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# Reinsurance contracts and back to back presumption

A comparative study between English and Norwegian law

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## Preface

I would like to thank the Scandinavian Institute of Maritime Law for the challenging, interesting and worthful opportunity of been enrolled in the LLM in Maritime Law programme.

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Author

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# 1 Introduction

## 1.1 The topic

The purpose of this thesis is to analyse and make a comparative study of how back to back presumption affects reinsurance contracts under English and Norwegian law.

Back to back can be defined as a rule of construction[1] by which in appropriate circumstances the wording of the reinsurance agreement is to be construed in the same way as the wording of the underlying policy.

Back to back cover is achieved if it was intended by the parties in the outset of the reinsurance agreement and if incorporation of terms laid down in the underlying policy are incorporated into the reinsurance agreement successfully. Incorporation is carried out by a full reinsurance clause or other incorporating words.

The discussion on whether or not two contracts are back to back is always interconnected with the contract wording. That way, the most suitable way to discuss the back to back principle is to discuss firstly the full reinsurance clause, incorporation, and then back to back principle conditions, scope, and limits.

Thus, I will firstly investigate the full reinsurance clause and incorporation. It is very common that a reinsurance agreement incorporates terms of the underlying policy. This is often made by means of a full reinsurance clause or by incorporation words such as “as original“ to the underlying policy, i.e., the terms of the underlying policy will be incorporated into the reinsurance agreement.

Common terms that might be subject to incorporation are coverage, warranties, and more rarely claims. Dispute resolution terms are in general not incorporated.

A concept that overlaps incorporation is the back to back presumption. So, if two contracts are rendered back to back, one contract incorporates terms of other one, and the incorporated terms in the reinsurance contract will hold the same meaning as in the underlying policy. It is very useful when, for example, the

[1] Or rule of interpretation

underlying policy and the reinsurance contract are governed for different laws. When back to back presumption is applied the reinsured is being guaranteed with the highest degree of protection.

Once back to back presumption is addressed, I will approach the follow the fortunes and follow the settlements, claims cooperation and claims control clauses. Such clauses are laid down exclusively in the reinsurance agreement and regulate the relationship between the reinsured and the reinsurer. These clauses can also have their application affected by the back to back presumption.

Follow the settlements and follow the fortunes clauses establish that the reinsurer will follow the payments made by the reinsured to the direct assured. This decreases overheads as less litigation is expected on the ground that the reinsurer will have lesser room to deny indemnification to the reinsured.

In the other hand, claims cooperation and claims control clauses gives to the reinsurer the right to influence the claims negotiation, adjustment, and settlement to be made by the reinsured. This is desired where the reinsurer assumes a large portion of the underlying risk as reinsurance.

As I will be discussing the backing of an underlying policy by a reinsurance agreement, it is also necessary to address what are an insurance contract and a reinsurance one.

An insurance contract is a risk transfer agreement from the assured to the insured in return of money as consideration (premium). If a peril insured against strikes some interest covered under the contract then the insured become liable to indemnify the assured. The interest covered by the contract varies as agreed upon. It can be a ship or the liability arising out a ship collision for example. As a starting point in English law the parties under an insurance contract are the assured and the insurer, but there can be other parties who benefits from the agreement, as a third party under a liability insurance policy. In Norwegian terminology the parties are the insurer and the person effecting the insurance, as in The Act relating to Insurance Contracts (The Insurance Contracts Act – ICA 1989) § 1-2 and as in the Nordic Marine Insurance Plan of 2013 (NP) § 1-1.

Reinsurance holds some similarities to insurance. Reinsurance also purports risk transfer between two parties. Two parts agree that one party will indemnify the other party if some event agreed upon in the reinsurance agreement implies in loss for the second party. In a reinsurance contract the insurer in the direct

insurance policy reinsures the risk to another insurer, the reinsurer, thus making the direct insurer the reinsured and the further insurer the reinsurer .

Reinsurance refers to insurance of an interest undertook upon an underlying policy. This underlying policy can be either an insurance or a reinsurance policy. If there is no underlying policy there is no reinsurance, but direct insurance.

As mostly reinsurance legal sources are in English law this thesis will mostly handle with English law. Similarities and differences with Norwegian law will be presented.

Finally, back to back related to reinsurance agreements is an interesting topic as it is in general desired that the backing provided by the reinsurers attaches so close as possible to the underlying policy. And this maximum attachment is achieved by means of the back to back presumption. It has an economic interest as it decreases litigation and in the very end the main beneficiary will be the direct insured as, if the direct insurer is able to recover from the reinsurer, then such direct insurer will be less likely to become insolvent and will be able to indemnify such direct assured under the direct insurance policy.

## 1.2 The outline of the thesis

The thesis analyses how the back to back presumption influences the relationship between the underlying policy and the reinsurance agreement. It will be discussed the scope, limitations, requirements, and what terms can have this meaning changed by the back to back presumption.

Chapter 2 presents reinsurance definition, purposes, and the different methods. This point is very important as the law may change depending on the reinsurance method.

Chapter 3 provides an overview of the legal sources on reinsurance law discussed in this thesis.

Chapter 4 discusses the concept of full reinsurance clause, incorporation, back to back presumption, and their relationships. It will also be shown the terms that may be incorporated by means of incorporation words, and to what extent they might be incorporated. Such terms are coverage, warrants, claims, and dispute resolution provisions.

Chapter 5 handles with follow the settlements and follow the fortunes clauses. According with those following clauses the reinsurer is obliged to follow the adjustments and settlements made by the reinsured

Chapter 6, finally, refers to claims control and claims cooperation clauses. Such clauses give to the reinsurer the right to influence the adjustment and settlement of claims of the reinsured. It will be discussed their rationale, scope, limitation, and how they can be influenced by back to back principle. Also it will be assessed a possible conflict as between claims and following clauses.

# 2 Reinsurance and reinsurance methods

## 2.1 Reinsurance definition and purposes

Before defining reinsurance I will define insurance as the former just can be understood if the later is properly introduced.

An insurance contract in English law is a contract entered into by one party (insurer) that promises in return for a money consideration (premium) to pay the other party (assured) a sum of money or to provide a specific benefit to him upon the occurrence of some event as agreed upon in the insurance policy[2].

In Norwegian law there is a distinction between the assured and the person effecting the insurance. The former is the party entitled to compensation under a insurance contract, and the later is the party who enters into a insurance contract with an insurance company[3].

The agreed event will generally be a loss incurred into by the assured. The assured is the one who buys insurance, and the insurer is the party who sells insurance.

Reinsurance is a similar operation to insurance as it is also an agreement where the reinsurer promises in return for a reinsurance premium as consideration to pay a reinsured a sum of money upon the occurrence of some event as agreed upon in the reinsurance contract.

The reinsured can reinsurer a part or the entirety of a single policy, or a whole portfolio, i.e., the totality of single policies that compound one of his business lines.

The laying off of a risk by means of reinsurance has traditionally three main goals.

The first one is to enable the reinsured to undertake larger risks, as policies with higher sum insured, or a higher number of smaller policies. So long as the reinsured can rely on the capital base of the reinsurer, reinsurance increases the

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[2] Prudential Insurance Co. v. Inaland Revenue Commissioners [1904] 2 K. B. 658
[3] ICA 1989 § 1-2, NP § 1-1

capital of the reinsured and, therefore, his capacity of accepting risks is increased. There is a connection between the capital base and the liability exposure: if the capital base is higher, the reinsured can increase his exposure by undertaking higher sum insured policies. For example, if a reinsured has a capital base of 1 billion nok and the reinsurer has a capital base of 4 billion nok, the reinsured will able to rely on a capital base of 5 billion nok and therefore will be able to accept larger risks.

Secondly, reinsurance ameliorates financial stability of the reinsured by means of absorbing accumulated losses or a single catastrophic loss. If reinsurance is agreed upon then losses will be shared between the reinsured and the reinsurer. That way, in case of 1 billion nok loss the reinsurer and the reinsured will share the loss as agreed upon in the reinsurance contract. If there is no reinsurance then the reinsured will bear the loss by himself. It is not desirable as it can interfere in the companies financial results and even in his solvency.

Thirdly, the solvency of the reinsured is ameliorated because the solvency parameters are based on the ratio of the size of reinsured's net assets to all risks he has taken. As the reinsured can rely on the reinsurer capital base the reinsured's net asset is boosted by reinsurance and, therefore, the solvency is ameliorated. That is the reason why reinsurance is not just risk transfer but also the spreading or sharing of risks over an extended capital base[4].

Finally, if reinsurance is not ceded by a direct insurer but by a reinsurer, the operation is so called retrocession. The company that buys reinsurance is the retrocedant. The company that accepts such retrocession transaction is the retrocessionaire. Retrocession is subject to the same rules as regular reinsurance as retrocession is just a special nomenclature to a specific kind of reinsurance transaction, or else, when the reinsured is other reinsurance company. It is possible to find some extra reinsurance levels by means of retrocession. An example of that is the International Group pool reinsurance programme, programme designed to be the reinsurance agreement to P&I Clubs[5].

[4] O'Neil (2010) pp.4-5
[5] See more in http://www.igpandi.org/Group+Agreements/Pool+reinsurance+programme+2013-14

## 2.2 Reinsurance methods

Reinsurance can be classified by means of two main distinctions[6]. Reinsurance can be either proportional or non proportional, or facultative or treaty reinsurance. The first distinction refers to how premium and losses will be shared between reinsured and reinsurer. The second distinction refers to if the reinsured will cede to the reinsurer a single risk, for example a single hull marine insurance policy, or if the reinsured will cede to the reinsurer a portfolio as a whole, for example every hull marine insurance policy that the reinsured has undertaken. So, there are 4 different and possible combinations: proportional facultative, non proportional facultative, proportional treaty, and non proportional treaty reinsurance.

### 2.2.1 Proportional and non proportional reinsurance

#### 2.2.1.1 Proportional reinsurance

Proportional reinsurance implies that reinsurer's share on premium and claims recover will be the same. Proportional reinsurance can be either quota share or surplus as follows.

##### *2.2.1.1.1 Quota share reinsurance*

It is the simplest form of reinsurance. The reinsured and the reinsurer agree to share a fixed proportion of a single risk or a whole portfolio. Both of them bear the same proportion of the losses as well. In return the reinsurer will receive the same proportion of the premium. It is a very simple method and requires very little administration and accounting. For example, the parties can agree that for every policy undertaken by the reinsured, the reinsured will retain 20% of the premium and therefore he will be obliged to pay 20% of the losses, and the reinsurer will be entitled to 80% of the premium but will be liable to pay 80% of the losses in the same way.

##### *2.2.1.1.2 Surplus reinsurance*

[6] Carter (2000) pp. 181-238

In surplus reinsurance the reinsured only reinsurers the portion of each risk that exceeds his own retention. Beyond this retention the reinsurer will receive the proportion of the premium and will be liable for the same proportion of the claims.

So, if the reinsured establishes that his retention is 1 million nok, when he undertakes a 2 million nok policy the exceeding 1 million nok will be reinsured and the reinsurer will be entitled to 50% of the premium. Conversely, if the same reinsured undertakes a 4 million nok policy then 3 million nok will be reinsured and the reinsurer will be entitled to 75% of the premium.

