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INSURANCE AND REINSURANCE
NewsWire

November 2011

Recent Cases May Signal a Trend For U.S. Courts to Accord Insurers Increased Rights to Object to the Institution of an Asbestos Settlement Trust

By Howard Seife, David Raim, Donald Mros and Francisco Vazquez

An article by the National Underwriter Company discusses a recent Moody's report that asbestos claims are again on the rise after years of declining or flat claims.[1] This has led several insurers to increase their asbestos reserves and Moody's views this trend as a warning flag for the property and casualty insurance industry as a whole.

One major means of addressing asbestos claims has been through an asbestos settlement trust implemented under section 524(g) of the United States Bankruptcy Code (the "Bankruptcy Code"). These trusts are typically funded by insurance recoveries assigned to the trusts by a debtor in a chapter 11 bankruptcy case. Nevertheless, courts have previously concluded that insurers do not have the right to object to these trusts, because the chapter 11 plans that create them are "insurance neutral." As reflected in two recent decisions, however (and despite the purported insurance neutrality of a chapter 11 plan), a court may allow an insurer to object to an asbestos trust where the plan ultimately proves **not** to be insurance neutral, either because of the circumstances surrounding the plan or the plan's provisions.

Background

In connection with a chapter 11 plan, a court may issue a "channeling injunction" under section 524(g) of the Bankruptcy Code, enjoining parties from asserting asbestos-related claims against a debtor and channeling such claims into an asbestos settlement trust.

As of March 2011, 56 asbestos settlement trusts have been implemented on behalf of companies in chapter 11. The largest 26 trusts have paid out / continued page 2

[1] Phil Gusman, *Moody's: Recent Increase in Asbestos Claims a Warning for U.S. Insurers*, http://www.propertycasualty360.com (Aug. 15, 2011).

IN THIS ISSUE

1 Recent Cases May Signal a Trend For U.S. Courts to Accord Insurers Increased Rights to Object to the Institution of an Asbestos Settlement Trust

5 U.S. Insurers and Producers Gain Free Trade Advantages

8 The Scope of a "Follow The Leader" Clause Under English Law

9 Reinsurance Contracts – The Devil is in the Detail

12 Recent News – UK

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Asbestos Settlement Trust

continued from page 1

$10.9 billion to 2.4 million claimants through 2008.[2] Most recently, asbestos settlement trusts have been implemented in connection with the Thorpe Insulation Company and the General Motors chapter 11 cases. More asbestos trusts are in the pipeline.

Although asbestos trusts are often funded primarily through substantial insurance recoveries assigned to them by the debtor, courts have held that insurers do not have the legal right or standing to object to the implementation of these trusts. According to a line of decisions, insurers lack standing, or the requisite legal harm, to voice their objections where the plan is found to be "insurance neutral." A plan is considered "insurance neutral" where the assignment of insurance proceeds to a trust does not increase an insurer's pre-petition obligations or impair their pre-petition contractual rights under the insurance policies. The decisions discussed below should be considered by insurers in reviewing future proposed asbestos trusts that purport to preserve insurance neutrality.

"Although asbestos trusts are often funded primarily through substantial insurance recoveries ... courts have held that insurers do not have the legal right or standing to object to the implementation of these trusts."

I. Global Industrial Technologies, Incorporated Decision

A. Lower Court Decisions

In 1998, Global Industrial Technologies, Inc. ("GIT") acquired A.P. Green Industries, Inc. ("APG"), a manufacturer of refractory and other industrial products. Beginning in the 1980s, APG faced substantial asbestos-related claims as a result of its use of asbestos in some of its products. APG also faced silica-related claims (from another component of some of its products), although on a far smaller scale. As a result of the asbestos-related claims, in 2002, GIT and certain subsidiaries including APG (together, the "GIT Debtors") filed for relief under chapter 11 of the Bankruptcy Code.

