# International Association of Defense Counsel
# Annual Meeting
# Quebec City, Quebec
# July 2017

**Class Actions – Uniquely American?**

Elizabeth J. Bondurant
WOMBLE CARLYLE SANDRIDGE & RICE LLP
271 17th Street, N.W., Suite 2400
Atlanta, GA 30363-1017

**Canadian Landscape – what is keeping the Canadian insurers from sleeping at night?**

Mylène Côté, LL.B
VP, Specialty Casualty Claims Manager
Liberty International Underwriters
2000 ave. McGill Collège, Suite 2350
Montréal, Québec, H3A 3H3
(514) 904-4920

**Insurers and International Claims – Traps for the Unwary**

Rod S. Attride-Stirling
ASW Law Limited
Crawford House
50 Cedar Avenue
Hamilton HM11
Bermuda

**UK Insurers and Reinsurers' Liability for Late Payment of Claims**

Julian Miller
DAC Beachcroft LLP
1 Minster Court
Mincing Lane
London
EC3R 7AA
Tel: 020 7894 6859
Email: jmiller@dacbeachcroft.com

# Class Actions – Uniquely American?

Elizabeth J. Bondurant
WOMBLE CARLYLE SANDRIDGE & RICE LLP
271 17th Street, N.W., Suite 2400
Atlanta, GA 30363-1017

IADC Annual Meeting
Quebec City, Quebec
July 2017

**Class Actions in the United States**

## I. Introduction

There are differences between litigation in the United States of America and other countries and jurisdictions, but one key difference, is the ability in America of Plaintiffs to bring legal action on behalf of a group of individuals or entities, commonly called a "class action". The federal rules of civil procedure and most states rules of civil procedure permit such actions.

This paper touches on the history of class actions in the United States, including the Class Action Fairness Act, pertinent proposed legislative changes, and the mechanisms and requirements for a successful class action. A few recent cases from the Supreme Court of the United States are discussed, just for illustration.

This paper demonstrates the general principles of class actions but is not an exhaustive discussion of the principles or case law.

## II. History of Rule 23 of the Federal Rules of Civil Procedure

The Federal Rules of Civil Procedure were first promulgated in 1938 with the desired purpose of "efficiently enforcing the substantive law." Robert G. Bone, Walking the Class Action Maze: Toward a More Functional Rule 23, 46 U. Mich. J. L. Reform 1097, 1100 (2013). In furtherance of this purpose, the original Federal Rules of Civil Procedure were established in order to organize "procedural law into a coherent set of statements which would govern the conduct of all civil litigation in the federal courts." John G. Harkins, Jr., Federal Rule 23—The Early Years, 39 Ariz. L. Rev. 705, 705 (1997). Thus, the Federal Rules of Civil Procedure were "designed as pragmatic and functional rules." Bone, Walking the Class Action Maze: Toward a More Functional Rule 23, 46 U. Mich. J. L. Reform at 1100.

Included within the initial Federal Rules of Civil Procedure was the original version of Rule 23. Id. Prior to the implementation of this rule, the class action device was utilized solely in the context of actions for equity. Harkins, Jr., Federal Rule 23—The Early Years, 39 Ariz. L. Rev. at 706. However, the Federal Rules of Civil Procedure effectively abolished any distinction between actions in law and actions in equity from a procedural standpoint. Id. Accordingly, the original version of Rule 23 applied to actions seeking either monetary or equitable relief. The original version of Rule 23 provided in part as follows:

> a. Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued when the character of the right sought to be enforced for or against the class is
>
> (1) joint, or common, or secondary in the sense that an owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it; or
>
> (2) several, and the object of the action is the adjudication of claims which do or may affect specific property involved in the action; or
>
> (3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought.

Id. (citing FED. R. CIV. P. 23 (1940)).

In effect, therefore, the original Rule 23 divided class actions into the following three groups: 1. The “true class actions” represented in subsection (a)(1); 2. The “hybrid class actions” represented in subsection (a)(2); and 3. The “spurious class actions” represented in subsection (a)(3). Bone, Walking the Class Action Maze: Toward a More Functional Rule 23, 46 U. Mich. J. L. Reform at 1100. These groups were effectively “rights-based,” meaning they were categorized by the type of relief sought to be enforced. Id. at 1101-02. Specifically, the “true class actions” were classes in which “the rights sought to be enforced were shared rights--the ‘jural relationship’--and joinder of all members of the class would be required to adjudicate those rights." Harkins, Jr., Federal Rule 23—The Early Years, 39 Ariz. L. Rev. at 707. In comparison, the "hybrid class actions" related to "some specific property, often a fund, over which the court would assume what would be (or at least would be akin to) in rem jurisdiction." Id. In this class action group, "[t]he jural relationship would arise from the fact that the members of the class had 'several' (rather than joint) interests involving some distinct property and the interests of all of them with respect to that property might be affected by the outcome of the litigation." Id. Lastly, "spurious class actions" encompassed individuals that had "several rights" that "would depend at least in part on resolution of a common question of law or fact." Id. However, outside of these common questions of law and fact, the members of a "spurious class action" had no relationship. Id. Thus, the "jural relationship" of these class members "was a fiction created to justify bringing together those who had no prior relationship whatsoever." Id.

Rule 23 was subsequently amended in 1966 to, at least in part, "eliminate[] the rights-based formalisms of the 1938 Rule." Bone, Walking the Class Action Maze: Toward a More Functional Rule 23, 46 U. Mich. J. L. Reform at 1100. More specifically, Rule 23 was amended to "rebuild the law on functional lines responsive to those recurrent life patterns which call for mass litigation through representative parties." Benjamin Kaplan, A Preparatory Note, 10 B.C.L. Rev. 497, 497 (1969). Thus, the amended Rule 23 removed the "spurious class action" provided under the original rule, and articulated the "permissible types of class actions which appear in subdivision (b) of the revised Rule." Id. While minor subsequent revisions have occurred, the 1966 amendment is considered the modern version of Rule 23. Noah Smith-Drelich, Curing The Mass Tort Settlement Malaise, 48 Loy. L.A. L. Rev. 1, 17 (2014).

## III. <u>Current Version of Rule 23</u>

The current version of Rule 23 of the Federal Rules of Civil Procedure provides in part as follows:

> (a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:
>
> (1) the class is so numerous that joinder of all members is impracticable;
>
> (2) there are questions of law or fact common to the class;
>
> (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
>
> (4) the representative parties will fairly and adequately protect the interests of the class; and
>
> (b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:
>
> (1) prosecuting separate actions by or against individual class members would create a risk of:
>
> > (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
> >
> > (B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;
>
> (2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or
>
> (3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:
>
> > (A) the class members' interests in individually controlling the prosecution or defense of separate actions;

> (B) the extent and nature of any litigation concerning the controversy already begun by or against class members;
>
> (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
>
> (D) the likely difficulties in managing a class action.

FED. R. CIV. P. 23.

Section (a) of Rule 23 sets forth the four prerequisites that every proposed class must satisfy in order to be certified has a proper class action. Young v. Nationwide Mut. Ins. Co., 693 F.3d 532, 537 (6th Cir. 2012). In the event these prerequisites are satisfied, the party seeking class certification must establish that his proposed class falls within one of the three types of class actions listed under section (b) of Rule 23. Id. Each of the subsections articulated within sections (a) and (b) of Rule 23 have a unique terminology that provides a shorthand for analyzing the sufficiency of class-action certification. Each of these terms is described in turn below.

## IV. Key Words and Phrases Applicable to Rule 23 Analysis

Rule 23(a)(1), which is the first prerequisite of class action certification, is commonly referred to as the "Numerosity" requirement. In essence, this prerequisite requires a party seeking class certification to establish that the amount of individuals in his proposed class are so *numerous* that joining them all to the action individually would be impracticable. While there is no fixed number to establish that joinder of all the proposed class members as individual plaintiffs would be impracticable, the general rule is "twenty-one is inadequate, more than forty adequate, with numbers between varying according to other factors." Cox v. Am. Cast Iron Pipe Co., 784 F.2d 1546, 1553 (11th Cir. 1986).

