

Lead insurer or “follow the leader” clauses: binding (re)insurers to the settlement of claims

Toby Blyth and Emily Brownlee COLIN BIGGERS & PAISLEY LAWYERS

In brief — lead insurers can bind market to a settlement

There are a number of mechanisms that primary insurers and reinsurers have at their disposal to enable an efficient claims handling process. Policies may include a “lead insurer” or “follow the leader” clause which outline the leader’s roles and responsibilities and whether the lead binds the following market.

“Follow the leader” clause developed by reinsurance market

Many composite and larger programmes will have co-insurers in various layers. Having multiple lines of communication and instruction can complicate efficient claims handling.

One insurer will typically be designated the lead insurer, usually because it has the greatest percentage on the layer, or (less commonly) because that insurer is recognised as having some special subject-matter expertise in the subject matter of the risk.

While one insurer may become a de facto leader by virtue of some special characteristic, more formal policy mechanisms will often appoint a lead insurer.

The lead insurer will usually provide day-to-day claims handling, which allows smaller insurers with less subject matter expertise to participate on risks where they might otherwise consider themselves not to have the necessary staff or expertise.

Although this has an air of informality, the policy will usually provide a contractual mechanism to formalise the lead’s powers and responsibilities, which may authorise the lead to bind the following market.

One contractual mechanism developed by the reinsurance market is the “follow the leader” clause, which is slightly more elastic than contractual provisions in underlying policies (as with most reinsurance clauses). Courts have interpreted the “follow the leader” clause as providing a framework in which a reinsurer or retrocessionaire will be *bound* by the leader.

Lead insurer clause can set out powers, following market’s rights, and whether lead’s decision is binding

A sample lead insurer clause is as follows:

- Each insurer agrees to provide cover as detailed in the policy.
- The cover afforded by each insurer:
 - shall be limited to the proportion of the insured direct financial loss or loss shown against its name; and
 - is several and not joint. Each Insurer is not responsible for the proportion of any co-insurer who, for any reason, does not satisfy all or part of its obligations.
- The Lead Insurer retains the rights to lead claims management, including but not limited to the investigation, defence and settlement of any claim or otherwise exercise rights accruing to the Underwriters under the policy.
- The Subscribing Insurer(s) shall have the right and shall be given the opportunity to effectively associate with the Lead Insurer in the investigation, adjustment and settlement, including but not limited to the negotiation of a settlement of any Claim.
- The Lead Insurer shall not bind the Subscribing Insurers to an admission of liability, contractual obligation with respect to, or settlement of any Claim without the prior written consent of each Subscribing Insurer, which consent shall not be unreasonably withheld. A Subscribing Insurer shall not be liable for any settlement, assumed obligation or admission to which it had not consented.

The sample clause provides an opportunity for following insurers/underwriters to participate in the settlement process, as well as setting out the powers of the leader and the rights of the following market. The sample does not bind the followers, however.

Alternative wording may expressly bind the following insurers/underwriters to the settlement decisions of the lead, without requiring their consent or approval.

Policy wording may also give a lead insurer the power to alter the slip (*Barlee Marine Corporation v Mountain*¹) and to bind the following insurers to these alterations (*Roadworks (1952) Ltd v Charman*²).

In the absence of any agency, it is unclear what, if any, duties the lead insurer owes to the following market

(other than usual obligations to act in accordance with the contract and, presumably, not to misuse the contractual power granted to it).

However, many problems encountered will be taken care of by the mutual convenience of having one insurer handle day-to-day claims handling, in the context of reputational risk to the leader for future claims handling.

In the absence of express agreement, is the lead insurer the agent of the co-insurers?

The law remains divided as to whether a lead insurer/underwriter is the agent for the underwriters who follow it in the absence of an express binding clause or power to alter the slip. This can be important as an agent has power to bind its principals.

In *Roadworks v Charman*, an agreement that any alteration to the terms of cover by the lead would be “binding on all Underwriters subscribing hereto” was held to be sufficient to make the lead an agent of the following underwriters.

In *Unum Life Insurance v Israel Phoenix Assurance*,³ the view of lead insurers as agents was described as “thoroughly arguable”.

Co-insurers usually retain full rights subject to express contractual terms

However, where there is express wording in a leader clause reserving ultimate control to each insurer, it is less than likely that a lead insurer would be found to be the agent of other co-insurers.

Depending upon the commercial relationships involved, and the market reputation of the leader, it is quite possible that co-insurers will cede most of the decisions to the lead, with a reservation of prudential matters (such as reserving and formal execution of documents) to the following co-insurers.

However, this is only a *de facto* situation. Legally, all co-insurers will usually retain full rights, only subject to the express terms of the contractual clause agreed in the policy.

In *San Evans Maritime Inc v Aigaion Insurance Co*,⁴ the court found that a “follow clause” did not of itself make a lead underwriter an agent (see also *Mander v Commercial Union Assurance*⁵). In *San Evans*, the lead and following underwriters did not subscribe to the same policy, so a different finding might have been reached in other factual circumstances.

This area remains unsettled.

What is a “follow the leader” clause?

“Follow the leader” clauses, or “follow the settlement” clauses, bind reinsurers to any settlements made between the reinsured and the original insured.

Follow clauses are generally used to promote the efficient and commercial settlement of claims by attempting to minimise disputes with reinsurers, especially in the context of multi-layer/subsorption insurance.

