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Follow the fortunes clauses in reinsurance law – Practical problems in ensuring their effectiveness

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Introductory Work

Abstract

Follow the fortunes or follow the settlements clauses are included in reinsurance contracts by reinsureds wishing to limit their exposure to claims. They are intended to operate by ceding a proportion of claims to other reinsurers further up the chain. This paper examines the practical problems encountered when a $1.2 bn property damage settlement relating to the destruction of the world trade centre passed through various large chains of reinsurance. It highlights the difficulties inherent in long chains of reinsurance which can cause them to break down when follow the fortunes clauses fail to respond as intended and leave reinsureds exposed to losses which they had thought they were protected from.

Key Words: Reinsurance, Follow the Fortunes, Follow the Settlements, 9/11.

1. THE PURPOSE OF FOLLOW THE FORTUNES CLAUSES

Follow the fortunes and follow the settlements clauses at the most basic level are designed as a means by which to cede losses up through a chain of reinsurance, in doing so dissipating losses amongst the market. The clauses have to manage competing commercial interests inherent in reinsurance. In the context of simple reinsurance where a reinsurer reinsures a direct insurer, the reinsured does not want to wait to have its claim settled under the reinsurance whilst the reinsurer reinvestigates the underlying claim which has already been settled, particularly where the reinsurer, being one step removed from the original policyholder, has less information about the loss available to it than the reinsured. Opposing this is the reinsurers interest to avoid being bound to pay claims which may not have been properly adjusted prior to being settled and over which it has no control.

These competing interests become exaggerated in longer chains of reinsurance where the outermost reinsurers can be many stages removed from the direct insurer. It is not uncommon for the identity of the original insured(s) or the other reinsurers who make up the chain to be unknown to the outermost reinsurers at the time of placement, if at all.

2. SINGLE AND DOUBLE PROVISO CLAUSES

The market has tried to formulate wordings in response to these competing interests and certain standard forms have emerged. Two types of follow the settlements clause commonly found within liability reinsurance policies are "single proviso" and "double proviso" clauses. LSW (London Standard Wording) 343 provides an example of a typical single proviso clause found in aviation liability policies:

"Settlements hereunder in respect of losses coming under the scope of clause AVN.48B [War Hijacking and Other Perils Exclusion Clause] from the Reinsured's Excess of Loss acceptances are to follow those made by the Reinsured in all respects…"

The effect of such single proviso clauses under English law was described by Robert Goff L.J. in *Insurance Company of Africa v Scor*[1]*:*

"... the reinsurers agree to indemnify insurers in the event that they settle a claim by their assured, i.e.

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

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."[2]

To cede losses up the chain a cedent/retrocedent must therefore demonstrate to it's reinsurer/ retrocessionaire that;

– the claim settled fell within the risks covered by the reinsurance as a matter of law, and

– it acted honestly and in a proper and businesslike fashion when settling the claim.

LSW 334 provides an example of a common double proviso clause:

"…All loss settlements by the Reinsured including compromise settlements and the establishment of Funds for the settlement of losses shall be binding upon the Reinsurers, providing such settlements are within the terms and conditions of the original policies and/ or contracts… and within the terms and conditions of this Contract."

Materially identical double proviso clauses have featured in a number of English cases. Their effect is more complex and nuanced than that of single proviso clauses but there are a number of points worth noting:

– It does not necessarily follow that a settlement within the terms of the primary insurance will be covered by any reinsurance or retrocession. The reinsurer or retrocessionaire's obligation is to follow a settlement only where it is within both the terms and conditions of the original policies and of the reinsurance / retrocession.[3]

– A reinsured can be required to demonstrate not just that it acted in good faith and in a sensible and businesslike manner when it settled the claim but also that it was legally liable for the claim. A risk of an adverse jury determination at first instance, however great, does not necessarily equate to legal liability. Whilst there may be good commercial and businesslike reasons for settling a claim in such circumstances, if the insurer / reinsurer cannot demonstrate that the settlement was of a perceived legal liability the reinsurer / retrocessionaire will not be obliged to follow it.[4]

– There is a distinction between matters of fact and matters of law. The insurer's sensible and good faith determination of the facts underlying the settlement will bind the reinsurer/retrocessionaire. However, the insurer/reinsurer must still prove (on the balance of probabilities) to the reinsurer / retrocessionaire that those facts, if proven, would have given rise to a liability within the terms of the reinsurance / retrocession.[5]

