THE BURDEN OF PROOF IN REINSURANCE CLAIMS AND THE USE OF STATISTICAL EVIDENCE

Equitas v R&Q

The decision of Gross J in ***Equitas v R&Q*** (Comm Ct) in November 2009 has far reaching implications for the collection of reinsurance claims.

Thus, where a follow settlements clause in LMX reinsurance requires (amongst other matters) underlying settlements to be "within the terms and conditions of the original policies", there is no requirement of law that the reinsured must prove the entitlement to recover at each stage in the chain of contracts, from the original underlying insurance through to the retrocession in question, in order to recover.

Demonstrating an entitlement to recover is instead a matter of discharging the evidential burden of proof. There is nothing to prevent the reinsured relying on statistical or actuarial evidence in presenting a claim, the only question being whether the reinsured can prove the loss on the usual civil law test of the balance of probabilities.

Equitas v R&Q

The dispute between Equitas and R&Q concerned Equitas' attempt to recover losses paid under retrocessional contracts in respect of two catastrophe losses: (1) KAC and BA's loss of aircraft during the first Gulf War and (2) the Exxon Valdez oil spill.

Some of the payments Equitas had made on both of these losses were irrecoverable under the contracts with R&Q. This was because, some years after most LMX market participants had accepted that various elements of these catastrophic circumstances constituted single events for the purpose of aggregation of loss, and processed losses accordingly in many sets of quarterly accounts, and Equitas had "collapsed the spiral" in respect of inter-syndicate reinsurance, the courts determined that each event contained an element that should not have been included.

In the case of the KAC event, it was established in *Scott v Copenhagen Re (2003) CA* that the loss of the BA aircraft should not have been aggregated with KAC's losses. In the case of Exxon Valdez, it was held in *King*

v Brandywine (2005) CA that certain property damage losses and liability payments were irrecoverable and ought not to have been included in the claims submitted to the LMX market.

It was common ground between the parties that, because of the complexity of the LMX spiral, it would be impossible to disentangle the payments made along the chain of contracts and recalculate the aggregate loss on the correct basis.

R&Q's position was accordingly that, unless Equitas could demonstrate that each claimant syndicate's current ultimate net loss for correctly aggregated losses on the event exceeded the attachment point, Equitas had no claim. It was not acceptable to work backwards from wrongly aggregated losses and, unless Equitas could prove the sums claimed were properly due, contract by contract, the losses must lie where they fell. By contrast, Equitas argued that the contracts with R&Q should be enforced using the best evidence available in the circumstances to quantify the loss. Equitas argued that this consisted of actuarial models of the likely properly recoverable element of Equitas' losses.

What *Hill v M&G* decided

R&Q argued that the follow settlements clause in their reinsurances of the syndicates, which required underlying settlements to be "within the terms and conditions of the original policies", meant in this case that Equitas must show how correctly aggregated losses gave Equitas a loss upwards through the spiral of LMX contracts exceeding the attachment point on the R&Q contracts.

In support, R&Q relied on the leading House of Lords decision in *Hill v M&G (1996) HL*, where Lord Mustill held that the effect of such clauses is that the reinsurer cannot be held liable unless the loss falls within the cover of the original policy or contract reinsured.

However, Gross J held that in *Hill v M&G* the House of Lords had merely decided that, as a matter of legal construction of the follow settlements clause, in order to trigger the reinsurer's obligation to follow settlements the reinsured had to satisfy the proviso in the clause. The case had not affected the issue of how the reinsured is to do so evidentially.

Gross J further held that Lord Mustill's reference to the "original policy or contract" was to the inward LMX contract between the reinsured as reinsurer and its own reinsured, and not to the underlying original policy of insurance. He held there is no requirement of law that the reinsured has to prove the entitlement to recover at each underlying stage in the chain of reinsurance contracts in order to recover. That is a question of fact, or evidence. Thus the issue here was whether the actuarial analysis permitted conclusions

to be drawn with sufficient confidence and to the requisite standard of proof as to the recoverable quantum of losses for each Equitas syndicate.

Prevalent standard of proof in LMX contracts

In the course of his judgment, Gross J referred to market practice as to the evidence usually provided in support of claims submissions. Expert evidence had been submitted to the effect that the LMX market was a "good faith" market with business conducted on the basis of mutual trust. The right of inspection existed but was seldom exercised. The market would be unworkable, and reputational damage and insolvency would follow, if every market participant demanded strict proof of loss on every occasion. Further, the only documents generally used in the collection process were collection notes, i.e. invoices. This evidence supported Gross J's conclusion there was no reason to require Equitas to discharge a heavier burden now.

Cases where the Courts will accept statistics rather than factual evidence

Gross J held there is no difficulty as such with the use of statistical data as evidence. Ultimately he decided the case in Equitas' favour by concluding that Equitas' actuarial models were reliable and sufficient to discharge the burden of proof.

Acceptance of statistical data as evidence may be seen as part of a developing trend. Gross J referred to Tomlinson J's acceptance of the possibility of statistical evidence to discharge the burden of proof in *The Darya Radhe (2009) Comm Ct*.

In *Equitas v Horace Holman (2007) Comm Ct*, a reinsured who challenged the accuracy of accounts provided by its reinsurance broker cross-checked payments made by the broker against payments made by a reinsurer to whose records the reinsured. The purpose was to estimate the payments it ought to have received from the broker. This evidence was accepted in principle by Andrew Smith J as a sufficient discharge of the burden of proof.

Implications

The case is likely to lead to the unlocking of the LMX market for the KAC and Exxon Valdez events. It may also lead to reinsurers seeking to recoup losses already paid, using similar actuarial models.