The GIT Debtors proposed a plan that provided for two separate trusts, one for asbestos-related claims under section 524 (g) and one for silica-related claims under a separate section of the Bankruptcy Code.[3] The GIT Debtors' rights in certain insurance policies could be assigned to either the asbestos or the silica-related trust. Insurers ("Objecting Insurers") whose coverage was to be assigned to the

[2] Lloyd Dixon & Geoffrey McGovern, *Asbestos Bankruptcy Trusts and Tort Compensation*, Rand Institute of Civil Justice, at 1 (2011).

[3] Although section 524(g) is expressly limited to asbestos-related claims, some courts have approved of the use of an injunction and a trust to address other mass tort liabilities under other sections of the Bankruptcy Code.

silica-related trust objected to confirmation of the bankruptcy plan.

Under the Bankruptcy Code, a court could confirm a plan that implemented a silica-related trust only after a showing that the channeling injunction for the silica-related claims was both necessary to the reorganization and fair. Accordingly, the GIT Debtors had to show that the silica-related liability was sufficiently onerous to imperil the GIT Debtors' reorganization, if not resolved through the silica-related trust and channeling injunction. APG, though, had few silica-related claims prior to its bankruptcy. In order to satisfy the requirements of the Bankruptcy Code, the GIT Debtors solicited votes for their plan from counsel for individuals who had asserted claims, not against the GIT Debtors, but against an unrelated company in bankruptcy. Thereafter, the GIT Debtors were flooded with silica-related claims. The GIT Debtors then obtained the votes in favor of their plan from the requisite majorities of asbestos and silica-related claimants.

The Objecting Insurers argued that the GIT Debtors' plan should not be confirmed because the silica-related claims were inflated due to collusion. The GIT Debtors' plan included an insurance neutrality provision based upon Third Circuit precedent which provided that: "nothing therein or in Plan-related documents or in the Bankruptcy Court's confirmation order would preclude those insurers from asserting any rights or defenses under the policies, except those related to 'anti-assignment provisions.'"[4] In confirming the GIT Debtors' plan, the bankruptcy court ruled that the Objecting Insurers did not have the requisite standing to challenge the reorganization plan, because it was "insurance neutral" in that it preserved the insurers' rights and defenses. The bankruptcy court's decision was affirmed by the district court and subsequently appealed to the Third Circuit.

B. Third Circuit Decision

In a 5-4 decision, the Third Circuit held that the Objecting Insurers had standing to object to confirmation of the GIT Debtors' Plan on the issue of whether the plan was insurance neutral.

/ continued page 4

[4] *In re: Global Indus. Techs., Inc.*, 645 F.3d 201, 206 (3d Cir. 2011).

IN OTHER NEWS

Erin Callahan, International Partner

The London insurance practice continues to develop its additional strength in the areas of corporate, transactional, regulatory and risk management work.

Erin Callahan is a corporate lawyer with a decade of experience representing foreign private issuers in capital market transactions. She has also advised companies extensively on corporate governance issues and has counseled numerous international companies with regard to issues concerning directors and officers insurance, risk exposures, indemnification agreements and various insurance protections. Building on that experience, she joined Chadbourne & Parke's Corporate Governance and Risk Oversight team in July 2011.

Erin recently spent four years as Deputy Director and Head of the Legal Projects Team at the International Bar Association. While there, her team launched a global project alongside the UNODC and the OECD on fighting corruption in the legal profession.

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Asbestos Settlement Trust

continued from page 3

Citing its prior decision in *In re Combustion Engineering, Inc.,* the Third Circuit noted that a chapter 11 plan is insurance neutral if it does not materially increase the quantum of liability faced by insurers.[5] In this instance, the Debtors' solicitation of silica-related claims and the promise of the silica-related trust resulted in a significant increase in the number and amount of silica-related claims asserted against the GIT Debtors. Indeed, this solicitation "staggeringly increased — by more than 27 times — the pre-petition liability exposure" and was therefore potentially not insurance neutral. Moreover, notwithstanding the contingent nature of the claims, the availability of coverage defenses and the possibility that the Objecting Insurers would never be required to pay a claim, the GIT Debtors' plan harmed the Objecting Insurers by burdening them with increased administrative costs and investigative burden in handling the additional claims. The Third Circuit remanded the case to the bankruptcy court to conduct a more thorough review of the collusion issue.

