THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS.
SUPERIOR COURT

BEFORE THE COURT-APPOINTED REFEREE
IN RE THE LIQUIDATION OF THE HOME INSURANCE COMPANY
DISPUTED CLAIMS DOCKET

In re Liquidator Number:	2005-HICIL-7
Proof of Claim Number:	RAHM700335
	RAHM331506
	INTL709436
	RAHM700333
	RAHM70034
Claimant Name:	Kingscroft Insurance Company Ltd.
	Walbrook Insurance Company Ltd.
	El Paso Insurance Company Ltd.
	Lime Street Insurance Company Ltd.
	Mutual Reinsurance Company Ltd.

ENGLISH LAW AFFIDAVIT OF JOHN FREDERICK POWELL IN SUPPORT OF RESPONSE IN OPPOSITION TO LIQUIDATOR'S REPORT AND RECOMMENDATION ON KWELM COMPANIES' PROOFS OF CLAIM

JOHN FREDERICK POWELL, being duly sworn, deposes and states the following:

1. I am a solicitor of the English Supreme Court and a partner of Lovells, counsel to Century Indemnity Company ("CIC"). I head Lovells' global insurance and reinsurance practice area. I am one of the founders of the arbitral body ARIAS UK, which came into being in 1999. I am a vice chair of that organisation. I submit this affidavit based on my knowledge and experience in the area of insurance and reinsurance and in the area of arbitral dispute resolution over the past 36 years, as well as a review of documents where indicated below, in support of CIC's response in opposition to the report and recommendation of Roger A. Sevigny, Commissioner of Insurance for the State of New Hampshire, as Liquidator (the "Liquidator") of the Home Insurance Company ("Home") regarding the above-captioned KWELM companies' proofs of claim, dated March 15, 2006 (the "Report").

2. In this affidavit I will briefly describe schemes of arrangement under English law in general and the KWELM companies' scheme of arrangement in particular. As I more fully set out below, I conclude that:

(i) the KWELM scheme can neither in law - nor is it intended to - determine the claim of the KWELM companies against the Home for any purpose other than determining a setoff amount. This it does for the sole purpose of enabling the equitable calculation of the creditor dividend payable to the Home under the KWELM scheme;

(ii) the KWELM scheme can neither in law nor does it purport to alter the terms of reinsurance contracts between KWELM and the Home, under which KWELM's claim against the Home arises;
(iii) the KWELM scheme only binds creditors of KWELM in their capacity as creditors. It binds creditors in their capacity as debtors solely to enable the equitable assessment of a debtor offset amount to be set against a creditor balance. Under English law the KWELM scheme cannot and does not bind debtors in any way except that it makes specific provision for the reduction of creditor balances by way of assessed offset for the sole purpose of determining creditor balances for dividend calculation. KWELM has thus far agreed with this position in writing (see, for example, Exhibit C of the Report) and by its actions thus far in the Home proceedings (filing and prosecuting its proofs of claim in the New Hampshire proceedings); and
(iv) the contracts of reinsurance between KWELM and the Home, which are governed by English law, do not allow recovery of estimated potential future loss, such as IBNR claims, and in the absence of express contractual provisions, English law does not allow assertion of a claim against a reinsurer based on an IBNR claim or upon an IBNR element contained in an agreed commutation.

I. Schemes of Arrangement under English Law

3. Section 425 of the Companies Act 1985 ("section 425") enables the rights and obligations of a company and its creditors and members (shareholders) to be altered through a section 425 scheme of arrangement ("scheme") with the sanction of the court by means of a compromise or arrangement. A scheme does not in any way alter the rights of debtors to the scheme company and cannot affect the rights of third parties who were not a party to the scheme.

