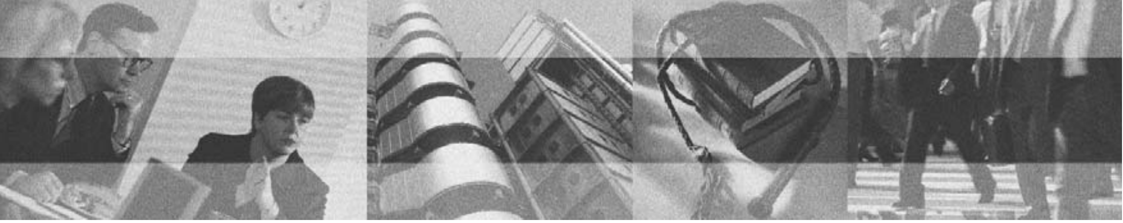

COMMERCIAL COURT CONFIRMS RELUCTANCE TO INTERFERE WITH ARBITRATORS' AWARDS

by
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This article considers two recent Commercial Court cases (one an insurance dispute, the other a reinsurance dispute), both of which demonstrate its reluctance to overturn arbitration awards. Although the cases deal with different substantive coverage issues, they both indicate that UK arbitration awards will in all but very limited circumstances be the final verdict on issues referred to arbitration.

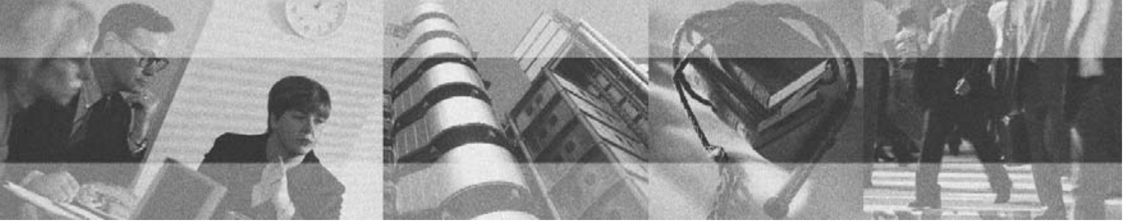
This should not come as a great surprise since the Arbitration Act 1996 gives parties only limited scope to appeal arbitration awards. In the absence of demonstrating that the tribunal lacks jurisdiction or that the dispute falls outside the scope of the arbitration agreement or that there has been some serious irregularity (such as fraud), Section 69 of the Act requires that leave to appeal will only be allowed on points of law if the tribunal's award is *"obviously wrong"* or there is a point of public importance where the award is *"at least open to serious doubt"*. This is a high hurdle to clear.

In the first case we consider, *IRB Brasil Resseguros SA v CX Reinsurance Company Ltd* Commercial Court, 7 May 2010, the Judge stressed that the Courts should *"strive to uphold arbitration awards"* and not subject them to unduly meticulous legal examination. In the second case, *Orient Express Hotels Limited v Assicurazioni Generale SVA (UK) (T/A Generale Global Risk)* [2010] EWHC 1186 (Comm), the Judge would not criticise an arbitration tribunal for applying the "*but for*" test for causation, notwithstanding arguments that it produced a result that was unfair and not what the parties had intended. He held that the question of *"fairness and reasonableness"* in applying the *"but for"* test was one for the tribunal to decide.

Both of these cases are also of interest on substantive points of insurance and reinsurance law. In *IRB v CX Re*, there is valuable guidance on the application of the so-called *Hill v M&G "follow the settlements"* clause which has been used widely, subject to variations, in London market reinsurance contracts. The *Orient Express* case demonstrates that the Court will interpret the words of an insurance contract literally and will not seek to achieve a more *"realistic"* commercial outcome by implying additional words into the contract. The case is the first judicial consideration of the Trends Clause that appears in the Business Interruption section of many insurance contracts and can be interpreted to produce very different results in terms of quantum recoverable.

IRB Brasil Resseguros SA v CX Reinsurance Company

This judgment follows the 2009 decision in *Equitas v R&Q* which equally demonstrated the Commercial Court adopting a pragmatic and commercial approach in circumstances where a reinsured has no realistic prospect of demonstrating its liability for each and every original



loss which makes up a claim to its reinsurers. The losses in this case arose out of well-known US liability claims and class actions (e.g. breast implants, asbestos) which had been settled on commercial terms. IRB Brasil appealed against an arbitration award in favour of its reinsured, CX Re.

