risk, which will normally be measured by reference to time on risk…" Males LJ found it unnecessary to place any reliance on the doctrine of utmost good faith. Leggatt LJ, reached the same conclusion but made two references to good faith. The Court would:

> "imply a term as to the manner in which a contractual power may be exercised so as to ensure that the power is not abused and is exercised in good faith. The doctrine of good faith in this context requires a contractual power to be exercised in a way which is consistent with the justified expectations of the parties arising from their agreement, construed in its relevant context."

Leggatt LJ drew back from reaching the conclusion that spiking was constrained by utmost good faith alone, but was plainly sympathetic to that view.

The decision not to extend *Fairchild* to reinsurance was explicitly one of general policy. *Fairchild* was necessary to ensure that victims had tort claims, *Durham* was necessary to secure insurance coverage and *IEG* was necessary to guarantee actual payment by a solvent insurer. All of that was achieved at the cost of some violence to accepted legal principles. The Court of Appeal saw no justification to extend the artificiality beyond the point at which it had achieved its purpose.

The anticipated appeal to the Supreme Court in *Equitas*, scheduled for July 2020, did not take place. The case settled on confidential terms.

[52] Under s 93 of the Arbitration Act 1996.
[53] *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd* [2018] EWCA Civ 991.

4.5. The Insurance Act 2015

Section 14 of the Insurance Act 2015 repealed the concluding words of s 17 of the 1906 Act, thereby leaving the bare statement that a contract of marine insurance is one of the utmost good faith. The remedy of avoidance for a breach of the duty of utmost good faith has thus been abolished. Pre-contractual non-disclosure and misrepresentation on the part of the assured have been hived off into an entirely separate duty of fair presentation. Any lingering doubts that fraudulent claims were an element of utmost good faith with an avoidance remedy to match have been removed by separate fraudulent claims provisions in s 12 of the 2015 Act under which a fraudulent claim defeats the claim and allows the insurers to terminate the contract for breach as of the date of the fraud but does not confer any retroactive remedy. The revised s 17 of the 1906 Act will therefore apply to pre-contractual misconduct on the part of the reinsurers, and to both pre- and post-contractual misconduct by both reinsured and reinsurers.

The deafening silence of the legislation as to remedies for breach of s 17 gives rise to a number of possibilities. First, s 17 is an implied term. If correct, the duty can necessarily apply only to post-contract dealings. The implied term approach has been adopted as a general principle in Australia in s 13(1) of the Insurance Contracts Act 1984,[54] under which:

> "A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith."

This is supplemented by s 14(1) under which: "If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision." These sections are enforceable in private litigation and also by the regulator, the Australian Securities and Investments Commission, which, following amendments to the legislation in 2013, may bring class actions and, ultimately, may cancel authorisation to carry on insurance business. The implied term has in practice been of limited impact and has focused on process rather than substantive outcomes,[55] but need detain us no further because reinsurance is excluded from the 1984 Act.[56] The implied term analysis has been adopted by the High Court of New Zealand in *Young v Tower Insurance Ltd*,[57] where Gendall J. held that the duty of utmost good faith bound insurers both at the pre- and post-contractual stages. Remarkably, that was the case even though New Zealand is the sole common law jurisdiction adopting the UK Marine Insurance Act 1906 to omit the general statement enshrined in s 17 that marine insurance contracts are of utmost good faith. *Young* requires an insurer (and, by extension, a reinsurer) to "act reasonably, fairly and transparently, including but not limited to … during and after the

[54] Australian Government, Federal Register of Legislation, Insurance Contracts Act 1984, No. 80, 1984. https://www.legislation.gov.au/Details/C2016C00820
[55] See: *Enright and Merkin*, Sutton's Law of Insurance in Australia (4th ed) 2013 and updated online 2019, ch 6; Ashton, "Keeping the Faith – Good Faith in Insurance and the Emergence of General Contractual Good Faith" (2011) 22 Ins LJ 81.
[56] By s 9.
[57] [2016] NZHC 2956.

lodgement of a claim"[58] and to "process the claim in a reasonable time."[59] Breach would, therefore, give rise to damages.

