

## FOLLOW CLAUSES

### **(1) *San Evans Maritime Inc* (2) *Livanbros Maritime SA* (3) *Mrs Chariklia Livanou v Aigaion Insurance Co SA* [2014] EWHC 163 (Comm)**

#### **Introduction**

This decision of Mr Justice Teare of the High Court of Justice in England (Queen's Bench Division, Commercial Court) determined preliminary questions about whether a following insurer was required to follow a settlement reached between the insured and three Lloyd's syndicates (including the lead underwriter).

The decision acknowledged the uncertainty and conflicting authorities as to whether a follow clause operates on the basis of agency and whether a lead underwriter owes a duty to following underwriters.

#### **Facts**

The case concerned a general cargo vessel, the *St Efrem*. The first and second claimants were the owner and manager of the vessel respectively. The third claimant was a mortgagee of the vessel. There was an issue as to whether the third claimant had title to sue, but that issue was not the subject of this decision. For simplicity, the claimants will be referred to collectively below as **the insured**.

The defendant in the case, Aigaion Insurance Co SA (**Aigaion**), is an insurer based in Greece.

Fifty percent of the interest in the vessel was insured by three Lloyd's syndicates. Catlin was the slip leader with 25%. Ark and Brit underwrote 12.5% each.

Aigaion insured 30% of the interest in the vessel, through a different policy which did not match the terms of the Lloyd's policy. The Aigaion policy contained a follow clause in these terms:

'Agreed to follow London's Catlin and Brit Syndicate in claims excluding ex-gratia payments.'

The remaining 20% interest was uninsured.

In July 2010, the vessel ran aground in Brazil and suffered a generator failure. It was towed to Abidjan, Ivory Coast, and an insurance claim was lodged under both policies.

In April 2012, the three Lloyd's syndicates settled with the insured for USD 779,500, with each syndicate being liable for its respective share of that sum. Clause 7 of the settlement agreement provided as follows:

'The settlement and release pursuant to the terms of this Agreement is made by each Underwriter for their respective participations in the Policy only and none of the Underwriters that are party to this Agreement participate in the capacity of a Leading Underwriter under the Policy and do not bind any other insurer providing hull and machinery cover in respect of the *St. Efrem*.'

Notwithstanding that clause, the insured asserted that Aigaion was obliged to follow the settlement and to pay USD 450,000, being 30% of an purported loss of USD 1.5 million.

#### **Issues and decision**

In a judgment delivered on 4 February 2014, Mr Justice Teare determined three preliminary issues presented by the case: (1) *San Evans Maritime Inc* (2) *Livanbros Maritime SA* (3) *Mrs Chariklia Livanou v Aigaion Insurance Co SA* [2014] EWHC 163 (Comm).

First issue: Did the follow clause in the Aigaion policy require Aigaion to follow any settlement made by Catlin and Brit, or did it merely authorise Catlin and Brit to negotiate on Aigaion's behalf in settling disputed claims?

His Honour noted that follow clauses come in different forms and the manner in which they are intended to work depends on an examination of the terms of the follow clause in question.

By this particular follow clause, Aigaion agreed that it would follow Catlin and Brit in claims, and therefore in settlements. The agreement was with the insured, not with Catlin or Brit. The clause said nothing about how a settlement must be reached, only that ex-gratia payments were excluded from its operation.

Aigaion contended that the clause merely authorised Catlin and Brit to act on its behalf when settling a claim. Teare J acknowledged the uncertainty in the authorities regarding whether a follow clause operates on the basis of agency.

His Honour took the view that effect could be given to this follow clause by construing it as an agreement between Aigaion and the insured to follow a settlement by Catlin and Brit. This would be consistent with the simple language of the clause, and also with the commercial purpose of a follow settlements clause to simplify claims settlement. A construction involving agency would ignore, and add to, the simple words of the clause.

Answer: The follow clause required Aigaion to follow any settlement made by Catlin and Brit.

Second issue: If Aigaion was required to follow any settlement made by Catlin and Brit, was the follow clause triggered by the settlement agreement with the insured?

Although this was the second preliminary issue as enunciated by Teare J, his Honour chose to deal with it last.

