REINSURANCE PRACTICE AND THE LAW

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1.75 Section 17 of the Marine Insurance Act 1906 states that a contract of insurance is a contract of utmost good faith. Section 18(1) provides that: " . . . the assured must disclose to the insurer, *before* the contract is concluded, *every material circumstance* which is known to the assured . . . ". Section 18(2) provides that: "Every circumstance is material which would *influence the judgment* of a *prudent insurer* in fixing the premium, or determining whether he will take the risk."

1.76 Section 18(3) provides, however, that in the absence of enquiry, certain circumstances need not be disclosed; namely those: which diminish the risk; which are known or presumed to be known by the reinsurer; as to which information is waived by the reinsurer; and which are superfluous by reason of express or implied warranty.

1.77 In *Pan Atlantic Insurance Co. Ltd* v. *Pinetop Insurance Co.*[1] the House of Lords set out to define "material" in the context of non-disclosure in a reinsurance contract. The effect of the decision is that a reinsurer can avoid for non-disclosure and/or misrepresentation of material facts if it can prove:

(a) that the mind of a prudent underwriter would have been influenced although it need not be shown that it would be decisively influenced—a prudent underwriter would have taken the matter into account but would not necessarily have acted any differently (for the purposes of establishing the attitude of a prudent underwriter reference is usually made to the evidence of an independent expert underwriter); and

(b) that the non-disclosure induced the *actual* underwriter. In the event that the actual underwriter is not available to (or cannot) give evidence, there is a presumption of inducement, i.e. it is presumed that in the event of a material non-disclosure, the reinsurer relied on it. It is up to the reinsured to prove that the reinsurer did not. This is a difficult presumption to rebut.

1. [1994] 2 Lloyd's Rep 427.

1.78 The Court of Appeal applied the *Pan Atlantic*[1] test for "materiality" in *Brotherton* v. *Aseguradora Colseguros SA (No. 2)*.[2] In this case, it was held to be irrelevant whether or not newspaper reports alleging corruption by officers of a bank in whose favour professional indemnity policies had been written by the reinsured subsequently turned out to be without substance. In ascertaining whether or not disclosure should have been made to the reinsurers, the relevant question was whether these matters would have been regarded as material by a prudent reinsurer and would have been likely to have induced him to act differently, at the time of placement. The appellant was wrong in contending that an allegation, which could affect an insurer's decision to write a policy, was material only if it was true.

1. [1994] 2 Lloyd's Rep 427.
2. [2003] 2 All ER (Comm) 298.

1.79 *Brotherton* was later distinguished by the Court of Appeal in the case of *Drake Insurance plc* v. *Provident Insurance plc*.[1] In *Drake* an attempt was made by an insurance company to avoid a motor policy. The insured had renewed his motor policy without declaring on his proposal form a speeding offence. He also incorrectly declared a separate incident involving his wife who was a named driver. At first instance, Moore-Bick J held that a court should not be allowed to overturn an avoidance where, with hindsight, the facts relied upon are shown to be unfounded or immaterial. However, the majority

of the Court of Appeal, allowing the appeal, instead held that on the facts of the case, the insurance company was not induced by the non-disclosure of the speeding conviction and, on those grounds could not avoid cover. Clarke LJ commented that on the facts of this case as they were known at the renewal date, the speeding conviction was not material to the reasonably prudent insurer. However, *Brotherton* was followed by the Commercial Court in *North Star* v. *Sphere Drake*[2] and the High Court in *Norwich Union Insurance Ltd* v. *Meisel*.[3]

1. [2004] 2 All ER (Comm) 65.
2. [2005] 2 Lloyd's Rep 76.
3. [2007] 1 All ER (Comm) 1138.

1.80 In *Assicurazioni Generali SpA* v. *Arab Insurance Group (BSC)*[1] the Court of Appeal also commented further on the requirement of "inducement". It was confirmed as a key principle that the matter which was misrepresented or not disclosed must be the effective cause of the underwriter entering the contract, but it need not be the sole cause. Clarke LJ noted that if the reinsurer would have entered into the contract on the same terms anyway, the representation could not, however material, be the effective cause of the making of the contract.

1. [2002] EWCA Civ 1642.