– Ordinarily a finding of liability by a court of competent jurisdiction that the insured or insurer was liable would be conclusive to establish the existence of a liability. Where the loss relates to a settlement the relevant test is whether, on the balance of probabilities, the matters of fact alleged (had they been proven) would have given rise to a liability under the relevant governing law and that this was a liability of a type within the terms of the relevant contract.[6]

Certain distinctions can be drawn between the effect of single and double proviso clauses. Single proviso clauses require the reinsured to prove that the claim recognized by the admission or settlement falls within the risks covered by the reinsurance as a matter of law. Double proviso wordings go further to oblige the reinsured to prove that the claim as recognised also fell within the risks covered by the underlying insurance / reinsurance. Under a single proviso clause the insurer / reinsurer seeking to bind its reinsurer / retrocessionaire to a settlement need only prove that the claim fell within the terms of the reinsurance and that it acted honestly and took all proper and business like steps in settling it. Under a double proviso clause it must additionally prove that the claim as recognised also fell within the risks covered by its own inwards insurance / reinsurance as a matter of law.

Beyond these requirements, neither single or double proviso wordings exempt the reinsurer from being required to demonstrate the existence of an insured interest. In the case of liability insurance the insured interest is a liability of the type covered. *Wasa v Lexington*[7], which concerned very broad follow the settlements language aimed at providing back to back cover[8], clarified that under English law a reinsurance contract is independent of any underlying insurance contract and liability under a reinsurance contract will only arise in respect of risks falling within the cover created by that reinsurance. That position is not affected by the inclusion of follow the fortunes or follow the settlements wording. Hence there remains a fundamental requirement to demonstrate the existence of a liability of a type insured.

[2] [1985] 1 Lloyd's Rep. @ 330 left hand column.

[3] *Hill v Mercantile & General* [1996] 1 WLR 1239.

[4] *Commercial Union v NRG Victory* [1998] 2 Lloyd's Rep 600.

[5] *Hill v Mercantile*, ibid.; *Equitas v R&Q Reinsurance* [2009] EWHC 2787 (Comm.).

[6] *Equitas v R&Q* and *Commercial Union v NRG*; ibid.

[7] *Wasa v Lexington* [2009] UKHL 40.

[8] *"Being a reinsurance of and warranted same gross rate, terms and conditions as to follow the settlements of the Company…"*

3. THE NATURE OF 9/11 LOSSES

The images of 9/11 are well known, particularly the destruction of the twin towers of the World Trade Centre ("WTC") when two commercial aircraft, having been hijacked as part of a co-ordinated terrorist attack, were deliberately flown into them. The resulting impact on the insurance market was large, estimated at around $ 40 bn.[9] The largest categories of insured loss were loss of life and personal injury and property damage and business interruption.[10] Loss of life and personal injury claims were addressed primarily through the September 11 Victim Compensation Fund, James Zadroga 9/11 Health and Compensation Act and a number of cases brought against the airlines, security companies, Port Authority of New York and New Jersey and City of New York.

At the time of writing, property damage and business interruption claims remain an ongoing issue but a significant step towards finalising them was taken on 1 July 2010 when the New York Court[11] approved a $ 1.2 bn settlement[12] in favour of a number of subrogated insurers and plaintiffs asserting claims for uninsured losses relating to business and leasehold properties destroyed or damaged as a result of the WTC attack. The settlement was entered against American and United Airlines (the operators of the two planes which were used in the attack) and Globe[13] and Huntleigh[14] (the security companies employed to screen passengers by the two airlines respectively). These parties were known collectively as the "Aviation Defendants."

Some terms of the settlement agreement remain confidential but they are not of themselves significant to this paper. Of significant is the background against which the settlement was entered into as this has influenced the reaction of certain reinsurance market participants and has been the source of a number of difficulties raised in the application of follow the settlements provisions. In summary:

– Following the events of 9/11 the US government, by an act of congress, passed the Air Transportation Safety and System Stabilization Act of 2001[15] ("ATSSSA"). This act limited the liability of the Aviation Defendants for claims brought in relation to the events of 9/11 to the amount of their available liability insurance.[16]

– The US courts, specifically through a ruling of Judge Hellerstein[17], affirmed that the amounts paid by the Aviation Defendants counted towards the limits of liability set out by the ATSSSA.