4. Section 425 is a Companies Act procedure. Although schemes of arrangement are often used as a means to distribute the assets of insolvent London Market insurers such as KWELM, the scheme procedure is not a bankruptcy process. The scheme procedure is a statutory means of imposing a compromise. It is often used when two companies merge. It is more flexible than English insolvency process. In particular, in the case of insurance, the use of a scheme allows the submission and evaluation of claims against an insolvent insurer or reinsurer to be tailored to the particular circumstances of the business. The result is a mechanism that enables claims to be processed more quickly and for assets to be distributed to creditors earlier than would otherwise be the case. And more particularly it permits reinsurance collections to be made in the ordinary course of business pursuant to existing contractual obligations for the benefit of creditors generally. Liquidation makes this problematic.

5. A scheme becomes binding on the scheme company and its creditors (or a class of creditors) once (a) the scheme is voted on and approved by a majority of the creditors representing 75% of creditors by value, (b) the scheme is sanctioned by the court, and (c) an

office copy of the court order sanctioning the scheme is delivered to the Registrar of Companies for registration.

6. Once a scheme is sanctioned there is no ongoing supervision of it by a court. The scheme administrator is left to manage the company in strict compliance with the provisions of the scheme.

II. The KWELM Scheme

7. In 1994 a run-off scheme of arrangement was sanctioned for the KWELM companies under section 425. The principal feature of a run-off scheme for insurance companies is that claims continue to be submitted in the ordinary course when losses arise and are adjusted in the ordinary course. If the claim is agreed under the terms of the relevant contract entered into between KWELM and its creditors, KWELM's liability is admitted as between company and the creditor. Once a claim is admitted under the scheme, KWELM may properly make a claim against its reinsurers (in this case, The Home). Although the company will admit claims, under the terms of the scheme it is not obligated to pay such claims to its creditors. The company will, from time to time, pay a percentage amount of those claims to those creditors whose claims are admitted. It will always retain sufficient assets to make similar distributions to those creditors whose claims may be admitted in the future.

8. In 2004, the KWELM converted its scheme from a runoff scheme into a commutation or "cut-off" scheme (the "KWELM Scheme"), a copy of which is annexed hereto as Exhibit A. The purpose of a commutation scheme is to achieve finality by implementing a procedure through which all present and future claims against the company can be estimated on a once and for all basis. Under a commutation scheme, a company can agree and pay creditor claims earlier than would be the case had the claims arisen and been agreed and paid in the ordinary course. The effect of the commutation scheme as to unmatured and unliquidated future claims, such as claims falling in the IBNR category, is that KWELM and their creditors agree that KWELM companies will estimate and accept for dividend purposes those claims falling within the IBNR category. The actuarial methodology to be applied for this purpose by the Scheme Actuary is also set out in the KWELM Scheme.

9. In order to achieve finality under a scheme and assess whether dividends will be payable to a creditor, where there are monies owed to the scheme company by a creditor, the scheme will provide for a setoff procedure to enable the company to make payment of the creditor's net, rather than its gross, claim. Part 9 of the KWELM Scheme sets forth the procedure for determining setoffs for purposes of the scheme. This part deals with "Outward Reserves and IBNR" and "Outwards Unpaid Losses" and sets out the procedure for assessing, for scheme purposes only, the actual and potential future liabilities of a Scheme Creditor in its capacity of

reinsurer. Under part 9 of the KWELM Scheme, the debtor balances owed by such a Scheme Creditor are determined by "the application of the principles, policies and assumptions comprised within the Estimation Methodology" (paragraph 9.4.25 of the KWELM Scheme). These same principles apply to the estimation of claims against the KWELM companies. They are assessed as of the Valuation Date. In the assessment procedure, the Scheme Administrators, the Scheme Adjudicator and the Scheme Actuary are entitled to take into account, amongst other things, market information and developments.

10. The KWELM Scheme is not binding on scheme creditors in their capacity as debtors but provides for an agreement on a debtor balance (up to the amount of the creditor's gross claim) for the purpose of giving effect to set-off and allowing the net agreed claim to be paid. It is not a process pursuant to which KWELM could in any circumstance submit a claim against its creditors for Outwards IBNR, or for Outwards Unpaid Losses.