1.81 What is the duration of the obligation? Section 18 clearly states that the obligation of disclosing every material fact exists *before* the contract is concluded. The reason for this is quite simply that the reinsured will know considerably more about the subject matter of the reinsurance, and indeed the subject matter of the original insurance, than the reinsurer and the purpose is to ensure that the reinsurer is given as fair and accurate presentation of the risk as possible in order to evaluate whether it wishes to underwrite it. Therefore if the reinsured becomes aware of facts which are material *after* the conclusion of the contract, it is under no obligation to disclose those to the reinsurer.

1.82 Case law has investigated what continuing duties of good faith (if any) an insured has once the contract has been concluded. In *Manifest Shipping Co. Ltd* v. *Uni-Polaris (The Star Sea)*[1] the Court of Appeal determined that the failure of the claimant to disclose certain material reports after conclusion of the contract did not provide any remedy or right to the reinsurer to avoid the contract, although the assured was under a continuing duty not to make fraudulent claims. This duty continued until litigation was commenced, at which point the rights of the parties became regulated by the courts and the contractual duty ended. A differently constituted Court of Appeal returned to this issue in *K/S Merc-Skandia XXXXII* v. *Certain Lloyd's Underwriters*.[2] Longmore LJ concluded that:

(i) The continuing duty of good faith had no application to fraudulent claims. Rather the rationale for defeating such claims was that the assured could not profit from his own wrong.

(ii) Duties of good faith arose when the assured sought to increase or extend the risk or in "held covered" cases. The right to avoid only arose in respect of the variation or "held covered" and not the original insurance. These duties were in fact pre-contractual matters governed by pre-contractual principles and not, strictly speaking, part of any continuing duty of good faith.

(iii) Where the insurer had a right to information under the terms of the policy, then the assured had to act with good faith in relation to the provision of that information.

1. [2001] Lloyd's Rep IR 247 (HL).
2. [2001] 2 Lloyd's Rep 563.

1.83 In English law, the only sanction available to a reinsurer for a non-disclosure of a material fact is to avoid the contract *ab initio*, i.e. from the beginning. It is an all or nothing remedy; there is no half-way house, such as damages or an increased premium as in many continental jurisdictions. Any premium already paid is returned to the reinsured, who in turn has to return any claims payments received from the reinsurer.

CLAIMS

1.84 In general terms reinsurance premiums tend to be lower than those charged by insurers for the same risk, because the reinsurers hope that they can cut out certain overheads and administrative costs, and indeed the costs of a claim unless they are specifically included. Reinsurers do not wish to become involved, in many cases, in the settlement of a claim by a reinsured, and prefer to rely upon the integrity and professionalism of the reinsured when it settles a claim and then requests an indemnity from the reinsurer. To avoid the necessity for the reinsured to re-prove the claim to its reinsurer, a clause was developed many years ago whereby the reinsurer simply pays and essentially trusts its reinsured to underwrite its portfolio of business and adjust claims professionally, called a "follow the settlements" clause. A typical "follow the settlements" clause as it might appear in a facultative reinsurance contract is as follows: "Being a reinsurance of and warranted same gross rate, terms and conditions as and to Follow the Settlements of [the reinsured]."

1.85 Although at first sight this clause may appear straightforward, its meaning and effect have caused considerable disagreement between reinsureds and reinsurers. Reinsurers sometimes consider they should still have the right under the clause to review the reinsured's settlement of the underlying claim. However, in *Insurance Co. of Africa v. SCOR UK Reinsurance Co. Ltd*[1] the Court of Appeal held that the effect of the clause was that the reinsurer was bound to follow the settlements of its reinsured subject to two conditions which are known as the "two provisos":

(a) As a matter of *fact*, that in settling the claim the reinsured had acted honestly and had taken all proper and businesslike steps in making the settlement.
(b) As a matter of *law*, that the claim paid by the reinsured to the original insured falls within the risks covered by the policy of reinsurance.

1. [1985] 1 Lloyd's Rep 312.

1.86 If these two provisos are satisfied, the reinsurer is bound to follow the reinsured's settlement (but only up to the reinsurance policy limit) where there has been either a compromise of liability or quantum or both. In particular, the reinsurer cannot seek to go behind the reinsured's settlement of the original insured's claim and it must rely on the reinsured's professionalism.

The first proviso: The reinsured has acted honestly and has taken all proper and businesslike steps

1.87 In most cases, on the production by the reinsured of its records and claims in proper form, a settlement made by the reinsured of an original claim will be presumed to be both honest and businesslike. If either of these elements is challenged by the

reinsurer, the onus of proof is on the reinsurer to show that the original settlement was not in fact honest or businesslike.