– In 2003 a motion was brought in New York before Judge Hellerstein[18] to dismiss personal injury claims brought against the Aviation Defendants (amongst others) as groundless because no duty of care existed between the Aviation Defendants and victims on the ground. Judge Hellerstein provided a view that such a duty did exist but specifically did not address the scope of that duty, whether the acts of the terrorists could have breached the chain of causation or whether the Aviation Defendants had any liability to anyone on the ground, leaving this open to challenge.[19]

– The original claim brought by the parties to the settlement was approximately $ 4.4 bn. After an extensive period of discovery and vast document review the parties had failed to reach a compromise and agreed to enter into a mediation process in which retired U.S. District Judge John S. Martin, Jr acted as the mediator. At the conclusion of a 2 week mediation the parties positions were still far apart and the settlement figure agreed to was one proposed by the mediator. Described as a "mediator's number" the settlement amount of $1.2bn proposed by Judge Martin was believed by him to "represent a reasonable settlement of all of the Settling Plaintiffs' claims." It reflected a 72 percent discount from the Settling Plaintiffs' total claimed damages of $ 4.4 billion, and was higher than the last settlement offer by the Aviation Defendants.[20]

– The settlement released both the Aviation Defendants and their insurers from all claims brought by the settling parties.

[9] 9/11 and Insurance: The Eight Year Anniversary, Insurance Journal, Sept 11 2009.

[10] Insurance Information Institute.

[11] Judge Hellerstein, sitting in the United States Southern New York District Court.

[12] This judgement was appealed but the Appeal was denied and the judgement affirmed by the U.S. Court of Appeals Second Circuit on 8 April 2011.

[13] Globe Airport Security Services, Inc.

[14] Huntleigh USA Corp.

[15] Pub. L. No. 107-42, 115 Stat. 230 (2001) (codified as amended at 49 U.S.C. § 40101).

[16] ATSSSA Section 408(a)(1).

[17]Sitting in the Southern New York District Court and confirmed by the U.S. Court of Appeals Second Circuit.

[18] Sitting in the United States District Court, Southern District of New York.

[19] Page 12 of the Opinion and Order Denying Defendants' Motion to Dismiss in Re September 11 Litigation, 9 September 2003.

[20] Ruling of Debra Ann Livingston (Circuit Judge) in a ruling by the U.S. Court of Appeals Second Circuit on 8 April 2011.

– The settlement was apportioned 60/40 between American and United Airlines and their respective security companies.

– The settlement exhausted the limits of Huntleigh's insurance cover.

From the facts above it is apparent that a reinsurer presented with a claim for a proportion of the $ 1.2 bn settlement would have reasons to question whether the settlement was strictly one of liability or whether there were commercial motives behind it. There was never any finding of liability against the Aviation Defendants. On one analysis it could be assumed that there was only perceived to be a 28% risk of the Aviation Defendants being held liable (the inverse of the 72% discount proposed by Judge Martin as representing a reasonable settlement and accepted by the parties), a significant discount if the quantum of the claim was even approximately accepted. There had been questions raised over whether the Aviation Defendants could ever be legally liable to ground victims, as highlighted by the points raised in the motion to dismiss the 2003 personal injury claims. Finally, insurers, whilst not benefitting directly from the settlement, would have been reassured that it eroded the limit of the Aviation Defendants (and consequentially their own) liability due to the operation of the ATSSSA.

For at least these reasons, upon being presented with claims by their inwards reinsureds, certain reinsurers questioned whether the settlement represented a settlement of a genuine liability or was essentially of a commercial or ex-gratia nature.

This is a common situation and one which insurers wish to avoid. In such circumstances insurers would prefer not to have the burden of proving the nature of a settlement or compromise agreement reached to their reinsurers before having claims paid. The same is true of reinsurers when presenting losses to others further up the chain. In the case of large losses such as this, there are many layers of reinsurance/retrocessionary cover potentially responding and the desire to avoid having to re-prove the nature of the original loss becomes even more acute as one moves further from the original insurance policy. There are a number of reasons for this:

– The further removed the relevant retrocessionaire is from the original insured the less information it is likely to have available to it as to the nature of the underlying loss.

– Remote reinsurers/retrocessionaires have little or no access to the underlying insured or insurer to investigate losses independently.

– Requiring the nature of the underlying loss to be proved at each level of the chain would require an additional time and cost burden on each reinsurer / retrocessionaire.