The main difference between surplus and quota share reinsurance is that in quota one the percentages undertook by reinsured and reinsurer are fixed, and in surplus reinsurance the reinsured's retention is fixed.

#### 2.2.1.2 Non proportional reinsurance

In non proportional reinsurance the reinsurer undertakes to indemnify the reinsured against the balance of any losses occurred in a single risk or in a portfolio as a whole in excess of an agreed amount under the reinsurance agreement. In general the reinsurer's liability is also subject to an upper limit. It is common that excess of loss reinsurance is arranged in layers.

There are some different types of non proportional reinsurance.

##### *2.2.1.2.1 Excess of loss reinsurance per risk*

In such a reinsurance type the reinsured will bear every claim up to the deductible upper limit agreed upon the reinsurance contract and will be able to recover from the reinsurer every time a loss exceeds the deductible. This method is not designed to protect the reinsured against an accumulation of many losses throughout an underwriting year. For example, in a 5 million nok policy the reinsured establishes he will bear a first layer (so called deductible to the reinsurance contract) of 1 million nok and the 4 million nok left will be reinsured. In case of three distinct losses of 800.000 nok, 1 million nok and 1.5 million nok the reinsured will just be able to recover 500.000 nok from the reinsurer in the third loss and will be obliged to pay from his own reserves 800.000 nok, 1 million nok and 1 million (2.800.000nok in total) to the direct insured, plus the 500.000 nok recovered from the reinsurer.

##### *2.2.1.2.2 Excess of loss reinsurance per occurrence or per event*

Under this method the reinsurer will indemnify the reinsured when the latter's liability exceeds an aggregate net loss agreed upon the reinsurance contract and covered in the underlying policy. Such method is desirable whenever a portfolio of risks is exposed to any catastrophic event that might give rise to many individual claims. Generally a catastrophic event affects more than one interest under the same reinsurance contract, for example, vehicle and property insurance, and takes place within a restricted period; such a period is defined in a *hours clause*[7]. An example of catastrophic event is a huge flood that causes damages both to property and to vehicles parked.

*2.2.1.2.3 Stop loss or excess of loss ratio*

This reinsurance protects the reinsured against an unexpected variance in the aggregate loss ratio in his whole portfolio. Loss ratio is a proportionate relationship of incurred losses to earned premiums. It is expressed as a percentage. For example, reinsured and reinsurer can agree upon that if the loss ratio over a whole reinsured portfolio (e.g., all hull marine policies) exceeds 80% then the reinsured can recover from the reinsurer. It shall be noted that there is no cover for individual losses; instead of it, the reinsured can recover from the reinsurer if the loss ratio exceeds a threshold agreed upon in the reinsurance contract.

### 2.2.2 Facultative and treaty reinsurance

It was shown thus far that reinsurance can be either proportional or non proportional. Besides, reinsurance can be bought to a single risk or to a portfolio as a whole. Therefore, there are four possible combinations as stated in the subchapter 2.2.

In facultative transactions reinsurance is bought to a specific single underlying policy. Facultative reinsurance implies in higher administrative costs as every single reinsurance transaction has to be negotiated between the parties. In treaties a whole portfolio is negotiated all in one and therefore the overheads are lower.

Nevertheless, facultative reinsurance is a desired solution to very large risks as oil platforms and rigs as a very large capacity is required. In general so large risks exceed any treaty reinsurance compensation limit. Facultative reinsur-

[7] Carter (2000) pp. 411-414

ance is also useful where reinsurance is sought for commonly excluded perils insured against by the reinsurance treaty but not by the underlying policy. In other words, if it is not be possible to attach an underlying policy into the reinsurance treaty due to some exclusion laid down in the reinsurance treaty, it can be made by means of facultative reinsurance.

In treaty reinsurance the reinsured and reinsurer undertakes that the reinsured is obliged to cede and the reinsurer is obliged to accept every risk within a whole reinsured's portfolio. Nevertheless, the reinsured can cede to the reinsurer just risks that fall within the treaty terms. For example, if the reinsured has in his portfolio 10 hull policies which 5 refer to insurance against marine perils and 5 refer to insurance against war perils and the reinsurance treaty has an exclusion to war perils, thus just the 5 insurance policy against marine perils policies can be ceded to the reinsurance treaty.

Two forms of reinsurance that lies midway between facultative and treaty reinsurance are the so called facultative obligatory and open cover reinsurance. In such methods the reinsurer enters into an agreement with either a broker or a insurance company to accept all reinsurance offered that conforms to the conditions set out in the agreement. If the agreement is entered into with a broker so the agreement is called open cover, if it is entered into with a direct insurer it is called facultative obligatory reinsurance. Nevertheless, neither the broker nor the insurance company are obliged to offer any risk for reinsurance during the period of the agreement.

# 3 Legal sources

The rules applicable to reinsurance contracts in England and in Norway are the relevant legal framework of this work. Therefore English and Norwegian law are the proper legal basis for the reinsurance clauses analyzed hereinafter. As said in the Introduction, such clauses are the full reinsurance clause, follow the settlements and follow the fortunes, and claims control and claims cooperation clauses, and their relationship with the back to back principle.

Norwegian legal system is a civil law system and the English is a common law one. Therefore, the legal methods differ and the systems will be addressed separately.

## 3.1 Legal Sources in Norway

### 3.1.1 Statutes

As starting point there is no Reinsurance Act in Norway.

There is an Insurance Contract Act (ICA 1989). This Act could be deemed as the best starting point regarding background reinsurance law, but it is not, as follows.

ICA is divided into two main parts. Part A is applicable to casualty insurance and part B is related to life and health insurance. Nevertheless, as per in § 1-1 and § 10-1, ICA 1989 does not apply directly to reinsurance.

ICA 1989 could be deemed as background law to reinsurance for historical reasons. There are some references to reinsurance in the Insurance Contract Act of 1930 (ICA 1930). As starting point, ICA 1930 §1 establishes that such Act is not applicable to reinsurance. Nevertheless, in articles §1, §45, §63, and §87 the word reinsurance is addressed. So, it may be deemed that ICA 1930, that was superceded by ICA 1989, regulated reinsurance in some aspects

However, even though ICA 1989 may be deemed as to regulate reinsurance for historical reasons, its content is not rendered as a good starting point to reinsurance as it is very consumer friendly law. The same argument was at stake

to justify the grounds on why ICA is not applicable to marine insurance to ocean going ships. Shipowners are much more professional players than other groups of assureds and therefore ICA would not be a good starting point[8]. The same argument can be used to reinsurance as reinsured and reinsurers are highly professionalized and big companies as general rule.

### 3.1.2 Reinsurance standard condition

There is no Norwegian standard wording to reinsurance contracts with so wide acceptance as there is, for example, the standard Norwegian wording to marine insurance, the Nordic Plan (NP).

Reinsurance is a quite international issue and therefore reinsurance contracts generally are based on international and standardized forms.

Nevertheless, NP portraits an important role with regard to reinsurance regulations in Norway as to background law[9].

NP is an agreed document between insurance companies, ship-owners, adjusters, and other professionals engaged in the marine insurance field. It provides a well elaborated, detailed, and comprehensive framework for marine insurance policies. Its periodical revisions align it to the newest international market practices.

Part one of the NP provides general rules and parts two to four consist of conditions for different marine insurance types.

One cannot say that the Plan is directly applicable to reinsurance. First of all, the insurable interests are different. Secondly, the clauses contained in the Plan are not applicable to reinsurance but to insurance. Therefore, the Plan as a whole is not applicable to reinsurance.

However, the Plan is deemed as to a better starting point to reinsurance background law rather than the consumer friendly ICA[10].

The first reason that explains why the Plan is suitable as to reinsurance background law is historical. The Norwegian Marine Insurance Plan 1871 contained some references to reinsurance. In particular, §25 stated that reinsurance

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[8] Wilhelmsen (2007) pp.27-28
[9] Vibe (2006) pp.41-47
[10] Actually, in §1.1 (4) and §10.1 (4) it is expressly stated that ICA does not apply to reinsurance

and the underlying police were presumed to be back to back. Furthermore, §3(4) states that the insurance undertook by a insurer is likewise deemed as insurance. The old references to reinsurance raises the presumption the Plan may be used as background law to reinsurance.

Secondly, insurance and reinsurance contracts deals with issues with some similarities. Both are often international commercial contracts. When both contracts came to existence they were both related to marine risks[11].

Thirdly, NP can be a more desirable source law for reinsurance dispute resolution than ICA 1989 when it comes to Norwegian law. NP deals with assets of high value, or else, ship and other floating structures, and such assets are subject to a professional insurance management. This is the same factual background as in reinsurance market as reinsured and reinsurers are highly professionalized companies. ICA 1989 is more consumer friendly and its set of regulation does not resemble to commercial contracts regulation. Furthermore, NP is built based on the regulation laid down in ICA 1930, which actually did apply to reinsurance.

In order to the NP rendered as standard condition to reinsurance, it has either to be incorporated into the reinsurance or the parties must have agreed so. Nevertheless, even though if it does not happen, NP can still be deemed as declaratory law[12] and therefore it can be used as a starting point as background law to reinsurance.

### 3.1.3 Case law

Case law, i.e., decisions held by courts and arbitration awards are of high interest with regard to reinsurance as reinsurance is a very international activity and with a high number of standardized contracts available. Arbitration awards in Norway are often published in ND[13]. Case law helps to clarify and explain specific problems.

Nevertheless, there are quite a few decisions in Norway on reinsurance.

For that reason, English decisions are of interest in Norway. Firstly, the international nature of reinsurance influences the Norwegian legal approach on such

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[11] The Chartered Accountant. June 2004. http://www.tarikbrahimi.com/reinsurance/reinsurance.pdf [last visit 12-10-2013]
[12] Vibe (2006). P.42
[13] Law Report on Maritime Law Decisions from Nordic Countries

contracts[14]. Secondly, in ND1995-447 the Oslo Court expressly stated that the Norwegian legal practice should not depart from English one. So, foreign decisions on reinsurance are of interest in Norway as long as Norwegian sources on reinsurance are quite bare.

## 3.2 Legal sources in England

### 3.2.1 Statutes

England has developed no Reinsurance Act. As in Norway, general contract law is applicable to reinsurance contracts. In particular, insurance law is applicable to reinsurance as background law.

The Marine Insurance Act 1906 (MIA 1906) is the main English regulation on insurance. Common law on insurance, as developed in the nineteenth century, was codified in MIA 1906. So, even though there are provisions in MIA 1906 that were especially designed to marine insurance, there also are general provisions that can be used as reinsurance background law as, for example, provisions on material non disclosure (Section 18). Such a provision can be extended to all insurance and insurance related fields[15].

Furthermore, Section 9 addresses the word *reinsurance* while establishing the legality of reinsurance in England and also that the direct assured has no right or interest against the reinsurer as insurance and reinsurance are different agreements. Such direct references imply that MIA 1906 is applicable as reinsurance background law.

> 9. Re-insurance
> (1) The insurer under a contract of marine insurance has an insurable interest in his risk, and may reinsure in respect of it.
> (2) Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.