Secondly, the Law Commissions regarded the amended s 17 as an "interpretative provision", presumably meaning that neither side can rely upon the wording of the policy to produce an interpretation that operates in some means akin to a want of good faith.[60]

Thirdly, utmost good faith is the framework for the operation of the contract, setting the scene for the implication of terms into the agreement whereby its operation is rendered consistent with good faith principles. If that is correct, then the fact that the contract is of utmost good faith might potentially operate to shade the strict requirements for the implication of terms into a contract. The New Zealand Court of Appeal has on two recent occasions, *obiter* expressed its preference for utmost good faith being the trigger for implying specific terms rather than operating as an implied term in its own right.[61]

It is our submission that it does not matter much which analysis is correct, because the broad concept of utmost good faith as modified by the IA 2015 will on any view give added impetus to the pre-Act decisions of the Courts. It is of course the case that the Law Commission's position on 'good faith' as an interpretative principle does not give rise to any independent remedies, as such remedies would be dependent upon an actual express or implied term being breached. The practical distinction between an actual implied term of utmost good faith, and the principle of utmost good faith triggering a specific implied term, is zero, because either way the relevant party is in breach of contract for failing to observe utmost good faith in a specific manner. In *Equitas v MMI* the Court of Appeal was able to imply an anti-spiking term independently of the duty of utmost good faith, and although Leggatt LJ was clearly willing to go further down the utmost good faith line he was constrained from doing so because the amendment had not been in force at the date the excess of loss treaties were entered into.

Our firm conclusion is that s 17 in its amended form is likely to provide further justification for the implication of a term or the interpretation of an express term consistently with good faith principles. US reinsurance cases are replete with references to utmost good faith obligations on both parties, and article 2.1.2 of PRICL[62] states that: "The parties owe one another the duty of utmost good faith. 'Utmost Good Faith' means honesty and transparency as well as fairly taking into account the interest of the other party." A specific illustration of utmost good faith arises where reinsurers have failed to settle or to approve settlements and have thereby caused loss to the reinsured: this point is considered in section 6 below.

---

[58] [2016] NZHC 2956, at para 163.
[59] *Ibid.*
[60] The Law Commission and The Scottish Law Commission (LAW COM No 353) (SCOT LAW COM No 238), *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* Explanatory Notes A.20, p. 391, Chapter 11. Para 11.98, p. 171, July 2014, Cm 8898 SG/2014/131, OCL, Crown Copyright 2014, https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/11/Report-Insurance-contract-law.pdf.
[61] *Taylor v Asteron Life Ltd* [2020] NZCA 354; *Southern Response Earthquake Services Ltd v Dodds* [2020] NZCA 395.
[62] The phrase appears on no fewer than 130 occasions in the text of and notes to PRICL.

5. Disclosure Requirements and the Duty of Fair Presentation

The IA 2015 applies, by s 1, to any "contract of insurance". Both the Law Commissions and the IA 2015 only refer to reinsurance in relation to the knowledge for pre-contractual disclosure purposes. The IA 2015 retains the requirement that an assured must disclose material circumstances before the contract is entered into. Although ss 18-20 of the 1906 Act have been repealed and replaced, much of their content has been re-enacted in different form as the duty of fair presentation. In particular, the concept of "prudent underwriter" has been retained despite calls for a move to a "prudent assured" test, although the legislation has confirmed the common law principle in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*[63] that there is no remedy unless the insurer can prove subjective inducement in the form of reaching an underwriting decision different from that which would have prevailed had there been full compliance with the duty of fair presentation.[64] The key changes are: the right of the assured to give limited disclosure in a manner that puts a prudent insurer on notice that further information is available if requested (s 3(4));[65] an express ban on "data dumping" in the requirement that disclosure must be "in a manner which would be reasonably clear and accessible to a prudent underwriter" (s 3(3)(b)); an expanded definition of the assured's knowledge for disclosure purposes (s 4), including the obligation on the assured to make a "reasonable search" of information available to the assured (s 4(6)); clarification of information known to the insurer and therefore not requiring disclosure (s 5); and a switch from avoidance as the sole remedy to a range of proportional remedies (s 8 and Schedule 1).