1.88 In *Charman v. Guardian Royal Exchange Assurance plc*[1] the court was asked to consider whether the obligation to act in a businesslike fashion was satisfied simply by appointing a reputable loss adjuster. It was decided that the appointment would have to be in a businesslike fashion, i.e. would have to be of a competent firm and the reinsured must act in a businesslike fashion when settling the claim in the light of the report.

1. [1992] 2 Lloyd's Rep 607.

1.89 The case of *Assicurazioni Generali SpA v. CGU International Insurance plc*[1] also dealt with the question of the scope of the obligation to behave in a "business-like manner". A reinsurance contract was made by declaration to an open cover. A term in the contract required payment "to follow without question the settlements of the Reassured. . . .". The reinsured argued that the words "without question" meant that the only limitation on the reinsurer's obligation to follow the reinsured's settlements was that the reinsured should not have acted in bad faith. However, the court did not consider that these words relieved the reinsured of its implied obligation to take all proper and businesslike steps in relation to any compromise of liability or amount with respect to the original claim. It held that the significance of the words 'without question' was to emphasise that if the reinsured admitted or compromised an issue of liability on a basis which fell within the risks covered by the contract of insurance as a matter of law, the reinsurers could not go behind the settlement, but were bound by it, even if they were able to prove, following a trial of the issue, that there was in fact no liability. The decision in the Commercial Court was subsequently confirmed by the Court of Appeal.[2]

1. [2003] EWHC 1073 (Comm).
2. [2004] 2 All ER (Comm) 114.

The second proviso: Claims must fall within the terms of the reinsurance contract as a matter of law

1.90 Although it will be assumed that the reinsured has acted in an honest and businesslike manner as a matter of fact, the reinsurer is nevertheless entitled to insist that claims paid by the reinsured fall within the terms of the reinsurance contract as a matter of law. It is this aspect that continues to cause reinsureds and reinsurers to differ. Before turning to the most important cases in this area, it is necessary to consider the distinction between issues of fact and issues of law.

1.91 Assume that an insurance policy expires at midnight on a particular Saturday night. A burglary occurs sometime on Saturday night but it is not clear whether the burglary took place before midnight on Saturday or in the early hours of Sunday morning. If the reinsured can point to any circumstance which properly indicates that the burglary took place before midnight, then it is entitled to say that the loss is covered by the policy as a matter of fact. If, however, there is a condition precedent in the policy requiring the premises to be protected by a burglar alarm, and the facts are that the insured had installed a burglar alarm at his home but that at the crucial time the alarm was not functioning properly, a dispute may arise between the reinsured and reinsurer over the meaning of the word "protected", and the reinsurer may argue that the burglary is not covered as a matter of law because at the relevant time the premises were not properly "protected" and the condition precedent was therefore not fulfilled.

1.92 In *Hiscox v. Outhwaite (No. 3)*[1] the reinsurance agreement considered by the court was in excess of loss form, and contained the usual "ultimate net loss" clause whereby the reinsurer agreed to pay the reinsured unlimited sums in excess of the reinsured's ultimate net loss (retention) of $7,500,000. The ultimate net loss was (as is generally the case) defined in terms of sums actually paid by the reinsured, including legal costs. The reinsuring clause provided that the reinsurance agreement was "subject to the identical periods, terms, clauses, conditions and warranties as contained in the original policies . . . and in all things falling within the scope of this agreement the Reinsurers shall share to the extent of their interest the fortunes of the reinsured." This provision was supplemented by a further clause which required the reinsured to exercise due diligence in dealing with its liabilities, subject to which all reasonable compromises and settlements (including *ex gratia* settlements) were to be "unconditionally binding" on the reinsurer. It was common ground that the combined effect of these clauses was to produce a "follow the settlements" obligation on the reinsurer. This case concerned the liability of the reinsurer for payments made by the reinsured under the "Wellington Agreement", which settled coverage disputes in the United States between asbestos producers and their insurers by allocating a percentage of the total liability to each producer, irrespective of whether that producer had been named as a defendant by a claimant and irrespective of whether that producer could have been legally liable to that claimant. Its purpose was to reduce the overall cost of asbestos settlements.

1. [1991] 2 Lloyd's Rep 524.