The WTC settlement provides an example of a large loss making its way up through a typical chain of reinsurance. In addressing the practical problems and difficulties encountered when trying to apply typical follow the settlements clauses this paper centres around the application of some of the more common follow the settlements and follow the fortunes clauses under English law for convenience, however, the nature of the problems identified means that they are likely to also be encountered when the underlying insurance, or intermediary contracts within the chain, are subject to different governing laws.

4. SPECIFIC DIFFICULTIES ARISING OUT OF WTC LOSSES

The WTC property damage claims have highlighted a number of practical difficulties in giving effect to follow the fortunes clauses, particularly but not exclusively the double proviso wording described. Primarily difficulties have arisen due to the remoteness of the reinsurers / retrocessionaires from the underlying settlement. The settlement was negotiated and paid by the airlines and their insurers. Those insurers have, in the normal way, looked to pass on a proportion of that settlement to their reinsurers, and, where they have paid, those reinsurers have looked to pass on a further proportion to their reinsurers and so on. This is completely typical for a large loss event.

At various levels in the chain certain reinsurers have sought to challenge the loss presentation and required the cedent to demonstrate that it falls within the terms of the particular reinsurance. Given the size of the loss multiple layers of cover have been triggered and again, as typical in large chains placed, many of the reinsurance contracts have been negotiated by different brokers and placed with different reinsurers on different terms. Typical differences between the reinsurance contracts include different governing law and jurisdiction clauses, different exclusions, different dispute resolution provisions and different aggregation provisions. Similarities in the contracts are the existence of follow the settlements provisions such to those described above.

This exemplifies in practice, the competing commercial interests described above. Reinsurers write policies based on their view of a particular risk. Depending on their view of the risk they write policies on particular terms. Those terms, including aggregation and governing law provisions form the

essence of the bargain between the parties and the basis upon which they choose to contract. The fact that these provisions commonly vary between insurers and between particular policies highlights reinsurers desire to assess each risk individually and to adjust the bargain accordingly. Follow the fortunes clauses are the means by which losses are passed up the chain of reinsurance and losses dissipated amongst the market. It is important to reinsurers that they operate effectively but it is also important that they do not alter the nature of the bargain entered into.

4.1. Aggregation

Typical examples of aggregation language found within the relevant reinsurance agreements are as follows:

"each and every loss or accident or occurrence or series thereof arising out of one event, each aircraft."

"All such losses sustained by the Reinsured which occur during any one period of 24 consecutive hours and within an area of radius 10 miles which arise from one of the perils stipulated in clause AVN.48B [War Hi-jacking and other perils]."

When applied to the facts of 9/11 it is easy to see how under English law at least these two different forms of aggregation language can produce very different results in terms of the amount of cover available. The first specifies that losses can only be aggregated "per aircraft" and in the case of the WTC claims there were 2 aircraft involved, hence in simple terms a minimum of 2 losses. Under the second set of language it is possible to see the destruction of the twin towers as a single event.

The fact that different aggregation provisions apply at different levels of cover causes problems in terms of passing losses up the chain. Many reinsurers have tried to rely on follow the fortunes clauses to achieve this but in the case of double proviso clauses at least, it does not follow that just because the inwards reinsured settled claims on a two event basis that the reinsurer is also obliged to settle on the same basis. It is clear from the established meaning of such clauses that they do not affect the reinsurer's ability to specify independent aggregation conditions within it's own cover to that in the layers below.

This leaves reinsurers with a problem where they have settled the claim on a two event basis and applied two limits of cover but can only pass the same losses up the chain on a one event basis. They are often left out of pocket due to the effect of policy limits and applicable excesses.

The situation can become further complicated when different governing laws apply to inwards and outwards reinsurance contracts. In such circumstances even identical aggregation wordings may result in different results under the two contracts due to the different interpretations given to them. English law, for example, determines an "event" by applying the "unities" test set out in the *Dawson's Field* arbitration and later approved in *Kuwait Airways*[21] but the same does not apply to all other jurisdictions.

4.2. Requirement To Prove The Loss

The meaning of double proviso type follow the fortunes clauses has been the subject of significant debate in English Courts, the seminal ruling on the subject is that delivered by Lord Mustill, sitting in the House of Lords (the highest appellate court in England at the time) in the case of *Hill v M&G*[22]. Aside from summarising a number of the commercial issues which the clause attempts to tackle[23], Lord Mustill's judgement makes a number of important points about the meaning and effect of such clauses, distilled to the following two principles:

– The reinsurer cannot be held liable unless the loss falls within the cover of the policy reinsured and the within the cover created by the reinsurance.