The second class prerequisite articulated under Rule 23(a)(2) is known as the "Commonality" requirement. This prerequisite requires that there are questions of law or fact applicable to all individuals in the proposed class. This prerequisite is usually very easy to satisfy, as Rule 23(a)(2) does not require that *all* questions of law and fact be common between the proposed class members, "nor does it establish any quantitative or qualitative test of commonality." 7 C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1763 (3d ed. 2005).

The class action prerequisite articulated under Rule 23(a)(3) is known as the "Typicality" requirement. This prerequisite requires that the claims and/or the defenses of the party seeking class certification are *typical* of those of his proposed class. Thus, subsection (a)(3) was one of the key amendments made to Rule 23 in 1966 for the purpose of eliminating "spurious class action" litigation. 7 C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1764 (3d ed. 2005). While there is no clear test for determining when claims and defenses of one individual are "typical" of another, the general consensus is that claims and defenses do not need to be identical to satisfy the Rule 23(a)(3) requirement. <u>Id.</u>

The last class action prerequisite, articulated under Rule 23(a)(4), is known as the "Adequate Representation" requirement. This prerequisite concerns whether the party seeking class certification can properly represent the interests of his proposed class. As this prerequisite is in place to protect potential class members that would be bound by a judgment entered in a certified class action, Rule 23(a)(4) is considered one of the more significant prerequisites. 7 C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1765 (3d ed. 2005). While the adequacy of representation is generally a question of fact that depends on the circumstances of each case, the biggest factor in finding this prerequisite is satisfied is whether the representative party has interests adverse to the class. Obviously, "[a] class representative whose interests are materially adverse to some of the class cannot be an adequate representative for the whole class because in promoting her own interests she may undercut the interests of other class members." William B. Rubenstein, Newberg on Class Actions § 3:54 (5th ed. 2014). Possible conflicts that would make the representative potentially adverse to the proposed class include "differences in the type of relief sought, especially retrospective versus prospective relief; class representatives with current injuries representing a class that includes members who may experience injury in the future; and economic competitors within the same class." Id.

The first type of class action provided under Rule 23(b) is known as the "Prejudice" class. Lucas Hamilton, The Breaking of a Wave: Jacobsen v. Allstate Ins. Co. & Class Certification, 76 Mont. L. Rev. 157, 161 (2015). This type of class action is considered "mandatory" which means that class members generally do not have the option of opting out of the proposed class and are therefore bound by any final judgment. Id. at 162. Articulated under subsection (b)(1) of Rule 23, the Prejudiced class actually provides for two types of class actions that ensure no party is *prejudiced* in the event class litigation does not proceed. The first, articulated under Rule 23(b)(1)(A), is known as the "Incompatible Standards" class. This class seeks to protect against members of the proposed class filing individual actions that would potentially require the defendant to comply with multiple judicial rulings that articulate inconsistent standards of conduct. Zinser v. Accufix Research Inst., Inc., 253 F.3d 1180, 1193 (9th Cir. 2001).

The second sub-group of the Prejudice class is known as the "Limited Fund" class action and is provided for in Rule 23(b)(1)(B). This type of class is necessary when the defendant does not have sufficient funds to pay damages to the members of the proposed class if they each filed an action on an individual basis. William B. Rubenstein, Newberg on Class Actions § 4:16 (5th ed. 2014). Thus, if the underlying action at issue does not proceed as a class, some members of the proposed class would not obtain an adequate remedy. Id.

The second type of class action is provided under Rule 23(b)(2) and is referred to as the "Injunctive Relief" class. Similar to the Prejudice classes, Injunctive Relief classes are considered mandatory. Hamilton, The Breaking of a Wave: Jacobsen v. Allstate Ins. Co. & Class Certification, 76 Mont. L. Rev. at 162. Class certification under Rule 23(b)(2) is appropriate when the defendant has acted, or has refused to act, on grounds that apply generally to the proposed class. Thus, the defendant's conduct can be enjoined or otherwise declared unlawful as to each member of the proposed class. Put more simply, an "Injunctive Relief" class is appropriate when "a single injunction or declaratory judgment would provide relief to each member of the class." William B. Rubenstein, Newberg on Class Actions § 4:26 (5th ed. 2014).

The last type of class action, which is articulated in Rule 23(b)(3), is known as the "Damages" class. This is type of class, which seeks to obtain money damages, is the most common type of class action litigation. Kara M. Moorcroft, The Path to Preclusion: Federal Injunctive Relief Against Nationwide Classes in State Court, 54 Duke L. J. 221, 251 (2004). Unlike the other types of class actions, a Damages class is not mandatory and, therefore, due process demands additional protections for absent class members. Hamilton, The Breaking of a Wave: Jacobsen v. Allstate Ins. Co. & Class Certification, 76 Mont. L. Rev. at 162. Specifically, a certified Damages class must provide sufficient notice to its members that they have the ability to opt-out of the class and preserve their right to file an individual claim for damages rather than simply accept their portion of damages obtained by the Damages class. Id. To be valid, the opt-out notice requirement must provide all the information set forth in Rule 23(c)(2)(B)(i)-(vii). Id.

Class action certification under section 23(b)(3) is proper when the following two conditions are met: 1. The questions of law or fact common to the proposed class members *predominate* over any questions affecting only individual members; and 2. Proceeding as a class action is *superior* to other available methods for fairly and efficiently adjudicating the controversy. William B. Rubenstein, Newberg on Class Actions § 4:47 (5th ed. 2014). The predominance requirement is in place in order to assess whether the proposed class's interests are "sufficiently cohesive to warrant adjudication by representation." Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 623 (1997). To properly determine whether the predominance element is satisfied, "[a] court must first characterize the issues in the case as common or individual and then weigh which predominate." William B. Rubenstein, Newberg on Class Actions § 4:50 (5th ed. 2014). In performing this analysis, courts generally provide that the predominance element is not met when "a great deal of individualized proof would need to be introduced or a number of individualized legal points would need to be established after common questions were resolved." Id. (citation and internal quotation marks omitted). In comparison, the superiority element requires an analysis on whether class representation is better than other procedural alternatives—such as multiple individual actions, joinder of claims, and administrative proceedings—to resolve the claims at issue. William B. Rubenstein, Newberg on Class Actions § 4:64 (5th ed. 2014). This determination is usually made by analyzing the four factors articulated in Rule 23(b)(3)(A)-(D). Id. In general, however, the superiority element is met in two distinct situations. The first is "when many individuals have small damage claims . . . because absent a class suit, it is unlikely that any of the claimants will be accorded relief." Id. The second situation occurs when the court is receiving a significant number of the same type of claims and, therefore, "aggregation may be efficient because it may avoid duplication and enable faster processing of the multitude of claims." Id.

## V. The Class Action Fairness Act

The Class Action Fairness Act ("CAFA") was passed by Congress in 2005 with the intended purpose of curbing the amount of class action litigation arising in state courts. Jeffrey L. Roether, Interpreting Congressional Silence: CAFA's Jurisdictional Burden of Proof in Post-Removal Remand Proceedings, 75 Fordham L. Rev. 2745, 2752 (2007). At the time, the Senate Judiciary Committee believed a limitation on state court class actions was necessary because "some state court judges are less careful than their federal court counterparts about applying the procedural requirements that govern class actions." Judiciary Committee Report on Class Action Fairness Act, S. Rep. No. 109-14, at 14. More to the point, the Senate Judicial Committee believed that some state court judges were certifying class actions "not because they believe a class trial would be more efficient than an individual trial, but because they believe class certification will simply induce the defendant to settle the case without trial." Id. at 21. Thus, CAFA was put in place to "sweep[ ] more class actions into federal courts." Roether, Interpreting Congressional Silence: CAFA's Jurisdictional Burden of Proof in Post-Removal Remand Proceedings, 75 Fordham L. Rev. at 2754. To that end, CAFA effectively expanded the amount of class actions filed in federal court under Rule 23 by "broadening federal jurisdiction over class actions." Id. at 2752.