1.93 The arbitrator found that the reinsurer was not liable for Wellington Agreement payments made by the reinsured which were not based on any legal liability, although the reinsurer was liable for reasonably agreed settlements in respect of claims *actually* made against the reinsured. In support of this ruling, the reinsured claimed that the reinsurer was liable for all claims which had been settled in a reasonable fashion; the reinsurer, however, argued that it could only be liable for sums paid out under legal liability.

1.94 Mr Justice Evans considered the *SCOR* ruling,[1] and derived from it three principles applicable to "follow the settlements" clauses.

(a) The reinsurer is only liable for those losses which fall within the reinsurance agreement itself.

(b) If the terms of the reinsurance are identical with those of the original insurance policy, the reinsurer is able to plead by way of defence that claims met by the reinsured *without legal liability* are not binding on the reinsured and thus do not fall within the reinsurance agreement, and this remains so despite the presence of a "follow the settlements" clause and despite the fact the reinsured has acted in a reasonable and businesslike fashion.

(c) However, by way of exception to (b), the reinsurer is bound to follow the reinsured's reasonable settlement of a disputed claim, and cannot subsequently seek to establish that the reinsured would not have been found liable for that claim had the matter proceeded to litigation i.e. if the reinsured *could* have been liable, that is enough.

1. [1985] 1 Lloyd's Rep 312.

1.95 Applying these principles, Mr Justice Evans held that the arbitrator had been correct in holding that the reinsurer was not liable for payments made by the reinsured

to persons towards whom the reinsured plainly faced no legal liability. However, the reinsurer was liable for payments made by the reinsured where the reinsured was either liable in law to make payment or at least arguably liable to do so.

1.96 *Hill and Charman v. Mercantile & General Reinsurance Co.*[1] arose from the appropriation by Iraqi forces of aircraft belonging to Kuwait Airways during the Gulf War. The original insurers made a single $300 million payment to Kuwait Airways on the basis that the loss of all the aircraft constituted one event under the terms of the contract. The claimant reinsurers settled claims in respect of the inwards reinsurances written by them on the basis that such claims represented one loss which had occurred on the date of the Iraqi invasion of Kuwait. The claimants then made corresponding claims on their outward reinsurance contracts underwritten by M&G. M&G resisted the claim on a number of bases including the fact that it regarded the loss of each aircraft as a single event. They also argued that on the facts the losses occurred subsequently in 1991 at a time when at least some of the relevant outwards reinsurance contracts had expired. There was no issue as to the proper and businesslike conduct of the reinsured. The defence was put on the basis that the payments were not covered either under the terms and conditions of the original insurance or under the terms and conditions of the reinsurance contracts.

1. [1996] 1 WLR 1239 (HL).

1.97 The dispute centred upon interpretation of the "follow the settlements" clause incorporated in all the reinsurance contracts, which is a clause commonly found in reinsurance excess of loss contracts, and reads as follows:

"All loss settlements by the reassured including compromise settlements and the establishment of funds for the settlement of losses shall be binding upon the reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts . . . and within the terms and conditions of this reinsurance."

1.98 Lord Mustill, giving the leading judgment of the House of Lords, stated that the conflict inherent in reinsurance, namely the need to avoid an investigation of the same issues twice as against the need to ensure that the integrity of the reinsurer's bargain is not eroded by an agreement over which it has no control, is easily managed where the insurance and reinsurance are on the same terms and the parties are essentially co-adventurers. The problems become more acute when the terms of policies are different, so that a claim under the direct policy may not require the determination of an issue crucial to liability under the reinsurance, or the reinsurance is of another reinsurer, at one or more removes from the direct cover.

1.99 Lord Mustill stated that there are only two rules, both of which are obvious. The first is that the reinsurer cannot be held liable unless the loss falls both within the cover of the policy reinsured and within the cover created by the reinsurance. The second is that the parties are free to agree on ways of proving whether these requirements are satisfied.

1.100 He went on to distinguish this case from *ICA v. SCOR*[1] on the grounds that the "follow the settlements" clause in dispute in this case specifically required claims under the outwards reinsurance to be within the terms and conditions of the original policies and the outwards reinsurance. Thus the decision appears to be binding authority only so far as this particular clause is concerned.

1. [1985] 1 Lloyd's Rep 312.

1.101 However, the court made it quite clear that the numerous variations of these clauses and their differing application under different types of reinsurance contracts made it confusing and fruitless to lay down general principles. Each contract should be considered separately. The language used by Lord Mustill was guarded and it is difficult to distil all relevant principles relating to "follow the settlement" clauses. Lord Mustill refused to analyse in detail the correctness or general applicability of *ICA* v. *SCOR*. He simply said that it did not apply in this situation. Lord Goff, who had analysed and clarified the two provisos in *ICA* v. *SCOR*, did not comment at all.