– The parties are free to agree on ways of proving whether these requirements are satisfied. [24]

"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."[25]

In the context of the WTC settlement it is therefore incumbent upon reinsurers to demonstrate firstly that they conducted a proper and businesslike assessment of the facts underpinning the settlement (as presented to them by their cedents) and secondly, that had those facts been proven they would, on the balance of probabilities, have given rise to a liability to the Aviation Defendants under New York law. This does not mean that to have their claims paid reinsurers are required to reconstruct hypothetical litigation and demonstrate that the Aviation Defendants would in fact have been found liable by a New York Court, the follow settlements clause removes that requirement. What it does not

[21] *Kuwait Airways Corporation v Kuwait Insurance Co SAK* [1996] 1 Lloyd's Rep 664.

[22] *Hill and Others v Mercantile and General Reinsurance Co. Plc.* [1996] 1 W.L.R. 1239 – Lord Mustill's judgement was approved by 4 other law lords sitting with him; Lord Mackay of Clashfern L.C. , Lord Goff of Chieveley, Lord Slynn of Hadley and Lord Hoffmann.

[23] Ibid. – Lord Mustill's judgement, as recorded from paragraph E, p. 1251 onwards.

[24] Ibid.

[25] Ibid.

remove, however, is a requirement for the reinsurers to show that prima facie, on the facts presented to them regarding the settlement it was of a type which would have been covered under the original policies as well as the reinsurance. On one measure that does not in itself impose a particularly high burden to overcome. It aims to balance the needs of retrocedents who want to avoid complex and expensive reinvestigation of the loss with reinsurers who do not wish to be bound to pay losses outside of the scope of the original liability cover when, for commercial reasons which do not affect them, the inwards insurers may have chosen to pay them regardless.

A number of practical issues arise due to the fact that reinsurances at different levels of the chain contain more or less restrictive follow the settlements clauses and are subject to the application of different governing laws.

There are situations in which reinsurers have very broad follow the fortunes language in their inwards policies but more restrictive language in their outwards. This can lead to the reinsurer being required to settle claims under its inwards policies on very limited information regarding the nature of the settlement. The retrocedent when it then seeks to pass a share of the loss it has settled up the chain, can be confronted with a retrocessionaire who, given more restrictive follow the fortunes language, may enquire as to the basis on which the reinsurer paid that loss. If the reinsurer has paid it blindly in consideration of broad follow settlements/fortunes language within its inwards policy, it may not have sufficient information available to it to be able to satisfy the more restrictive follow the fortunes clause in the outwards policy. Being far removed from the original loss, it is also not in a position to obtain this information and its own cedent (who may also have paid blindly) has no real incentive to request further details. In that case the reinsurer, who prior to the loss took comfort in the fact that it had ceded much or all of any liability it may have on the basis of standard follow the fortunes wording, can discover that the reality of the situation means that it cannot do so and must retain the full loss itself.

Problems also arose as a result of different governing laws in the inwards and outwards contracts. This is common where reinsurers based in various jurisdictions around the world agreed to write cover on the basis of the law governing their own jurisdictions. Whilst this is understandable, it often fails to give consideration to the fact that the same follow the fortunes clause may be treated differently with respect to different governing laws. Whereas English law, for example, is reluctant to impose an unconditional obligation on reinsurers to follow settlements made under the inwards policy without very clear wording to that effect in any case due to the requirement to show the existence of an insured interest), other legal regimes take a wider view of follow the fortunes and follow the settlements provisions. In the US, for example, an assured under a liability policy can recover the amount of a settlement from insurers without establishing actual legal liability so long as a potential liability can be said to exist on the facts known to the assured and the settlement amount is reasonable in view of the size of the possible recovery and degree of probability of the claimant's success against the assured[26]. That is much wider than the requirement under English law to demonstrate that the prospects of liability exceeded 50% based on the underlying facts (the balance of probabilities threshold). The WTC settlement was agreed at a 72% discount to the claim. If that reflected (even approximately) the parties views of the prospects of the aviation defendants being held liable it would not be sufficient to bind insurers to the settlement under an English law policy. In contrast, under US law[27] the fact that the possibility of liability existed, coupled with the low level of the settlement means that insurers would be bound to the settlement.

