I have outlined major trends and problems in the regulation of financial services. Many of them point towards the need for a more homogeneous regulatory system, built on the Financial Services Act when it comes into force. But the desirability and practicability of this is nevertheless open to question; that will be the next great debate on regulation.

5. UPDATE ON REINSURANCE LAW
by Gordon Cornish
The Victory Reinsurance Co. Ltd.

In his magnum opus "Reinsurance: Principles and Practice" Dr. Klaus Gerathewohl of the Munich Reinsurance Company makes the bold assertion that, of all sources of reinsurance law, judge-made law is by far the least significant. Well, that may be the case in the Federal Republic, where arbitrations seem to take care of any lack of harmony between cedant and reinsurer, but over here the activity of our Commercial Court and Court of Appeal in reinsurance matters over the past few years has been nothing if not impressive.

It was in February 1984 that the landmark decision in CTI v. Oceanus has a look at what a material fact is within Section 18 of the Marine Insurance Act of 1906.

The Court's decision was taken in the context of marine insurance, but in April this year Mr. Justice Steyn in the Commercial Court was faced in the case of Highlands Insurance Company v. Continental Insurance Company with a similar question, but this time in the context of non-marine reinsurance. So: Did the CTI test now apply to non-marine reinsurance as well?

The dispute arose out of a claim which had led reinsurance to investigate the loss and which investigations has caused them to avoid the contract on the grounds of material misrepresentation.

His Lordship held that the matter which was misrepresented i.e. that the premises concerned were sprinklered, was a fact which a prudent reinsurance underwriter would have taken into account in his underwriting assessment and so he held the contract to have been validly avoided.

The defendants had also argued that, even if there was material misrepresentation, the plaintiffs were precluded from avoiding by, inter alia, an Errors and Omissions Clause which has been contained in the original policy and which, it was alleged, was incorporated in the reinsurance contract.

First of all His Lordship said that the language of the clause was not apt to follow its incorporation into the reinsurance contract. He then added that it would be "quite inconceivable that it was intended to apply to a risk which was materially misrepresented." He was quite satisfied that it would not apply in any event to a pre-contractual material misrepresentating, which entitled the reinsurers to avoid on the grounds of misrepresentation.

In the case of Edmunds v. Lloyd Italico and ADAS (1986) 1 Ll. Rep. 326 the plaintiff Lloyd's syndicate had reinsured certain risks with the defendants. These fell due in April and August 1979 when the defendants failed to pay what was due. In October 1982 the plaintiff issued a writ claiming £10,046 and $46,752 together with interest.

Mr. Justice Leggatt at first instance described what happened – or, rather, did not happen – as "a highly successful programme of prevarication." In March 1985 solicitors on behalf of the defendants submitted two drafts in settlement of the plaintiff's claim in the above action.

Now, the plaintiff's solicitors replied by accepting the sums in settlement of the principal sums whilst at the same time asking what the defendants intended to do about the interest question and costs. "No instructions" was the reply.

Judgement was duly given for the full amounts together with interest and the defendants appealed.

In the Court of Appeal Sir John Donaldson emphasised first of all that a claim under a contract of insurance was a claim for damages for breach of contract rather than a claim in debt.

He then went on to deal with the possibility that payment of an amount of damages might extinguish the cause of action. He pointed out, however, that, although payment in full of a debt extinguishes the cause of action, this is not so in the case of payment in full of an amount of damages; in such a case the court still has the power to give judgement on liability and to assess both damages and interest, although it must take into account any payment already accepted by the plaintiff.

The case of Vesta v. Butcher (1986) 2 All E.R. 488 dealth with the following situation:

The Norwegian insurer Vesta had insured a salmon and trout farm against loss of fish from any cause whatsoever. The policy contained a condition that

a 24 hour watch on the cages was to be kept, but the fish farmer knew that he could not keep that condition and so he told Vesta. Vesta then told the broker who had placed the reinsurance on an "as original" basis, but the broker failed to tell the reinsurer. In September 1978 a storm destroyed some cages and thousands of fish were lost.

Vesta effected a compromise settlement and turned to the defendant reinsurer for indemnity but the reinsurer declined, maintaining that consent to the settlement had not been given which meant that Vesta had been in breach of the Claims Control Clause contained in the original policy which stated that "no payment, offer or compromise shall be made without the consent of underwriters".

An action was therefore brought against the reinsurer and Mr. Justice Hobhouse held first of all that the original insurance policy was subject to Norwegian Law although the reinsurance contract was subject to English Law. His Lordship went on to hold that it was quite possible, where the parties could be held to have intended it, for a reinsurance contract, which is subject to English Law, to be interpreted subject to the construction and effect of certain relevant clauses being determined in accordance with another system of law. This was the point with reference to the 24 hour watch condition because, although in Norwegian Law the breach of such a condition gave the defendent reinsurers no defence to the plaintiff's claim for indemnity in the absence of a nexus between the breach and the loss, in English Law breach of that type of condition would have granted a valid defence.

In reaching his decision His Lordship followed the Court of Appeal in ICA v. SCOR (UK) and held:

"Where a reinsurance contract contains a provision requiring the reinsurers to follow the settlements of the reassured, a consent and control of the negotiations clause is a qualification of that provision. Thus reinsurers are not under an obligation to follow settlements if made without their consent. If the consent has not been obtained then the reassured must prove his loss, that is to say, prove his legal liability under the policy of original insurance to the original assured... if he succeeds, he has proved his loss and may, subject to other defences, recover under the reinsurance contract".

Finally, a brief look at a recent case which, although not technically a reinsurance dispute as such, did deal with a problem which is very common when a reinsurance dispute erupts.

The case is South Carolina Insurance Co v. Seven Provines, Al Ahlia and Arabian Seas Insurance Company and it is a House of Lords decision of 29 July 1986.

When an action is commenced, reinsurance being the world-wide business it is, it can often be very difficult for the parties to obtain access to certain documents which they feel they need to have to enable them to prepare their case adequately.

A U.S. Insurer, United National, had reinsured with South Carolina who in turn had retroceded to the defendants. But when South Carolina called upon the defendants to settle some claims, they were faced with a refusal. An action in the Commercial Court was duly commenced, but the defendants were up against a difficulty: They were very remote from the actual facts in dispute and so they approached the underwriting agency involved in the U.S.A. for permission to inspect some documents out there to enable them quite simply to prepare a full defence. However, South Carolina, when asked by the agency, refused permission.

They then decided to do something about solving their problem and applied to the District Court in Seattle for an order against the underwriting agents and the loss adjusters concerned for production of documents and appearance of three named persons to give testimony by deposition.

South Carolina duly applied to our Court for an injunction restraining the defendants from taking any further steps before the U.S. Court and this injunction was granted by Mr. Justice Hobhouse, his decision being later affirmed by the Court of Appeal.

Well, up the case then went to the House of Lords where it was decided that the use of the foreign discovery rules under these circumstances did not represent unconscionable conduct on the part of the defendants and so no injunction was granted in accordance with Section 37 (1) of the Supreme Court Act 1981 restraining them from proceeding with their U.S. action.