II. The Pittsburgh Corning Corporation Decision

A. Insurers' Objections Due To Lack Of Insurance Neutrality

Pittsburgh Corning Corporation ("PCC") is an insulation and glass block manufacturer that is owned by PPG Industries, Inc. ("PPG") and Corning Incorporated ("Corning"). PCC faced numerous asbestos claims due to its prior manufacture of the insulation product, Unibestos, which contained asbestos fibers. By the time of its bankruptcy filing in 2000, PCC had resolved over 200,000 claims at an aggregate cost of $1.2 billion but was still faced with over 235,000 unresolved asbestos claims. Although Corning and PPG did not manufacture Unibestos, they were also faced with Unibestos-related claims based on alleged derivative liability due to their ownership interest in PCC (the "PCC Relationship Claims"). Corning and PPG were also subject to a limited number of their own asbestos claims that did not involve PCC or Unibestos.

Along with the Unibestos-related claims against PCC, the chapter 11 plan of PCC provided for the channeling of the PCC Relationship Claims into the PCC Asbestos Trust. The chapter 11 plan also attempted to preserve PPG's and Corning's claims against their insurers for their independent asbestos claims. The PCC Asbestos Trust was funded by PCC recoveries on certain insurance policies. Almost all of PCC's insurers reached settlements with PCC and with PCC's parent companies regarding the PCC Relationship Claims. These settling insurers were included within the scope of the channeling injunction.

Certain non-settling insurers, however, opposed confirmation of the chapter 11 plan because, among other things, the plan was not insurance neutral. According to the non-settling insurers, the insurance neutrality provision that sought to preserve the insurers' rights and defenses was rendered incomprehensible by being made subject to a host of other bankruptcy plan provisions and related agreements that sought to protect the claims of PCC's parent companies. The non-settling insurers further argued that it was unclear whether the insurance neutrality provision superseded or was subject to the qualifying provisions. According to the non-settling insurers, the plan therefore did not preserve insurance neutrality as required under Third Circuit precedent and could not be confirmed.

B. Decision of the Bankruptcy Court

According to the bankruptcy court, the insurance neutrality language in a bankruptcy plan must be consistent with the analysis in In re Combustion Engineering and cannot be subject to a multitude of qualifications that create ambiguity about whether the insurers' policy rights and defenses are preserved.

Ultimately, the court concluded that it was not clear whether the insurance neutrality provision in the PCC Plan took precedence over other plan provisions that conceivably would impair the pre-petition contractual rights of the insurers. Thus, the court held that the non-settling insurers had

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[5] *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

standing to object to confirmation of the PCC Plan. After considering the non-settling insurers' objections, the court agreed with them that the PCC Plan did not satisfy the requirements of insurance neutrality and that the channeling injunction was overbroad - and therefore refused to confirm the PCC Plan. Nevertheless, the court allowed the plan proponents to propose a fourth modified plan in accordance with its decision. [6]

Conclusion

The *GIT* and *PCC* decisions may provide guidance to insurers in deciding whether a future proposed plan of reorganization with an asbestos settlement trust is insurance neutral.

In *GIT*, insurers were accorded standing to object to the plan even though it included an insurance neutrality provision that followed the *In re Combustion Engineering* precedent. This provision was rendered meaningless, however, by the alleged collusion between the Debtors and certain claimants that resulted in a material increase in silica-related claims.

In *PCC*, the neutrality provision was similarly rendered meaningless, not by collusion, but by the terms of the plan itself. A neutrality provision must be clear that the insurers' rights
and defenses under a plan are preserved and not subject to qualifications that may make these provisions ambiguous or unclear. As illustrated by these cases, an insurer may be able to demonstrate sufficient harm and standing to object to the implementation of asbestos trusts despite the efforts of plan proponents to keep insurers at bay by the inclusion of neutrality provisions. ◎

[6] *In re Pittsburgh Corning Corp.*, 453 B.R. 570 (2011).