The issue is not confined to double proviso wordings. As explained earlier, *Wasa v Lexington*[28] clarified that even single proviso wordings, whilst focussing on the terms of the immediate reinsurance do not exempt the reinsured from being required to demonstrate the existence of an insured interest. Under English law a reinsurance contract is independent of any underlying insurance contract and liability under it will only arise in respect of risks falling within the cover created by the reinsurance. That position is not affected by the inclusion of follow the fortunes or follow the settlements wording. Hence, where different governing laws apply in respect of the original insurance and the reinsurance or retrocession, it can lead to differing results in terms of the application of follow the fortunes provisions.

There are examples where the WTC settlement falls both within and outside of the terms of cover of specific reinsurance contracts due simply to slight variations in the terms of follow the fortunes or governing law clauses within those contracts and the inwards contracts to which they relate. In almost all cases the reinsurers concerned believed, prior to the loss, that follow the fortunes clauses would allow them to cede, further up the chain, any losses which they were obligated to pay.

[26] *Luria Brothers & Co v Alliance Assurance Co Ltd* 780 F 2d 1082 (2nd Cir 1986) – a decision under Delaware State law.

[27] At least Delaware law, although this would be likely to also follow in other states.

[28] *Wasa v Lexington* [2009] UKHL 40.

These variations, often unknown to them at the time of placement, have resulted in a breakdown in the chain and in certain cases either only a lower proportion of the loss has been capable of being ceded due to the aggregation issues discussed, or in some cases the chain has been broken completely due to an inability on the part of the retrocedent to satisfy the requirements of the follow the fortunes clauses.

5. POSSIBLE SOLUTIONS

In examples such as this, reinsurers further up the chain were far removed from the underlying policies and were often reinsuring, for example, the retrocedents full book of aviation business. They did not know at the time of placement what underlying contracts existed or the law applicable to them. In some cases they were unaware of the governing law or terms of their retrocedents inwards policies under which losses were ultimately presented to them.

In hindsight reinsurers who have avoided liability may argue that the clauses operated as intended but this view will not be shared by many who have been unable to successfully cede their losses. It is clear that this is an undesirable situation for the market and highlights a potential risk throughout all reinsurance chains.

One solution may be to ensure that all contracts of reinsurance are placed on terms so broad as to unconditionally bind reinsurers to follow any payments made by the inwards reinsured. This would solve the problem of being able to cede losses, but it would not address the desire of reinsurers to control the terms on which they are providing cover. It also fails to avoid the potential problem highlighted by *Wasa v Lexington* in cases where different governing laws can be applied to the insurance and reinsurance.

Another solution may be for all reinsurers to adopt a single standard form contract applying the same governing law. This would eliminate variation in treatment of the loss at different stages in the chain and allow for some interrogation of the underlying loss but would remove the ability of reinsurers to negotiate an independent bargain and may force them to contract under an unfamiliar system of law.

Another solution may be to adopt an independent system of standard form reinsurance contracts similar in concept to the Bermuda form but designed specifically for long chains of reinsurance. If all reinsurers were willing to contract under a single system it would remove the uncertainty inherent in long chains introduced by incompatible variations in the terms on which cover in the chain below has been placed. This would be practically difficult to establish and would require commitment from the market as a whole if it were to be effective, but may allow for a solution which would continue to permit the operation of follow the fortunes clauses within certain parameters, whilst also allowing for reinsurers to adapt the scope of cover they may provide at any particular stage in the chain.

6. CONCLUSION

The practical problems described will be of general application to many long chain reinsurances due to the nature of the market. There is no obvious or easy solution which will allow certainty that any chain will function so long as reinsurers wish to retain some degree of control over the adjustment of claims at the lowest level of the chain and of the limits to the cover they write.

SUMMARY

Long chain reinsurance has an inherent problem in that those contracting higher up the chain do not know the terms upon which those lower down have contracted and often have not seen the underlying insurance. The inclusion of follow the fortunes or follow the settlements clauses is not enough to guarantee that losses will be successfully ceded up the chain and distributed amongst the market. As has been seen with the WTC property damage settlement, differences in governing law and in the scope of reinsurance cover at various stages in the chain, particularly aggregation language, can cause such chains to break.

Differences in governing law and policy terms are not visible to all those in the chain at the time of placement making potential problems hard to foresee. There is a real issue as to whether it is possible to guarantee the successful operation of long chains of reinsurance through follow the fortunes clauses, whilst retaining some independence of the bargain entered into by those within the chain.