[14] Meidel (2006) p.205
[15] O'Neil (2010) p.330

### 3.2.2 English standard conditions

England has a long term tradition in reinsurance. The most traditional reinsurance centre in the world is Lloyds that gathers in the same place various different underwriters.

For such reason the English market has developed throughout the years a big variety of standardized reinsurance clauses that have been used in the whole world and especially when transactions evolves an English party. Standard clauses as full reinsurance, follow the fortunes and follow the settlements, and claims cooperation and claims control clauses can be found in online databases[16].

### 3.2.3 Case law

As I addressed before case law is of highly interest in England. In a common law system previous case law is the basis for solving future disputes.

In English law there is a high number of decisions related to reinsurance as the reinsurance market is quite huge in England and litigation is very common, in particular on facultative reinsurance.

## 3.3 Legal literature

Legal literature is also a source to analyse reinsurance contracts in England and in Norway even though case law, as in English law, and statutes, as in Norwegian law, play a more important role. Such literature collaborates to gather information in order to analyse the complex problems related to reinsurance and to assess the scope of applicable rules.

There is a huge variety of English books published on reinsurance. It is a direct consequence of the importance of reinsurance in English economy. In Norway there is quite a few publications on reinsurance, and often authors use English cases combined with Norwegian ones to support their ideas.

[16] As in www.reinsurancelaw.org/

# 4 Back to back cover

## 4.1 Relationship between the reinsurance contract and the underlying policy

In the previous chapters I defined insurance, reinsurance, the purposes of laying down reinsurance, the different reinsurance methods. I also defined the relevant legal sources, and how reinsurance is regulated under English and Norwegian law.

In this chapter I will discuss the relationship between the underlying policy and the reinsurance contract by focusing in the full reinsurance clause, incorporation, back to back presumption, and their similarities and differences as well.

The full reinsurance clause provides that underlying policy and reinsurance will operate according with the same terms, and that the reinsurer will follow the settlements of the reinsured. This clause is in general found in facultative reinsurance agreements.

Incorporation means that terms laid down in one contract will be incorporated into other contract. Incorporation in reinsurance is operated by full reinsurance clause or by any other incorporating wording in the reinsurance agreement, e.g. “as original”. An example of incorporation clause in reinsurance treaty is as follows:

> Cessions under this Treaty shall be subject to the same clauses, conditions and premiums as the original insurances and the liability of the Reinsurer shall always be identical with that of […][17]

A further effect of full reinsurance clause is to render the underlying policy and the reinsurance agreement back to back in proportional facultative contracts. Or else, terms incorporated into the reinsurance agreement are supposed to assume the same meaning as in the underlying policy. That way, back to back principle overlaps incorporation. It constitutes the highest degree of protection to the reinsured and it is very useful when the two contracts are governed by different laws. If the underlying policy and reinsurance contracts are governed by different

[17] Wilhelmsson (1976) p. 44.

laws, different considerations may be raised with regard to how an incorporated term will be interpreted. In one hand the reinsurer may prefer the incorporated term to be interpreted according the governing law of the reinsurance contract. In the other hand the reinsured may prefer the incorporated term to be interpreted according the governing law of the underlying policy. This issue is solved by the back to back principle: the incorporated term will be interpreted according the governing law of the underlying policy.

However, the back to back presumption is mainly restricted to proportional facultative reinsurance[18] in English law. Back to back is a presumption as long as facultative reinsurance is deemed as back to back as a starting point, and the contrary must be proved in order to disregard such presumption. So, in one hand, there is a general presumption that a proportional facultative reinsurance is back to back to back to the underlying policy. On the other hand, there is a general presumption that non proportional reinsurance and treaty reinsurance are not back to back to the underlying policy. In Norwegian law the presumption the presumption is restricted to proportional reinsurance, and not to proportional *facultative* reinsurance as in English law. So, in this sense, I assess that the back to back presumption regarding reinsurance contracts in Norway is broader than the one in English law as in Norway both proportional facultative and proportional treaty contracts are comprised by the presumption.

In this chapter all this issues will be discussed. I will approach firstly the full reinsurance clause. Secondly, incorporation. And, finally, the back to back presumption.

## 4.2 Full reinsurance clause

The modern wording of the "full reinsurance clause" is typically as below[19]:

> Being a reinsurance and warranted same gross rate, terms and conditions as and to follow the settlements of the company... and to follow the settlements

[18] O'Neil (2010) p.133
[19] Merkin (2007) p.174

The word “warranted” does not create any warranty. Instead, the meaning of the word “warranted” is that some terms of one policy is simply incorporated into other one.

Incorporation can also be carried out by the very usual phrase in slips placing proportional facultative reinsurance “subject to the same terms as original…”. Often is abbreviated to “as original”. Such statement is also rendered as a full reinsurance clause and has the same effect of incorporating into the reinsurance contract some terms of the direct policy.

This clause apparently purports to render the contract of reinsurance back to back with the underlying policy. Nevertheless, just the laying down of a full reinsurance clause does not suffice. Some additional requirements have to be fulfilled: the incorporation must be carried out successfully and it must be intention of the parties to render the contracts back to back. Such issues will be discussed below.

## 4.3 Incorporation

### 4.3.1 Definition and conditions

The meaning of incorporation in a reinsurance context is that some terms of the underlying policy are incorporated into the reinsurance agreement by means of a full reinsurance clause or by incorporation words.

Incorporation is carried out by a full reinsurance clause as the one stated in subchapter 4.2 or by other incorporating words.

Incorporation is not a concept exclusive of reinsurance. It does happen in other fields such as maritime and construction contracts.

There are four main conditions to be satisfied before a term of the direct policy is deemed to be successfully incorporated into the reinsurance agreement. Such conditions were laid down by David Steel J. In *HIH Casualty and General Insurance Ltd v. New Hampshire Insurance Co*[20], a facultative reinsurance.

The term must be:

1) Germane to the reinsurance.

[20] [2001] Lloyd’s Rep. IR 224

2) It makes sense in the context of reinsurance. Some linguistic manipulation is allowed: e.g., where it is written “assured”, it can be read “reinsured”

3) Consistent with the express terms of reinsurance

4) Apposite for its inclusion into the reinsurance agreement.

One further issue should be noted. It has to be shown that the incorporated term was part of the underlying policy at the time the reinsurance agreement was entered into. It might cause problems if the underlying policy wording has not been agreed at the outset of the reinsurance contract, as it is often the case[21]. A case of this type is *Excess Insurance Co. Ltd v. Mender*[22].

The incorporation of terms of the underlying policy into the reinsurance agreement has as outcome that the reinsurers are held liable to the full extent that their reinsured have been liable to as in the underlying policy.

### 4.3.2 Consequences of incorporation

There are two possible consequences of the incorporation of a term from a direct policy into a reinsurance agreement.

1) The term of direct policy is incorporate into the reinsurance agreement as part of the latter contract as if it was written into the reinsurance contract. So, the relationship between the reinsured and the reinsurers will be governed by such a term. Some permissible linguistic manipulation is allowed as rewriting *insured* per *reinsured*, and *insurer* per *reinsurer*.

2) The term of the direct policy does not form a part of the reinsurance agreement so as to influence the legal relationship between the parties. Instead, such a term will be understood as a statement of circumstance in which the reinsured will face liability. So, by means of incorporation the reinsurers will thereby acknowledge that they will indemnify the reinsured if the conditions under this statement of circumstances are met. If this kind of incorporation is at stake, no wording manipulation is required as long as the incorporated term makes perfect sense as it stands[23]; conversely, as long as the term is not written into the reinsurance agreement but it is kept as a statement of circumstances, no wording ma-

[21] Merkin (2007) p.175
[22] [1995] L.R.L.R 359
[23] Merkin (2007) p.176

nipulation is required. In other words, the reinsurer will be obliged to indemnify the reinsured every time the latter faces liability as consequence of such term, but this incorporated terms will not regulate any aspect of the legal relationship as between reinsured and reinsurer.

Nevertheless, there are clauses in the underlying police where manipulation of language is not deemed feasible and, therefore, the reinsurer cannot be subject to even with manipulation of language as replacing "insured" by "reinsured" and "insurer" by "reinsurer". Examples of clauses in the underlying contract the courts have held not to have been incorporated into the reinsurance are period[24] and notice provisions[25], jurisdiction[26], arbitration[27], and choice of law[28] clauses.

Besides, the incorporation in the manipulated form gives to the reinsurer all defences available to the reinsured on the underlying policy against the direct policy holder as the terms of the clause will in fact be part of the reinsurance agreement. The reinsurer will have such defences even though the reinsured has failed to oppose then to the policy holder[29].

Incorporation in the manipulated form has a limitation regarding with the back to back presumption. First of all the incorporated term has to make sense in the reinsurance context. Secondly, if the contracts are rendered back to back, the incorporated clause cannot enable the reinsurer to raise defences totally unconnected to the underlying policy as it would mischaracterize the back to back cover In *HIH Casualty and General Insurance Ltd v. New Hampshire Insurance*[30] the direct policy contained a waiver of rights clause in case of misrepresentation or non-disclosure by the reinsured's named brokers. The reinsurance agreement was "as original". The reinsurers then alleged that the reinsured's brokers made false statements and purported to avoid the policy. The reinsured tried to recover from the reinsurers as in his view the waiver of rights had been incorporated into the reinsurance contract and therefore the reinsurers were not entitled avoid the policy

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[24] Home Insurance Co of New York v Victoria-Montreal Fire Insurance Co [1907] A.C. 59
[25] Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd [1996] L.R.L.R. 265
[26] AIG Europe (UK) Ltd v The Ethniki [2000] Lloyd's Rep I.R. 343
[27] Excess Insurance v Mander [1995] L.R.L.R. 358
[28] Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd [1999] Lloyd's Rep. I.R. 472
[29] HIH Casualty and General Insurance Ltd v. New Hampshire Insurance Co. [2001] Lloyd's Rep. IR 596
[30] Co. [2001] Lloyd's Rep. IR 596

by misrepresentation. The Court of Appeal held that the waiver of rights did not protect the reinsured. Among other reasoning, it was stated by the Court that the waiver of rights were not incorporated in its manipulated form and thus such term could not be invoked upon the relationship between the reinsured and the reinsurer. The incorporation was not accepted by the Court as, firstly, the waiver of rights in the underlying policy addressed the name of the reinsured's brokers and no language manipulation could make it fit for being incorporated into the reinsurance agreement. Secondly, if the reinsurers were prevented to avoid the policy for misrepresentation of the reinsured's brokers this would lead to a waiving of rights totally unconnected to the underlying risk and therefore would maculate the back to back presumption.

In the next four subchapters I will discuss incorporation of terms in English law, and in the subchapter 4.3.6 I will address incorporation in Norwegian law.

### 4.3.3 Incorporation of coverage

It is the main purpose of the full reinsurance clause to incorporate into the reinsurance agreement the coverage terms. They are the most important incorporated terms as the reinsured will rely upon them in order to require reimbursement from the reinsurer. As I have already shown incorporation is operated by the full reinsurance clause.

Nevertheless, there are some restrictions on it.

Firstly, if the reinsurance terms are self contained and expressly different from the ones laid down in the underlying police incorporation may not be possible. A further restriction arises where the underlying policy coverage wording is so unusual that it would not be possible to the reinsurer to anticipate it and therefore incorporation is not possible.