1.102 It is probably correct to say that the second of the provisos in *ICA* v. *SCOR* remain important where insurance and reinsurance agreements are worded differently in any significant respect, but one interpretation of Lord Mustill's comments that has been put forward is that where the wordings of the direct policy and the indirect policy are the same, unqualified "follow the settlement" clauses may well remove the reinsurers' protection under the second limb of *SCOR*. The basis for this theory is that a reinsurer should not be entitled to rely on questions of law as to the meaning of its own contract when exactly the same questions have been considered and resolved by the reinsured under the direct policy, which had produced a bona fide, honest, proper and businesslike settlement with the direct insured. Whilst this clearly has some merit and indeed may be commercially desirable, it fails to take into account the second of the Evans principles in *Hiscox* v. *Outhwaite (No. 3)*[1] which clearly states that if the reinsured is not legally liable to pay a claim, such a claim would not be binding and would not fall within the reinsurance agreement.

1. [1991] 2 Lloyd's Rep 524.

1.103 It seems that on any interpretation the distinction drawn in *ICA* v. *SCOR* between questions of fact and questions of law remains intact and that any reinsurer is entitled to argue that as a matter of law the claim does not fall within the policy of reinsurance. The requirement that the settlement falls within the terms of the reinsurance contract is well demonstrated by the case of *Wasa* v. *Lexington*.[1] A US court held that Lexington was liable to indemnify its insured, Alcoa, in respect of all property damage which had occurred between 1942 and 1986 even though the period of insurance was between 1 July 1977 and 1 July 1980. Lexington paid Alcoa $103m in settlement. Lexington had back-to-back facultative reinsurance with Wasa. The reinsurance, governed by English law, contained a follow clause and was for the same period. The House of Lords held that Wasa was not bound by the settlement because the period clause in the reinsurance is of fundamental importance; Wasa had agreed to reinsure Lexington in relation to Alcoa's property between 1 July 1977 and 1 July 1980 only, and the reinsurance could not be construed as a matter of English law as if it provided cover in respect of damage whenever it occurred.

1. [2009] 2 Lloyd's Rep 508 (HL).

1.104 The case of *Commercial Union* v. *NRG Victory*[1] is also worthy of note. In this case, Exxon made two claims against its insurers in Texas for the costs of clean-up after the *Exxon Valdez* disaster. Insurers repudiated the two claims and finally agreed a substantial settlement of one claim in the expectation that they would lose and on the second claim the matter went to trial and insurers lost. Insurers had purchased excess of loss protections which contained the "follow the settlements" clause in the same form as *Hill* v. *M&G*[2]; that is to say that it was made clear that any settlements to be followed had to fall

both within the original policy and the contract of reinsurance. Insurers then sued reinsurers in London for an indemnity in respect of the settlement which they had agreed in Texas. They relied upon evidence from their Texas attorney who admitted in an affidavit that the settlement might have been outside the cover of the original policy but made it clear that the judge and jury in Texas were either unlikely to appreciate the legal arguments or would simply be biased against the insurers, who would probably lose and end up paying a higher figure than the settled claim.

1. [1998] 2 All ER 434.
2. [1996] 1 WLR 1239.

1.105 The reinsurers defended the claim on the basis that the insurers must prove that they were liable for the loss under the original policy of insurance, so that even if the Texas court had given judgment against insurers, that judgment would not in itself prove that there had been a loss under the original policy. They also argued that the evidence of the Texas attorney could not amount to proof of insurers' liability under the original policy, however prudent the insurers' decision to settle might have been. The matter went to the Court of Appeal who accepted reinsurers' argument that the evidence of the insurers' attorney did not establish liability under the original insurance, and insurers would not be permitted to recover in reliance upon it. However, the Court of Appeal made it clear that a judgment of a court or arbitration panel in favour of the insured was conclusive proof of insurers' liability under the original policy, provided four conditions were met:

(a) the foreign court had jurisdiction;
(b) the original judgment was not obtained in breach of a clause giving exclusive jurisdiction to some other court;
(c) the reinsured took all proper defences;
(d) the judgment was not manifestly perverse.

1.106 Thus a judgment on the original insurance policy appears now to be conclusive evidence of the liability of the insurer, which it can rely upon in claiming against its reinsurers.

