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Some reflections on the "ultimate nett loss clause" in the excess of loss contract

par

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This clause appears in most excess of loss contracts, the form may vary in detail but the following is fairly standard:

"The term 'ultimate nett loss' shall be understood to mean the sum or sums paid by the Company in settlement of all losses for which the Company is liable after deducting all sums recoverable under other reinsurances whether recovered or not and all recoveries and salvages and shall include all expenses including legal costs incurred in the investigation settlement and adjustment of claims (other than office and salary expenses of the Company)."

The main object of the clause is to establish clearly the basis to be used to arrive at the amount of any loss, so that the Company and the Reinsurer may know beyond doubt what is to be included and what excluded from the statement of claim.

No doubt when excess of loss reinsurance first came to be used on a wide scale, the assessment of the final cost of a claim was not an easy matter. Indeed at a time when neither party had any great experience of this form of reinsurance, there must have been considerable difference of opinion regarding some items of expense. Such differences were presumably settled with good will and understanding on both sides, but it became clear that a precise definition was required.

The reference to the deduction of sums recoverable under other reinsurances is interesting. When all reinsurance was on a proportional basis, the assessment of the liability of each reinsurer was not in doubt. Each reinsurer paid the loss in the exact proportion to his share of the original policy or policies. If there was double reinsurance, the position was exactly the same as if there was double insurance. The shares were scaled down and the appropriate premium returned, the loss if any was dealt with on the basis of the corrected sums reinsured.

However, with the introduction of excess of loss the matter became more complicated. The Company may have felt, if by design or mistake reinsurance of two different forms had been arranged, that the Company should have the right to decide under which of the two a recovery should be effected. Should the Company apply the excess of loss and protect the surplus, or apply the surplus and protect the excess of loss ?

The excess of loss Reinsurer at least was not in any doubt. His firm view was that this was merely an extension of the insurance principle that when more than one insurance applied to a particular risk, the more specific insurance should first meet losses. The proportional reinsurance was evidently the more specific as it would meet a share of the small as well as of the large losses.

However, almost any rule can be altered by prior agreement between the parties, and as excess of loss developed it became admitted practice that the contract should protect not only the nett retention of the Company but also shares ceded to proportional Reinsurers. The most usual example is in the case of liability business where the Company may cede say 50% of the risk on a quota share basis and arrange excess of loss reinsurance in respect of the joint interest.

Excess of loss Reinsurers generally, having established the principle that proportional reinsurance was the more specific reinsurance, were reluctant to do anything which would weaken this, and they require that it shall be clearly stated whether the excess of loss reinsurance is for nett account or not. As a matter of information they may wish to know the nett retention of the Company.

However, when it is agreed that, for example, quota share reinsurers also are being protected, the question arises as to how this is to be written into the contract.

One method is to include the quota share reinsurers in the definition of "Company". For example "The Insurance Company of Montreal and its quota share reinsurers (hereinafter called "the Company") of the one part".

It would then seem that no alteration would be necessary to the clause as set out above. But is this strictly correct? The clause still refers to sums recoverable under other reinsurances. This will now include any reinsurances arranged by the quota share reinsurers in respect of their (for example) 50% of the first risk. Thus, strictly on the wording of the contract, the excess of loss Reinsurer might be entitled to enquire whether the quota share reinsurer has any separate protection, and if so to require that it should enure to the benefit of the excess of loss Reinsurer.

Further, the claims notification clause requires the Company to notify the claims as soon as the excess of loss Reinsurer is likely to be interested. The word "Company" now includes the quota share reinsurers. so that such duty may now devolve on them also, as indeed would all the other duties of "the Company" under the contract.

Furthermore, if quota share reinsurers are included in "the Company", there might be a case for saying that there

is a contract between such quota share reinsurers and the excess of loss Reinsurers. If so, then the scope of the reinsurance described, for example, as covering "all Automobile insurances written by the Company in the Province of Quebec" might extend to such business written by the quota share reinsurer in his capacity as an Insurer. This possibly neither the quota share reinsurer nor the Reinsurers had ever contemplated.

Thus it seems evident that the simplest and most satisfactory method of meeting this point is to include in the text set out above, the necessary words of clarification for example:

> "... sums recoverable under other reinsurances (other than quota share reinsurances) whether ..."

In this manner both parties made a declaration of their intentions as to the protection afforded by the reinsurance.