11. Section 2.5.3 of the KWELM Scheme makes clear the limited purpose of the setoff provisions of the scheme. Section 2.5.3 states as follows:

> "When quantifying the amount of a Scheme Creditor's Established Scheme Liabilities (**but not otherwise**), such Established Scheme Liabilities shall be reduced or eliminated by set-off of the amount agreed and/or determined in accordance with Part 9 of any contingent and/or prospective liabilities of the Scheme creditor top the relevant Scheme Company". (Emphasis added.)

12. In this process, no liability is established on the part of either KWELM or the relevant creditor. If the amount owing to KWELM exceeds the amount owing to the creditor, the creditor's claim in the Scheme is zero. Conversely, if the amount owing to KWELM is less than the Scheme Creditor's claim, the creditor will receive a dividend. The Scheme, therefore, arrives at a debtor balance solely for the purpose of establishing a creditor balance after offset. The KWELM Scheme does not establish a liability for either the debtor or creditor. The application of the methodology in the KWELM Scheme to the assessment for set-off purposes of a debtor balance is designed to achieve substantive fairness between Scheme Creditors, not to determine liability.

13. For example, if the agreed estimation methodology established a creditor balance of 100 and a debtor balance of 150, the valuation of the creditor balance for Scheme purposes would be zero. If the company (here, KWELM) wished to recover the additional 50 debtor balance it would need to commence proceedings under the relevant reinsurance contract and show that the entire 150 claim was actually due under the terms of the reinsurance contract. The estimation of a 150 debtor balance would be irrelevant. The fact that no such actions have been

commenced by KWELM illustrates their belief that no such balances would be recoverable under the terms of the reinsurance contract.

14. Not only is the purpose of the KWELM Scheme different from the purpose of the Home liquidation's Claims Procedure Order and Protocol, the Protocol and the Scheme propose entirely different methodology for assessing claims and would inevitably lead to entirely different results. This is not surprising. The KWELM Scheme sets out its own methodology designed within the intent to establish equity between creditors of KWELM. The Protocol is designed to establish liability under contracts of reinsurance in accordance with the applicable law and the contract terms. The latter is not the function of the KWELM Scheme.

15. My understanding of this position as set out above is confirmed by KWELM Management Services representing the KWELM Scheme Administrator. I refer to the exchange of correspondence between ACE European Group and KWELM Management Services of 12 April 2005 and 14 April 2005 (which appear as Exhibits B and C). In the latter letter, KWELM Management Services state that the sole determinant of liability for debtor balances to be used solely for set-off purposes is the Scheme procedure. It does not determine debtor balances for any other purpose. Such balances must be recovered "by agreement, or ...by arbitration under the relevant contracts". Here the KWELM Scheme has no application. In fact, I understand that KWELM has thus far behaved accordingly by prosecuting $1.7 million of its claims in the Home liquidation proceeding pursuant to the Claims Procedure Order and Protocol approved in the Home's proceeding.

16. It is the responsibility of ACE-INA Services UK Limited ("ASIUK") to handle claims presented by KWELM in the estate of the Home Insurance Company pursuant to an Insurance and Reinsurance Assumption Agreement between Century Indemnity and Home. On behalf of Home, and not otherwise, AISUK represented Home in the KWELM Scheme. On 12 April, AISUK wrote to the KWELM Scheme Administrators to confirm the status of the KWELM Scheme in relation to debtor balances. In particular, ASIUK asked for confirmation that:

(i) "*the Scheme provides a uniform structure for agreeing or assessing the amount by which debtor balances as agreed or assessed by the application of the Scheme principles are to be set off against the agreed or assessed creditor balances which are also agreed or assessed by the application of the same Scheme principles*"; and that

(ii) "*once the scheme assessed debtor balance reaches an amount equal to the scheme assessed creditor balance, then the sum admitted in the Scheme becomes zero. In such circumstances a net debtor balance cannot be assessed under the Scheme, is outside the Scheme and is recoverable only under the particular contract or contracts under which the debtor balance entitlement arises*".