U.S. Insurers and Producers Gain Free Trade Advantages

By Richard Liskov

In a rare example of bi-partisan Congressional action, President Obama has recently signed legislation to implement three free trade agreements between the U.S. and, respectively, Colombia, South Korea and Panama. Each agreement specifically addresses insurance services, including direct insurance, reinsurance, brokerage and such ancillary services as actuarial consulting and risk management.

Although the agreements broadly commit the U.S. to treat insurance firms from these three countries equally with U.S. firms, all of the agreements contain reservations and exceptions which allow the current restrictions on foreign players embedded in various U.S. state insurance laws to remain in force. By contrast, the agreements specifically commit Colombia, South Korea and Panama to open their insurance markets to U.S. firms within four years. As was the case with the 1995 services agreement negotiated by the World Trade Organization, insurers and producers from outside the U.S. must still contend with 54 separate sets of regulations, including barriers to non-U.S. firms, while American insurers and producers will enjoy greater access to foreign markets.

The Broad Strokes

Each agreement contains a separate article for financial services, which includes *"all insurance and insurance-related services"* that are provided by financial institutions and cross-border insurance providers.

Within the insurance category are: direct insurance of life and non-life, reinsurance and retrocession, insurance intermediation and such auxiliary services as actuarial, risk assessment, claims settlement and */ continued page 6*

Free Trade Advantages

continued from page 6

consultancy. Each signatory undertakes to accord insurance financial institutions, and investors in such enterprises, *"treatment no less favorable than that it accords to its own financial institutions and to investments of its own investors in financial institutions, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments."* Thus, U.S. insurance regulators are supposed to treat Colombian, Panamanian and South Korean insurers no worse than they treat U.S. insurers.

As to cross-border trade in the insurance sector, the agreements provide that each party shall permit certain direct insurers, along with reinsurers and producers, to operate from the other party's territory. The types of direct insurance which can be provided on a cross-border basis are (i) maritime shipping, commercial aviation, and space satellites (including insurance on goods being transported). However, the agreements do not require the parties to allow an insurance company or producer of the other country to solicit and do business in their respective nations.

"The [free trade] agreements provide that each party shall permit certain direct insurers, along with reinsurers and producers, to operate from the other party's territory."

Besides equality of treatment, the agreement also requires each party to accord investors and firms of the other party *"treatment no less favorable than it accords to the investors, financial institutions,... and cross border financial service providers of a non-Party"*, i.e., another country. In addition, the agreements prohibit a party from enforcing any measure as to the other party's institutions operating in its country that imposes limits on the number of financial institutions, the total value of financial service transactions, and the total number of persons which may be employed in a particular financial service sector, such as insurance. Nor may a party require the other party's financial institution to conduct business in its territory through a specific type of legal entity, i.e., a corporation or partnership.

The Fine Print

Despite the seemingly fulsome language promising equality of treatment and *"most favored nation"* status to players in each nation's insurance market, the agreements allow the signatories to adopt and maintain laws which conflict with those commitments *"for prudential reasons, including for the protection of investors, depositors, [and] policyholders ... or to insure the integrity and stability of the financial system."* (emphasis added). According to each agreement, "prudential reasons" concern safety, soundness, integrity and financial responsibility of financial institutions and cross-border service suppliers.

Parties cannot use these non-conforming measures to evade otherwise applicable commitments made in the agree-

ments. Nevertheless, it would be difficult for a South Korean insurer, for example, to argue that a state law such as Section 1315 of the New York Insurance Law requiring it to place its reserves in a trust located in the U.S. to secure claims of U.S. policyholders — as a condition of having its U.S. branch licensed in New York — is not a *"prudential"* measure intended to protect policyholders. Such a requirement would therefore be permitted under the agreement, notwithstanding the broad language guaranteeing equality of treatment between U.S. and South Korean insurance companies.