In *Maritime Insurance Co. v. Stearns*[31] the underlying cargo insurance policy contained a "held covered clause" that stated that in case of deviation of the route: (1) the direct insurer would not be discharged of liability, and (2) the assured would be held liable to pay extra premium on the ground of the deviation.

> In the event of the vessel making any deviation or change of voyage it is mutually agreed that such deviation shall be held covered at a premium to be arranged, pro-

[31] [1901] 2 KB 912

> vided that due notice is given by the assured on receipt of advice of such deviation or change of voyage

This clause was considered unusual to a marine cargo policy by that time (1901) and then the reinsurers were discharged of liability. The main outcome from this decision is that if the coverage is extraneous to the insurance type so the reinsurer might be discharged of liability.

Secondly, if the underlying risk is altered or extended after the outset of the reinsurance agreement then the reinsurer cannot be bound by such an alteration. This issue was tried in *Wasa International Insurance Co. Ltd and AGF Insurance C. Ltd. v Lexington Insurance Co*[32]. As factual background the reinsured (Lexington) had previously been held liable upon the Washington Supreme Court to cover the assured's liability to losses occurred during nearly 50 years. The grounds for this ruling was the Perils Insured clause which stated "*...* all physical loss of, or damage to*...*". This wording was considered so broad that overrode the period clause that established the policy should cover just a three year period. So, the reinsured was held liable upon the US Court for losses of the assured in reason of damages occurred before, during, and after the three-year policy period.

The reinsurers Wasa and AGF claimed that they were not liable according English law and commenced proceedings in England against Lexington. They sought for a negative declaratory relief.

It was held that the reinsurers were not bound by the settlement as the reinsurance duration provision was expressed and established that the reinsurance duration was 3 years. The coverage scope of the underlying policy was broadened after the reinsurance agreement outset due to the US Court decision that interpreted the scope of coverage in a much broader way and that strongly extended the liability of the reinsured. Thus, pro-rata rule was applied and the reinsurers were just held liable for losses occurred within the 3 year reinsurance period. This outcome shows that the insurance and reinsurance contracts were not rendered as back to back.

[32] [2009] 2 Lloyd's Rep 508

### 4.3.4 Incorporation of warranties

In English law warranty is a contractual promise. A reinsured makes such a promise with regard to either a current state of affairs or to a future condition. A warranty is defined on Section 33(1) of the MIA 1906:

> 33(1) A warranty… means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.

In English law the compliance with a warranty is strict. Its breach discharges the reinsurers of liability. It is stated in MIA 33(3). Warranties are stringent terms.

The main issue on incorporation of warranties is that if warranties assume different meanings in the underlying policy and in the reinsurance agreement then the reinsurer will have defences against the reinsured that may not be open to the reinsured against the underlying policy holder.

The general positioning of English courts was that the reinsurer should not be able to rely upon a defence that was not opened to the reinsured and it is illustrated by the cases as follows.

A leading authority in this point is *Forsakringsaktielskapet Vesta v. Butcher*[33], a proportional facultative reinsurance. This case involved a Norwegian fish farm which obtained insurance from the claimants, a Norwegian insurance company. The direct policy was governed by Norwegian law and it was reinsured under a facultative reinsurance which contained the full reinsurance clause that performed incorporation of terms contained in the underlying policy into the reinsurance contract. The reinsurance contract was governed by English Law.

Vesta reinsured 90% of its liability under the policy with the defendant. Both the reinsurance and insurance contract incorporated expressly identical wording known as *Aquacultural Wording No. V*. Such a clause contained a warranty that 24 hours watch had to be kept under the whole site. Furthermore, the clause also contained the following statement: “Failure to comply with any of the warranties outlined hereunder will render this policy null and void. All warranties to be com-

[33] [1989] 1 A.C. 852

pleted at the assured's expense". The reinsurance contract contained a full reinsurance clause:

> Being a reinsurance of and warranted the same gross rate, terms and conditions as and to follow the settlements of the company and that the company retains during the currency of this policy at least the amount stated in the schedule as the retention on the identical subject matter and risk and in identically the same proportion on each separate part thereof but, in the event of the retention being less than that stated in the schedule, the underwriters' lines to be proportionately reduced.

The assured informed Vesta that he would not be able to comply with the 24 hour watchkeeping warranty. Vesta informed the brokers but nothing more happened.

The fish farm was destroyed by a storm. It was common ground that the assured had not maintained the 24 hour watch keeping. However, it was also common ground that even though the 24 hour watchkeeping had been maintained, the fish would be lost anyway. So, there was no causative connection between the live fish loss and the assured's negligence and therefore according with Norwegian law the reinsured would not be discharged of liability. However, there is no such a requirement under English law and as long as the reinsurance contract was governed by English law the reinsurers claimed themselves discharged of liability.

It was not disputed that all the parties had intended to build the reinsurance contract in a back to back basis to the direct policy.

At first instance it was held that the warranty in the reinsurance contract was governed by Norwegian law in reason of the full reinsurance clause. This approach was upheld by the Court of Appeal. It was also stressed that even though both contracts were governed by different laws, the warranties should be interpreted under Norwegian law so as to not open to the reinsurer a defence not available to the reinsured against the direct assured.

The House of Lords approached this case in the view of the back to back principle. The Court held that reinsurers were liable under the reinsurance policy that incorporated the underlying policy by the "as original" clause. Also, the reinsurance clause in the reinsurance contract rendered both contracts with the same cover; the warranties were to be rendered with the same meaning in both policies; the word "failure" was understood as "causative failure" in both contracts according with Norwegian law; and, finally, there was a presumption of back to back cover. Therefore, the reinsurers could not rely upon a defence not opened to the reinsured.

Other leading case on incorporation of warranties and back to back cover is *Groupama Navigation et Transports Continent SA v. Catatumbo Ca Seguros*[34], other proportional facultative reinsurance case. In this case it was discussed if a warranty under the direct policy could override an express warranty under the reinsurance agreement with a similar but not the same wording.

A fleet was insured in a hull and machinery policy whose governing law was Venezuelan one.

The defendant is a Venezuelan insurance company that issued a hull and machinery policy governed by Venezuelan law to a Venezuelan shipping company. The claimants are the reinsurers that issued a facultative reinsurance policy governed by English law.

The underlying policy incorporated some US classification provisions that aimed to guarantee the stated classification of the vessel and to terminate the policy in the event of a change of class. The reinsurance slip contained a clause on "All terms clauses conditions warranties... as original and to follow all decisions settlements agreements of same in every respect... Warranted existing class maintained". The direct policy contained the same warranty on "Guarantee of maintenance of class". The only difference between the warranties in the reinsurance agreement and in the underlying policy was that the classification society name was set out in the underlying policy.

During a storm two vessels were damaged and investigations proved the vessels had not been ever classified by a classification society.

Venezuelan law, as Norwegian law in *Vesta* case hereinabove, required a causative breach of warranty and so the reinsurers were held liable despite the breach of warranty. There is not such a requirement under English law.

If the reinsurers tried to rely upon *Vesta* case they would be defeated as in *Vesta* it was clear that the reinsurance agreement is supposed to follow the terms of the underlying policy by means of the back to back principle.

So, the reinsurers tried to differentiate this case from *Vesta* because, in their view, the reinsurance warranty was free standing, or else, it supports itself with an entirely different meaning of the warranty laid down in the reinsurance con-

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[34] [2000] 2 Lloyd's Rep. 350

tract, and to be construed as discharging them from liability as long as the reinsurance contract was governed by English Law.

The Court of Appeal refused such arguments.

The case was ruled to the defendant reinsured because, firstly, both warranty wordings were quite similar in both underlying policy and reinsurance agreement. If the wordings were very different there would be no incorporation, no back to back presumption, and the reinsurers would be able to rely upon the reinsurance express terms[35]. Secondly, the Court place emphasis on the back to back cover presumption on facultative proportional reinsurance contract. Such a presumption was sustained by the full reinsurance clause.

Tuckey LJ stated that if the parties intended the two warranties to be constructed with different meanings in the two contracts they should expressly said so. According with Mance LJ if the warranties were irreconcilable, or if there was no counter party warranty in the underlying policy to the reinsurance contract, different considerations could have arisen and both contracts could not be treated as constructed in a back to back basis.

This decision is criticized as long as the reinsurers were prevented to rely upon express reinsurance terms. Nevertheless, in this case the Court of Appeal ruled that primacy should be given to the back to back principle. I disagree with such criticism. Facultative reinsurance is a tailor made transaction and therefore the reinsurance has to cover the reinsurance in the same terms as the underlying policy every time it is possible. Reinsurance back to back cover should be denied just when the contracts are manifestly different.

### 4.3.5 Incorporation of claims conditions

Claims clauses in the underlying policy aim to regulate how claims will be handled by the reinsured towards the underlying policy holder.

Nonetheless, incorporation of claims clauses laid down in the underlying policy into the reinsurance agreement in general is not consistent with the reinsurance policy.

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[35] Merkin (2007) pp.186-187

Firstly, facultative reinsurance has its own claims conditions[36] and therefore incorporation of underlying claims conditions are not desirable. Secondly, direct insurance claims clauses generally have content suitable to his line of business, e.g., property or marine insurance, and reinsurance claims conditions generally resemble a liability cover as the reinsurer indemnifies the reinsured when the later incurs into liability. Thirdly, direct insurance claims conditions resemble words used in direct insurance claims, and such vocabulary does not match with reinsurance wording on claims conditions and therefore such language manipulation would be required to make such incorporation feasible.

In *Municipal Mutual Insurance Ltd v. Sea Insurance Ltd* [37] the underlying policy contained a condition whereby the assured should give immediate notice to the insured in case of loss. In the aftermath of a loss the reinsured failed to give notice to the reinsurer. So, the question that arose was whether or not the notice of claims condition was incorporated into the reinsurance agreement. The Court held that the notice of claims clause was not incorporated into the reinsurance agreement as it had been designed especially to deal with third party claims under a liability policy, and not with reinsurance claims.

Nevertheless, in *CNA International Reinsurance Co. v. Companhia de Seguros Tranquilidade*[38] *S.A.* the claims conditions were held as incorporated into the reinsurance contract. In this case the direct policy incorporated the Lloyd's Contingency wording. The facultative reinsurance agreement contained a full reinsurance and a reference that the coverage would be "as per Lloyd's Contingency Policy". Also, 90% of the underlying policy was reinsured in London market, and the policy looked like a fronting from the Portuguese insurers to the London market. The Court held that, firstly, the claims conditions were deemed neither onerous nor repugnant to the reinsurance contract. Secondly, the claims condition imposed on the assured in the underlying policy were incorporated into the reinsurance contract in its manipulated form, or else, by the device of substituting "assured" for "reinsured" and "insured" for "reinsured". Thirdly, the reinsurance and the underlying policy were rendered as back to back. So, as one can see, it was

[36] Claims control and claims cooperation clauses
[37] [1996] L.R.L.R. 265
[38] [1999] Lloyd's I.R. 289

needed some accumulation of facts to render the claims conditions as incorporated into the reinsurance policy so as to overwhelm the general presumption that claims condition are not incorporated into the reinsurance contract.