Claims in arbitration

The arbitration dealt with claims under CX Re's reinsurance programme protecting its book of casualty business for the years 1976 to 1983. The claims and settlements all arose out of well-known US liability market losses including: the AHS and 3M silicone breast implant claims; the Baxter and Revlon HIV-contaminated blood product claims; and the Corning asbestos claims. CX Re had entered into various settlement agreements which it was acknowledged were almost universally paid and supported by the London market. As is common in such cases, the settlements involved liabilities being to some extent artificially allocated between insurers and years of account.

The reinsurance contracts each incorporated a *Hill v M&G*-type *"follow the settlements"* clause as follows:

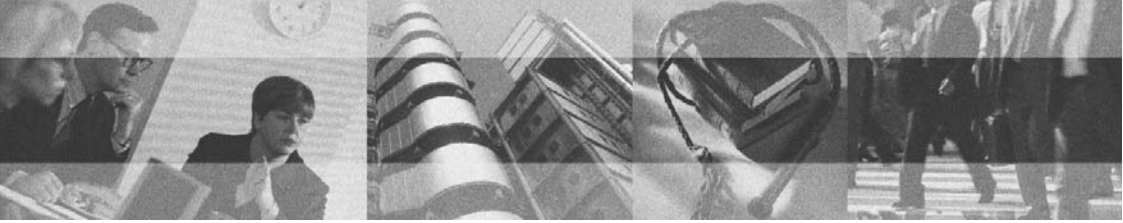
> *"All loss settlements made by the Reinsured, including compromise settlements, shall be unconditionally binding upon Reinsurers provided such settlements are within the conditions of the original policies and/or contracts and within the terms of this reinsurance, and amounts falling to the share of the Reinsurers shall be payable by them upon reasonable evidence of the amount paid being given by the Reinsured."*

In the arbitration, IRB relied on the fact that the settlements involved market-sharing agreements and payments into settlement funds which required CX Re to pay sums in relation to claimants and years of account for which there was no evidence that it was actually liable. It followed that CX Re could not prove that all of the paid losses fell within the terms of the original insurances and the reinsurance.

The tribunal concluded not only that the settlements were reasonable and business-like, but that it was sufficient for CX Re to show that the total of payments it had made under the settlements was equivalent, on the balance of probabilities, to its market share of the losses. CX Re could not be required to demonstrate that each individual payment made related to a loss for which it was liable. The panel even allowed CX Re to recover a portion of the settlements which related to future claims on the basis that they had reached a reasonable and business-like settlement involving a final determination of all potential liabilities, including claims which had not yet been advised.

Appeal

In the Commercial Court, IRB's lawyers argued that the arbitrators had erred in law in concluding that the settlements were within the terms of the original policies and the reinsurance. IRB's case rested, in part, on the language used in the arbitration award which referred to losses *"arguably"* falling within the terms of the original policies and the reinsurance, when the test that should have been applied was whether the losses fell within the original policies and reinsurance on *"the balance of probability"*.



The Commercial Court expressed its reluctance to challenge any decision of an arbitration panel unless there was a very good reason. The use of incorrect terminology was not such a *"good reason"* and the Court would not allow an arbitration award to be challenged if the tribunal had relied on the proper authorities and made no legal error in applying them to the facts. Importantly, in the case of a *"follow the settlements"* case like this, the relevant facts were those as they appeared in the terms of the original compromise agreements – not the facts as they may or may not have actually occurred.