Then there are the reservations which each country expressed in the annexes to the agreements. The United States' specific reservation as to insurance covers *"[a]ll existing non-conforming measures of all states, the District of Columbia, and Puerto Rico."* Effectively this insulates such laws as the current credit for reinsurance requirements of every state, which require foreign reinsurers to post collateral for 100% of reinsurance liabilities. Indeed, when the Office of the United States Trade Representative prepared a summary of each agreement for Congress, the summary of the provisions dealing with financial services stated explicitly: *"Existing non-conforming U.S. state and local laws and regulations are exempted ..."*

Another indication of the one-sided nature of the insurance provisions can be seen in the specific commitments made by South Korea, Colombia, and Panama, in contrast to the absence of any similar undertaking by the U.S. The agreement with South Korea commits that nation to undertake specific measures to open its insurance market, such as permitting U.S. insurers to offer any product or service that is not specifically prohibited or restricted by regulation and requiring South Korea to expedite regulatory approvals for these products. By contrast, the only commitment made by the United States for liberalizing its insurance market is to note the efforts of state insurance regulators and the National Association of Insurance Commissioners to reform U.S. state insurance laws.

The agreements with Colombia and Panama contain a similar dichotomy between the vague U.S. promise to consult and the specific undertakings by those countries to allow entry to their respective insurance arenas. Colombia commits to allowing branches of U.S. insurers to open in Colombia within four years. The U.S. merely commits to consulting with the NAIC about repealing state laws which prohibit branches of non-U.S. insurers from licensure in those states. Similarly, Panama agreed that any U.S. insurer applying for approval of a new product will receive a decision within 30 days of the day the filing is complete; the U.S. merely said it would consider ways of streamlining product approval.

The Likely Implications

So long as individual states remain the primary regulators of U.S. insurers, these recent agreements will do little to remove the barriers to market entry that the states have erected against foreign firms. By contrast, these agreements and similar ones with other trading partners afford significant opportunities to American insurers and producers to compete in emerging markets.

The advantages that U.S. players receive from these pacts will not significantly change until Congress votes to federalize insurance regulation. The newly-established Federal Insurance Office (FIO) enjoys the theoretical power under the Dodd-Frank Act to declare as "preempted" a state law which unreasonably bars foreign insurance firms from operating in a state. That process requires, however, protracted consultation with state regulators and, so far, there is no indication that the FIO or the Administration has any appetite to confront individual states in this way.

Although eager to override state laws governing health insurance which could interfere with the smooth implementation of President Obama's signature health-care legislation, opening U.S. states to foreign insurance companies is simply not a priority for his Administration. Without significant and sustained pressure on federal decision-makers from foreign insurers, reinsurers and producers to remove the reservations and narrow the exceptions dealing with insurance in these agreements, there is little prospect for change. In the interim, U.S. insurers, reinsurers and producers can look forward to significant new global opportunities. ◎

The Scope of a "Follow The Leader" Clause Under English Law

By Mark Pring

In a recent decision of the English Commercial Court (*P. T. Buana Samudra Pratama v Marine Mutual Insurance Association (NZ)* Ltd [2011] EWHC 2413 (Comm)), Mr. Justice Teare rejected the claimant tug owner's application for summary judgment in respect of a claim against one of its insurers (MMI).

The dispute focused in particular on the scope of a "follow the leader" clause in the relevant marine insurance policy (the "Policy") and the decision offers useful guidance on a number of related issues.

The Policy

The Policy was underwritten by Axa (as lead), Aegis and MMI.

Under the Policy, it was agreed that Aegis and MMI would *"follow Axa in respect of all decisions, surveys and settlements regarding claims within the terms of the policy, unless these settlements are to be made on an ex gratia or without prejudice basis."*

The Policy allowed the tug to be employed in operations relating to the loading or discharging of cargo at sea from or into another vessel. It permitted the tug to assist and tow vessels in distress, but also incorporated a warranty that *"the Vessel shall not ... undertake towage or salvage services under a contract previously arranged by the Assured"* and separately stated that it would be *"Held covered in case of any breach of warranty as to ... towage ... provided notice be given to the Underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed."*

The Facts

In 2005, a tanker owned by a company related to the claimant ran aground on its approach to an oil terminal in

"MMI's position was that it was not liable to meet its share of the CTL claim because, in breach of the Policy warranty, the tug had been engaged to provide towage and/or salvage services to the tanker. In response, the tug owner asserted that MMI was contractually obliged to follow Axa's settlement."