17. The KWELM Scheme Administrator responded by letter of 14 April 2005. This letter stated, *inter alia*, that "the Home Insurance Company as a Scheme Creditor is bound by the terms of the KWELM Scheme." It also stated that the above paragraph in the letter of 12 March

> "*broadly conforms to our understanding of the position. Within the terms of the Scheme, a Scheme Creditor whose claim is exhausted by set-off, such that the claim is reduced to zero, becomes an Offset Creditor, a term defined in clause 1.1.1 of the Scheme. In relation to such Offset Creditors KWELM will look to recover the remaining net debt either by agreement or if necessary by arbitration under the relevant contracts of reinsurance.*"

18. As stated above, AISUK represented Home in the KWELM proceedings. However, AISUK did so on the specific understanding that Home considered that claims against Home had to be adjudicated and determined in the New Hampshire liquidation of Home. This position was reiterated in the letter of 12 April 2005 referred to above. Thus, it is incorrect for the Liquidator to state that CIC though AISUK "fully participated" in a "determination" of KWELM's claim under the Scheme or otherwise.

19. It is also clear that the claims procedure required by the Claims Procedure Order and the Protocol in the Home proceedings differs significantly from the claims assessment procedure under the restated KWELM Scheme. Under the Kwelm Scheme, the only form of dispute resolution as between a creditor and the company is as specified in Part 9 of the scheme. Disputes are to be adjudicated by a person appointed under the Scheme. The procedure for determination of these disputes is provided for in the Scheme document. No oral representations are permitted. The adjudication will determine both unpaid paid claims, outstanding claims and IBNR, the latter discounted to present value and assessed in accordance with the actuarial methodology provided for by the Scheme itself. The determination of creditor balances by the adjudicator is final, binding and subject to no appeal. Similarly, the adjudicator determines - for offset purposes only - debtor balances due by the creditor using exactly the same methodology.

20. This procedure adopted in the KWELM Scheme differs significantly from normal dispute resolutions and from the procedures adopted under the Protocol. Under the Scheme, the KWELM companies determine both the creditor balance and the offset debtor balance. They notify the creditor of these balances. If the creditor takes no steps within 30 days to object, then the determination is binding upon him. The creditor has no appeal. (9.4.19). If an objection is raised, the matter is referred to the Scheme Adjudicator (19.4.21). The Scheme Adjudicator will then consider the papers forwarded to him by the Scheme Administrators. He will then decide within 30 days whether he "requires further written explanations, documents, data or information from the Scheme Creditor, the Scheme Administrators, the Scheme Actuary or other Scheme

Companies" (9.5.2(a)). "In no circumstances whatsoever shall the Scheme Creditor (or their duly authorised representative) be entitled to appear before and address the Scheme Adjudicator on any matter and any submissions which the Scheme Creditor, Scheme Administrators (and their duly authorised representatives) shall be made solely in writing." (9.5.2(b))

21. As is apparent from Section 9 of the KWELM Scheme, particularly Section 9.5 dealing with the adjudication process, the claims evaluation process is simpler than the process that would operate outside a scheme. KWELM wish to close their Scheme and to obtain final figures from all their creditors. KWELM wish to do so in a way that is equitable as between their respective Scheme Creditors. They have devised a scheme procedure and an estimation methodology which ensures uniformity in treatment among KWELM's creditors. It is a procedure agreed between KWELM and their creditors and sanctioned by the court. Had the procedure not been so agreed, then the whole process would have no validity.

22. The KWELM scheme turns the normal adversarial proceedings for the resolution of disputes into an inquisitorial system. It denies a party the right to make oral submissions. It imposes unreasonable deadlines for proper consideration of the issues normally raised in the dispute resolution process. Additionally, the scheme process bears no resemblance to the dispute resolution procedure required by English arbitration. It differs totally from the process for proper claim review required by the Protocol. The Scheme is, after all, an agreement between an insolvent company and its creditors as to how the assets of KWELM are to be equitably distributed to creditors.