The only reference to reinsurance appears in the context of knowledge, which, as converted to the reinsurance context, is defined by s 4(2)-(3) as falling into two classes: information known to the reinsured; and information known to a person responsible for the reinsured's insurance. The former category depends upon whether the reinsured is an individual, in which case the relevant knowledge is of that individual, or whether the reinsured is a company, in which case the relevant knowledge is that of the reinsured's senior management. The latter category, which applies to both individual and corporate reinsureds, is defined by s 4(8)(b) as meaning an individual who participates on behalf of the reinsured in the process of procuring the reinsurance (whether the individual does so as the reinsured's employee or agent, as an employee of the reinsured's agent or in any other capacity). The effect of the definition is that the reinsured is deemed to be in possession of the broker's knowledge so that its disclosure is required (in practice, by the broker) unless the information is confidential.[66]

How is this going to affect reinsurance? As a preliminary point, the type of the reinsurance contract will determine the point at which the duty of fair presentation applies. The Marine Insurance Act 1906, like the IA 2015, applies to contracts of insurance rather than contracts for insurance, and so the effect of the earlier law is preserved. The courts decided under the 1906 Act that in the case of an obligatory treaty the duty operated only on the making of

[63] [1994] 3 All ER 581.
[64] See the detailed analysis of the inducement test in the context of reinsurance in *AXA Versicherung v Arab Insurance Group* [2017] EWCA Civ 96.
[65] If there is a difference between the right of limited disclosure and the established waiver principle as retained by s 2(5)(e), then it has yet to become apparent. The Law Commissions regarded this as a "signpost" to insurers that the pre-contractual disclosure process is interactive.
[66] The effect of s 4(4)-(5).

the treaty[67] and not in respect of individual cessions,[68] with the consequences that the reinsurers have no remedy against the treaty itself or in respect of any of the cessions under it if there has been a failure to disclose material facts in respect of a cession. By contrast, if the treaty is non-obligatory so that it operates as a framework contract[69] under which individual cessions may be made, the duty of disclosure clearly attaches to each cession. Although there seems no reason why the duty of fair presentation should attach to a non-obligatory treaty given that it is a contract *for* insurance and independent of the cessions made under it, the English courts have assumed that such a treaty remains subject to the duty.[70]

The IA 2015, s 7(4), gives examples as to the facts that may be material for disclosure purposes, including: special or unusual facts relating to the risk; any particular concerns which led the insured to seek insurance cover for the risk; and anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question. There is nothing here that is directed specifically to reinsurance. Treaties in particular are concerned less with the terms of underlying policies and more with the insurer's general underwriting practices, its reserving policies in handling claims (which may distort the presentation to reinsurers of previous loss experience if potential claims are discounted until liability for them is actually established) and claims-handling procedures. Such law as there is on materiality in reinsurance will not be affected by the IA 2015.

A series of complex issues relate to knowledge for disclosure purposes. The extent of the search will be limited only by what is "reasonable", which is likely to depend, among other matters, on the type and size of the particular risk.[71] It is unclear how either of these "tests" will translate to the reinsurance sphere. The Ince Group in this context have raised a series of important but unresolved questions.[72] Suppose that the assured has utilised the right under the IA 2015, s. 3(4)(b)[73] to make a limited disclosure only, and the reinsured has unreasonably failed to ask the obvious follow-up questions. It then becomes arguable that the reinsured has, at least for the purposes of a facultative contract, failed to undertake a reasonable search for the purposes of the reinsurance. The concept of "senior management" as defined by s 4(8)(b) is not easy to apply where the reinsurance is in the form of a whole account treaty covering the reinsured's entire portfolio, as a determination will then have to be made as to which of the various individual office-holders in the group need to be taken into account. Again, if the reinsured is a "captive" and therefore possibly with interlocking directorships, how are the rules of attribution in the IA 2015 to operate? The House of Lords' debates on the Insurance Bill recognised that a director might not be part of senior management for this purpose, and equally a non-director could be a part of senior management, but that merely