Indonesia. The insured tug was sent to tow the tanker to shore to allow for tank cleaning and repairs, but in the course of this journey the tug also ran aground.

The tug was declared a constructive total loss (CTL) and Axa (followed by Aegis) subsequently paid the claim on that basis. Before doing so, Axa expressly rejected MMI's request for it to confirm that any payment would be made on a "without prejudice" basis.

MMI's position was that it was not liable to meet its share of the CTL claim because, in breach of the Policy warranty, the tug had been engaged to provide towage and /or salvage services to the tanker. In response, the tug owner asserted that MMI was contractually obliged to follow Axa's settlement (and, in any event, that there was no breach of warranty).

The Liability Issues

MMI considered that the follow clause only obliged it to follow a settlement where a claim fell **within** the terms of the Policy, i.e. to follow as to quantum; it did not require MMI to follow Axa where it disputed its liability for the claim based on the alleged breach of warranty.

MMI also argued that it was discharged from liability because the owner had fraudulently misrepresented to MMI (after Axa's settlement) that it never intended the tug to tow the tanker.

The Decision

On the key question of the interpretation of the relevant follow clause, the Judge found that it obliged MMI to follow Axa's settlement as to both liability and quantum. There was no indication on the face of the Policy that the parties intended to restrict the scope of the follow clause to the quantum of claims that otherwise fell within the terms of the Policy.

Further, the Judge held that the clause applied even in circumstances where (as in this instance) it was alleged that there had been a breach of warranty that occurred before the date of the decision or settlement. A contrary decision would significantly reduce the "efficacy" of the follow clause and frustrate its commercial purpose

As a consequence, the Judge did not need to decide whether MMI had a real prospect of establishing a breach of warranty. He noted, however, that there was no breach of warranty involved in merely agreeing to undertake towage operations and only at trial could it be determined whether towage had actually commenced at the time of the loss — albeit he considered that MMI had a real prospect of success in this regard. ◎

Reinsurance Contracts – The Devil is in the Detail

For many years, it was not uncommon in the London Market for "slips" to be agreed by underwriters with the full wording "TBA" or "to be agreed". Days, weeks, months and years passed by and the full wording was never finalised. Years later, disputes were not uncommon as to what terms the parties to the reinsurance contract had actually agreed. For example, where the slip referred to an "Arbitration Clause", which clause was it referring to? There are numerous arbitration clauses used in the London Market so the actual wording of the arbitration clause that the parties (or more likely the broker) had in mind is often far from clear. Sometimes slips would refer to a particular clause as being "attached" but no wording for the clause was ever attached.

The London Market recognised that radical changes to the agreement of wordings had to be made. First proposed in 2004, so-called "Contract Certainty" brought about an end to the "deal now, detail later" culture. It ensured the complete and final agreement of all terms between reinsured and reinsurer at the time they enter into the contract, with the reinsurance contract wording provided shortly thereafter.

Contract Certainty means that the market practices of the past have been stamped out and there is now always a reinsurance wording for contracts written in the London Market. However, the perennial problem of / *continued page 10*

Devil is in the Detail

continued from page 10

"Many of the facultative wordings agreed by the London Market have been developed based on clauses used for many years ... Where the governing law of the reinsurance contract is not English law, caution needs to be exercised to ensure that the terms agreed between the parties are valid and effective under the governing law chosen by the parties."

incompatible clauses being written into the reinsurance contract remains.

The most notable example in facultative reinsurance contracts is the inclusion of a follow the settlements clause (often as part of a "full reinsurance clause") or a follow the fortunes clause in the same contract as a claims control or claims cooperation clause.[1] A follow clause and a claims control clause cannot co-habit in the same reinsurance agreement. The effect, for instance, of a follow the settlements clause is that reinsurers agree to follow the reinsured's settlements (provided they fall within the reinsurance as a matter of law and the reinsured has taken proper and businesslike steps to settle the claim). By contrast, a claims control clause means that reinsurers have the right to take over conduct of the underlying claim against the reinsured and **no** settlement can be reached by the reinsured without reinsurers' consent.