The key provision in CAFA for expanding class action litigation in federal court is 28 U.S.C. § 1332(d), which lessens the burden of "diversity" jurisdiction for certain types of class actions. In general, diversity jurisdiction is a basis of jurisdiction which allows an action to proceed in federal court when two conditions are met: 1. Each plaintiff is a citizen of a different state of each defendant (i.e. the plaintiffs are "diverse" from the defendants); and 2. The amount in controversy (i.e. the amount of asserted damages) is greater than $75,000.00. 28 U.S.C. § 1332(a)(1). Prior to CAFA, a class action was only able to obtain diversity jurisdiction if every named plaintiff was diverse from the defendant(s) and each class member (not just the named class members) was entitled to damages of over $75,000.00. Roether, <u>Interpreting Congressional Silence: CAFA's Jurisdictional Burden of Proof in Post-Removal Remand Proceedings</u>, 75 Fordham L. Rev. at 2748. Under 28 U.S.C. § 1332(d), however, federal jurisdiction now generally exists over class actions when: 1. The class has over 100 members; 2. Any member of the class is diverse from the defendant; and 3. The collective damages of all class members exceeds $5,000,000.00. 28 U.S.C. § 1332(d)(2)(A), (d)(5)(B).

In effect, therefore, CAFA "changed two long-standing rules that previously limited federal jurisdiction over class actions." Roether, <u>Interpreting Congressional Silence: CAFA's Jurisdictional Burden of Proof in Post-Removal Remand Proceedings</u>, 75 Fordham L. Rev. at 2759. First, CAFA departs from the *complete* diversity standard to allow for "'minimal' diversity—that is, just one party with citizenship different from all others" in class actions that meet the requirements specified in 28 U.S.C. § 1332(d). <u>Hart v. FedEx Ground Package Sys. Inc.</u>, 457 F.3d 675, 676 (7th Cir. 2006). Second, CAFA abrogated the rule that the amount in controversy necessary to establish diversity jurisdiction must always be satisfied by each individual member of a class. <u>Exxon Mobil Corp. v. Allapattah Servs., Inc.</u>, 545 U.S. 546, 571-72 (2005). As a result of these changes, "the number of class actions in federal courts has risen dramatically--as intended and predicted." Georgene Vairo, <u>What Goes Around, Comes Around: From the Rector of Barkway to Knowles</u>, 32 Rev. Litig. 721, 774 (2013).

## VI. **Recent Supreme Court Cases Impacting Rule 23 Analysis**

This section discusses a few of the most recent seminal cases from the Supreme Court.

The first two address the rigor required of the district court before certifying a class. Class actions are facing greater scrutiny after the Supreme Court's rulings in *Wal-mart Stores, Inc. v. Dukes*,564 U.S. 338 (2011) and *Comcast Corp. v. Behrend*, 133 S.Ct. 1426 (2013). Before the duo federal courts varied on the applicable standard for certifying a class.

The Supreme Court in *Wal-Mart* confirmed that a district court must conduct a rigorous analysis of the Rule 23 requirements. There, the plaintiff brought claims of gender discrimination under Title VII of the Civil Rights Act of 1964. Plaintiffs alleged that Wal-mart's local managers exercised their discretion over pay and promotions disproportionately in favor of men, which discriminated against female employees. The district court certified the class, and the Ninth Circuit affirmed.

Wal-Mart argued on appeal that the claims of the class members did not satisfy Rule 23's commonality requirement. The Supreme Court agreed, holding that a district court must conduct a rigorous analysis of whether the plaintiff can demonstrate that the class members have suffered the same injury and that their claims depend on a "common contention . . . which means that determination of its truth or falsity will resolve an issue that is central to the validity of each of the claims in one stroke."

In *Comcast*, the Supreme Court again confirmed that the rigorous analysis extended to the requirements of Rule 23(b)(3). In *Comcast*, the plaintiffs brought an action for antitrust violations. The Supreme Court first again that a rigorous analysis must be conducted to ensure that the Rule 23(a) requirements have been satisfied and further stated that the same analytical principles governed Rule 23(b).

These cases have made it more difficult for putative class actions to be certified and placed more responsibility on the trial court to understand whether there is commonality and predominance before ruling on motion to certify.

Other recent cases from the Supreme Court are illustrative of different issues implicated by class actions. In Campbell-Ewald Co. v. Gomez, 136 S. Ct. 663 (2016), the Supreme Court addressed the validity of a common class action defense tactic known as the “pick off” tactic. Under this tactic, a defendant attempts to “pick off” the class representative by making him an offer of judgment for complete relief (i.e. the full amount of damages the class representative seeks to recover) under Rule 68 prior to the filing of a motion for class certification. Russell v. Pallito, No. 5:15-cv-126, 2017 WL 1093187, at *9 (D. Vt. Mar. 23, 2017). In the event the offer is not accepted, the defendant files a motion to dismiss which argues that its offer of complete judgment renders the class representative’s claim moot and, therefore, the court no longer has jurisdiction over the matter. David Hill Koysza, Preventing Defendants From Mooting Class Actions By Picking Off Named Plaintiffs, 53 Duke L. J. 781, 789 (2003). The Supreme Court effectively abolished this tactic in Gomez, holding that an unaccepted settlement offer or offer of judgment does not moot a plaintiff’s case. 136 S. Ct. at 666. In issuing this holding, the Supreme Court articulated that a “settlement bid and Rule 68 offer of judgment, once rejected, had no continuing efficacy.” Id. at 670. Accordingly, because a class representative’s claim is not mooted by an unaccepted settlement offer, his claim “retain[s] vitality during the time involved in determining whether the case c[an] proceed on behalf of a class.” Id.

In Tyson Foods, Inc. v. Bouaphakeo, 136 S. Ct. 1036 (2016), the Supreme Court held that statistical or representative evidence can be used to establish class-wide liability for class actions brought under Rule 23(b)(3). 136 S. Ct. at 1049. In Bouaphakeo, a class of Tyson Foods, Inc. employees sought overtime compensation for undocumented time spent putting on and taking off protective gear necessary to slaughter, trim and prepare meats for shipment, otherwise known as "donning and doffing" activity. Id. at 1041-42. After receiving class certification from the district court pursuant to Rule 23(b)(3), the employees introduced evidence at trial in the form of a study performed by an industrial relations expert to establish they each worked over 40 hours a week. Id. at 1043. This report produced estimates that employees in Tyson Foods, Inc.'s cut and retrim departments spent 18 minutes a day donning and doffing, while employees in the kill department spent 21.25 minutes donning and doffing. Id. After the jury returned a verdict in favor of the employees, Tyson Foods, Inc. filed a motion to set aside the verdict, arguing that the class should not have been certified because the employees had to rely on representative proof in the form of the expert's study to establish class-wide liability. Id. at 1044. This motion was denied and subsequently appealed to the United States Court of Appeals for the Eighth Circuit. Id. The Eighth Circuit affirmed the trial court's decision on the grounds that the expert study provided a sufficient basis to draw a "reasonable inference" of class-wide liability in this case. Id. at 1045.

The Supreme Court affirmed the decisions of the trial court and Eight Circuit, articulating that "each employee worked in the same facility, did similar work, and was paid under the same policy." Id. at 1048. As a result, the expert study constituted sufficient evidence because "the experiences of a subset of employees can be probative as to the experiences of all of them." Id. Through this determination, the Supreme Court implicitly ruled that statistical or representative evidence can be used to establish class-wide liability.

In issuing this ruling, however, the Supreme Court refrained from making a general rule about when the use of statistical or representative evidence to establish class-wide liability is proper. Specifically, the Supreme Court articulated that "[w]hether a representative sample may be used to establish classwide liability will depend on the purpose for which the sample is being introduced and on the underlying cause of action." Id. at 1049. Therefore, the appropriateness of statistical or representative evidence "will depend on facts and circumstances particular to [individualized] cases." Id.