[67] *Reliance Marine v Duder* [1913] 1 KB 265; *Mander v Commercial Union Assurance Co Plc* [1998] Lloyd's Rep IR 93; *Abrahams v Mediterranean Insurance and Reinsurance Co* [1991] 1 Lloyd's Rep 216; *HIH Casualty and General Insurance v Chase Manhattan* [2001] Lloyd's Rep IR 191.
[68] *Trans-Pacific Insurance Co (Aust) Ltd v Grand Union Insurance Co Ltd* (1989) 6 ANZ Insurance Cases 60–949 (SC NSW).
[69] *AXA Versicherung v Arab Insurance Group* [2017] EWCA Civ 96, at paras, 53,95, 121
[70] *Limit No 2 Ltd v Axa Versicherung AG* [2009] Lloyd's Rep IR 396; *AXA Versicherung v Arab Insurance Group* [2017] EWCA Civ 96.
[71] CMS, "Insurance Act 2015: what does it mean for reinsurance?", Law-Now, 6.11.2015. http://www.cms-lawnow.com/ealerts/2015/11/insurance-act-2015-what-does-it-mean-for-reinsurance
[72] Ince Group, op cit, n 11.
[73] The disclosure required is disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances. https://www.legislation.gov.uk/ukpga/2015/4/section/3.

indicates that there is much room for dispute on the facts of any one case. The matter may be resolved in practice by disclosure waiver provisions, whereby only the knowledge of a restricted class of individuals is relevant.[74]

A further layer of difficulty arises in the application of proportional remedies to reinsurance. Facultative contracts are straightforward enough,[75] but treaties reinsure both policies by class and also particular risks arising under a variety of different types of policy (e.g., natural catastrophes). On the assumption that the treaty is obligatory so that it encompasses all risks without allowing the insurer to make any underwriting decision other than at the very outset, the reinsurer has a remedy only by establishing, under s 8(1) of the 2015 Act that it would have either refused to enter into the treaty at all or would have done so only on different terms or with an adjusted premium. Quite how the latter in particular can be demonstrated is a matter that awaits resolution. Some light has been shed in the matter of the extent of the obligation of disclosure and misrepresentation in the recent judgment of the High Court in *ABN Amro Bank N.V. v Royal & Sun Alliance Insurance plc (and others)*[76] whereby the High Court ruled in favour of ABN Amro, in finding that an "unusual" and "unprecedented" clause provided credit risk cover in an "all risks" marine cargo policy and that the Bank was not obliged to disclose the purpose and intention behind the inclusion of the TPC clause or the non-avoidance clause in the policy, as an assured is not to be regarded as required to disclose facts presumed known to underwriters.

6. Late payment[77]

The English view of the common law is that damages are not awardable against an insurer for economic or other loss inflicted on an assured who has been deprived of the benefit of the insurance proceeds. The principle here is that it is the duty of an insurer is to "hold the assured harmless" and to provide an immediate indemnity, so that the obligation to pay damages arises on the occurrence of the insured peril. The consequence is that failure to pay damages cannot of itself give rise to further damages, because "the law knows no such thing as a claim for damages for failing to pay damages":[78] the remedy for non-payment of damages is simple interest.[79] In *Sprung v Royal Insurance*[80] the Court of Appeal dismissed an attempt to sidestep the rule by means of an implied term for prompt payment.