TRIGGERS AND AGGREGATIONS

1.107 What triggers the process leading to payment of a claim by a reinsurer? The simple answer to this is "a relevant loss within the terms and period of the reinsurance".

1.108 A problem that can arise is that the duration of a contract of reinsurance does not always fit exactly the duration of an underlying contract of insurance. There are three main formulae for ascertaining which policies of insurances are covered by a contract of reinsurance and which should be contained in the contract.

1.109 The first is on a "policies issued" or "risks attaching" basis whereby original policies issued by the reinsured during the period of the reinsurance fall within the reinsurance cover, which then covers any loss under that original policy. A reinsurer could therefore find itself liable for losses which become apparent years after the reinsurance policy period expires.

1.110 Secondly, the "losses occurring" basis can be used. Provided the date of the relevant loss falls within the reinsurance treaty period, it will be covered. Needless to say, this type of reinsurance can give rise to problems where the exact date of loss cannot be ascertained with any degree of accuracy.

1.111 Finally, there is the "claims made" basis of reinsurance which covers all those claims made within the reinsurance period. Unlike the two previous bases, this last form covers losses where the exact date of the loss may not be known at all.

1.112 In the past, the insurance market has sometimes assumed that when an insurer takes out reinsurance then, unless the contract specifically states otherwise, the intention of the parties is to reinsure back-to-back with the original insurance.

1.113 When the Lloyd's Names' losses began to gather momentum, however, reinsurers' and insurers' attention became focused on the differences in wording of their respective policies. This led to disputes over cover, with some reinsurers claiming that in fact there were gaps between the cover of insurer and reinsurer, thus affecting their liability.

Originating cause/event/occurrence

1.114 In the case of *Deeny* v. *Gooda Walker*[1] the underwriters of four syndicates, which were managed by two Gooda Walker companies, underwrote excess of loss contracts which resulted in enormous losses to the Names involved. This was primarily because the underwriters failed to understand the peculiarities of the LMX spiral or to appreciate its likely ramifications. As a result, the syndicates sued the two Gooda Walker companies responsible for managing their underwriting and recovered damages for negligence.

1. [1994] CLC 1224.

1.115 The next case, which followed on from *Gooda Walker*, was that of *Cox* v. *Bankside*.[1] This case was brought by the errors and omissions insurers ("E&O insurers") responsible for covering the damages awarded in Gooda Walker. The E&O insurers wanted a declaration from the court as to whether the many losses sustained by the Names could be said to stem from one or more (and if so how many) *originating causes*.

1. [1995] CLC 180.

1.116 In the E&O insurers' policy, a cap on liability was included for a series of losses arising from one originating cause. In the event more than one originating cause existed, that cap would necessarily be multiplied by the number of originating causes (subject to a limited number of reinstatements of the policy indemnity), amounting to a substantial difference in the amount due to the insured under the policy.

1.117 The Names' losses in *Gooda Walker* stemmed from contracts underwritten by three underwriters. In *Cox* v. *Bankside*, the managing agents argued that each of the underwriters was a separate originating cause, resulting in the liability cap never being reached and the damages awarded against them in *Gooda Walker* being fully recoverable. The E&O insurers, however, argued in favour of one originating cause, which would cap the recovery.

1.118 The court ruled in favour of the agents, finding that there were three originating causes; one for each of the three underwriters. In so doing it purported to follow the previous decision of *Caudle* v. *Sharp*[1] in which the court was concerned with the underwriting of 32 separate contracts by one underwriter, who had negligently failed to appreciate the risk of asbestosis. The court in that case had held that the 32 contracts

arose out of "one event" within the terms of the reinsurance covering the underwriter's E&O insurers.

1. [1995] LRLR 80.

1.119 The decision in *Caudle* v. *Sharp* was reversed on appeal, but the point about it in relation to *Cox* v. *Bankside* was that Phillips J had taken as read the fact that "event" in *Caudle* was the same as "originating cause" in *Cox* v. *Bankside*. It was not until this particular issue arose in *Axa Re* v. *Field*,[1] the final chapter in the Gooda Walker story, that it was definitively dealt with.

1. [1996] 1 WLR 1026 (HL).

1.120 In *Axa Re* the E&O insurers, having paid out on the basis of the decision in *Cox* v. *Bankside*, turned to their reinsurers for an indemnity. The E&O insurers' cover was phrased so as to embrace a claim or a series of claims arising from *one originating cause* whereas Axa's reinsurance policy covered a loss or losses arising out of *one event*.