Prior to its previous session, one of the more pertinent decisions of the Supreme Court regarding Rule 23 analysis was issued in Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338 (2011). In this case, the class action at issue consisted of 1.5 million female employees of Wal-Mart that were allegedly victims of sex discrimination. 564 U.S. at 343. Based on this allegation, the plaintiffs sought injunctive and declaratory relief, as well as an award of backpay for each class member. Id. At the district court level, the proposed class was certified as an Injunctive Relief class under Rule 23(b)(2). Id. at 347. Upon review, the Supreme Court addressed whether certification of the proposed class was appropriate under both Rule 23(a)(2) and Rule 23(b)(2). Id. at 342.

With respect to Rule 23(a)(2), the Supreme Court determined that class certification was not appropriate because the plaintiffs failed to establish sufficient commonality between the class members. Id. at 359. In making this determination, the Supreme Court clarified that, as a general principle, the common question necessary to establish a valid class action "must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." Id. at 350. Put more simply, the Supreme Court held that Rule 23(a)(2) is satisfied when a question of law or fact generates "common *answers* apt to drive the resolution of the litigation." Id. at 350. Based on this standard, the Supreme Court determined that plaintiffs did not satisfy Rule 23(a)(2) because they could not produce "significant proof" that each member of the class "operated under a general policy of discrimination." Id. at 354. As a result, the plaintiffs failed to establish a common question of law or fact that could "be proved on a classwide basis." Id. at 356.

The Supreme Court further determined that the plaintiffs' proposed class was improperly certified under Rule 23(b)(2). Id. at 359. In making this determination, the Supreme Court held that, as a general rule, a claim for monetary relief cannot be certified as an Injunctive Relief class where "the monetary relief is not incidental to the injunctive or declaratory relief." Id. This determination was made pursuant to the general principle that "Rule 23(b)(2) applies only when a single injunction or declaratory judgment would provide relief to each member of the class." Id. at 360. Thus, Rule 23(b)(2) "does not authorize class certification when each individual class member would be entitled to a different injunction or declaratory judgment" or "when each class member would be entitled to an individualized award of monetary damages." Id. at 360-61.

In further support of this determination, the Supreme Court noted that the structural difference between Rule 23(b)(2) and Rule 23(b)(3) mandates that claims for monetary relief that are not incidental to injunctive or declaratory relief cannot be certified as an Injunctive Relief class. Id. at 361-62. Specifically, an Injunctive Relief class is not mandatory because the injunctive relief sought by such a class, by its very nature, "affect[s] the entire class at once." Id. at 362. Conversely, a Damages class under Rule 23(b)(3) is not mandatory precisely because the amount of monetary damages owed may vary between class members. Id. Thus, the notice and opt-out requirements of Rule 23(b)(3) are in place to preserve each class members' due process right to bring their own individual claim for monetary relief. Id. at 363. The predominance and superiority requirements of Rule 23(b)(3) further protect the class members' interests by ensuring that class litigation is "benefitting all its members at once." Id. at 362. This protection is provided to members of a Damages class members because, unlike members of an Injunctive Relief class, it is not presumed that a class action is the best method to adjudicate "each class member's individualized claim for money." Id. Based on these distinctions, "individualized monetary claims belong in Rule 23(b)(3)." Id. at 362.

In applying these general rules to the plaintiffs' claims and proposed class, the Supreme Court recognized that "Wal–Mart is entitled to individualized determinations of each employee's eligibility for backpay." Id. at 367. Based on the need for such litigation, the plaintiffs' claims for backpay were not incidental to the injunction sought on behalf of the class. Id. Thus, the Supreme Court determined that plaintiffs' claims for monetary relief could not be awarded to an Injunctive Relief class. Id. Accordingly, the Supreme Court reversed the decision to certify the plaintiffs' Injunctive Relief class. Id.

## VII. Proposed Amendments to Rule 23

On February 9, 2017, the Chairman of the House Judiciary Committee, Re. Robert Goodlatte (R-Va), proposed several changes to Rule 23 by introducing the Fairness in Class Action Litigation Act of 2017 (the "Act"). Brian M. Forbes, et al., Proposed Fairness in Class Action Litigation Act of 2017 Seeks to Curb Attorney Abuses of Class Action Device and Expand Class Action Defendant Protections, The National Law Review, http://www.natlawreview.com/article/proposed-fairness-class-action-litigation-act-2017-seeks-to-curb-attorney-abuses. The three stated purposes of the Act are: 1. "assure fair and prompt recoveries for class members and multidistrict litigation plaintiffs with legitimate claims;" 2.

"diminish abuses in class action and mass tort litigation that are undermining the integrity of the U.S. legal system;" and 3. "restore the intent of the framers of the United States Constitution by ensuring Federal court consideration of interstate controversies of national importance consistent with diversity jurisdiction principles." Id. In essence, the proposed changes to Rule 23 articulated in the Act seek to benefit U.S. companies by curtailing the amount of class actions that include an "artificially inflated" number of individuals for the sole purpose of forcing defendants to enter unjustified settlement agreements. Press Release: Chairman Goodlatte Statement on H.R. 985, the Fairness in Class Action Litigation Act (February 15, 2017), https://judiciary.house.gov/press-release/chairman-goodlatte-statement-h-r-985-fairness-class-action-litigation-act.

The Act contains several provisions in furtherance of the goal of protecting companies by limiting the amount of class action litigation in federal courts. Most notably, the Act seeks to make class certification of Damages classes more onerous by requiring "the party seeking to maintain such a class action affirmatively demonstrate[ ] that each proposed class member suffered the same type and scope of injury as the named class representative or representatives." Fairness in Class Action Litigation Act of 2017, H.R. 985 at 3, 115th Cong. (2017), https://www.congress.gov/115/bills/hr985/BILLS-115hr985ih.pdf. Moreover, the Act seeks to limit Damages class certification by requiring the party seeking to establish such a class to "affirmatively demonstrate" there is a reliable and administratively feasible mechanism for determining all "putative class members fall within the class definition" and "for distributing directly to a substantial majority of class members any monetary relief secured by the class." Id. at 4. The Act also seeks to impose additional limitations on recoverable attorney's fees, thereby making "class actions less lucrative for plaintiff's attorneys." Forbes, et al., Proposed Fairness in

Class Action Litigation Act of 2017 Seeks to Curb Attorney Abuses of Class Action Device and Expand Class Action Defendant Protections, The National Law Review, http://www.natlawreview.com/article/proposed-fairness-class-action-litigation-act-2017-seeks-to-curb-attorney-abuses.

The Act was passed by the House with a 220-201 vote on March 9, 2017. Pamela Wolf, Federal Legislation—House Approves Three Bills Aimed At Curbing Litigation Abuses, Wolters Kluwer Employment Law Daily, http://www.employmentlawdaily.com/index.php/news/house-approves-three-bills-aimed-at-curbing-litigation-abuses. As a result, the Act "will now move to the Senate and be referred to the Committee on the Judiciary." Kymberly Kochis & Veronica M. Wayner, Expansion of Jurisprudence Under New Class Action Bill, https://www.law360.com/appellate/articles/901917/expansion-of-jurisprudence-under-new-class-action-bill. However, because a "more modest" version of the Act's proposed amendments to Rule 232 stalled in the Senate in 2016, the ultimate future on the Act and its proposed impact on Rule 23 "is uncertain." Id.

# Canadian Landscape – what is keeping the Canadian insurers from sleeping at night?

Mylène Côté, LL.B
VP, Specialty Casualty Claims Manager
Liberty International Underwriters
2000 ave. McGill Collège, Suite 2350
Montréal, Québec, H3A 3H3
(514) 904-4920

IADC Annual Meeting
Quebec City, Quebec
July 2017

**Canadian Landscape – what is keeping the Canadian insurers from sleeping at night?**

- *The views, information and content expressed herein are those of the presenter and do not necessarily represent the views of Liberty International Underwriters, a division of the Liberty Mutual Insurance Company ("Liberty").*

- *The information contained herein is provided to provide a general understanding of risk management and D&O exposures and should not be relied upon as legal advice, a definitive statement of the law or advice in respect of insurance needs or products. For such advice an applicant, insured, listener or reader should consult his, her or its own legal counsel or a qualified insurance broker.*

## Cross-Border Securities Class Actions

On December 31, 2005, the changes to the *Ontario Securities Act (*"OSA") proposed by Bill 198 came into force, creating a "fraud on the market" theory that did not previously exist in Canada. These amendments made it easier to bring class action suits against companies that allegedly mislead investors when they traded on the secondary market. This lead to the filing of several securities class actions in Canada, often accompanied by one or more US lawsuits. This changed the landscape in Canada and has had a resultant impact on director and officers' liability insurance. These cross-border proceedings are costly and a source of concern both for dual-listed issuers and their insurers. As these provisions are still relatively new, in the sense of being largely untested by Canadian courts, defence counsel must juggle with unestablished theories, work jointly with US colleagues on strategy, and often deal with a tower of several insurers.