The position has been altered by s 13A of the IA 2015, added by the Enterprise Act 2016 following Government disquiet over including a controversial measure of this type in a Law Commission Bill where Parliamentary debate would inevitably be truncated. Section 13A(1) provides that it is an implied term of every insurance contract that an insurer must pay sums due under it within a reasonable period of time. The Act, in s 13A(3) gives some guidance on the meaning of "reasonable time", relevant factors including the type of insurance, the size and

[74] Eg, in banking cases, disclosure may be limited to the knowledge of the "deal team".
[75] But can also cause difficulties where there is a remedy mis-match as between different subscribing reinsurers, and/or between the remedy available at the underlying insurance level and the remedy available on the reinsurance level.
[76] *ABN Amro Bank N.V. v Royal & Sun Alliance Insurance plc (and others)* [2021] EWHC 442 (Comm).
[77] Merkin, "Late Payment of Insurance Claims", in Kotsiris and Noussia, *Liber Amicorum in Honour of Ioannis K. Rokas*, Nomiki Vivliothiki, 2017, 210-220.
[78] *Sempra Metals Ltd v HM Commissioners of Inland Revenue* [2007] UKHL 34, applying *President of India v Lips Maritime, The Lips* [1988] AC 395.
[79] *Burts & Harvey v Vulcan Boiler* [1966] 1 Lloyd's Rep 354.
[80] [1999] Lloyd's Rep IR 111.

complexity of the claim and compliance with any relevant statutory or regulatory rules or guidance and matters beyond the control of the insurers. The time required to obtain all relevant information or secure legal advice is, by s 13(2), inevitably part of the investigation of a claim.[81]

A breach of the implied term will provide grounds for the policyholder to claim the usual contractual remedies, including damages (s 13A(5)). It is expressly stated that the sums awardable by way of damages are in addition to and distinct from the sums due under the policy and any interest on those sums.[82] There is as yet no English authority on s 13A, although it might be thought that a good analogy is the award of interest, the test for which – as laid down by Tomlinson J in *Hellenic Industrial Development Bank v Atkin, The Julia*[83] - is causal. Thus, where a claimant has been guilty of excessive delay in making the original claim or in pursuing it, the date on which interest starts to run may be adjusted adversely to him to reflect his contribution to his own loss.

The only relevant authority, somewhat bizarrely, comes from New Zealand. In *Young v Tower Insurance Ltd* Gendall J's implied term of utmost good faith encompasses an obligation to pay claims within a reasonable time. The judge cited verbatim the provisions of IA 2015, s 13A(3), albeit without acknowledging the source. Subsequently, in *Kilduff v Tower Insurance Ltd* Gendall J, applying these criteria, rejected a claim for damages for late payment on the grounds that the insurers had sought to settle the claim, that the claimant herself had been guilty of delay and that the insurer faced some 25,000 other claims and that delays were all but inevitable given the dearth of expert assessors. In short, the delay was by reason of factors outside the insurer's control. Australian cases, which have taken a different view of the common law and treat late payment as breach of contract, have indicated that valid claims should be paid as soon as the insurer has received all material information regarding the claim, failing which there is a liability in damages.[84]

Damages for late payment may affect reinsurance in a number of ways.

First, and most obviously, the reinsurers themselves may have failed to make payment within a reasonable time of the reinsured validly establishing and quantifying its liability to the policyholder. In that situation IA 2015, s 13A will be applicable.[85] Facultative reinsurance agreements commonly contain "simultaneous settlement" clauses obliging the reinsurers to make payment at the same time as the insurer, so any failure would independently of s 13A expose the reinsurers to damages for breach of contract.

Secondly, the insurer may, for reasons unconnected with reinsurance, have failed to make payment to its policyholder(s) within a reasonable time of the loss. There will – absent contracting out, which under s 16A(1) is not possible for consumer insurances – potentially be a liability in damages. The question then arises as to whether the damages fall within the scope of reinsurance coverage. The refusal of the common law to recognise damages for late payment meant that, before IA 2015, the point arose only where the law governing the insurance policy

[81] M. Crorie, E. Kawai, "Damages for Late Payment of Claims: Introduction of s.13A to the Insurance Act 2015", Clyde & Co, 9.6.2016, https://www.clydeco.com/insight/article/damages-for-late-payment-of-claims-introduction-of-s.13a-to-the-insurance-a.
[82] R. Merkin, «Late Payment of Insurance Claims», in L. Kotsiris, K. Noussia, *Liber Amicorum* in Honour of Ioannis K. Rokas, Nomiki Vivliothiki, 2017, 210-220.
[83] [2005] Lloyd's Rep IR 365.
[84] *Moss v Sun Alliance Ltd* (1990) 55 SASR 145; *Tropicus Orchids Flowers and Foliage Pty Ltd v Territory Insurance Office* [1997] NTSC 46.
[85] Ince Group, *op cit,* n 11.