23. Even under English law, the Scheme Adjudicator's determination of debtor balances would be totally irrelevant if a dispute resolution procedure were commenced to recover those debtor balances. In my opinion an arbitral tribunal would reject such assessment as irrelevant.

III. KWELM'S RETROCESSION CONTRACTS WITH HOME DO NOT ALLOW THE RECOVERY OF IBNR CLAIMS

1. A. SUMMARY

24. I have been asked to consider the recoverability of commutations, including IBNR, under certain reinsurance contracts entered into between KWELM companies and the Home (the "Relevant Contracts") which form the basis of KWELM's claim against the Home. I have considered the question from the viewpoint of English law and have concluded that IBNR claims are not assertable against the Home by KWELM under English law or under the terms of the Relevant Contracts.

25. English law holds that, unless there is a specific contractual provision to the contrary, an underlying claim must be properly payable under the underlying policy and must then be properly payable under the terms of the reinsurance policy in order for a reinsurer to be obliged to indemnify the reinsured. A commutation, only so far as it covers paid losses and some classes of outstandings will likely fall within this definition. A commutation that covers claims that have neither been paid nor ascertained fails to comply with the definition of the protection given by the Relevant Contracts of reinsurance in the present instance. I have seen in other cases contract wording in which commuted amounts may properly be payable by reinsurers. This is more usual in proportional contracts. In the Relevant Contracts I have reviewed under which Home reinsures KWELM companies there is no cover given for a commutation of unascertained liability in respect of claims which have never been submitted to the cedant. In the absence of such specific provision, such claims are not recoverable under the Relevant Contracts.[1]

2. B. ENGLISH LAW OF CONTRACT INTERPRETATION

(i) Powers of an Arbitral Tribunal

26. The proper law of the Relevant Contracts in this matter is English law. The final paragraph of the Arbitration Clause contained in each of the Relevant Contracts states "*This reinsurance shall be governed by and construed in accordance with English law.*" Save in exceptional circumstances - which only apply to contracts entered into after February 1997 - English arbitrators are bound to apply the proper law of the contract when interpreting a contract.

27. Issues of contract interpretation before the courts and before arbitrators are the same. Interpretation of the meaning of a contract is a matter of English law. Arbitrators in England are bound to follow the law. Under English law, arbitrators do not have "equitable" jurisdiction, and are not permitted to make an award which they deem equitable but which is contrary to the terms of the contract, notwithstanding any references to "honourable engagement" or the like which regularly appear in arbitration clauses in reinsurance contracts.[2]

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[1] Copies of the Relevant Contracts are not filed herewith, but are believed to be available to the Liquidator and will be provided to the Liquidator and the Court upon request.

[2] Certain of the Relevant Contracts contain a clause which purports to give arbitrators equitable jurisdiction:

> "*The Arbitrators and the Umpire shall interpret this reinsurance as an honourable engagement and they shall make their aware with a view to effecting the general purpose of this Reinsurance in a reasonable manner, rather than in accordance with a literal interpretation of the language, the true intention of the parties being that the Reinsurers shall follow the fortunes of the Reinsured.*"

The only effect of this under English law is to allow the tribunal to adopt equitable *procedures*; it relieves them from strict technicalities, but it certainly does not allow them to produce an "equitable" result by rewriting the contractual obligation, or ignoring the meaning that would be ascribed to the contract terms by the proper law of the contract. *Eagle Star v Yuval [1978] 1 Lloyd's Rep p 362* .