## Background to Bill 198

In the United States, SEC Rule 10b-5 prohibits any act or omission resulting in fraud or deceit in connection with the purchase or sale of any security, or "fraud on the market" as it is commonly referred to. Until Bill 198 was enacted into law, there was no similar "fraud on the market" theory in Canada. Investors had a right under common law to sue but the plaintiffs faced a heavy evidentiary burden. To successfully bring a lawsuit based on misrepresentation of material information resulting in artificially inflating the price of shares, one needed to prove that, among other things, each shareholder had relied on the alleged misrepresentation to make the purchase. Bill 198 came into effect at the end of 2005 and amended the OSA. Eventually, the other provinces also made similar changes to their respective securities acts. Key components of the new legislation include a rebuttable presumption of reliance, a leave requirement to avoid strike suits, caps on damages and application to both individual and class actions.

Following the enactment of Bill 198, the filing of securities class action increased significantly. There was one (1) filing in 2006, three (3) in 2007 and an average of 9 filings per year after that. Interestingly and not surprisingly, while between 1997 and 2005 only 17% of US filings had a parallel Canadian action, that percentage jumped to over 50% between 2006 and 2016. Needless to say, this has greatly affected the insurance industry.

Those filings, some of which will be briefly discussed below, have shed some light on the interpretation to be given to the Canadian secondary market legislation. However, much remains unknown or unclear and therefore challenging to manage.

**Securities Class Actions**

*Silver v IMAX*, 2012 ONSC 4881, was the first case filed under the new provisions of the OSA. *IMAX* was dually listed and a US action was also commenced. In Canada, granting leave to proceed and certifying a global class, the court stated that the threshold for leave was "relatively low". The global class certification however became problematic when, in the US, a settlement was achieved. Upon obtaining both US and Canadian courts approval, the size (and costs) of the Canadian class action was greatly reduced since the class consisted of 85% Americans.

This case illustrates the importance for counsel to communicate with their colleagues across the border in making strategic decisions as well as with the insurers who are often managing both suits.

After the certification decision in *IMAX*, Canadian courts have somewhat elevated the threshold for leave in light of its purpose, which is to prevent strike suits, namely coercive and unmeritorious claims, which are aimed at pressuring a defendant into settlement in order to avoid costly litigation. In *Bradley v Eastern Platinum Ltd,* 2016 ONSC 1903, the Ontario Superior Court denied leave, describing the leave test as more than a "speed bump" in the litigation process. Following guidance from the Supreme Court of Canada in *CIBC v Green,* 2015 SCC 60, it is now accepted that the leave test requires a robust, meaningful examination and critical evaluation of both the facts and expert evidence filed by the parties.

On another topic, the question of jurisdiction has been debated in a few cases, including *Abdula v Canadian Solar, 2012 ONCA 211,* in which the Ontario Court of Appeal confirmed that an issuer who is not a reporting issuer in the province may still be liable under the new legislation. However, most recently, it appears that Ontario is moving closer to the approach taken by the court in *Morrison v National Australia Bank,* 561 U.S. 247. In the US, *Morrison* held that jurisdiction can only be assumed where securities are traded on a domestic exchange. In *Kaynes v BP*, 2016 ONCA 601, for instance, the Ontario Court of Appeal reversed the motion judge's decision and held that jurisdiction should be declined on the ground of *forum non conveniens* where securities were purchased on foreign exchanges. It further observed that order and fairness will be achieved by adhering to the prevailing international standard tying jurisdiction to the place where the securities were traded and avoiding a multiplicity of proceedings involving the same claims or class of claims. Similarly, in *Mouaikel v Facebook*, 2013 QCCS 476, the Quebec Court of Appeal dismissed a proposed securities class action on Facebook IPO on jurisdiction grounds.

There are some important distinctions between the U.S. and Canada, which can lead to very different outcomes on the same securities class action depending on its venue. For instance, the scienter requirement in the U.S. is not part of the threshold test in Canada so cases may take very different turns in each country in the early stages.

Another difference between Canada and the U.S., which can result in a dramatic effect, is the way damages are calculated. In the U.S, the damage per share is limited to price decline caused by the correction of the alleged misstatements while in Canada, the damage per share is based on the difference between the purchase price and the price just after the correction of the alleged misstatement. In Canada, as previously indicated, the legislator capped the damage (for the issuer to $1M or 5% of the market capitalization and for the individuals to $25,000 or 50% of their compensation) unless the misstatement is made knowingly.

**The Insurance Perspective and the Tripartite Relationship**

Most large companies carry director and officers' liability insurance which typically provides coverage, partially or entirely, to both the individuals and the entity in cases of securities class actions. When asked to defend a company in such a suit, defence counsel will inevitably have some involvement with the insurance carriers.

Canadian courts generally have held that the disclosure of insurance policies should be done early on in the proceedings. The courts have held that the disclosure of insurance policies encouraged the parties to make practical decisions about likelihood of recovery and possibility of settlement and that it was unlikely that the disclosure would encourage baseless lawsuits (see *Sharma v Timminco,* 2012 ONCA 107).

Even when the insurer does not have a duty to defend, which is most often the case in those types of policies, the insurer does have the right to associate in the defence and must consent to the defence costs being incurred and any settlement. As such, it is in the best interest of the Insured(s) to keep the insurer informed and involved so as to not jeopardize his coverage under the policy.

There is a tripartite relationship between the Insured, the insurer and the defence counsel. Effective communication among the three is essential and collaboration in strategic decisions, crucial. At the same time, it can be challenging to deal with interests that could differ. Our experience has been, however, that the better the flow of communication, the easier it was to manage those files and to achieve consensus on critical decisions.

Confidentiality and privilege issues are often raised, mostly in the U.S., to prevent full communication and disclosure to the insurer. However, that approach by defence counsel creates problems in the tripartite relationship. It is difficult, if not impossible, for an insurer to be able to assist in a meaningful way or, at the very least, grasp the full exposure of a case, when it only receives part of the information. Too often, the insurers are told early on that the case is very defendable and that the likelihood of success is high. However, years down the road after significant defence costs have been incurred, with mediation approaching, the tone changes and it becomes crucial that a settlement is reached. Internally, insurers must set reserves and have numerous reporting requirements. Without the full understanding of the case at an early stage, including the insured's strengths and weaknesses, it is challenging to meet its internal requirements while quickly coming up with settlement funds for the mediation.

Some defence firms clearly understand this tripartite relationship and have found ways to deal with confidentiality issues, via signing confidentiality agreements or other similar documents. When the potential exposure is well established and both the insured and its insurers understand the case fully, better outcomes can be reached, which often means early settlements.

An added challenge in the securities cases is that generally there is an entire tower of insurance, consisting of a primary carrier and excess carriers (usually with follow form policies). Of course, interests may diverge at times among the carriers however, everyone drives for the same ultimate goal which is based on the merits of the case and the lowest possible cost to all involved. This does not mean that insurer should (or do) systematically want to settle every claim. Most carriers want to review and understand the facts of each case early on and armed with that knowledge work with the insured to make the best strategic decisions, based on counsel's recommendations.

If the case is strong, in light of some of the decisions mentioned above, it may be best to fight the leave motion but if the opposite is true, it may be worth consenting to the leave in exchange for narrower pleadings or others and explore early settlement opportunities. Either way, the insurer should be kept in the loop throughout the process.