I reach two conclusions from the previous discussion. Firstly, it is very hard to a claim provision to be incorporated into the reinsurance contract. Further conditions have to be met and the assessment has to be made case by case. In *CNA* case the underlying policy incorporated a Lloyd's general wording, it looked like a fronting from the Portuguese insurers to Lloyd's, the contracts were constructed back to back, and the claims conditions were deemed as onerous to the reinsurance. The full reinsurance clause was not enough to incorporate claims provisions by itself.

Secondly, I believe it is desirable to reinsurers to lay down their own express reinsurance conditions in facultative reinsurance slips as expressly stating that the conditions to be followed are the ones in the reinsurance contract, and not the ones in the underlying policy, otherwise they might be bound by claims conditions in the underlying policy, what is not often desirable as they generally do not fit into a reinsurance agreement.

### 4.3.6 Incorporation of Dispute Resolution Provisions

Other kind of provision that could theoretically be incorporated into a reinsurance agreement are dispute resolutions provisions. Main kinds of dispute resolution provisions are arbitration clauses and choice of law clauses.

Nevertheless, dispute resolution provisions are not incorporated into the reinsurance contract. The main ground for it is that a party cannot be deprived of any means of defence in case of litigation. If a dispute resolution provision of one is incorporated into another then the access to courts might be lessened.

Regarding with arbitration clauses, it is an ancillary term and it is not incorporated by means of a full reinsurance which refers in general to terms and conditions. If it is intention of the parties to incorporate an arbitration clause they should expressly say so. This conclusion was reached in *Excess Insurance Co. v. Mander*[39].

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[39] [1995] L.R.L.R. 358

Choices of law clauses are not presumed to be incorporated as well. To such incorporation take effect would be required an express statement in the reinsurance agreement. Nevertheless, I doubt any reinsurer would be willing to be subject to a foreign law as general rule. In *GAN Insurance Co. Ltda v. Tai Ping Co. Ltd*[40] the direct policy was governed by law of Taiwan and there was no express choice of law provision in the reinsurance agreement. In various different points of the reinsurance agreement it was stated the reinsurance was "as original" to the underlying policy. The defendant reinsured claimed that the reinsurance agreement was governed by law of Taiwan by means of incorporation. The English reinsurers so seek a declaratory relief in England. The question that arose was if the English court would have jurisdiction over this case. The answer was yes. It was held that it would be not desirable for English reinsurers to lose the right of establishing proceedings in England in reason of a choice of law policy in the underlying policy

### 4.3.7 Norwegian law

In Norwegian law the phenomenon of incorporation into the reinsurance contract of underlying insurance conditions is also possible.

The incorporation of coverage terms in the underlying policy is also primarily important as the reinsurance scope of coverage should match the underlying policy one.

Furthermore, in Norway and in other markets, the reinsurance coverage provisions are quite short and broad and therefore must be supplemented by the provisions contained in the underlying policy

The first issue regarding with incorporation is how it is achieved. The incorporation phenomenon in Norwegian law is also operated by the expression "terms as original" or the like. In the same way as English law, incorporation of provisions of the underlying contract into the reinsurance one may lead to conflict of provisions.

The second issue refers to the moment incorporation takes effect in Norwegian law. Terms of the underlying police are incorporated at the moment the rein-

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[40] [1999] Lloyd's Rep. IR 472

surance contract is entered into[41]. Therefore, alteration or expansion of the scope of coverage of the underlying conditions after the reinsurance contract is entered into might discharge reinsurers of liability.

In this sense, in a Danish ruling of 24 May 2006 the reinsurer was discharged of liability as the reinsured expanded the original coverage without giving proper notice. It was added into the coverage scope damages caused to a shipyard crane due to storm after the reinsurance contract had been entered into. Such expansion was not a peril insured against at the time the reinsurance was agreed upon. Therefore, the scope of coverage was expanded and the Danish Supreme Court discharged the reinsurers of liability[42].

This same solution is found in the NP. As said in subchapter 3.1.2, NP is a source of reinsurance background law. § 3-8 defines alteration of the risk as "a change of circumstances which, according to the contract, are to form the basis of the insurance, and the risk is thereby altered contrary to the implied conditions of the contract". So, an extension of perils insured against is clearly an alteration of the risk under NP. The sanctions under NP is that the insurer (in a reinsurance context, the reinsurer, by means of manipulation of language) can be either discharged of liability if he would not accept the risk or have his liability reduced in a pro rata basis to the extent that the loss is proved not to be attributable to the alteration of the risk according with § 3-9. The insurer (reinsurer, after manipulation of language) can also cancel the policy by giving fourteen days' notice as in § 3-10. This provision is important as it sets out a general Norwegian mindset in case of an expansion of coverage without giving notice to the reinsurer.

In Norwegian mindset the main purpose of incorporating terms is to render the reinsurance contract and underlying policy back to back[43]. The rationale behind it is that the reinsured can recover from the reinsurer whenever the former incurs into liability for indemnification under the underlying policy.

In order to the back to back presumption be achieved a set of terms have to be successfully incorporated into the reinsurance agreement as terms and conditions of coverage, duration and warranties.

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[41] Meidel (2006) p.208
[42] U.2006.2421H.
[43] Vibe (2006) pp. 111-112

Regarding with such incorporation, there are two main types of disputes on it. The first one handles with whether or not a term was incorporated into. The second one deals with the impact of the incorporated term between the parties, or else, reinsurer and reinsured.

Regarding the first type of dispute, incorporation can lead to conflict between an incorporated provision and a explicitly agreed term. The general mindset is that the term expressly laid down in the reinsurance agreement should prevail. Besides, the reinsurance agreement can also contain a statement stressing that in case of conflicts the reinsurance wording has to prevail as, for example, this statement: “In the event of inconsistencies between the Original Policy and this Contract, this Contract shall prevail”. This mindset is supported by market practices of the international reinsurance market.

An alternative solution is to interpret the incorporating clause restrictively. So, if one clause of the underlying policy conflicts with an express clause of the reinsurance agreement so the former will be deemed as not incorporated at all. Anyways, the express term in the reinsurance agreement should prevail again.

Regarding the second type of dispute, there are two main views. The first one is that in one hand incorporation just establishes the reinsured’s rights and obligations upon the underlying policy and in the other hand such incorporation effect is to render insurance and reinsurance back to back. The second view is that the incorporated term may regulate the relationship between the reinsured and the reinsurer by means of language manipulation as changing replacing “assured” by “reinsured” and “insurer” by “reinsurer”.

As one can see this discussion in Norwegian law is a very similar discussion to the one in English law.

Actually, Kaja de Vibe sets out that there are four conditions to be met so that incorporation is successful[44]. And such conditions were extracted from *HIH Casualty and General Insurance Ltd v. New Hampshire Insurance Co*[45], the English case discussed in subchapter 4.3. So, I conclude, firstly, that the criteria for incorporation of reinsurance terms in Norway are quite similar to the criteria under

[44] Vibe (2006) pp. 115-116
[45] [2001] Lloyd’s Rep. IR 224

English law. Secondly, where Norwegian law is silent regarding with reinsurance law, English law can be used as complementary legal source.

## 4.4 Back to back cover

### 4.4.1 Definition, conditions and scope

Back to back cover with regard to reinsurance can be defined as[46] "a principle of construction of reinsurance agreements, which dictates that in appropriate circumstances the wording of the reinsurance agreement is to be construed in the same way as the wording of the underlying policy".

A principle or rule of construction in English law mindset is a rule used for interpreting legal instruments, especially contracts and statutes. Such a rule establishes either the ascertained intention of a contract containing an ambiguous term or establishes how a court should rule if the intention is neither express nor implied.

The principle of back to back cover is regarded as not being a rebuttable rule of construction only, i.e., a rule that can be disproved by evidence to the contrary. The modern court's sight is that they will seek to ensure that the cover provided by the direct policy and the reinsurance agreement are back to back whenever it is possible[47]. The rationale behind that is that a facultative reinsurance should attach as close as possible to the underlying policy in order to prevent a reinsured of being uncovered by his reinsurer. If reinsured is often deprived of coverage so there will be no motivation in buying reinsurance, and litigation will tend to high up.

Furthermore, back to back and incorporation are different concepts. The concept of back to back overlaps the incorporation one. Back to back is performed by means of incorporation. However, it has further effects than incorporation as back to back can even override express term of a reinsurance agreement by precluding reinsurers to rely on them as in *Groupama* case[48] discussed hereinabove.

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[46] Merkin (2007) p.195
[47] Merkin (2007) p.177
[48] [2000] 2 Lloyd's Rep. 350

I assess that the first step to back to back coverage to be achieved is the successful incorporation. The second step is to avoid terms manifestly contradictory in both reinsurance agreement\ and underlying policy; if the terms are manifestly different in both contracts it can be presumed that it was not intention of the parties to construct the contract as back to back and so the presumption does not apply. In other words, the presumption has to be cautious and depend upon the intention of the parties; if reinsurance and underlying contracts are different it can be deemed it was not intention of the parties to make both contracts back to back even though if there is an incorporation clause.

A further requirement is that the governing law must be known from the outset of the reinsurance agreement. It was held in *Wasa* case. Actually, if the underlying policy governing law is not known from the outset so the meaning of the underlying policy as a whole cannot be assessed. In fact, it is not possible to the reinsurers to agree upon a wording where they do not know the meaning. Therefore, any back to back presumption will be void in such a case.

Also, the back to back presumption has to be cautious. It was held in *HIH v. New Hampshire [2001] CA*. A cautious presumptions means that such presumption is not applicable where the reinsurance and the underlying police are evidently different. In other words, if the same provision is contained in both underlying and reinsurance policy but with very different wordings or it is not possible to assess if the parties have intended the provisions to hold the same meaning, then such provisions cannot be regarded as back to back.

The back to back cover is applicable in various situations[49].

First and foremost it is applicable to coverage terms, as these terms are the ones the reinsured is mostly interested in.

Secondly, it is also applicable to warranties, as discussed in *Vesta* and in *Groupama* cases.

Thirdly, the presumption at stake also handles with duration. In *Commercial Union Assurance Co. plc v. Sun Alliance Insurance Group plc*[50]the underlying policy contained a tacit renewal underlying. According with such clause the policy would be renewed unless a three month cancellation notice was given. The rein-

[49] Merkin (2007) p.196
[50] [1992] 1 Lloyd's Rep. 475

surance contract contained clause establishing the reinsurance duration as "12 months… with 120 days NCAD". NCAD is an abbreviation for Notice of Cancellation at Anniversary Date. In other words, if the reinsurance policy were to be cancelled then notice of cancellation should be given with 120 days in advance. The Court held that the provisions in the underlying policy and in the reinsurance contract held the same meaning even though different wording. Therefore, the contracts were rendered back to back. This case shows that different clauses containing the same meaning can lead the underlying policy as fully backed by the reinsurance agreement.

Despite this general definition, back to back cover principle is not applicable within all reinsurance methods. It is mainly applicable to proportional facultative reinsurance as ruled in English law.

