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AUTOMATIC RENEWALS MAY UNWITTINGLY END IN SANCTIONS BREACH

By Lindsay McQuillian and Graham Gowland

Since an EU Regulation imposing economic sanctions against Iran came into force in October 2010, the insurance industry has been waiting for guidance as to its effect. A recent Court of Appeal judgment offers some guidance in the context of automatic policy renewal, specifically will such renewals expose insurers to the risk of breaching applicable sanctions legislation?

The Background

In this case, the Claimant, Arash Shipping Enterprises, was a representative of the co-assureds under a composite marine policy. The assets insured under the policy comprised the Iranian fleet of oil tankers. Arash sued the lead underwriter, Groupama Transport (as representative of the other underwriters subscribing to the policy and on its own behalf).

The policy contained a review clause which stated that, provided the loss ratio did not exceed a specified threshold, "*...combined Underwriters hereon will extend the period of this insurance for a further twelve months on an unaltered basis.*" The loss ratio did not exceed the threshold, nevertheless Groupama served a cancellation notice. It relied on a provision allowing cancellation in circumstances where the assured has or might expose insurers to the risk of penalties for breaching applicable sanctions regimes against Iran.

Arash's solicitor had written to both HM Treasury and the European Commission, seeking their opinion on how the Regulation (which prohibits the extension/renewal of (re)insurance contracts concluded before the Regulation came into force, but which does not prohibit compliance with such contracts) impacts on the automatic renewal of policies. HM Treasury responded in clear terms, stating that it did not consider automatic renewal to be permitted. The Commission agreed, although in less definitive terms.

The Court was asked to rule on two issues:

(i) whether extension of the policy period was prohibited by the Regulation; and

(ii) whether Groupama was entitled to serve notice of cancellation, and whether that notice was effective.

As an aside, it is important to note that before addressing these questions, the Court ruled that Groupama should not have been made a representative party because, amongst other things, the other underwriters subscribing to the policy were not bound by Groupama's cancellation and some were incorporated in different jurisdictions (and as such were subject to different sanctions legislation).

The Decision

Addressing issue (ii) first, the Court decided that Groupama's notice was legitimately served and was effective. The Court rejected Arash's argument that the cancellation clause required an act or omission on the part of the Assured that would expose insurers to the relevant risk.

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In light of its conclusion on issue (ii), the Court found it unnecessary to decide issue (i) – whether the EU Regulation prohibits extension of the policy period. As such, what clarification the Court has been able to provide on this issue is relatively limited. Nevertheless, the Court did offer the provisional view that any extension or renewal of a policy, even if automatic, will be caught by Article 26(4) of the Regulation. However, the breach of a sanctions regime is a criminal offence and criminal courts are not bound by decisions of the civil courts (such as the Court of Appeal).

What Should Insurers Do?

In the Arash case, insurers were able to rely on a clause enabling them to cancel the policy in circumstances where the automatic renewal/extension would or might expose them to the risk of breaching a sanctions regime. Insurers should give serious thought to including such a clause in all policies where the assured, or the subject matter of the insurance, has a connection to a sanctioned state or entity. This is especially so, given that the Court's views on the applicability of Article 26(4) of the Regulation to the renewal/extension of policies were not definitive. When electing to decline a renewal/extension in reliance on such a clause, insurers should communicate this to the assured by reference to the specific terms of the policy, rather than relying per se on the terms of the Regulation.