**Particularities of Québec**

Unlike the rest of the country which is subject to common law, the Province of Québec is governed by the Civil Code of Québec (the "C.C.Q.")., Article 2503 of the C.C.Q. is of particular interest as it imposes a duty to defend on the part of the insurer and specifies that such obligation should be over and above the limits of insurance. Article 2503 reads as follows:

> "2503. The insurer is bound to take up the interest of any person entitled to the benefit of the insurance and assume his defence in any action brought against him.
>
> Costs and expenses resulting from actions against the insured, including those of the defence and interest on the proceeds of the insurance are borne by the insurer over and above the proceeds of the insurance."

This article is a rule of public order, meaning that the insurer may only derogate from its duty to defend to the extent that the derogation imparts increased benefits to the insured.

The second part of this article can have a significant impact on insurers and gives rise to several questions. First, when does it apply? Article 3119 provides that "notwithstanding any agreement to the contrary, a contract of insurance respecting property or an interest situated in Québec or subscribed in Québec by a person resident in Québec is governed by the law of Québec if the policyholder applies therefor in Québec or the insurer signs or delivers the policy in Québec".

So, does the C.C.Q. apply to a claim filed outside of Québec? It has been argued that laws enacted and in force in Québec apply in Québec but have no binding authority outside Québec. What happens to a Québec insured involved in a cross-border securities class action where it is not uncommon to see defence costs climb to the $20-$40M range? What if there is a tower of insurance responding to the claim? Some decisions have considered article 2503 (*Fridhandler v Le fonds d'assurance responsabilité professionnelle du barreau du Québec*, 2002 R,R,A 513, J.E. 2002-1101 (C.S.) which was eventually settled and *Déguisé v Montminy et als*, 2014 QCCS 2672, which is under appeal), implying that it is restricted to claims filed in Québec . Unfortunately, there has yet to be a final decision in Québec which specifically addresses these issues. However, we are hopeful that there will be a well-reasoned decision on these points in the near future. In the interim, it is important to be aware of these provisions and conscious of the potential repercussions of claims subject to Québec law.

Article 2503 of the C.C.Q. also creates a debate in Québec regarding its interpretation as it relates to the right of an insurer to charge a deductible or a retention to an insured that would be applicable to the payment of defence costs. Again, no decision have been rendered on that issue but it is prudent to be aware that no matter the size of the retention, it may be argued that it does not apply to defence costs.

**Conclusion**

The Canadian securities class action regime is still in a relatively early stage and outcomes can be difficult to predict and appeals are frequent. This makes litigation expensive and uncertain, especially when joined with a U.S. parallel action and involving a Québec insured. Throughout the defence, it is crucial to keep the insured and their insurers informed, to properly assess the exposure (liability and damages) early on and advise as it changes, to discuss strategy with them and explore settlement opportunities early on, when appropriate.

*International Association of Defence Counsel*
*Quebec Conference – July 2017*

*Rod S. Attride-Stirling*
*ASW Law Limited*
*Crawford House*
*50 Cedar Avenue*
*Hamilton HM11*
*Bermuda*

**Presentation relating to the programme:**
**'Insurers and International Claims – Traps for the Unwary'**

*********

## ***Follow the Settlements in Reinsurance***

*********

## Follow the Settlements in Reinsurance

### What is a Follow the Settlements clause?

Follow the Settlements clauses prevent a reinsurer from second-guessing bona fide claim settlements.

Insurance companies should not assume that if they enter into a settlement agreement with an insured, that the insurer's reinsurers are necessarily bound to pay to the insurer the amount of the Settlement. Reinsurers will want to satisfy themselves in relation to several issues. Various questions arise, including: was there a follow the settlements clause, was there a claims co-operation clause, were the reinsurers consulted in relation to the settlement, did the reinsurers agree to the terms of the settlement, was there coverage under the insurance contract, was there coverage under the reinsurance contract, did the Insurer take all reasonable defences, did the insurer act in a proper and business like fashion in the investigation and settlement of the claim?

It would be wrong to assume that in the absence of an express and sufficient follow the settlements clause, that one will be implied into the contract. That is the position in Bermuda and in the UK, however note that in the US there is some case law which suggests that a follow the settlements clause can and should be implied into reinsurance contracts.

### What does a Follow the Settlements clause look like?

It is important to note that just because a clause may look like a follow the settlements clause, it doesn't mean that it is. The modern clause often appears in the following terms "…*subject to the same terms, clauses and conditions as the original and to follow the settlements of the Reinsured.*"

The effect is that the reinsurer has to follow all settlements so long as:

(1) The reinsured has acted honestly and taken all proper and business like steps in reaching the settlement;
(2) The claim is arguably as a matter of law within the scope of the original insurance; and
(3) The claim so recognised falls within the risks covered as a matter of law under the reinsurance contract.

## Follow the Fortunes

It is sometimes assumed that follow the settlement clauses and follow the fortunes clauses are the same thing. In the US there is some case law which suggests that the two terms are interchangeable. However as a matter of Bermuda and UK law this is not the case. Further, whilst there is English case law that defines follow the settlements clauses, there is no such authority on the precise meaning of a 'follow the fortunes clause'.

In *CGU International Insurance Plc v AstraZeneca Insurance Co Ltd.* (2005) EWHC 2755 (Comm); (2006) Lloyds Re IR 409, Cresswell J considered the following wording contained in a reinsurance slip:

> "The Reinsurer agrees to follow in all respects the fortunes of the Reinsured. Reinsurers hereunder will, however, have the right to and shall be given the opportunity to associate with the Reinsured in the defence and control of any claim, suit or proceedings relative to any loss where the claim or suit involves or appears relatively likely to involve Reinsurers hereunder."

Cresswell J confirmed that, under English law, a "follow the fortunes" clause was not equivalent to a "follow the settlements" clause. He thus treated the contract of reinsurance as if there was no "follow the settlements" clause. So, although he did not decide the effect of the "follow the fortunes" clause, Cresswell J indicated that in order to recover, the reinsured would have to prove against the reinsurer, that the claim was covered, in the same way that the insured would have had to prove against the reinsured. This means that the reinsurer could run any defences that the reinsured could have run against the insured, despite the "follow the fortunes" clause.

## Follow the Settlements Principles

The Starting point in relation to the law of follow the settlements provisions is found in *Hill v Mercantile & General* ([1996] L.R.L.R. 341) Lord Mustill said:

> "There are only two rules, both obvious. First, that the reinsurer cannot be held liable unless the loss falls within the cover of the policy reinsured and within the cover created by the reinsurance. Second, that the parties are free to agree on ways of proving whether these requirements are satisfied. Beyond this, all the problems come

> from the efforts of those in the market to strike a workable balance between conflicting practical demands and then to express the balance in words."

Every reinsurance contract may be expected to contain some provision defining the extent of the obligation of the reinsurer to pay losses, which the reinsured is held legally liable to pay, and loss settlements. Three quite distinct questions arise when the reinsured asks the reinsurer to pay a loss:

(1) Is there in fact a loss?
(2) Is the loss covered as a matter of (a) fact and (b) law under the original insurance contract?
(3) Is the loss covered as a matter of (a) fact and (b) law under the reinsurance contract?

If the answer to questions (1) and (2) is in the negative, question (3) never arises. The "follow the settlements" clause seeks to address question (2) and, as we shall see, the effect of such a clause is to restrict the ability of a reinsurer to argue (or re-argue), that he is not liable to pay a settlement which the reinsured has made on the grounds that the reinsured was not, as a matter of fact or law, liable to the original insured or liable in the amount settled. There is some debate as to whether a follow the settlements clause has any direct bearing on question (3).

It appears from the commercial history of the "follow the settlements" clause that if these, or very similar words, do not appear in a reinsurance contract, then evidence of a loss settlement (even if it is of a payment after the reinsured' s liability to the original insured has been proved in a trial or an arbitration) does not prevent a reinsurer from disputing liability, and that even if the reinsured has acted in good faith, the burden is on him to prove the loss was covered both in fact and in law under the insurance contract and the reinsurance contract.