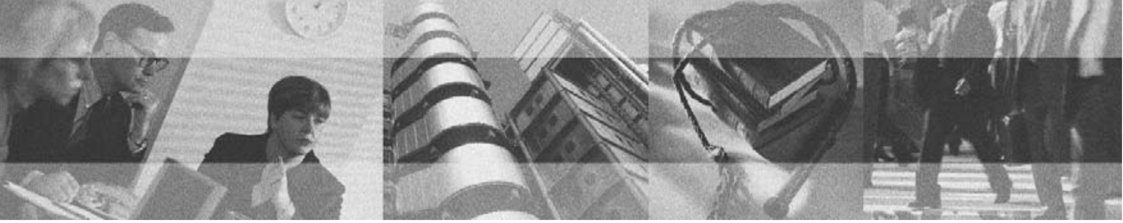
The use of *"confused terminology"* (for example between *"event"* and *"cause"* in the case of a question as to whether losses arose out of *"one event"*) was of no assistance to IRB because the panel's reasoning was clear from the circumstances and language of the award. The Court was therefore able to conclude that the arbitrators were satisfied, on the balance of probabilities, that the claims as settled by the relevant compromise agreements fell within the terms of the original insurance contracts and the reinsurance. They had applied the proper law to the facts and so there was no basis on which to challenge the arbitration award. It may provide comfort to the parties in an arbitration and to the arbitrators themselves that the clumsy wording of an award will not provide grounds for it to be appealed.

Effect of *Hill v M&G* "Follow The Settlements" Clause

The judgment supports the arbitrators' decision not to re-examine the factual basis of the underlying settlements made by CX Re. This is notwithstanding that the *Hill v M&G "follow the settlements"* clause in the reinsurances required the reinsured to demonstrate that losses fell within the terms of both the policy reinsured and the reinsurance. It appears to have been accepted by the parties that this so-called double proviso applies to questions of law but not to questions of fact.

Such a pragmatic approach demonstrates a willingness to acknowledge the commercial context of a reinsurance contract which could not reasonably have been entered into with the expectation that the reinsured should have to prove again the facts on which it settled each underlying loss. The *"classic"* interpretation of these clauses leads to the peculiar position that a *Hill v M&G "follow the settlements"* clause leaves the reinsured in exactly the same position as if there was no *"follow the settlements"* language in the contract at all. The judgment therefore supports the argument that *"follow the settlements"* language in a reinsurance contract must in some way improve a reinsured's position, even though this arguably contradicts how the test in *Hill v M&G* has been applied in other cases and is interpreted by most legal commentators.

Applying *Equitas v R&Q*, the arbitration award confirmed that the standard of proof to which a reinsured is required to prove that losses fall within the terms of an original policy and a reinsurance contract as a matter of law is *"the balance of probability"*. It appears from this decision that a market settlement or other compromise agreement may itself be sufficient evidence. The settlements in this case were all well-known market settlements and it is not clear whether this influenced the arbitrators' decision. Nevertheless, the judgment indicates that a reinsured will not be prevented from relying on the settlement to prove its loss even though the settlement includes payments which cannot be allocated to specific claims or



liabilities. It may be sufficient to demonstrate that the overall loss paid by the reinsured is at least the value of the likely total quantum of claims for which the reinsured is liable.

If the arbitrators' approach is correct (and the Commercial Court decision suggests it is), it is arguable that any form of *"follow the settlements"* language in a reinsurance contract which expressly includes cover for compromise settlements will be sufficient to prevent a reinsurer challenging the facts which gave rise to an underlying settlement.

IBNR

What is even more striking is the Court's reluctance to challenge the arbitration panel's decision to allow recovery of settlements including amounts in relation to future and as yet unreported liabilities. In this case, the court upheld the award's findings on the basis that the proportion of future claims which made up the settlement in question was apparently small, and that coverage for such claims was not expected to have been in issue.

This could have implications for the recovery by reinsureds of commutations including values for IBNR and appears at odds with the accepted position that a reinsurer cannot be liable until its reinsured's liability is ascertained by judgment, award or settlement. Most commentators have concluded that a settlement for IBNR (where, by definition, no liability attaches) could not satisfy the requirements for ascertaining liability. By way of caveat, although the Judge confirmed that the arbitrators had applied the proper law to the facts, it does not necessarily follow that the Commercial Court would at first instance apply the law in the same way as the arbitrators.