was of a jurisdiction that provided compensation to assureds who had suffered loss by reason of delay in payment. Such liability typically arose in jurisdictions such as Texas and New York, where late payment can be treated as a stand-alone bad faith tort. To counter that possibility, reinsurance contracts issued on the London market have long expressly excluded extra-contractual claims made against the insurer. However, liability under IA 2015, s 13A is contractual, based upon an implied term, and not extra contractual. The principle discussed earlier that a contract of reinsurance constitutes a fresh cover on the original insured subject-matter[86] rather than on the insurers' liability means that there is no obvious basis on which the reinsurers should be required to indemnify the insurer for its liability in damages, but a clause which excludes extra-contractual damages only on the assumption that the problem is bad faith damages awarded by US Courts, could be taken as an indication that the parties do intend that contractual damages are within the scope of the reinsurers' obligation to indemnify. Doubtless the market will develop wording to counter that possibility if it is thought desirable to do so.

Thirdly, if reinsurers, by invoking a claims co-operation or claims control clause, refuse to give their consent to a settlement or to take over the control of a claim against the insurer, the initial question raised is whether such a refusal operates to relieve the insurer from its own s 13A obligation to pay damages to the assured for late payment. The only possible defence under s 13A(3) would be that the reinsurers' conduct amounts to circumstances beyond the insurer's control. There is nothing in the *Kilduff* judgment to assist on that question, but it may be that there is a distinction to be drawn between physical and legal circumstances: the absence of suitably-qualified loss assessors to deal with the volume of claims is one matter, but the refusal of an insurer to meet its legal obligations to an assured because of reinsurer intransigence is quite another. There is nothing to stop the insurer from paying, the only problem is that the insurer runs the risk of refusal of indemnity. It is our view that the insurer cannot escape s 13A liability by relying upon the conduct of the reinsurers, and this is further substantiated on the basis that insurance and reinsurance are separate contracts so that the prospect of reinsurance recoveries is not material to a claim under s 13A.

If that is right the further question becomes whether the insurer has any sort of claim against reinsurers who have refused consent. Section 13A itself does not assist, because the complaint is not one of late payment to the insurer but rather the exercise of a contractual discretion. The decisions in *Gan v Tai Ping*, *Eagle Star v Cresswell* and *Equitas v MMI* are of some assistance, because they point towards a duty on reinsurers to exercise a discretion in accordance with the intended purpose of the contract. However, they do not take the further step of affording a remedy in damages. The link nevertheless appears to have been forged by Lord Mance in *Ramsook v Crossley*.[87] The issue in this case was whether the assured could strike out a third party judgment against her in circumstances where her liability insurers had, without consultation, rejected an offer by the third party to settle at policy limits and then unsuccessfully conducted her defence leading to a judgment against her of some $2.1 million in excess of policy limits. The application was refused on the ground that the policy authorised the insurers to conduct the

[86] *Wasa v Lexington*, [2009] UKHL 40, at para. 62.

[87] [2018] UKPC 9, relying on the principle that liability insurers must not act exclusively in their own interests in handling claims: *Groom v Crocker* [1938] 1 KB 194; *Beacon Carpets Co Ltd v Langdale* [1939] 4 All ER 204. See also *Travelers Insurance Company Ltd v XYZ* [2019] UKHL 48, recognising that liability insurers defending proceedings in the assured's name but for their own benefit face a third party costs order under s 51 of the Senior Courts Act 1981 if the policy moneys are insufficient to cover defence costs.

defence without reference to the assured, and there was no claim by the assured against her insurers, but Lord Mance commented that the clause:

> "was not carte blanche to insurers to conduct proceedings in their own interests, without regard to reality or to their insured's account of events or to the fact that here the claim was likely severely to affect [her].. [The insurers} ought at least to have ascertained and considered her position, with a view to deciding whether it was appropriate simply to admit liability on her behalf. They ought also to have kept her informed about the continuing progress of proceedings, which would severely expose her financially".