**Case law**

In *Insurance Company of Africa v Scor (UK) Reinsurance Co. Ltd.* [1985] 1 Lloyd's Rep. 312 (the *Scor* case) the Court of Appeal considered the effect of the following clause in a facultative reinsurance contract:

> "Being a Reinsurance of and warranted same … terms and conditions as and to follow the settlements of the Insurance Company of Africa … "

As a result of this decision the expression "follow the settlements" appears to have become a term of art in English reinsurance law. *Scor* involved both a follow the settlements clause as well as a claims co-operation clause.

The "claims co-operation clause" provided 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 co-operate with the Reassured Underwriters and that no settlement shall be made without the approval of the Underwriters subscribing to this Policy."

On the facts of this case, it was held that the claims co-operation clause emaciated the follow the settlements clause, requiring the English court to retry the matter previously tried before a Liberian Court.

The Court of Appeal in *Hill v Mercantile & General Reinsurance Co. plc.* [1995] L.R.L.R. 160 held that the loss settlement clause in the excess of loss retrocession contracts was a *Scor* type of clause. The loss settlements clause provided as follows:

> "All loss settlements by the Reassured including compromise settlements and the establishment of funds for the settlement of losses shall be binding upon the Reinsurers, <u>providing such settlements are within the terms and conditions of the original policies</u> and/or contracts (or as provided for in the Extra Contractual Obligations clause hereof) and within the terms and conditions of this Reinsurance." (emphasis added)

Reversing the decision of the Commercial Court (Rix J.), the Court of Appeal granted the plaintiffs summary judgment on liability. The House of Lords however reversed the Court of Appeal and gave the defendants leave to defend. The speech of Lord Mustill focuses on the facts and the construction of the particular loss settlement clauses in the retrocession contracts. The passage cited above indicates that the correct approach, as a matter of principle, is to construe the meaning of the particular loss settlement clause (if any) in the reinsurance contract and then consider its application having regard to the particular facts of the case.

The legal effect of a "follow the settlements" clause of the *Scor* type was summarised by Potter J. in *Baker v Black Sea and Baltic General Insurance Co. Ltd.* [1995] L.R.L.R. 261, at p. 283, as follows (emphasis added):

> "The effect of such clause in respect of a claim settled by the reinsured (i.e. when the reinsured have disposed or bound themselves to dispose of such claim, whether by reason of admission or compromise) is as follows:
>
> (i) The reinsurer is not liable if the claim settled does not fall within the risks covered by the policy of reinsurance as a matter of law, but
>
> (ii) The reinsurer is bound to indemnify the reinsured in respect of the settled claim, provided that in settling the claim the reinsured have acted honestly and taken all proper and businesslike steps in making the settlement. In that respect, the burden of proof that they have not so acted rests on the reinsurer.
>
> (iii) The principle in (i) is subject to the qualification that, where the risks the subject of reinsurance are coextensive with those of the underlying insurance and the reinsured has settled a claim of his insured which, arguably as a matter of law, is within the scope of the original insurance, then the reinsurer will be bound to follow the settlement by the reinsured even if, on the issue being fully argued before the Court, it might as a matter of law hold that the claim of the original insured would have failed.
>
> (iv) In relation to the test of whether the reinsured has acted in a businesslike way, he is to be identified with the conduct of his loss adjusters and any other agents employed for the purpose of making the settlement. Thus, he must not only select and appoint his loss adjusters and/or lawyers charged with the effecting of the settlement in a businesslike manner but is answerable for a failure on their part to act with good faith or in a businesslike manner.
>
> Propositions (i)-(iii) are derived from the authority of Scor per Lord Justice Robert Goff at p. 330 and 334 per Lord Justice Fox, as expanded in Insurance Co. of Pennsylvania v. Grand Union Insurance Co., [1990] 1 Lloyd's Rep. 208 (Hong Kong Court of Appeal) at pp. 223-224 per Hunter J.A. and Hiscox v. Outhwaite (No. 3), [1991] 2 Lloyd's L.R. 524 at 530 per Mr. Justice Evans. The authority for proposition (iv) is Charman v. Guardian Royal Exchange Assurance Plc., [1992] 2 Lloyd's Rep. 607 at p. 612 per Mr. Justice Webster."

Proposition (iii) must necessarily be read subject to proposition (ii), i.e. any settlement by the reassured must be proper and businesslike. In Insurance Company of Africa v. Scor *(UK)*, Robert Goff LJ said (at p. 330, emphasis added):

> "In my judgment, the effect of a clause binding reinsurers to follow settlements of the insurers, is that the reinsurers agree to indemnify insurers in the event that they settle a claim by their assured, i.e., when they dispose, or bind themselves to dispose, of a claim, whether by reason of admission or compromise, provided that the claim so recognized by them falls within the risks covered by the policy of reinsurance as a matter of law, and provided also that in settling the claim the insurers have acted honestly and have taken all proper and businesslike steps in making the settlement … In particular, I do not read the clause as inhibiting reinsurers from contesting that the claim settled by insurers does not, as a matter of law, fall within the risks covered by the reinsurance policy; but … I do consider that the clause presupposes that reinsurers are entitled to rely not merely on the honesty, but also on the professionalism of insurers, and so is susceptible of an implication that the insurers must have acted both honestly and in a proper and businesslike manner … Furthermore, in my judgment, if insurers have so settled a claim, acting honestly and in a proper and businesslike manner, then the fact that reinsurers may thereafter be able to prove that the claim of the assured was fraudulent does not of itself entitle reinsurers not to follow the settlement of the insurers. In my judgment, they must follow the settlement, as they have contracted to do; and they must have recourse to their rights of subrogation, arising upon payment of the claim under the policy of reinsurance, in order to seek to rescind the settlement with the assured and to recover the money paid by the insurers under that settlement."

In *Commercial Union Assurance Company plc v NRG Victory Reinsurance Ltd* ([1998] 2 Lloyd's Rep 600), the reinsured entered into a settlement agreement with its insured on the basis of reasonable legal advise that they would lose at trial, essentially because a Texas jury would in all likelihood rule in favour of the insured. There was a loss settlement clause of the Hill v. Mercantile & General type, i.e. there was no express contractual obligation on the part of the reinsurer to "follow the settlements" of the reassured. When the reinsured sought summary judgment in the UK, the Court of Appeal (reversing the lower court), allowed the reinsured leave to defend. Thus, the reinsured who has not agreed a follow the settlements clause with his reinsurer faces a dilemma if the reinsurer does not accept that the claim is covered under the underlying contract.

In *Tokio Marine Europe Insurance Limited v Novae Corporate Underwriting Limited* [2013] EWHC 3362 (Comm) the Defendant, Novae, raised various policy construction issues in an attempt to resist liability under a follow the settlement clause.

In October 2011, Thailand experienced severe flooding. Among the properties damaged were various shops and distribution centres owned by a subsidiary of Tesco Plc. ACE provided insurance to Tesco under a local Thai policy issued by a local insurer, and under a global master policy. Tesco made claims for property damage and business interruption losses arising from the Thai floods. ACE was reinsured by, amongst others, Tokio. Tokio in turn purchased from Novae Corporate Underwriting Ltd. ("Novae") facultative excess of loss reinsurance (the "Retrocession"). The Retrocession Agreement contained a follow settlements clause in these terms:

> "This Contract is subject in all respects … to the same terms, clauses and conditions as original and without prejudice to the generality of the foregoing, Reinsurers agree to follow all settlements (excluding without prejudice and ex gratia payments) made by original Insurers arising out of and in connection with the original insurance…"

Novae resisted liability to Tokio under the follow the settlements clause on the basis that ACE did not take all proper and business like steps in making the settlement with Tesco. Tokio applied for summary judgment against Novae on the basis that this defence had no real prospect of success. In dealing with these issues the Court looked at:

(1) The extent to which reinsurance cover could be presumed to be back to back with an underlying policy; and
(2) The standard of proof applying to a reinsurance policy containing a follow the settlements clause.

