Direct action against reinsurers

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INSURANCE FORUM

Section 100 of the Amended Insurance Code provides: "*The original insured has no interest in a contract of reinsurance*." There is no privity of contract between the original insured and the reinsurer. Thus, the original insured would have no cause of action to recover insurance proceeds from the reinsurer. Conversely, the reinsurer, as a general rule, is not liable to the original insured of the ceding insurer. The reinsurer is not a co-signer of the policy issued. It is also not jointly and severally (solidarily) obligated to the policyholder. The reinsurer is only in contractual privity with the ceding insurer.

Likewise, the insurer (or ceding insurer) may not raise the defense to an insurance claim that the insurer had obtained reinsurance from other companies to cover its liability. The insured can only move for enforcement of its insurance contract with its insurer. A reinsurance contract is generally a separate and distinct arrangement from the original contract of insurance, whose contracted risk is insured in the reinsurance agreement.

The case of *Artex Development Co., Inc. v. Wellington Insurance Co*., Inc. upheld the doctrine that "a third party not privy to a contract that contains no stipulations *pour autrui* in its favor may not sue for enforcement of the contract." Hence, an insured, not being a party or privy to the insurer's reinsurance contracts, could not directly demand enforcement of such insurance contracts. Consequently, a reinsurer is not a party in an action by the insured against the insurer. In *Gibson v. Hon. Revilla et al*., the reinsurer was not allowed to intervene in an action filed by the original insured against the insurer. The petitioner filed a motion to intervene in his capacity as one of the sixty-three (63) syndicate members of Lloyds, the reinsurer. The Supreme Court denied the intervention and cited the general rule in the law of reinsurance that the reinsurer is entitled to avail itself of every defense which the reinsured might have in an action by the original insured, to point out that the reinsurer will not be prejudiced anyway.

The legal basis of this doctrine is Article 1311 of the New Civil Code which provides:Art. 1311. *Contracts take effect only between the parties, their assigns and heirs*, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not

liable beyond the value of the property he received from the decedent. *If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person*.

The second paragraph of Article 1311 provides the legal basis for stipulations *pour autrui*.

In *Uy Tam v. Leonard*, the court ruled that the "intent of the contracting parties to benefit a third party by means of such stipulations *pour autrui* must be clearly expressed". Hence, it was held that a clause in a contractor's bond pertaining solely to a municipality and conditioned to pay for all labor and material cannot be construed as a stipulation *pour autrui* available to material-men. The history and rationale of stipulations *pour autrui* was extensively discussed in the *Uy Tam* case.

Stipulations *pour autrui* has been applied to a number of insurance cases. In *Coquia et al. v. Fieldmen's Insurance Co., Inc.*, a common carrier accident insurance policy provided that the insurer "will indemnify any authorized Driver who is driving the Motor Vehicle" of the insured and, in the event of death of said driver, the insurer shall likewise "indemnify his personal representatives". The court ruled that the policy is a contract *pour autrui* which allowed the heirs of the deceased driver to directly sue the insurer.

In *Guingon v. Del Monte et al.*, a jeepney operator entered into a contract with Capital Insurance & Surety Co., Inc. to insure his jeepney against accidents with third-party liability. The court ruled that the "right of the person injured to sue the insurer of the party at fault (insured), depends on whether the contract of insurance is intended to benefit third parsons also or only the insured. And the test applied has been this: Where the contract provides for indemnity against *liability* to third persons, then third persons to whom the insured is liable, can sue the insurer. Where the contract is for indemnity against actual loss or payment, then third persons cannot proceed against the insurer, the contract being solely to reimburse the insured for liability actually discharged by him thru payment to third persons, said third persons' recourse being thus limited to the insured alone." In this case, the policy involved is "one whereby the insurer agreed to indemnify the insured 'against all sums . . . which the insured shall become legally *liable* to pay in respect of: death of or bodily injury to any person . . .' Clearly, therefore, it is one for indemnity against liability; from the fact then that the insured is liable to the third person, such third person is entitled to sue the insurer."

A stipulation *pour autrui* that intends to benefit an insured should be provided in the reinsurance contract or a specific agreement between the reinsurer and the original insured.

In addition to stipulations pour autrui, there are other exceptions to the general rule stated in Section 100. One is when an insurer, after acknowledging a claim payable, has assigned to the insured the reinsurance proceeds collectible from the reinsurers. The insured, as assignee and original insured, may institute a collection suit directly against the reinsurers (see *Avon Insurance PLC et al. v. Court of Appeals et al.*, G.R. No. 97642, August 29, 1997).

In the United States, one exception to the rule on lack of privity is when an insured is considered as a third-party beneficiary where the direct insurer is found to be insolvent or bankrupt and is considered merely as a fronting company (see *Koken v. Legion Ins. Co.*, 831 A. 2d 1196).

Another exception is when there is a cut-through provision (or cut-through endorsement) in the underlying policy which gives the insured a contractual right to take direct action against the reinsurer. The insured is then considered as a third-party beneficiary. Cut-through provisions are usually provided for in case of insolvency of the direct insurer. In the U.S., many states allow cut-through provisions, among them the California Insurance Code and the Texas Insurance Code.

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