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REINSURANCE ALERT: BC COURT OF APPEAL CLARIFIES TEST FOR FINDING LIABILITY AGAINST REINSURER IN SWISS REINSURANCE COMPANY V. CAMARIN LIMITED

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The BC Court of Appeal released reasons in *Swiss Reinsurance Company v. Camarin Limited*, 2015 BCCA 466, in November 2015. A central issue at trial (and on appeal) was the proper legal test to be met by an insurer who claims against a reinsurer after having settled third party liability claims against its insured. Notably, the claim against the reinsurer was pursuant to a policy of reinsurance that did not contain a "follow the settlements" clause. The absence of that clause in the policy appears to be the catalyst for this complex and cumbersome proceeding.

The Facts

The case involved property damage claims in the tens of millions arising from roofing tile that began to fail in the 1990's. The manufacturer was American Cemwood Inc., which had been acquired by MacMillan Bloedel Ltd. (now Weyerhauser, and hereafter referred to as "MB"). MB was insured by AIG under both primary and umbrella layers of insurance. Camarin, a captive insurer wholly owned by MB, reinsured AIG for 50% of its limits under five of AIG's policies with MB, and Swiss Reinsurance Company ("Swiss") in turn reinsured Camarin for 100% of its liabilities to AIG.

As the tiles failed, class actions were commenced in the US. These actions settled in 2003 for $70 million, triggering a $25 million claim by AIG against Camarin in respect of the excess insurance layer. It was this $25 million liability that was the subject of the battle at trial. Camarin of course claimed this sum against Swiss under the second layer reinsurance policy.

At Trial

The trial court (see *Swiss Reinsurance Company v. Camarin Limited*, 2012 BCSC 1006) had to determine the nature of Camarin's onus, where the underlying actions had been settled. What exactly had to be proven about the merits, or the outcome, of the underlying class action lawsuit in order to establish liability against the reinsurer? The trial judge ruled that Camarin was required only to prove the claims were *likely* covered by the AIG policy at issue, and the *likely* quantum which the California court would have awarded to the

plaintiff class. The trial judge wrote:

> Camarin is not required to relitigate the [class actions] to prove its claim for damages. To require a reinsured such as Camarin to effectively relitigate an underlying action destroys the motivation for reinsureds to settle claims made against them.

Satisfied that Camarin had met its burden, the trial judge rendered judgment against Swiss.

Note that at trial, Swiss also sought rescission of its reinsurance policies with Camarin. The basis for this argument was that MB, when the policies were written in 1993 through 1998, was in possession of reports that arguably identified the emerging faulty tile claims as not mere warranty claims but true property claims. Swiss argued that certain information in the reports was "material" to the insurer's risk, and ought to have been disclosed to Swiss at the time policies were written. The trial judge rejected this argument.

On the third party claim, Aon was found negligent. The evidence revealed that a "follow the settlements" clause had been included in Swiss' previous policy for the same risk, and the instructions to the broker were to renew "as is". However, the judgment against Aon was conditional upon a successful appeal by Swiss against its liability to Camarin.

On Appeal

The Court of Appeal disagreed with the trial judge about the proper legal test to apply. The focus of the trial judge, according to the Court of Appeal, was whether the settlement was prudent and reasonable. This focus was wrong. The trial judge was wrong also in not considering – at all – various defences raised by Swiss, which included limitation issues and damages defences under California law. The Court of Appeal stated:

> The judge was required as a matter of fact to conclude on a balance of probabilities that the plaintiffs in the [class actions] would have received judgment in the requisite amount. He had to further find on a balance of probabilities that the loss fell within the insured coverage for each of the policy years in question. The trial judge made none of the necessary findings of fact...he relied on the very strong evidence that the settlement was a prudent and fortuitous one. Persuasive as that evidence was, it was not sufficient to meet the legal test.

This test applied by the Court of Appeal arose from language in the primary policy providing coverage if ". . . the Insured shall become legally obligated to pay as damages for liability imposed upon the Insured . . .". In support, the Court of Appeal cited a number of cases out of the UK, which also ruled that a judicial determination on liability and coverage was required.

Having allowed Swiss' appeal, unfortunately, the Court of Appeal saw no choice but to order a new trial due to the complexity of the evidence and issues.

Practical Considerations for Insurers and Brokers

Given the money at stake and the very different approaches from the two levels of court in BC, perhaps the Supreme Court of Canada will be asked to consider these issues. As matters stand, this Court of Appeal ruling is a stark reminder of the importance of a "follow the settlements" clause. These not only give order and clarity to the obligations of the reinsurer, but also avoid the most onerous task for the reinsured of having to prove the underlying claim to a trial standard in order to establish the reinsurer's liability to indemnify following a settlement. The Court of Appeal seems to be saying that, absent the "follow the settlements" clause, a "trial within a settlement" is required, which in many cases will defeat the purpose of the settlement.