The situation in *Ramsook* is analogous to that where reinsurers fail to take into account the interests of the reinsured in making a commercial decision to reject a settlement, and it may be that the route to a remedy in damages[88] is the common law, but with the additional justification of the amended s 17 of the Marine Insurance Act 1906.

7. Sections 10 and 11: terms not relevant to the loss

IA 2015, s 10, reverses the common law rule that a breach of warranty automatically and irreparably discharges the insurer from all future liability, and replaces it with a suspension of the risk during the period of breach. Reinsurance treaties do not contain warranties. Hence any non-mention of reinsurance in the IA 2015, does not affect the position in relation to warranties.

Facultative reinsurances may contain warranties, but only if they are incorporated from the direct policy. It is clear from *Forsikrings Vesta v Butcher*[89] that an incorporated warranty will be construed consistently with that in the policy even if they are expressly subjected to different applicable laws, and so independently of s 10 it is inconceivable that a reinsurance warranty would give a defence to reinsurers if the same defence was not open to the insurer. Sections 10 and 11 have in any event rendered warranties of greatly diminished significance as opposed to the position prior to the IA 2015[90] in that they are now operative only where the breach subsisted at the time of the loss and even then had some impact on the nature of the loss.

Different considerations are raised by IA 2015, s 11. This is designed to prevent an insurer from relying on breaches of policy conditions where the breach is unrelated to the loss. Section 11(1) applies to a term that does not "define the risk as a whole" where compliance would "tend to reduce the risk of … (a) loss of a particular kind, (b) loss at a particular location, (c) loss at a particular time." If the term is caught, then the assured has the right to recover if it can prove that "non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred." All of these phrases have given rise to much

[88] That remedy has been afforded recognition in "excess judgments" cases in Canada and Hong Kong: *Plaza Fibreglass Manufacturing Ltd v Cardinal Insurance Co* 68 DLR (4th) 586 (1990) and *Fredrickson v Insurance Corp of British Colombia* 69 DLR (4th) 399 (1990); *Ace Insurance Ltd v Metropolitan Electrical Appliance Manufacturing Co Ltd* [2009] HKCFI 1132.

[89] [1989] 1 All ER 142. See also *Groupama Navigation et Transports v Catatumbo CA Seguros* [2001] Lloyd's Rep IR 141.

[90] Swan, Hoeneyben and.Lancaster, "Insurance and reinsurance newsletter: Insurance Act 2015 - are you prepared? Timing and background", Freshfields, Bruckhaus, Deringer, Newsletter 14.7.2016, http://knowledge.freshfields.com/m/Global/r/1590/insurance_and_reinsurance_newsletter__insurance_act_2015

discussion,[91] but stripping away the complexities the general idea is straightforward. A buildings policy contains a condition precedent to recovery requiring a burglar alarm to be fitted, and the premises are destroyed by fire: s 11 prevents reliance on the condition if the assured can show – and it should be straightforward to do so – that the absence of a burglar alarm could not have affected the risk of loss by fire.

It is clear from words of s 11(1) that the "loss" referred to is that of the assured and not the insurer. That means that at the insurance level s 11 has no application to anything other than "risk" clauses, namely, those relating to the loss of the subject matter. It does not apply to non-compliance with claims conditions: while a late or undocumented claim may increase the risk of loss to the insurer, eg, by prejudicing potential subrogation rights against a third party, it cannot affect the loss suffered by the assured which, by definition, will be on the occurrence of the peril.

When applied to reinsurance, s 11 can be read in two ways. It might apply to the terms of the underlying policy, at least insofar as they are incorporated into the reinsurance by "as original" wording, thereby matching the insurance and reinsurance coverage. Alternatively, it might apply to terms relating to the insurer's own loss, so that reinsurance policy terms relating to the manner in which the insurer has dealt with the assured's claim are caught. If the latter is correct, s 11 takes on an unanticipated and uncertain new dimension. It is our submission that s 11 refers to the former and thus has little or no impact at the reinsurance level. That is so for four reasons.