Orient Express Hotels Limited v Assicurazioni Generale SVA

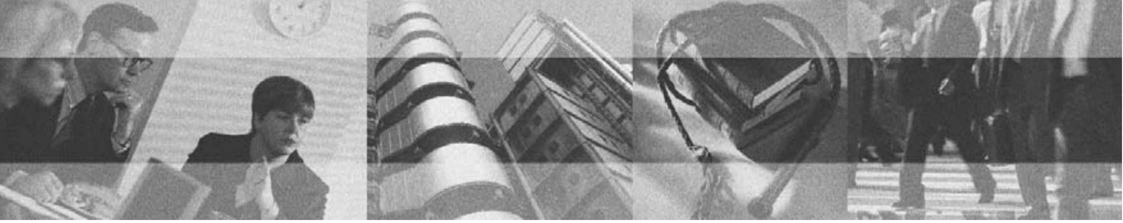
This case related to a claim by Orient Express Hotels under its Material Damage and Business Interruption policy, in respect of losses to its Windsor Court Hotel in New Orleans arising from Hurricanes Katrina and Rita in 2005. The Commercial Court upheld an arbitration award in favour of the insurer which found that the Insured was only able to recover Business Interruption losses consequent upon damage to the hotel itself, and that those losses were to be adjusted as if there had been no damage to the hotel but the damage in its vicinity had still occurred.

Claim and Arbitration

The Insuring Clause in the Policy provided cover for:

> *"loss due to interruption or interference with the Business directly arising from Damage".*

The tribunal held that this clause clearly provided that Orient Express was only entitled to recover Business Interruption losses that arose as a consequence of insured damage to the hotel caused by the hurricanes. The Insurer argued that the Business Interruption losses claimed by the Insured did not arise from damage to the hotel but rather from the damage to the surrounding area which had led to there being no customers for the hotel even if it had been open to trade.



The *"but for"* causation test was applied leading the Tribunal to find that the Insured was only able to recover BI losses which "but for" the damage to the hotel would have been earned by the Insured. The Insurer was therefore entitled to exclude losses which would have been suffered by the Insured indirectly as a result of the hurricanes. Recoverable Business Interruption losses were severely restricted as the Insured was unable to show that, if the hotel had not been damaged, it would have had any business during September 2005 when the city was shut down.

The tribunal was also required to determine the proper application of a Trends Clause in the Policy which provided that adjustments could be made to the quantum of Business Interruption losses:

> *"to provide for the trend of the Business and for variations in or special circumstances affecting the Business either before or after the Damage or which would have affected the Business had the Damage not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relevant period after the Damage"*.

It was held that the effect of this clause was that the loss should be adjusted to leave the Insured in the position of an owner of an undamaged hotel in an otherwise damaged city. There was no recoverable loss under the primary insuring clause of the Policy because there would have been few (if any) customers for such an undamaged hotel.

Appeal

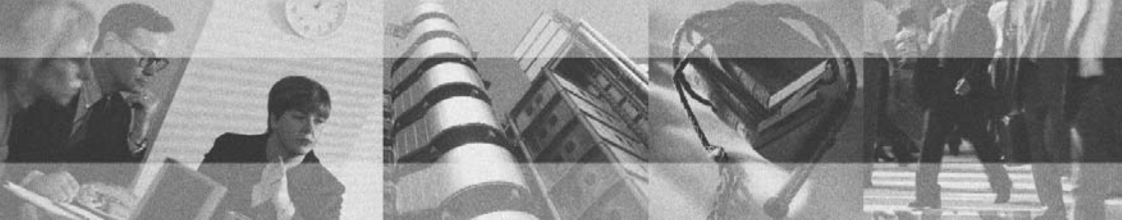
The Commercial Court held that there had been no error in law and the tribunal were right to have adopted the *"but for"* test for causation. Insurers were entitled to exclude losses which would have been suffered by the Insured in any event but for the damage to the hotel, and the appeal was therefore dismissed.

Causation

It is apparent from this judgment that the "*but for*" test remains a general rule for establishing causation. The Court accepted that there may be cases where a *"fairness and reasonableness"* argument means that the "*but for*" test was not applicable. This would more usually apply in tort cases where there are two concurrent causes, but the Judge made it clear that there was no reason, in principle, why it might not apply in contract cases. However, the Judge held that the question of whether the *"fairness and reasonableness"* test should apply was one for the tribunal and not for the Court. It was difficult to see how an arbitration tribunal could ever be shown to have erred in law by applying the "*but for*" test when the Insuring Clause clearly provided that Business Interruption losses were only covered if they were due to *"interruption or interference with the Business directly arising from the Damage"*.

