PREMIUM VOLUME - MISREPRESENTATION OR PROJECTION?

By

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I. Introduction

When the underwriting results of program business are seriously below expectations, it is not unusual for disputes to arise with reinsurers. Reinsurers sometimes allege misrepresentation and concealment of material information in the placement process as well as poor administration of underwriting and claims functions. One commonly cited area of misrepresentation or concealment is expected premium volume. The purpose of this article is to review case law dealing with representations of premium volume to determine the circumstances which support a defense for reinsurers.

II. Case Law on Projected Premium Volume

Actual premium volume was triple that projected in John Hancock Prop. and Cas. Ins.Co. v. Universale Ins. Co. 1993 U.S. Dist. Lexis 2486 (S.D.N.Y.). The reinsurer sought rescission arguing that increased volume correspondingly increased its loss exposure. The court rejected the premium defense:

Universale's claim of misrepresentation fails unless it can show that the premium income projections were made with the knowledge that they were incorrect. Statements concerning future projections are generally not actionable. However, future projection statements are actionable if, when made, they were known to be false. . . . In the instant case, no evidence has been submitted by either party indicating that the premium income projection, when made, was known to be false (internal citations omitted).[i]

Numerous misrepresentations at placement were alleged by the reinsurer in CNA Reins. of London v. Home Ins. Co., 1990 WL 3231 (S.D.N.Y.). These included improper delegation of underwriting authority, misrepresentation of geographic focus, profile of risk and premium volume. The Home sought to dismiss the action through summary judgement. The court denied such disposition as to most defenses but as to premium and the size of the staffs of insured, the court granted summary judgment:

Each of these statements, labeled by plaintiffs as representations, is no more than a projection or promise of future conduct. Absent proof of a present intent not to honor the statements of future intention, the statements are not actionable. Plaintiffs have failed to advert to any portion of the record which would support their assertion that the Home believed its prognostic statements were false when made (internal citations omitted).[ii]

A distinction between future premiums, on the one hand, and past and current premiums, on the other, is made in Calvert Fire Ins. Co. v. Unigard Mutual Ins. Co., 526 F.Supp. 623 (D.Neb.1980). This case involved a treaty that became effective July 1, 1973 with an incoming portfolio of unearned premium. The intermediary provided the prospective reinsurer with specific figures representing the written premium for April 1, 1972 - March 31, 1973 plus the estimated unearned premium portfolio as of July 1, 1973. In reality, the true figures were several multiples of the provided figures due to late reporting. The underwriter for the reinsurer testified that if he had been told the true figures, he would accepted a smaller portion of the cession. The court granted rescission noting:

The evidence makes clear that Unigard represented that the figures contained in the experience figures attached to the June 19, 1973 letter were actual and accurate when, in fact, Unigard knew they were not, that the plaintiffs

elected to accept a percentage of the business on the basis of such figures and that the plaintiffs were damaged by exposure to a much greater volume of loss than would have been possible had the figures originally quoted been correct.[iii]

III. Case Law Dealing with other Projections

Cases dealing with other projections have similar results. International Ins. Co. v. Scor S.A,, 1991 U.S. Dist. Lexis 12948 (N.D.Ill.) involved a demand for rescission for misrepresentation of the manner in which business would be underwritten and overrides be applied. The court ruled for the cedent on the basis that promises of future underwriting activities are not actionable unless made with the intent that they would not be performed.

Northwestern National Ins. Co. v. Marsh & McClennan, Inc., 817 F.Supp. 1424 (E.D.La.1993) was a suit by a cedent against the intermediary for misrepresentation concerning the intermediary's intent to look into and correct problems that had arisen in the account. The court found for the intermediary stating:

The court concludes that neither of these representations, nor any of the other less significant statements identified by Northwestern, support a claim for misrepresentation. The problem is that each of the statements relates to events that might have occurred in the future; none of the statements refers to any 'pre-existing fact." As a result, it is necessary for Northwestern to show that Sutton "knew facts incompatible" with his statements at the time he made them. Northwestern, however has not attempted to make such a showing, and the record does not indicate that Sutton thought he could not obtain the amendments he proposed obtaining (internal citations omitted).[iv]

In Old Reliable Fire Ins. Co. v. Castle Reins. Co., 665 F.2d 239 (8th Cir. 1981) the intermediary sent the reinsurer a telex stating that the cedent intended to tighten underwriting procedures, to require policyholders to insure to value and to force policyholders to increase the value of their policies by 30%. The court rejected the reinsurers' contention that these representations were enforceable:

That language certainly does not indicate any promise on behalf of Old Reliable, but instead describes the areas of underwriting which the company hopes to improve. The (lower) court did not err in concluding that the statements regarding underwriting procedures were not contractual promises.[v]

See also, ReliaStar Ins. Co. v. IOA Re, 303, F.3d 874, 879 (8th Cir. 2002).

IV. Comments on Case Law

Unexpected premium volume is a relatively common defense by reinsurers when they assume business that performs poorly and more of it than expected. While there is not a great deal of case law directly on point, existing case law suggests that a mistaken estimate or prediction of future premium volume is not a breach of contract or misrepresentation, at least when there is no proof that the estimate or prediction was known to be false when made. However, this rule does not apply to a representation of past or current premium volume since these are factual representations and not estimates.

V. Application to Arbitrations

By custom and practice, if not by explicit contractual provision, arbitrators are not required to apply the strict rule of law to a dispute and may seek solutions that reflect the marketplace and the customs and practice therein. As a result, arbitrators may balance case law with their own experience with premium volume estimates and how they may be relied upon by reinsurers *e.g.* to achieve a desired mix of business in their portfolio. However, such arbitrators may also be conversant with the vagaries of premium volume predictions and the manner in which divergence from estimates may be signaled to reinsurers through the cedent's periodic reports of business written, audits and renewal information.

ENDNOTES

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[i]. 1993 U.S. Dist. Lexis 2486*18-19.

[ii]. 1990 WL 3231*13.

[iii]. 526 F.Supp. 623 at 646.

[iv]. 817 F.Supp. 1424 at 1430.

[v]. 665 F.2d 239 at 245.