### 4.4.2 Back to back in facultative reinsurance

#### 4.4.2.1 English law

A comprehensive definition of back to back cover in facultative reinsurance may be found as follows[51]:

> Under a facultative reinsurance contract, since the reinsurer takes a proportion or all of the risk that the direct insurer has insured, it is to be presumed that in the absence of clear words to the contrary the risks covered by the two contracts are consistent. This naturally leads to the result that if the reinsurance and original insurance contain identical terms, for instance where the reinsurance slip contains the clause of "as original" and there are no exclusion clauses which differ from the insurance contract, where the reinsured's liability is established under the original insurance, it follows naturally that the reinsurer's liability is also established in that the construction of the terms of the original insurance is binding on the reinsurer.

So, one can say that in the absence of clearly different wording a underlying and a proportional facultative reinsurance policy will be deemed back to back. Back to back presumption can be understood in facultative reinsurance as the purpose of it is to share the risk and the premium. Reinsurers agree to be bound by the same terms and conditions as the reinsured in the underlying police unless the reinsurance contracts bears some term which differs from the direct policy.

In facultative reinsurance the back to back principle is often materialized by the full reinsurance clause, the effect of which is to incorporate the wording of the

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[51] Gürses (2010) pp.33-34

underlying police into de reinsurance agreement. Furthermore, such a wording will have precisely the same meaning in both reinsurance and direct insurance policy. Within that scope, back to back does not add too much to the concept of incorporation.

However, some difficulties may arise, firstly, where the reinsurance contract and the underlying policy contain different and conflicting terms and, secondly, when they are governed by different laws and such different laws attributes different meanings to the same term contained both in the underlying policy and in the reinsurance contract by means of incorporation or laid down expressly in the latter.

Regarding with the first issue, or else, reinsurance contract and underlying policy containing different terms, in leading cases such *Forsakrings Vesta v. Butcher*[52] and *Groupama v. Catatumbo*[53] it was established that even though if the reinsurance contracts contain a term that is not too different from its counter party in the underlying policy then the underlying term may override the term in the reinsurance agreement if both contracts are back to back. If the same words are used in both contracts then the presumption is achieved indeed.

Regarding with the second one, if a term is laid down both in the reinsurance and in the underlying contract and such contracts governed by different laws, if the contract are back to back the term may be interpreted according with the law of the underlying policy. As I see the condition for this backing is that the term was or might have been incorporated successfully in the reinsurance policy according with conditions stated in subchapter 4.3.1, and that the parties have intended to make the contracts back to back. In proportional facultative reinsurance such presumption is assumed.

Therefore, the presumption of back to back cover lies on proportional facultative reinsurance just. There is no such a presumption in non proportional facultative reinsurance, i.e., non proportional and treaty reinsurance as I will show in subchapter 4.4.3.

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[52] [1989] 1 A.C. 852
[53] [2000] 2 Lloyd's Rep. 350

#### 4.4.2.2 Norwegian law

The starting point in Norwegian law refers to autonomy of the reinsurance contract. Reinsurance agreement is a contract apart from the underlying policy. Besides, reinsurance contracts are highly standardized.

Nevertheless, such autonomy is lessened regarding reinsurance contracts as such contracts are barely formed, they follow market practices, and the underlying policy is important with regard to the contract interpretation.

I assess that such autonomy can be even more affected if back to back presumptions takes place as similar provisions will assume the same meaning as in the underlying policy

Firstly, as in English law, such presumption comes from a full reinsurance clause or other incorporation words such as “as original” or “as underlying”.

Secondly, the presumption must be inferred from the parties’ intention at the time the contract is entered into[54]. Thus, if the scope of coverage of the underlying policy is not set out in the outset of the reinsurance contract, it can be problematic whether or not such contract is presumed to be back-to-back to the underlying policy, even though the reinsurance form contains an incorporation clause.

The background for such a presumption in proportional contracts refers to the mindset that the cedent in general is willing to reinsurer the largest part of the underlying risk. In the shortage of any further evidence, both contracts are deemed to be back-to-back, and reinsurers must reckon they will incur in liability in the same extent as the reinsured.

Presumption is supported in older Norwegian law. Reider Brekkes draft an international reinsurance plan containing a presumption rule at par. 4(2). The plan was drafted based on a number of early 20th century reinsurance contracts, so that the general one hundred year ago mindset can be inferred from it.

> Unless otherwise agreed the reinsurers’ liability is the same as the cedant’s liability to the direct insured according with the original policy[55]

Also, § 25 in the 1871 Norwegian Marine Insurance Plan held the presumption.

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[54] Vibe (2006) p.117
[55] Free translation

> When the insurance is stated as a reinsurance, it is considered as taken over on the same conditions as in the main insurance, and the reinsurer is in case of a loss obliged to give the same compensation as one the main insurer was obliged to pay[56].

Newer legal sources also support the back-to-back presumption. Recent Norwegian legal literature holds that the scope of coverage in the underlying policy should be a mirror to the risk undertook by the reinsurers. Conversely, the scope of the coverage of the reinsurance agreement can be assessed by looking into the underlying policy scope of coverage[57].

If the reinsurance contract contains, nevertheless, different terms or exclusions rather then in underlying policy than back to back presumption can be rebutted. However, even though in such a case the underlying contract can still be considered as providing guidelines to the reinsurance coverage assessment[58].

To sum up, nowadays in Norwegian law there is back-to-back presumption as between and reinsurance contract and the underlying policy. Actual considerations stems that such presumption must be cautious, or else, presumption is not applicable where the reinsurance and the underlying police are evidently different.

### 4.4.3 Back to back in non proportional reinsurance and in treaty reinsurance

#### 4.4.3.1 English law

In non proportional reinsurance, there is no back to back presumption.

It arises out of the fact a reinsurance treaty is a framework where similar underlying policies can be attached in. It is not a tailor made agreement as a facultative reinsurance is. So, in general there is no intention of both reinsurer and reinsured to render a reinsurance treaty back to back with every policy in a whole portfolio.

The case *AXA Reinsurance (UK) Ltd v Field*[59] handled with that. It was held that in a treaty excess of loss liability reinsurance, if both insurance and reinsurance contracts contain provisions allowing a loss to be aggregated, it is not correct to assume that the parties intended the effects of those provisions to be the same.

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[56] Free translation
[57] Vibe (2006) pp.116-118
[58] Wilhelmsson (1976) pp.44-46
[59] [1996] 2 Lloyd's Rep. 233

The rationale behind that is the reinsured and the reinsurer are based in different parameters to assess the risk exposition as the reinsurer is just affected by losses that exceeds the deductible born by the reinsured. In one hand, the reinsured will assess the underlying risk with bias to losses that may affect the first layer, or else, the layer that the reinsured is liable for. In the other hand, the reinsurer will assess the risk with bias to losses that may exceed this first layer (the so called deductible in the reinsurance contract). Therefore an excess of loss treaty is not intended to be back to back to the underlying policy as the risk is assessed in different manners by the reinsured and by the reinsurer. This is a totally different mindset rather than in proportional facultative reinsurance. Such opinion was issued by Lord Mustill:

> " …where a reinsurer writes an excess of loss treaty for a layer of the whole account (or the whole of a stipulated account) of the reinsured, I see no reason to assume that aggregation clauses in one are intended to have the same effect as aggregation clauses in the other. The insurances are not in any real sense back-to back… I believe, plain that the elements of the prudent underwriter's judgment when writing policies of this kind need not be at all the same as if he were writing the underlying business direct."

Even though a non proportional facultative reinsurance is not supposed to be back to back with the underlying policy, it is still possible to incorporate terms of the underlying policy by means of general words of incorporation. In the absence of such words, the reinsurance slip will stand alone and will contain just the terms of the reinsurance contract.

In *Forsaking Vestal v. Butcher* Lord Griffiths creates an example of reinsurance contract where back to back principle is not applicable[60].

> "A reinsurer could, of course, make a special contract with an insurer and agree to reinsure only some of the risks covered by the policy of insurance, leaving the insurer to bar the full cost of the other risks. Such a contract would, I believe, be wholly exceptional, a departure from the normal understanding of the back-to-back nature of a reinsurance and would require to be spelt out in clear terms. I doubt if there is any market for such reinsurance."

A correction can be made to Lord Griffiths thoughts. Actually, it is possible to obtain reinsurance for just some of the risks covered by the insurance policy. Classic example is marine reinsurance for total loss only which is commonly transacted in a non proportional basis.

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[60] [1989] 1 A.C. 852

#### 4.4.3.2 Norwegian law

In Norwegian law, back to back presumption does not apply to non proportional contracts.

In non proportional contracts the reinsurer only to cover the portion of the loss which exceeds the predetermined deductible born by the reinsured. Also, the reinsurance agreement in general sets out an upper limit regarding the reinsured's liability. Those limits are set out by a net ultimate loss clause laid down in the reinsurance agreement.

Therefore, the parties' interests are other than in proportional contracts. Thus, there is no reason to render reinsurance contract and underlying policy as back to back as there is no reason to assume that the intend both contracts to have equivalent coverage. Moreover, theoretically, presumption is not applicable to stop loss contracts[61].

Wilhelmsson also contends that back to back presumption is not applicable to non proportional contracts. For him, liability under an excess of loss reinsurance agreement does not arise at the same time liability under the underlying policy arises. Instead of, conditions for liability in the reinsurance must be agreed upon[62]. Such a mindset is compatible with the ultimate net loss clause laid down in the reinsurance agreements as reinsurer's liability is triggered when the upper limit contained in this clause is exceeded.

So, the main difference as between Norwegian law and English law is that in Norwegian law proportional reinsurance in a broad sense (both facultative and treaty reinsurance) is rendered back to back, and in English law the presumption is mostly based on proportional facultative reinsurance.

### 4.4.4 Main limitations to the back to back presumption

As discussed in the previous sub-chapters there are some main limitations to back to back presumption. I will sum them up herein below.

First of all, the presumption is mainly confined to proportional facultative reinsurance in English law, and in proportional reinsurance in Norwegian law. There is no back to back presumption in non proportional reinsurance.

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[61] Vibe (2006) p.121
[62] Wilhelmsson (1976) pp.44-46

Regarding reinsurance treaties, if the reinsured is not sure if a specific underlying policy fits into the reinsurance treaty framework, he should consult the reinsurer before attaching the policy at stake into the reinsurance agreement as having guaranteed the reinsurance coverage.

For back to back in facultative proportional contracts it has to be successful incorporation and intention of the parties to make the contracts back to back. If the same clause is laid down in both underlying and reinsurance policy and the wording is the same or very similar, then the clauses will likely have the same meaning. Very different wordings imply different meanings and therefore no back to back presumption.

The applicable law and all terms of the underlying policy must be known since the outset of the reinsurance agreement.

Also, if the reinsurance contract and the underlying policy are governed by different laws the incorporated terms into the reinsurance contract will be governed by the law of the underlying policy if both contracts are rendered back to back.

If there is no incorporation I do not see other means on rendering an underlying policy and a reinsurance contract back to back. So, it is very unlikely that dispute resolution and claims provisions of the underlying policy are deemed back to back with the reinsurance as in general they are not incorporated.

If different words are used in both contracts then the presumption of back to back cover may be rejected even though in proportional reinsurance.