Trends Clause

The so-called Trends Clause is a difficult provision which has not previously been considered in any reported English cases. The intention of such clauses is to allow the insured and



insurer to take into account in adjusting the loss other factors affecting the business over the period of the loss. For example, an insured selling coffee beans may be entitled to adjust upward the quantum of its loss to take into account changing market conditions which meant that had the loss not occurred it could have taken advantage of increased coffee prices. Such adjustments should lead to a position where the loss paid *"shall represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relevant period after the Damage"*.

The Insured argued that the clause should be read such that the loss was adjusted as if neither Hurricanes Katrina nor Rita had occurred and that the term "*but for the Damage*" should be read as meaning "*but for the event(s) causing the Damage"*. Applying the Insurer's hypothetical scenario of no damage to the hotel but the surrounding area still being affected by the hurricanes, there was no recoverable loss. However, the Trends Clause referred to *"Damage"* and not to the event which caused the damage and the Tribunal found that the assumption to be made was *"had the Damage not occurred"* not *"had the Damage and whatever event caused the Damage not occurred"*.

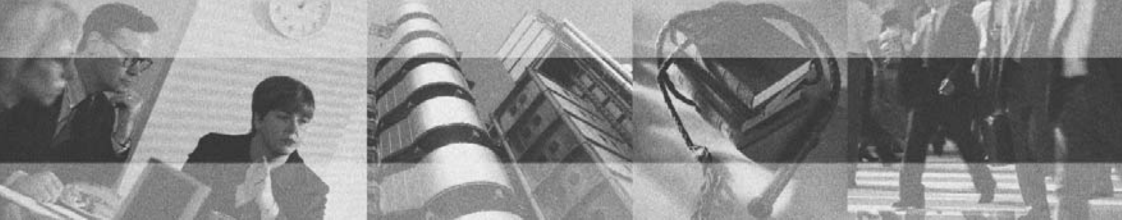
The Commercial Court held that this approach did not constitute any error in law notwithstanding that it was based on an unrealistic scenario and meant that the more widespread the impact of a natural peril the less cover would be afforded under a Business Interruption policy. Again, this approach is arguably unjust and could lead to a windfall gain to an insured who argues that its loss should take into account its monopoly position in the absence of competitors. It remains to be seen whether a Court or tribunal would be more reluctant to apply the clause in these terms if it led to such a windfall or if there were no cover available under separate Denial of Access or Loss of Attraction provisions.

There have been US cases arising out of similar clauses which have reached a different conclusion and prevented insureds obtaining windfall gains under their insurances by relying on the pretence that the hurricanes might not have caused damage to their property but caused damage to surrounding property. The Commercial Court made clear that such cases (e.g. *Prudential v Colleton Enterprises*) turned on the wording of particular clauses which, in any event, may not have been correctly interpreted.

Conclusion

The decision could have implications for insurance claims arising out of other catastrophes where businesses have incurred losses not only as a consequence of the damage to the insured property but of related damage in the vicinity. The decision appears unjust since an insured may be left without cover for Business Interruption losses in circumstances where it would have suffered those losses because damage to the surrounding area would have prevented it trading. However, in the *Orient Express* case, the Insured had limited cover under Prevention of Access and Loss of Attraction provisions such that it was not left wholly uninsured. It is not clear whether the tribunal or Court would have adopted the same approach if it would have left the Insured without any recourse to recover Business Interruption losses from its insurers.

The above implications should be caveated insofar as the Commercial Court when



considering the same facts at first instance may not have reached the same conclusion. However, this decision and *IRB Brasil v CX Re* demonstrate the Commercial Court's reluctance to overturn arbitration awards where it is satisfied that an arbitration panel has applied the proper law to the facts. It is indicative of an increasingly pragmatic and commercial approach by the Commercial Court. Perhaps more significantly, given how many insurance and reinsurance disputes are resolved by arbitration, an arbitration panel may feel more comfortable adopting such a commercial approach without fear of being overturned on appeal.