The conflict between such clauses has been considered by the English courts on a number of occasions. The 1985 decision of the Court of Appeal in *Insurance Company of Africa v. SCOR* in England held that the relevant claims cooperation clause overrode any follow settlements or follow the fortunes obligation. The rationale for this, at least in the London market, is that the claims cooperation obligation emasculates the effect of the follow obligation, such that the reinsured

[1] Depending upon the jurisdiction, the term "claims cooperation clause" can cause confusion. The focus in this article is on the London Market's use and understanding of such a clause, whereby it normally requires a reinsured both to cooperate with its reinsurer in the handling of a claim **and** to obtain the reinsurer's approval to any settlement (and in the case of a claims control clause, to allow the reinsurer to take over the negotiations). We are aware, however, that in the United States a claims cooperation clause does not normally require the reinsured even to follow the reinsurer's guidance.

has to prove it was under a liability to the original insured under the insurance policy before it can recover from reinsurers. In 1989, the House of Lords in *Vesta v. Butcher* was also faced with (on this occasion) the juxtaposition of a follow clause with a claims control clause. Here, the claims control clause was ignored and the follow clause took priority. Despite these English court rulings and their obvious incompatibility, follow clauses and claims control clauses are still found, on a not infrequent basis, in the same reinsurance contract.

A further problem is that the parties often pay insufficient attention to what the governing law of the reinsurance contract should be. Many of the facultative wordings agreed by the London Market have been developed based on clauses used for many years, taking into account English law principles and a large body of English court decisions regarding what these clauses mean. Where the governing law of the reinsurance contract is not English law, caution needs to be exercised to ensure that the terms agreed between the parties are valid and effective under the governing law chosen by the parties. For example, where the parties agree that Peruvian law applies to a reinsurance contract, the Peruvian Commercial and Civil Codes will apply. The Commercial Code includes a follow the fortunes obligation on reinsurers. Because it is part of the code, there is no need to include a follow obligation in the reinsurance contract. This means that even where no follow obligation is included in the reinsurance wording, reinsurers may still be under an obligation to follow its reinsured's fortunes.

A similar problem arises when the reinsurance contract provides that compliance with an all-important clause such as a claims control clause shall be a condition precedent to reinsurers' liability. If the contract is not governed by English law, the local governing law may not in fact recognise conditions precedent to liability. This is the case in many Latin American countries. In this context, the claims control clause may be rendered ineffective and reinsurers may not be able to escape liability for a claim if the claims control clause is breached. It may be possible to re-draft the standard London Market condition precedent (such as the claims control clause) to increase the likelihood of the clause being enforceable in a local jurisdiction. However, ensuring that the reinsurance contract is governed by English law is a far more effective solution.

Reinsureds and reinsurers need to ensure that they fully understand the implications of the governing law that they agree — the law that they have chosen may not give full effect to the terms included in the reinsurance contract. Equally, the reinsurance contract may be subject to terms that are not expressly included in the wording and this may override the contractual bargain that the parties believe that they have agreed. ◎

(The original version of this article was circulated by Michelle George and Christopher Cardona of the London office in a series of seminars in Latin America in September 2011.)

RECENT NEWS — UK

On 1 November 2011, the Serious Fraud Office (SFO), an independent government department in the UK, launched "SFO Confidential", an on-line service for confidential reporting of fraud or corruption. Anyone in an organisation, or connected with it through the conduct of business or provision of professional services, and with some inside knowledge of suspect practice, is encouraged to contact the SFO by way of this service.

In the next edition of *NewsWire* we will be looking at global fraud affecting the insurance and reinsurance sector. The identification of fraud can be obvious in straightforward cases of theft, obtaining property by deception and misappropriating funds, but in cases where the fraudulent activities are intertwined with day-to-day dealings, the identification of such activities can be more difficult.

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