First, it is now settled that a reinsurance contract is a further contract on the insured subject matter rather than a liability policy,[92] so the loss is the direct loss and not the insurance loss.

Secondly, the phrase "loss of a particular kind … at a particular location … at a particular time" does not sit easily with financial loss.

Thirdly, an analogous point was resolved in favour of the former view in *HIH Casualty and General Insurance v New Hampshire Insurance*,[93] the question being how a waiver of disclosure clause in the direct policy operated in the reinsurance contract into which it had been incorporated. The Court of Appeal rejected the argument that the clause had a life of its own at the reinsurance level and therefore waived the insurer's duty of disclosure towards the reinsurers. The analysis adopted was that the clause as incorporated merely acknowledged that the insurer had waived the assured's duty of disclosure so that the reinsurers were thereby undertaking that they would make payment if the insurer found itself facing liability to the assured which, but for the waiver, could have been denied. In other words, the reinsurance warranty applied to the direct policy and not to any claim under the reinsurance.

Finally, the latter approach risks blurring the distinction between risk and claims clauses. By way of example, a facultative contract will typically temper the reinsurers' obligation to provide an indemnity by a claims co-operation or claims control clause. The former requires the insurer to keep the reinsurers informed of the progress of any claim against it and also demands the consent of the reinsurers for any settlement. The latter – used where the insurance is a front for reinsurance so that the entirety of the risk is effectively borne by the reinsurers –

---

[91] Merkin and Gurses, "Insurance Contracts after the Insurance Act 2015", (2016) 132 LQR 444; Gurses, "When does an insurance term define the risk as a whole to retain contractual certainty for rights and remedies?" J.B.L. [2020], 3, 184-201.
[92] *Wasa International Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40.; *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd* [2019] EWCA Civ 718.
[93] [2001] Lloyd's Rep IR 596.

operates to transfer claims handling to the reinsurers. If the reinsured reaches a settlement without the consent or participation of the reinsurers, but it is shown that the settlement did not result in enhanced liability for the insurer, the breach is not relevant to the reinsured's loss.[94]

If all of that is right, then ss 10 and 11 are of little relevance in the context of reinsurance. What at least can be said is that English law has now been brought into line with that of many other jurisdictions, so the difficulties arising from cases such as *Vesta* where the law applicable to the underlying policy adopts a causal approach to the breach of policy terms, whereas the reinsurance does not, have been eliminated where the 2015 Act has not been excluded by agreement from the reinsurance.

8. Evaluation

The underlying philosophy of the IA 2015 is to provide a fair balance of the interests of policyholder and underwriter. It is an ambitious measure, in that it seeks to encompass all forms of cover, ranging from short term small premium travel policies to long term multi-million pound reinsurance treaties. Obvious injustices, such as all or nothing remedies for breach of disclosure obligations and for breach of policy terms, as well as the common law's refusal to recognise an obligation to pay claims in a timely fashion, have been eradicated. However, these matters are not on the face of things the primary concern of reinsurance agreements. The IA 2015 does not address policy terms other than those relating to the risk, and so leaves claims obligations to the rigours of the common law. The Act skims over how the duty of fair presentation operates in treaties and raises complex issues on knowledge and proportional remedies. In particular, virtually all of the leading firms of solicitors who have commented on the IA 2015 have raised concerns as to how the reasonable search is going to work where captives are involved, or where the insurance is simply a front for London market reinsurance. It remains to be seen whether the Courts will embrace the suggestions of Lord Leggatt and require good faith to be applied to the exercise of policy discretions. Much of this may not matter in a soft market where reinsurance is readily available at good rates, or if contracting-out is widely used. But the potential for complex disputes on exactly how reinsurance can be fitted into to a structure designed primarily for other purposes is obvious.

[94] That said, the same problem arises with third party liability insurance policies.