# 5 Follow the settlements and follow the fortunes clause

## 5.1 Definition and scope

In the previous chapter I defined the concepts of full reinsurance clause, incorporation, back to back coverage, and their interrelationship.

In this chapter I will analyse other kind of reinsurance clauses that have an independent meaning of back to back coverage. Nevertheless, their scope can be affect by the back to back presumption. Such clauses are the follow the settlements and follow the fortunes.

Follow the settlements and follow the fortunes are clauses laid down in the reinsurance agreement whereby the reinsurer and the reinsured undertake that the reinsurer will be bound by certain obligations of the reinsured. In other words, the reinsurer will follow the reinsured with regard to certain obligations of the latter.

Follow the settlements clause establishes that the reinsurer will follow the settlements entered into by the reinsured under certain conditions. It is a concept that comes into play in facultative reinsurance, but also appears in reinsurance treaties.

Follow the fortunes is an expression more common to treaty reinsurance[63], and has a meaning different from the follow the settlements. The former is mainly related to the reinsurer obligations under treaty reinsurance[64], and the later implies that the reinsurer is bound by the reinsured settlements.

Following clauses have an economical meaning as they are intended to diminish overheads and relitigation.

Nevertheless, such clauses conflict with claims controls and claims cooperation clauses as I will show in the next chapter. Furthermore, they can conflict with burden of proof provisions incorporated from an underlying policy.

In general, there are three distinct question that rise when the reinsurer is asked to pay the reinsured for losses. The questions are as follows:

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[63] O'Neil (2010) p.204
[64] CGU International Plc v Astrazeneca Insurance Co Ltd [2005] EWHC 2755 (Comm)

(1) Is there in fact a loss?

(2) Is the loss covered as a matter of fact and law under the original policy?

(3) Is the loss covered as a matter of fact and law under the reinsurance agreement?

The follow the settlements clause seeks to address question (2). The effect of this clause is to restrain the reinsurer's autonomy in challenging a claim settled by the reinsured in which the reinsurer pleads that he is not liable to pay the amount settled as a matter of fact, or as a matter of law[65].

## 5.2 Following clauses and back to back presumption

Following clauses constitute a different concept of back to back presumption. The consideration of whether of not the reinsurer should follow the reinsured settlements looks on the contract wording, but also on the loss and how such a loss is being handled by the reinsured. The consideration of whether or not insurance and reinsurance contracts are back to back looks on what the parties agreed at the inception of the contract period and is related to the contract interpretation and therefore happens prior to the follow the settlements consideration.

This issue was illustrated in *Wasa*[66] case. As seen in subchapter 4.3.3, in *Wasa* the question was "whether [the] same period of cover should receive the same interpretation in both the original insurance and the reinsurance..." or if "the same or equivalent wording in each of the contracts should... be given the same construction"[67].

The House of Lords was unanimous in giving a negative answer to this question.

Lord Philips addressed that the "follow the settlements" clause could not bring the risk within the reinsurance where it was not. According to him the parties could not anticipate that the reinsurance and insurance wording would differ in a

[65] O'Neil (2010) pp.205-206
[66] Facts in subchapter 4.3.3
[67] [2009] 2 Lloyd's Rep 508

so radical way as they did and there was no intention of the reinsurers to be bound by rules so different than the English ones[68].

In other words, in *Wasa* case the underlying policy and the reinsurance agreement were not considered as back to back as the coverage provisions were constructed in a quite different way. If the contracts were rendered back to back the coverage provisions would naturally assume the same meaning. Therefore, I conclude that a follow the settlements clause cannot be used by the reinsured to neither try to get indemnification neither where there is no coverage nor to render the contracts back to back.

### 5.3 Burden of proof, following clauses and back to back presumption

If a reinsurance contract does not contain a follow the settlements clauses or at least similar words, the reinsured must prove his loss as a matter of fact and establish that in law it falls within both the direct insurance policy and the reinsurance contract.

Furthermore, the reinsurer is not prevented of disputing liability even if the reinsured has acted in good faith[69]. In that case, the burden of proof will be on the reinsured. This applies even if the reinsured has been held liable in a trial or arbitration.

In fact, reinsurance contracts are perfectly workable without such a clause. In my opinion, however, a prudent reinsured should not set aside a so important clause.

An English case on burden of proof, perils of the sea, and proximate cause of loss is *Rhesa Shipping Co SA v Edmunds* (The "Popi M")[70]. Even though it is case on marine insurance its outcoming can be extended to reinsurance.

The vessel sank in calm waters. The expert witness called in behalf of the defendant underwriters contented the ship sank due to wear and tear ("the wear and tear theory"). The expert witness called in behalf of the insured shipowners contended the ship had been struck by a submerged submarine ("the submarine

[68] [2009] 2 Lloyd's Rep 508
[69] See Chipendale v Holt (1895) 1 Com. Cas. 197
[70] [1985] 2 Lloyd's Rep. 235

theory"). The House of Lords held that the former theory was virtually impossible and the later was improbable. Nevertheless, the case should be ruled as per the burden of proof rule, and it was ruled to the insurer.

English marine insurance conditions are based on the named perils principle. So, it bears on the insured the burden of proving that the proximate cause of his loss was a peril insured against. In this way, the shipowners could not be rendered as discharged of liability so long as they had failed to discharge the burden of proof which was on them" . In other words, as the burden of the proof was on the insured and he was not able to prove his theory, he was held liable.

In Norwegian law, the main rule regarding burden of proof is found in the NP §2-15 *(3*). First paragraph establishes the assured has the burden of proving he has suffered a loss covered by the policy, and second paragraph settles the insured has the burden of proving that the loss has been caused by a peril that is not covered by the insurance.

These rules are very important because in an all perils policy the insurer will hold the burden of proving that the loss does not fall within the policy terms. Conversely, in a named perils policy the insured will bear the burden of proving the loss he has incurred into is covered by the issued policy.

Provisions on burden of proof can be incorporated into a reinsurance agreement by means of incorporation words. In one hand one can adapt the wording and change the word "assured" by "reinsured", and "insurer" by "reinsurer", and the clause may be incorporated into a reinsurance slip for an incorporation clause. In the other hand, the clause may not be manipulated and will be incorporated as it stands.

If such incorporation is carried out, in my opinion the back to back presumption may be important about deciding how burden of proof will be defined. As shown in subchapter 3.1.2 the NP may be deemed as background law to the reinsurance agreement. Furthermore, NP provisions may be actually incorporated into.

Incorporation of NP provisions on burden of proof may cause some friction against a follow the settlements clause as the reinsurer may challenge the settlements made by the reinsured on the grounds of the burden of proof rules. Or else, the reinsurer may argue that the burden of proof rule of a named perils policy (as the ones in NP war insurance conditions) was incorporated into the reinsurance

contract and then the burden of the proof is on the reinsured to prove he incurred into a loss. This burden of proof rule collides with the follow the settlements clause scope

This friction may be solved by the back to back principle.

If the policies are rendered back to back, the burden of proof clause may be overridden by the follow the fortunes clause on the ground of the back to back principle, as in *Vesta*. This would be the case in a facultative proportional reinsurance and the reinsurer would be obliged to follow the settlements regardless an actual liability of the reinsured.

In an excess of loss reinsurance the back to back presumption is not applicable, nevertheless. But terms can be incorporated even though. So, in this case it would be less likely that the burden of proof rule were overridden by the follow the fortunes clause.

Anyways, it would be an issue to be tried and it would depend on the factual assessment and on the follow the settlements clause wording.

# 6 Claims Control and Claims Cooperation Clauses

## 6.1 Definition and grounds

Claims cooperation and claims control[71] clauses attributes to the reinsurer the right to influence the adjustment and settlement of claims upon the underlying policy.

These clauses are useful both to reinsured and reinsurers.

In one hand, in some occasions, the reinsurer will be willing for having access to information about the claim, being consulted on the claim adjustment and settlements, and approving or not both claims adjustment and settlements upon the underlying policy. This will be likely to upon a big loss or where the reinsured portion of the underlying risk is big.

In the other hand, the taking over of the claim handling by the reinsurer means that the reinsured will have the proper backing of the reinsurer as the reinsurer himself is adjusting the claim. In other words, the taking over of the claim handling by the reinsurer avoids future disputes between reinsured and reinsured. Disputes may arise as seen in the previous chapters regarding various issues as incorporation of warranties, coverage, duration, and any term contained in the underlying policy.

Claims cooperation clauses establish, firstly, an obligation on the reinsured to notify the reinsurer upon any occurrence which may give rise to a claim. Secondly, it gives to the reinsurer the right to cooperate with the reinsured in defending or settling such claim. Thirdly, no admission of liability under the underlying policy can be undertaken without the reinsurer's approval. Furthermore, some clauses establish a threshold; if the claim figure exceeds the threshold then the reinsurer can take over the claim negotiation. An example of claims cooperation clause is found in *ICA*[72] case:

> "It is a condition precedent to liability under this Insurance that all claims be notified immediately to the Underwriters subscribing to this Policy and the Reassured hereby undertake in arriving at the settlement of any claim, that they will co-

[71] Oppgjørsamarbeid and oppgjørskontroll in Norwegian language
[72] [1985] 1 Lloyd's Rep.312

> operate with the Reassured Underwriters and that no settlement shall be made without the approval of the Underwriters subscribing to this Policy".

If the reinsurer deems a claim cooperation clause does not set enough protection, he can require a claims control clause to be laid down into the reinsurance agreement.

A well drafted claims control will contain the following items. Firstly, an obligation to the reinsured to communicate all claims and circumstances that may give rise to a claim as in respect of timing, form, by whom and to whom the notice must be given. Secondly, a right to the reinsurers to control all negotiations with regard to the underlying loss and to appoint loss adjusters, surveyors, assessors, and other professionals. Thirdly, an express statement establishing compliance with obligations settled hereinabove. An example of claims control is laid down in *Eagle Star Insurance Co Ltd v Cresswell & Ors*[73].

> The company agree
> (a) To notify all claims or occurrences likely to involve the Underwriters within 7 days from the time that such claims or occurrences become known to them.
> (b) 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.

In the absence of a claims cooperation clause reinsurers are not entitled to be actually involved in or consulted about the settling and amounting of claim[74].

As claims cooperation and claims control clauses deal with notification, cooperation, and approval and control of adjustment and settling of claims, under performance of such duties may raise legal issues, as it will be discussed in this chapter.

### 6.1.1 Norwegian law

In Norwegian legal literature as I see there is a slightly different mindset regarding the main difference between a claims control and a claims cooperation clause. For Kaja de Vibe the distinction lies on whether or not the reinsured must seek for consent on the reinsured for assuming liability upon a loss. Upon a claims cooperation clause such consent is not necessary, but upon a claims control clause the

[73] [2003] EWHC 2224 (Comm); [2004] EWCA Civ 602
[74] Charman v Guardian Royal Exchange Assurance Plc [1992] 2 Lloyd's Rep. 607 at 614

reinsurer must manifest such consent[75]. Furthermore, if the clause requires that the reinsured obtains consent from the reinsurer, the later cannot withhold such consent unreasonably[76].

However, in both legal systems as I see the main effect of a claims control clause is to shift the responsibility for adjusting and settling the claim from the reinsured to the reinsurer. The only limitations are that it must be exercised in good faith and without any reference to extraneous considerations to the subject matter of the insurance.

