Published in issue 122 of the Journal of the British Insurance Lawyers Association

The limitation period for claims against reinsurers under English law

By Paul Bugden, partner, Clyde & Co, LLP

In the English law section of "Time Bar in Insurance and Reinsurance"[1] I comment upon two developments in English law, each of which has the effect that the limitation period for claims against reinsurers may commence earlier than expected. In this article I consider these developments in further detail.

The first of these developments arises from a decision on a direct liability policy that time runs from a denial of coverage and its extension, by analogy, to reinsurance. The second relates to reinsurance of property risks. It is a consequence of English law favouring the view that reinsurance is not a form of liability insurance, but is instead to be regarded as providing an indemnity in respect of the original loss. These two developments are discussed below under separate headings.

Time runs from denial of coverage

It has long been settled that the six year statutory limitation period for claims under liability policies runs from the date on which the insured's liability is ascertained by agreement, judgment or award. Reliance is routinely placed on the judgment of Lord Denning, Master of the Rolls, in *Post Office v Norwich Union* (1997) 1 Lloyd's Rep 216. Lord Denning's judgment was approved by Lord Brandon in the House of Lords in *Bradley v Eagle Star Insurance Company Limited [1989] 1 Lloyds Rep 465* .

But Lord Denning's judgment is qualified because he recognised that, where insurers have purported to avoid a policy, an aggrieved insured would have a right to seek a declaration, which would arise when insurers gave notice of avoidance. He said:-

> "In some circumstances the insured might sue earlier for a declaration, for example, if the insurance company were repudiating the policy for some reason. But where the policy is admittedly good, the insured cannot sue for an indemnity until his own liability to the third person is ascertained."

In *William McIlroy Swindon Limited & Another v Quinn Insurance Limited* [2010] EWHC 2448 (TCC) the Court had to decide whether Lord Denning's qualification extended beyond cases involving avoidance by insurers.

The case concerned a contractor called Lenihan Limited ("Lenihan") who had taken out a public liability policy with Quinn Insurance Limited ("Quinn"). The policy contained a provision requiring any dispute under it to be referred to arbitration within nine months. The arbitration clause stipulated that:-

Footnote

1 reviewed at page 74 of this issue of the BILA Journal.

> "Any dispute between the Insured and the Company on our liability in respect of a claim or the amount to be paid shall, in default of agreement, be referred within nine calendar months of the dispute arising, to an arbitrator …If the dispute has not been referred to arbitration within the aforesaid nine month period, then the claim shall be deemed to have been abandoned and not recoverable thereafter."

Lenihan was a sub-contractor at a site where a fire occurred, allegedly because one of its employees was careless with a blowtorch. Quinn wrote to Lenihan advising that due to a breach of a *"reasonable precautions"* condition in the policy it was declining to provide any indemnity.

Having taken the above position, Quinn did not defend third party claims against Lenihan and default judgments were entered. Lenihan subsequently went into voluntary liquidation. The third parties sought to claim against Quinn under the Third Parties (Rights Against Insurers) Act 1930. Quinn asserted that the claims were time barred because arbitration had not been commenced within nine months of the date on which they advised Lenihan that they would not indemnify him.

It was asserted for the third parties that Lord Denning's exception was restricted to cases where insurers had purported to avoid the policy. Reliance was placed on the words, *"But where the policy is admittedly good, the insured cannot sue for an indemnity until his own liability to the third person is ascertained."* It was argued that because the policy was not void it remained "good" and the nine month limitation period ran from the ascertainment of liability against Lenihan. But the judge, Mr. Justice Edwards-Stuart dismissed this argument on the basis that Lord Denning was only giving an example and was not limiting the circumstances in which a declaration may be sought to those involving avoidance for breach of utmost good faith.

It was held that Lenihan had a claim for a declaration from the date Quinn alleged breach of the policy terms and gave notice it would not provide an indemnity. As the claim had not been referred to arbitration within nine months of such notice it had become time barred. It was no longer open to the third parties, who were stepping into the shoes of Lenihan, to bring a claim for an indemnity even though nine months had not expired from the date on which they had obtained judgments ascertaining Lenihan's liability.

This case was particularly harsh on the third parties because it involved a relatively short contractual limitation period. Whilst Mr Justice Edwards-Stuart acknowledged this, he considered it could not affect the point of principle.

Following this judgment it is clear that, where insurers have given notice that they will rely on a breach of a policy term and will decline to provide an indemnity, the limitation period must be protected by reference to the notification of the insurer's position, rather than ascertainment of loss, which may occur months or years later.

There appears to be no reason, in principle, why the above position should not apply equally to reinsurance contracts. So, where a reinsurer or retrocessionaire has stated that they consider there has been a breach of the terms of the reinsurance or the retrocession, the limitation period should be treated as running from that date and be protected accordingly.

It is quite possible that a reinsured or retrocedant may not feel any immediate necessity to take proceedings to establish their right to an indemnity, as there may be uncertainty about whether they will eventually face any liability from the claim which they have notified. In such circumstances, it is easy to see how there is potential for reinsureds or retrocedants to be caught out by the earlier expiry of the limitation period than they may have assumed was applicable.

For property claims time may run against reinsurers from date of loss

There has been a long running debate in English law as to whether reinsurance is a form of liability insurance and covers the reinsured's liability or whether it actually covers the primary risk.

Lord Mustill said in *Charter Re v Fagan* [1997] AC 313:

> "…under this form of words, although perhaps not under all forms, the policy covers not, as might be thought the suffering of loss by the reinsured in the shape of a claim against him under the inwards policies, ***but the occurrence of a casualty suffered by the subject matter insured through the operation of an insured peril.*** It follows that in principle the liability of the reinsured is wholly unaffected by whether the reinsured has satisfied the claim under the inward insurance…" (emphasis added)

It seems that Lord Mustill considered that the liability of both the reinsured and the reinsurer would be triggered simultaneously by the *"occurrence of a casualty"* and the quantification of the loss was not a prerequisite for the reinsured's cause of action to accrue.