Aigaion contended that the follow clause did not apply to a settlement which was expressly agreed not to be binding on Aigaion. Teare J did not accept that submission, noting that a lead underwriter may wish to make it clear that in settling a claim the insurer is doing so on its own behalf only and is not purporting or intending to bind the following insurer, in order to protect itself from any claim by the following underwriter.

Moreover, the agreement to follow was between Aigaion and the insured. On his Honour's construction of the follow clause, it did not matter (as between Aigaion and the insured) that Catlin and Brit had purported to act only on their own behalf in settling the claim. They were in no position to countermand the effect of the agreement between Aigaion and the insured.

Answer: Yes, the follow clause was triggered by the settlement agreement with the insured.

Third issue: Did the insured agree by clause 7 of the settlement agreement that it would not be binding on Aigaion and, if so, is Aigaion entitled to rely on the *Contracts (Rights of Third Parties) Act 1999* to enforce that term?

Teare J accepted that clause 7 appeared to express an intention that, in circumstances where each syndicate entered into the settlement agreement in respect of its participation only and not in the capacity of a leading underwriter, they would not bind Aigaion.

Noting that the Lloyd's syndicates had copies of the Aigaion policy and knew about the follow clause prior to entering into the settlement agreement, his Honour considered that the purpose of clause 7 was to protect those syndicates from any possible liability to Aigaion. The purpose was not to confer a benefit on Aigaion, and Aigaion therefore was not entitled to rely on the Act to enforce clause 7.

His Honour also considered and accepted the insured's alternative argument that the construction of clause 7 was wholly irrelevant because of the effect of the follow clause, as a contractual agreement between the insured and Aigaion. The settlement agreement did not contain a promise by the insured not to rely on the follow clause as against Aigaion. The insured had the benefit of the follow clause and clear words would have been required to justify a conclusion that the insured intended to give up that valuable right.

Answer: The insured agreed by clause 7 that the Lloyd's syndicates were not purporting or intending to bind Aigaion, but Aigaion was not entitled to rely on the Act to enforce clause 7. In any event, clause 7 would not assist Aigaion because the insured did not give up the right to rely on the follow clause as against Aigaion.

## Comment

The outcome is notable because a co-insurer was required to follow a settlement, even though the lead insurers purported not to bind the co-insurer in settling the claim. This result presents potential issues in cases where following insurers are dissatisfied with a settlement entered into by the lead. The question of whether a lead underwriter owes a duty of care to following underwriters could well arise in such cases (and could have arisen in this case, although it did not).

The primary authorities on the issue are found in English law and are not settled. The existence of such a duty has variously been found to be 'manifest' (*The Leegas* [1987] 1 Lloyd's Reports 471), 'likely' or 'probable' (*Roar Marine v Bimeh Iran Insurance* [1998] 1 Lloyd's Reports 423) and 'unrealistic' (*Mander v Commercial Union Assurance* [1998] Lloyd's Report Insurance and Reinsurance 93).

Similarly, there are conflicting authorities on the question of whether a follow clause operates on the basis of agency. A lead insurer operating as an agent of the following insurers would owe a fiduciary duty to those insurers.

These issues have the potential to arise under Australian law and the outcome could not be predicted with any certainty. This would be particularly so in a case with a lesser degree of factual separation between lead insurer and following insurers (for example, if they were participating on the same policy).

In light of the uncertainty, lead insurers should consider what steps they might take to protect themselves when settling claims without the involvement of following insurers. In the *St Efreem* case, the Lloyd's syndicates sought to protect themselves by including a term in the settlement agreement to the effect that they did not intend or purport to bind the following insurer, but this did not prevent the following insurer being bound. Further steps may be necessary to avoid that outcome; for example, requiring the insured to waive any right to enforce the follow clause and/or to undertake not to rely on the settlement as against following insurers, with any breach of such terms by the insured to be actionable. An indemnity from the insured could provide additional protection, although this may be more than the insured would be prepared to accept as a condition of settlement.

For following insurers, the risks of an unsatisfactory settlement are obvious. A following insurer is subject to the terms of the follow clause to which it has agreed. On the other hand, it receives the benefits of simplified claims settlement and cost savings.

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