## 6.2 Claims cooperation and claims control in the various reinsurance methods

Claims cooperation and claims control clauses are very common in both proportional and non proportional contracts. They are mainly confined to facultative reinsurance, especially proportional ones, but they also appear in treaty reinsurance.

Such clauses are very common in facultative reinsurance as it is often written on the basis the reinsurer assumes a big share or even though the risk as whole[77]. One reason for this type of arrangement is in some countries foreign underwriters are prevented from participating in local policies due to local legal restraints. Other reason is some local insurance companies lack financial capacity to write large risks and then they require backing of foreign underwriters. So, the reinsurer will be willing to influence or even to take over the claims negotiations.

With regard to treaties, claims cooperation and claims control clauses are found particularly in proportional treaties on the ground of the reinsurer exposure can be high in the event of a single large loss.

## 6.3 Claims cooperation and claims control clauses in English and in Norwegian law

Once the claim is notified, the next step is to check out the in the reinsurance agreement whether or not there is a claim cooperation/control clause.

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[75] Vibe (2006) p.156
[76] Meidell (2006) p. 211
[77] The so called fronting

A leading authority on claims cooperation clause in English law is *ICA*[78] case. The slip contained the clause as follows:

> It is a condition precedent to liability under this insurance that all claims be notified immediately to the Underwriters subscribing to this policy and the reassured hereby undertake in arriving at the settlement of any claim, that they will cooperate with the Reassured Underwriters and that no settlement shall be made without the approval of the Underwriters subscribing to this Policy.

The first part of the clause ("It is a condition precedent to liability under this insurance that all claims be notified immediately…") was considered a condition precedent, but not the second part ("no settlement shall be made without the approval of the Underwriters subscribing to this Policy") as it was deemed as a distinct obligation. So, even though the reinsured failed to obtatin the approval of the reinsurer to settle the claim, it did not entail the reinsured to repudiate the policy as a whole in an automatic way.

A condition precedent is a concept of English law of contract subject. It is a condition that must occur before the performance of a contract, or before the performance of a transaction attached to a contract. In a reinsurance context it is possible to distinguish between a condition precedent upon the reinsurance agreement as a whole and a condition precedent upon a specific loss. If a condition precedent upon the reinsurance agreement is not met then the reinsurance agreement a whole is void. If a condition precedent upon a specific loss is not met then that loss can be repudiated, but not the contract as a whole.

As main outcome of ICA case, the fact that the reinsured have not complied with the terms of the claim cooperation clause does not entail itself a right to the reinsurer to refuse a claim. Such a defence depends upon whether or not the claim cooperation is rendered as a condition precedent to the reinsurer liability. In this case this case the second part of the clause was not deemed as a condition precedent upon the claim and therefore the reinsurer was not able to prevent the loss.

Norwegian law establishes some different criteria while assessing a claims cooperation clause.

In a case of Oslo District the reinsured paid a claim under the underlying policy without consulting the reinsurers as established in the cooperation clause[79].

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[78] [1985] 1 Lloyd's Rep. 312

Afterwards the reinsured sought for recovering his expenses from the reinsurers. The reinsurers denied liability. The Oslo District Court rulled to the reinsured as, *inter alia*, there was no causation between the lack of notification and the loss incurred into by the reinsurer under the reinsurance agreement.

The decision was reversed in the Borgarting Court of Appeal[80].

The Court rulled that interpretation of contracts should be done with great emphasis on the objective wording, and the Court did not find any grounds on the wording to imply that causation was intended by the parties. It was not disputed the claims cooperation clause had been breached.

With regard to back to back coverage, such a presumption had been raised by the reinsured on Oslo District Court as an argument to make the reinsurer fully obliged to back the reinsured's liability under the underlying policy. According with the reinsured the underlying policy and the reinsurance agreement were presumed back to back as the reinsurance policy contained the expression "as original". Nevertheless, the Court of Appeal established that back to back cover was unnecessary to solve the case as back to back presumption affects the interpretation of the provisions relating to coverage and other terms, and the claims cooperation clause is a specific term laid down just in the reinsurance agreement and should be interpreted strictly according with the Court's view . As I see, the position of the Court is that an express term in the reinsurance agreement prevails over any back to back presumption.

The claims cooperation clause contained the statement "notwithstanding anything herein contained to the contrary, it is a condition precedent to any liability under this Reinsurance…", and so was understood by the Court as compliance with the clause was rendered as a precedent condition to the reinsurer's liability. In other words, the reinsurers could just be held liable to indemnify the reinsured under a loss upon the underlying policy if such condition were met.

Comparing *ICA* case and the Borgarting Court of Appeal cases I see the Norwegian Court more strict with regard to the objective wording of the contract. In Norway the emphasis was placed in the objective wording of the reinsurance agreement. In English law there is a general presumption that such a term is an

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[79] Oslo Court District 3. June 2005, 04-058134TVI-OTIR/05
[80] LB-2005-136447

innominate term. Therefore its breach leads generally to damage and if such a breach is very serious it can lead to avoidance of the claim as a whole, but this kind of term is not a Norwegian concept and therefore such a solution does not exist in Norwegian law.

### 6.4 Conflict between following and controlling clauses

Thus far, it was shown that claims cooperation and claims control clauses gives the reinsurer permit to intervene on the adjustment and settlement of the underlying loss. Besides, in the previous chapter it was shown the follow the settlements and follow the fortunes clause create an obligation to the reinsurer follow the settlements carried out by the reinsured if certain conditions are fulfilled.

It creates an obvious conflict between claims cooperation and claims control and the following clauses. If both clauses are contained in the same reinsurance slip, in principle, the main effect will be the reinsurer will only be bound to follow a settlement that he has approved.

In *ICA* case the follow the settlements clause was weakened by the claims control clause. The reinsurer did not approve the settlement performed by the reinsured. However, even though the settlement was not approved, the reinsurer was not allowed to refuse the settlement. The main reason for that is the reinsurer was rendered as having done all by way of cooperation. Furthermore, even if the settlement was one which Scor would not had approved, the reinsurer could not refuse a claim that gives effect to a decision taken by the Liberian Court. So, this is an exception to the main rule the reinsurer will only be bound to follow a settlement he has approved.

Robert Goff LJ[81] dissented and expressed his opinion on the claims operation clause expressly stated that the reinsurer would only be bound by settlements of which he had approved, and so the clauses were not conflicting at all. Furthermore, he concluded that the effect of a claim not approved by the reinsurer would be to circumscribe the power of the reinsured to make a settlement binding upon the reinsurer. I disagree with such ruling as I see the clauses are contradictory.

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[81] [1985] 1 Lloyd's Rep. 607

In *Vesta* case it was decided that in back to back contracts a follow the settlements can override the claims cooperation clause if the claim cannot be rebutted under the underlying policy's foreign law. In *Vesta* the underlying policy was governed by Norwegian law.

I concluded from *ICA* and *Vesta* case that if both a claims cooperation or claims control and a follow the settlements clause are laid down in the reinsurance agreement then the clauses will emasculate one each other. Even though the underlying policy and the reinsurance are rendered back to back, the reinsured will have to prove the he incurred in legal liability to pay the claim. If the contracts are not rendered back to back the reinsured will also have to prove the claim falls within the reinsurance contract as a matter of facts and as a matter of law. This will be the case in non proportional or in treaty reinsurance.

Furthermore, despite it was not said in the rulings, I conclude the burden of the proof is shifted to the reinsured if the reinsurance agreement contains both clauses as the reinsured will have to show he is liable upon the underlying policy.

Besides, in general claims cooperation and claims control clauses impose a necessity of consent by the reinsurers. However, if for any reason, the clause laid down in a reinsurance contract does not impose any duty of consent then the scope of the follow the settlements clause is not affected and, therefore, there will be no conflict between the clauses.

# 7 Conclusion

A full reinsurance clause or other incorporation words renders terms laid down in an underlying policy incorporated into the reinsurance agreement.

Generally, four main types of provisions laid down in the underlying policy might be incorporated into the reinsurance agreement: coverage, warranties, claims, and dispute resolution provisions. The main purpose of incorporation is to bring into the reinsurance agreement provisions of coverage of an underlying policy so that both contracts have the same scope of coverage. Warranties are also generally incorporated; furthermore, in back to back contracts if the governing law of the reinsurance contracts differs from the one of the underlying policy then warranties will be interpreted according with the law of the underlying policy. Claims terms are less likely to be incorporated into the reinsurance agreement as the reinsurance contract in general have their own clauses; furthermore, claims term of a direct insurance policy are in general appropriate to the line of business the policy was issued and do not fit into a reinsurance context. Dispute resolution provisions are not incorporated as a main rule as the parties cannot be deprived of any means of defence in case of litigation.

Back to back presumption is a further effect originated from incorporation.

Back to back is a rule of construction that provides guidance for interpreting legal instruments, especially contracts and statutes. Such a rule establishes either the ascertained intention of a contract containing an ambiguous express term or establishes how a court should rule if the intention of the parties is neither express nor implied.

Back to back coverage is just achieved if there is successful incorporation of terms into the reinsurance contract and if it is presumed as intended by the parties in the outset of the reinsurance policy. Furthermore the content of both underlying policy and reinsurance contract have to be suitable for it. Or else: there must be a full reinsurance clause or other incorporation words, the wording of the underlying policy must not be usual, the governing law of both contracts are known from the outset, there is no exclusion laid down in the reinsurance contract but not in the underlying policy.

As a starting point, in English law, in general proportional facultative reinsurance is back to back with the underlying policy, and non proportional facultative reinsurance (or else, both non proportional and treaty reinsurance) is not back to back. In Norwegian the back to back presumption is broadened to proportional reinsurance in general (or else, both facultative and treaty reinsurance.

Back to back coverage renders the terms that are actually incorporated into the reinsurance agreement to assume the same meaning both in the underlying policy and in the reinsurance agreement. Furthermore, if terms are laid down both in the reinsurance agreement and in the underlying policy, and if these terms are just slightly different then the back to back principle can override the express terms contained in the reinsurance policy.

Nevertheless, the back to back to back presumption is not the only factor that can affect the relationship between the reinsurer and the reinsured. The follow the settlements, follow the fortunes, claims cooperation, and claims control clauses may influence such relationship as well.

Follow the settlements and follow the fortunes are clauses laid down in the reinsurance agreement and establish that the reinsurer will follow the claims settled by the reinsured. Claims control and claims cooperation are clauses laid down in the reinsurance agreement as well and establish that the reinsurer will have the right to influence or to control the claims settled and calculated by the reinsured. The definition of these clauses create a conflict as following clauses attribute autonomy to the reinsured to settle and calculate the claim and as opposed claims control and claims cooperation clause withdraw such autonomy.

Even though these clauses are laid down just in the reinsurance contract and therefore not incorporated into, the back to back principle may influence their interpretation as in back to back contracts the following may override the claims control clauses scope.

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**List of abbreviations**

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|---|---|
| ICA | Norwegian Insurance Contracts Act |
| MIA 1906 | Marine Insurance Act of 1906 |
| NP | The Nordic Marine Insurance Plan of 2013 |
| P&I | Protection & Indemnity |