In the end, summary judgment was granted against Novae. The Court agreed with Tokio that it merely had to establish that the claim settled by ACE arguably fell within the terms of the Retrocession.

**Summary of Clauses and Effects**

(1) Follow Settlements clause: *Scor*
    (i) if reinsured acted in good faith; and proper and business-like manner in investigating and settlement (re quantum and liability);

(ii) if the claim is *arguably* as a matter of law within the scope of the original insurance; and

(iii) if within reinsurance,

Reinsurer must follow the settlements.

(2) Loss Settlements clause: *Hill v Mercantile*

(i) if within insurance, and

(ii) if within reinsurance,

Reinsurer must follow the settlements.

(3) It should be borne in mind that the loss settlements clause in *Hill v Mercantile* required proof that the loss was actually covered under the original insurance, something that was not strictly speaking necessary, if using a follow the settlements clause of the type used in Scor.

**ASW Law Ltd**

# UK Insurers and Reinsurers' Liability for Late Payment of Claims

Julian Miller
DAC Beachcroft
1 Minster Court
Mincing Lane
London
EC3R 7AA

Tel: 020 7894 6859
Email: jmiller@dacbeachcroft.com

IADC Annual Meeting
Quebec City, Quebec
July 2017

# **UK Insurers and Reinsurers' Liability for Late Payment of Claims**

## Background

Historically, English law has imposed no contractual obligation on insurers or reinsurers to pay valid claims within a reasonable time.  In circumstances where an insured or reinsured proved entitlement to be paid where this had been refused, at best it would be compensated by payment of interest.

This has now changed.  With effect from 4 May 2017 there is implied into every insurance policy and reinsurance contract a contractual term that claims must be paid within a reasonable time.  If payment is not made on this basis, the insured can bring a claim for damage suffered. This will have the potential to exceed policy limits.

The ability of insurers and reinsurers to contract out of these provisions is limited.

This is a new regime under English law.  It represents the latest in a series of reforms to modernise English law governing insurance more generally, and seeks to achieve an appropriate balance in the rights of insurers and insureds.

## The Historical Position

The leading case confirming the historical position is *Sprung v Royal Insurance (UK) Limited* [1].

The insured in this case ran a family business in Liverpool carrying on the collection, processing and redistribution of animal waste products.  The insured's premises were attacked by vandals resulting in the destruction of the insured's machinery required to run its business.  Although the insurers paid out for some items of damaged equipment, the larger part of the claim was rejected. The result was that the insured was unable to continue to trade, or to achieve a sale of his business as he had contemplated.  The insured brought an action and was partially successful, additionally sought to make a claim for damages for late payment.

Lord Justice Evans in the Court of Appeal held that English law does not recognise a cause of action in damages for the late payment of damages.  The claimant would need to show "some other and separate breach of contract".

The principle set out in *Sprung* was generally viewed as a correct analysis of the law albeit having the potential to cause hardship for insureds in certain cases.

---

[1] [1997] C.L.C.70

Notably the decision in *Sprung* was followed in *Tonkin v UK Insurance Limited* [2] even though the general conditions of the insurance policy in that case recognised an obligation on the part of insurers to make payment of claims "quickly". Judge Peter Coulson QC concluded that *Sprung* was binding on him and no additional head of claim could be advanced for any damages sustained as a result of delay on the part of insurers. He noted that this "is just the sort of claim which the authorities …. hold to be invalid". The judge concluded that "the Claimants have no entitlement to make their claims for delay and consequential damages".

In light of these and other cases, the entitlement of insureds was limited to the payment of interest. Since the financial crisis in 2008, interest rates have been sustained at exceptionally low rates, unprecedented in modern times. This has had the potential to be especially unfavourable to insureds. Beyond this however, there was an increasing recognition that in extreme cases this had the potential to result in injustice for insureds.

## The Law Commission

The Law Commission commenced a root-and-branch review of English law governing the obligations of insurers and insureds in the early 2000s. This led ultimately to the Insurance Act 2015 which made a number of key amendments to the law on issues such as the duty of fair presentation on placement of insurance policy, the rights of insurers to avoid, and the consequences of fraudulent conduct.

One issue not picked up by the Act initially related to damages for late payment of insurance claims. As the bill leading to the Act passed through the legislative process, the government faced the risk of electoral defeat. In an effort to preserve the key reforms and simplify the bill, several matters likely to encounter opposition or generate controversy were jettisoned. Damages for late payment was a matter considered at length by the Law Commission which did not survive this pruning. As a result it did not feature in the Insurance Act 2015 as originally passed.

In the event, the same administration remained in office and the Law Commission was empowered to continue its work. As a result, amendments to the Insurance Act 2015 were introduced via other legislation, namely the Enterprise Act 2016. The amendments came into force on 4 May 2017.

## The New Law

There is now an implied term in every contract of insurance that the insurer must pay any sums due within a reasonable time.

[2] [2006] EWHC 1120 (TCC).

Insurers are permitted a reasonable time to investigate a claim. The legislation sets out some of the factors which may be taken into consideration when deciding what is a reasonable time. Size and complexity of a claim are relevant. In addition, the court will take account of matters beyond an insurer's control. The obvious example of this will arise where information or co-operation required from the insured is not forthcoming. A further example is where the insurer requires advice from legal advisers, loss adjusters or other experts. Difficulties have been foreshadowed if the insurer wishes to rely upon advice received, possibly to reject a claim on grounds which at the time the advice is given appear reasonable. English law does not readily facilitate selected, and inevitably self-serving, waiver of privilege over advice obtained. This is likely to be an area which gives rise to difficulties as the law in this area comes under scrutiny.

It should be noted that the insured still has to prove actual damage if it is to make an additional recovery. Damages are not expected to be awarded on an exemplary or punitive basis. Where it is able to prove damage, the insured's entitlement will not be constrained by the normal policy limits.

## Contracting Out

Contracting out of the new provisions is not permitted at all in consumer insurance.

For non-consumer contracts the position is more complicated. It is possible that some insurers will wish to introduce modifications to limit the insured's entitlement to sums within the policy limits. Whether this is possible will depend upon a number of factors. The first, and most obvious, is whether this is commercially feasible in a competitive marketplace. Assuming that it is, the insurer cannot contract out where the delay in payment of a claim is deliberate or reckless. Thus, insurers cannot escape a decision made in bad faith to turn down a valid claim which triggers consequential losses for the insured.

Where the breach is not deliberate or reckless, the insurer may be able to contract out of these provisions, subject to certain safeguards for the insured. Notably the insurer must draw this to the attention of the insured. The level of sophistication of the insured will be taken into consideration when deciding whether this requirement has been satisfied.

## Implications for Reinsurers

There are three points to be considered in a reinsurance context.

The first is that the same statutory provisions apply to reinsurers and reinsureds as in the insurance market. Thus a reinsured who sustains loss due to late payment of a valid claim will have an entitlement to damages. It appears to the writer that the circumstances in which this is likely to apply will be limited. In most cases, an insurance company which purchases reinsurance protections can be adequately compensated in interest. However, there may be exceptions. A reinsured which is already in a financially precarious state may be imperilled by late payment. A captive insurer which has limited resources may also come under strain. While this may happen rarely, the new remedies may occasionally be applicable in a reinsurance context.

I suspect the next two issues are more likely to arise in practice. They relate to payment by the reinsured for damages for late payment to its own policyholder. To what extent in these circumstances should the reinsured be able to recover from its reinsurer a share of this exposure?

In my view, the answer to this lies in who has control over settlement of the claims by the original policyholder. If the reinsurer has control, and directions by the reinsurer trigger this liability on the part of the reinsured, it should expect to bear its share of the additional loss.

Where the reinsurer is bound to follow the settlements of the reinsured, this is unlikely to apply.

I have two concerns arising from this: the first is that one size does not fit all, and reinsureds and their brokers will need to give this consideration in each case. My second concern is that specific drafting not currently found in reinsurance contracts will be required to produce a reasonable outcome.

**Julian Miller**
**DAC Beachcroft LLP**