The House of Lords in *Wasa v Lexington* [2009] UKHL 40 has now declared that reinsurance is not a form of liability insurance and that the reinsurer reinsures the underlying risks accepted by the reinsured.

This debate is relevant to the question of when the limitation period for claims against reinsurers commences. The position in property insurance is that there is a right to an indemnity from the moment the property has suffered an insured peril (*Chandris v Argo Insurance Co* [1963] 2 Lloyd's Rep. 65), whereas in liability insurance it is necessary for the amount of the claim to be ascertained before a cause of action accrues. So, assuming the original subject matter is a property risk and reinsurance is to be treated as covering the underlying risk, it would follow that claims against the reinsurers arise at the time the property is damaged, rather than when the value of such damage is ascertained.

Some light is thrown on this debate in *Teal Assurance Co Ltd v WR Berkley Insurance & Anor* [2011] EWHC 91 (Comm), which concerned reinsurance contracts covering liability and expenses incurred.

The claimant was a captive insurer which underwrote certain layers of the professional indemnity programme of the Black & Veatch group ("BV"). Policies underwritten by the claimant and another insurer provided cover of US$ 60m in excess of a self-insured retention (and deductibles) of $10m for any one claim or $20m in the annual aggregate (a so-called "p.i. tower"). Those policies provided "mitigation cover" (i.e. cover for the insured's actual costs and expenses incurred in rectifying a design defect) and did not exclude American claims. The claimant further insured BV for liability in excess of the p.i. tower ("the Original Policy") and the claimant reinsured this risk by entering into an excess reinsurance policy with the defendants ("the Excess Policy"). Both the Original Policy and the Excess Policy excluded American claims, but did provide (inter alia) mitigation cover.

Broadly, two types of claims arose against BV: (1) non-American claims for alleged design defects (requiring mitigation cover) and (2) alleged design defect claims for a number of power plants in the USA ("the American claims") and thus not covered by the Excess Policy. The critical issue in this case was therefore whether (as the claimant argued) the American claims exhausted, or were likely to exhaust, the cover provided by the p.i. tower, so that the non-American claims would subsequently fall under the Original Policy (thus allowing a claim under the Excess Policy). This case therefore turns on the particular facts and policy structure concerned.

However, the judge, Mr. Justice Andrew Smith confirmed that the general legal principles are as follows:

a) Reinsurance is not insurance of an insurer's liability but of the same risk as the original insurance: *"Hence, the reinsurers' liability arises fundamentally from loss suffered by the original insured, not from insurers' liability in respect of that loss."* (He was agreeing with Lord Mance in *Wasa v Lexington* (see above)),

b) Subject to the terms of the reinsurance contract, in the case of liability cover, the application of this principle is that a loss is suffered when liability is established and the amount of liability has been ascertained, whether by action or arbitration or by settlement, and not earlier (see *Post Office v Norwich Union* (discussed above) and *Bradley v Eagle Star* [1989] *1 Lloyds Rep 465*),

c) In the case of reinsurance, the right of the reinsured to an indemnity arises once his own liability has been ascertained and quantified and does not depend on the reinsured paying the original insured.

Applying those principles to the case, Mr. Justice Andrew Smith held that BV's losses eroded the p.i. tower in the order in which they were suffered by BV: "and the question whether a loss has already been suffered by BV depends in the case of the liability cover provided by the p.i. tower upon whether BV's liability has been established and ascertained in amount, and ***in the case of the mitigation cover upon when BV incurred the costs and expenses***" (emphasis added). The judge was effectively treating mitigation costs as being akin to property loss, as they were a form of loss giving rise to a claim as soon as the loss arose. He rejected the claimant's argument that mitigation losses were only incurred when notification of a claim was made to the insurers and they were asked to pay (even though mitigation cover was here provided in the context of a liability policy).

The result was that the non-American claims were covered by the p.i. tower as, at the relevant times, the American claims had not exhausted that cover.

The judgment has the result that losses in respect of the two types or claim covered arise at different times. Liability claims arise only when the reinsured's liability is ascertained but mitigation expenses claims (which were treated like property claims) arise when the loss was incurred. It follows that the limitation period for claims against reinsurers in respect of liability claims and expenses/property losses would start at markedly different times.

Discussion

If it is the case that reinsurers of property risks are liable from the date when property is lost or damaged, this would result in the limitation period expiring rather earlier than might have been anticipated. This could cause difficulty for reinsurers in a chain of reinsurances, assuming each of them is to be regarded as being liable from the moment property is lost or damaged. This is because, by the time a claim reaches higher levels, six years may have expired from the date of the original loss and the reinsurer's right to claim against its own reinsurer may have already expired.

The difficulty outlined above could be avoided by reinsureds insisting upon appropriate language in their property reinsurance/retrocession covers. The language might have the effect of ensuring that, as a matter of contract, it is agreed that the limitation period shall be treated as starting only when the reinsured's liability is ascertained. Alternatively, reinsureds could protect their positions by obtaining "standstill" agreements from their reinsurers/retrocessionaires, suspending the operation of the limitation period.

In the absence of satisfactory reinsurance wordings or agreement to a standstill, reinsureds will have to commence proceedings to protect the limitation period from expiring. They may be required to take this step at a stage where they may have limited information on the quantum of their claim.

The possibility cannot be ruled out that some reinsurers may seek to exploit the position by claiming that property losses are time barred on the expiry of 6 years from the property being lost or damaged, notwithstanding that their reinsureds have limited information about the claim and their liability is yet to be quantified.