(ii) Rules of Contract Interpretation

28. The basic rule of contract interpretation is that the words set within the context of the contract as a whole must be given their ordinary and natural meaning. See, e.g., the following cases: [3]"*What an author says is usually the best guide to what he means*" (*Arbuthnott v Fagan & Others* [1996] LRLR 135). "*To force upon words a meaning which they cannot fairly bear is to substitute for the bargain actually made, one which the court believes could better have been made. This is an illegitimate role for a court.*" per Lord Mustill in the House of Lords in *Charter Reinsurance Company Ltd v Fagan* [1997] A.C. 313 - "*Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.*" *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] WLR 896.

29. However, "*If detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense*". *Antaios Compania Naviera SA v Salen Rederierna A.B.* [1985] AC 191 ('the Antaios"). The construction of a contract must take into account the commercial context in which the contract was made. This context is variously referred to as "*the factual matrix*" (*Arbuthnott v Fagan*) or "*the landscape of the contract as a whole*" (Lord Mustill in *Charter Re v Fagan*).

30. In certain circumstances a 'custom' and 'usage' may lead to contractual obligations differing form those derived from the face of the contract. The custom or usage must be notorious, certain, reasonable, invariable and regarded as binding in the trade in question. Trade practice is insufficient. In the insurance industry I have rarely come across an invariable practice which alters an express contractual obligation. I am unaware of any custom or usage that would assist the court in the present issue.

31. I refer also to the principle expressed by the Court of Appeal in *Sunport Shipping Ltd and Others v Tryg-Baltica International (UK) Ltd* ('the Kleovoulas of Rhodes') [2003] EWCA CIV 12:

> "*Where a word has a proper legal meaning it is that meaning which must ordinarily prevail in a legal document*".
>
> and
>
> "*Where a relevant expression has been given a settled meaning by the courts the courts must so construe it in the same context in future*".

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[3] Copies of all English law cases and articles cited herein are annexed hereto as Exhibit D

32. In summary, the approach of the English Courts and English arbitration tribunals is to ascertain the common intent of the parties from the words they use and the context within which the words are used.

(iii) Application of English Law to Interpretation of the Relevant Contracts Indicates That Future Loss Claims Such as IBNR Are Not Recoverable

33. The wording of the Relevant Contracts under which Home reinsures the KWELM companies contain similar contractual provisions, and specifically contain the following provisions (emphasis mine):

(i) a Reinsuring Clause covering "**each and every loss**".

(ii) an "Ultimate Net Loss Clause" which states that the term "ultimate net loss" shall mean

"*the sum actually paid by the reinsured in settlement of* ***losses or liability*** ..." .

(iii) The definition of "each and every loss" is

"*each and every loss and/or current or catastrophe and/or disaster ... arising out of one event*".

(iv) There is no definition of "event".

(v) A so-called "fully developed" Aggregate Extension Clause ("AEC") is incorporated.

(vi) The "Reinsurance Clause" further states:

"*This reinsurance shall be deemed to be subject to the same terms, clauses and conditions as the original policies and/or contracts as far as they may be applicable hereto and shall pay as may be paid thereon, but subject nevertheless to the terms and conditions of the reinsurance*".

(vii) In addition there is a "Notice of Loss" clause which reads

"All loss settlements made by the reinsured, including compromise settlements, shall be unconditionally binding upon the reinsurers ***provided*** *such settlements are within the conditions of the original policies and/or contracts* ***and*** *within the terms of this reinsurance."*

These conjunctive obligations are later referred to herein as the "double proviso" of the Notice of Loss clause.

33. When assessing the recoverability of IBNR agreed by a reinsured with a third party cedant it is necessary to consider the contractual obligation as a whole. I make two initial points. Firstly, there is no contractual provision in the Relevant Contracts for the recovery of IBNR claims, an omission which suggests that unascertained liability may not be compromised

and recovered. For that to occur there must be a particular provision so permitting. Further, the Relevant Contracts provide cover only in respect of "losses" both under the Reinsuring Clause and under the AEC, and there is nothing to suggest that such unascertained liability can properly be referred to as a "claim" or "loss."