Examples of policy wording include:

Type of reinsurance	Follow clause wording
Facultative	“to follow the settlements of”
	“to follow without question the settlements of the Reassured”
	“to follow all settlements (excluding without prejudice and ex-gratia payments) made by the original Insurers”
Treaty	“Being a reinsurance subject to all terms, clauses and conditions as the original and to follow the settlements and agreements of [the reinsured] in all respects”
Excess of loss (qualified)	“All loss settlements by the reinsured shall be binding upon reinsurers provided that such settlements are within the terms and conditions of the original policies and <i>within the terms and conditions of this policy</i> ” (emphasis added)

“Follow the leader” and “follow the settlements” clauses both operate to bind insurers to settlements

“Follow the leader” clauses are used in policies where multiple insurers have subscribed, binding the following market to the settlement decisions of the lead.

“Follow the settlements” clauses are routinely included in reinsurance treaties to bind all reinsurers to any settlements entered into between the insured and reinsured.

These terms are often used interchangeably as there is limited practical difference between their effect in so far as they will operate to bind insurers to settlements.

Scor proviso requirements trigger the “follow the leader” clause

Two provisos must be satisfied to trigger the operation of a “follow the leader” clause, known as *Scor* provisos (from *Insurance Co of Africa v Scor Reinsurance*⁶ (*ICA v Scor*)):

- The reinsured has acted honestly and has taken all proper and businesslike steps in making the settlement (as a question of fact).
- The claim, as recognised by the reinsured, falls within the risks covered by the reinsurance policy (as a question of law).

Proof the reinsured acted in a non-businesslike manner may mean the reinsurer is not bound to follow the settlement. For example, a failure to take account of a relevant exclusion may constitute negligence by the reinsured. (See *Aegis Electrical and Gas International Services Ltd v Continental Casualty Co*.⁷)

The reinsurer bears the onus of establishing that the insured acted in a non-businesslike manner. In *Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd*,⁸ acting in a “non-businesslike manner” was described as equivalent to requiring a finding of professional negligence.

Reinsurers are entitled to insist that the underlying loss respond to the true construction of the reinsurance contract (including that the loss triggers indemnity for excess layers, and that the losses occurred within the currency of the reinsurance contract). For example, where a foreign judgment on the underlying policy includes damages outside the currency of a reinsurance contract, a follow clause does not bring risks not otherwise covered by the reinsurance within its cover. (See *Wasa International Co Ltd and AG Insurance Co Ltd v Lexington Insurance Co*.⁹)

Reinsurers can be left with no control over claims under follow clauses requiring unconditional acceptance of settlements. It is important that reinsurers understand the ramifications of such clauses prior to entry into a reinsurance treaty.

It is possible, though difficult, to expressly contract out of the requirement to satisfy the provisos. (See *Assicurazioni Generali SpA v CGU International Insurance*.¹⁰)

Claims cooperation and claims control clauses specify reinsurers' role

Reinsurance contracts with “follow the leader” clauses may also include cooperation/control clauses, which can either require reinsurer approval for settlement, or give control of settlement negotiations to the reinsurer.

For example, the claims cooperation clause in *ICA v Scor* provided:

... the Underwriters subscribing to this policy and the reassured hereby undertake in arriving at the settlement of any claim, that they will co-operate with the Reassured Underwriters and that **no settlement shall be made without the approval of the Underwriters subscribing to this Policy**. [Emphasis added.]

The claims control clause in *Eagle Star Insurance Co Ltd v JN Cresswell*¹¹ provided:

The [reinsurers] hereon shall **control the negotiations and settlements** of any claims under this policy. In this event, the [reinsurers] will not be liable to pay any claim not controlled as set out above. [emphasis added]

A claims cooperation clause may modify the circumstances in which the leader can exercise its rights under

the “follow the leader” clause. Whether the claims cooperation clause provides a defence beyond the *Scor* provisos is unclear.

Conclusion

Both practical considerations and the case law reinforce the point that the time for insurers to consider what they want as a leader (or follower) and for reinsurers to consider what obligations they have to follow the leader or settlements is at the time of policy inception. At the time a claim is made, it may be too late.



Toby Blyth

Lawyer

Colin Biggers & Paisley Lawyers

toby.blyth@cbp.com.au

www.cbp.com.au



Emily Brownlee

Lawyer

Colin Biggers & Paisley Lawyers

emily.brownlee@cbp.com.au

www.cbp.com.au

Toby Blyth and Emily Brownlee are lawyers in the insurance team at Colin Biggers & Paisley.

Footnotes

1. *Barlee Marine Corporation v Mountain* [1987] 1 Lloyd's Rep 471.
2. *Roadworks (1952) Ltd v Charman* [1994] 2 Lloyd's Rep 99.
3. *Unum Life Insurance v Israel Phoenix Assurance* [2002] LRR 374.
4. *San Evans Maritime Inc v Aigaion Insurance Co* [2014] EWHC 163.
5. *Mander v Commercial Union Assurance* [1998] LRR 93.
6. *Insurance Co of Africa v Scor Reinsurance* [1985] 1 Lloyd's Rep 312, 330.
7. *Aegis Electrical and Gas International Services Ltd v Continental Casualty Co* [2008] Lloyd's Rep IR 17, at [33].
8. *Tokio Marine Europe Insurance Ltd v Novae Corporate Underwriting Ltd* [2014] EWHC 2105.
9. *Wasa International Co Ltd and AG Insurance Co Ltd v Lexington Insurance Co* [2009] 2 Lloyd's Rep 508, at [6].
10. *Assicurazioni Generali SpA v CGU International Insurance* [2004] Lloyd's Rep IR 457.
11. *Eagle Star Insurance Co Ltd v JN Cresswell* [2004] 2 All ER 244.