34. Nor does the Notice of Loss clause referenced in paragraph 32(vii) above and its "double proviso" indicate that IBNR is recoverable under the Relevant Contracts. The general position under English law is that:

> "*it is well settled that (subject to any provision to the contrary in the reinsurance policy), the reassured, in order to recover from their underwriters, must prove the loss in the same manner as the original assured must have proved it against them and the reinsurers can raise all defences which (were open to the reassured against the original assured)*"
> *In Re London County Commercial Reinsurance Office [1922] 2 Ch 67 at p80.*

35. The Notice of Loss clause in the Relevant Contracts containing the double proviso does not constitue a 'provision to the contrary' to the general rule under English law. The double proviso clause was considered in detail by Lord Mustill in the House of Lords case *Hill and Others v Mercantile & General Reinsurance Co plc [1996]* 1 WLR 1239. In Lord Mustill's view these provisions were designed to ensure that the reinsurance liability was not altered by a settlement which, even if soundly based on the facts, transferred into the outward retrocessions risks which properly lay outside them.

36. The contracts which form the basis of KWELM's claim against Home are contracts of reinsurance. Reinsurance is, by its very nature, akin to liability insurance. The reinsured's liability to his insured is a necessary ingredient of the right to recover on the reinsurance. It is established law that in liability insurance a loss is established at the point in time when the insured's or reinsured's liability to the third party is ascertained by agreement, judgment or award.

> "*the Insured cannot sue for indemnity from the [liability] insurers unless and until the existence and amount of his liability to a third party has been established by action, arbitration or agreement*" - Lord Brandon in *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957 at 966 confirming the view taken by the Court of Appeal in *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2QB 363.

37. The applicability of these principles to reinsurance was confirmed in *Versicherungs und Transport A/G Daugava -v- Henderson and Others* [1934] 48 LLR 54 and [1934] 49 LLR 252, where it was held by the Court of Appeal that a reinsurer of a facultative reinsurance was not liable to the reinsured until the amount for which the reinsured was liable to

the insured was ascertained under the terms of the policy. These principles were again confirmed in *Halvanon Insurance Co Ltd v Companhia de Seguros do Estado de San Paolo and Others* [1995] LRLR 303.

38. In the absence of language in the Relevant Contracts to the contrary, the general proposition that unascertained estimated potential future loss is irrecoverable is also well expressed in cases such as the judgment of Colman J in *Lumberman's Mutual Casualty Co v Bovis Lend Lease Ltd* [2005] 1 Lloyds Rep 494. In that case an attempt was made to recover from reinsurers the value of a commutation which included unpaid paid losses, outstanding losses and IBNR. In rejecting this claim, the judge stated that as the commutation agreement did not differentiate between unpaid paid losses, outstanding losses and IBNR, *no* element of the commutation was recoverable. Further, it was held not possible to go back and isolate the elements of unpaid paid losses and outstanding losses which would properly have been recoverable, had they been identified and established.

39. There is no authority for the proposition that a commutation in respect of IBNR is recoverable under the terms of a reinsurance contract. Indeed, as earlier noted, there are numerous authorities which suggest a commutation of unascertained liabilities cannot form the basis of a claim under a policy of reinsurance. See, for example, *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957 at 966, *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2QB 363, *Versicherungs und Transport A/G Daugava -v- Henderson and Others* [1934] 48 LLR 54 and [1934] 49 LLR 252, *Halvanon Insurance Co Ltd v Companhia de Seguros do Estado de San Paolo and Others* [1995] LRLR 303 at Pg 306, *West Wake Price & Co v Ching* [1957] 1 WLR 45, *Thorman v New Hampshire Insurance Co (UK) Ltd* [1988] 1LLR 7. The general proposition that emerges from all these cases is that the right of indemnity arises only in respect of a claim properly made under the terms of the underlying policy. The existence and establishment of a claim giving rise to an insured loss is a prerequisite to a right to indemnity under the contracts of reinsurance. IBNR does not fall within the definition of 'claims' or 'losses' and is not recoverable under the Relevant Contracts.

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