1.121 Axa wished the court to establish whether the two phrases meant the same thing and, if not, how many events had arisen for the purposes of the reinsurance. Axa's view was that notwithstanding the fact that there may have been three originating causes, an event was something different and, in their view, there may have been as many events as there were individual LMX contracts underwritten by the Gooda Walker underwriters.

1.122 The House of Lords ruled that an event was not something which could be characterised as a continuing state of affairs (for example ongoing negligence), whereas an originating cause could be so characterised. An event was something which happened at a particular time, at a particular place and in a particular way. In other words, an event was a more constricted concept than a cause, which was a term designed to allow for the widest possible basis for aggregation of claims.

1.123 The stance taken by Lord Mustill in *Axa* regarding the meaning of the phrase "originating cause" was followed by the Court of Appeal in *Municipal Mutual Insurance Ltd* v. *Sea Insurance Co. Ltd.*[1] This case involved facultative excess of loss reinsurance contracts which covered the reinsured's interest in certain legal liability policies. The conditions of the reinsurances were expressed to be the same as the original policies and it was stated that a single limit of indemnity applied to "all compensation payable to any claimant or any number of claimants . . . in respect of or arising out of all occurrences of a series consequent on or attributable to one source or original cause". Under the legal liability policies, the reassured (the Port of Sunderland) was required to compensate owners of excavators stored at the port which had been vandalised due to successive acts of independent individuals over an 18-month period. The court held that the reinsured was entitled to make an aggregate presentation of the loss, on the basis that there was a clear unifying factor in the history of the losses, namely the want of care of the port authority. Following the "ordinary use of language", these were a series of occurrences attributable to a single source or original cause.

1. [1998] Lloyd's Rep IR 421 (CA).

1.124 Similar issues of aggregation have arisen in cases relating to E&O coverage in respect of pension mis-selling. In *Lloyds TSB General Insurance Holdings Ltd* v. *Lloyds Bank Group Insurance Co. Ltd*[1] a clause in an E&O policy provided that a "single act or omission, or a related series of acts or omissions" would be treated as a single third-party claim, and thus subject to a single deductible. At first instance, the Commercial Court considered that the real and effective cause of the third-party claim was the failure of management to adequately train its sales staff. The individual instances of mis-selling were the result of a single act or omission, and could therefore be aggregated in respect of the deductible. The Court of Appeal, considering *Caudle* v. *Sharp*,[2] took a different approach, saying that the words "act or omission" referred to failures by the individual sales consultants to provide best advice to policyholders. Nonetheless, these were a related series of acts or omissions under the express words of the policy, and a single deductible did apply. However, the Court of Appeal decision was subsequently reversed by the House of Lords.[3] The House of Lords held that the relevant "act or omission" had to be one which gave rise to civil liability. The mere absence of a training or monitoring system was irrelevant in this regard as civil liability would not arise unless such a system was breached. Therefore, although the claims may have arisen from the same underlying cause, the relevant acts or omissions in this case were a series of separate instances of mis-selling. On proper construction of the contract, the Court of Appeal was wrong to say that this was a "related series" of acts or omissions: this was because each claim was attributable to a particular breach of the rules and did not result from all or some of the breaches taken together.

1. [2002] 1 All ER (Comm) 42.
2. [1995] LRLR 80.
3. [2003] 4 All ER 43.

1.125 In a similar context in *Countrywide Assured Group plc* v. *Marshall*[1] it was held (applying *Axa Re* v. *Field*[2]) that individual cases of mis-selling were attributable to one source or cause, namely Countrywide's failure to ensure a proper system of training. Nonetheless, the claims could not be aggregated in this case as the policy expressly provided for claims to be subject to a claim by claim excess. Given the commercial background to the contract, and the fact that it was widely known that pensions had previously been mis-sold, there was no reason why the court should not give effect to the express words of the contract.

1. [2003] 1 All ER (Comm) 237.
2. [1996] 1 WLR 1026 (HL).

1.126 It is often assumed that "event" and "occurrence" have the same meaning. As a matter of English law, *Scott* v. *Copenhagen Reinsurance Co. (UK) Ltd*[1] indicates that these words will generally be viewed as synonymous, unless the context dictates otherwise. In practice, the wording of given contracts may sometimes suggest a distinction between the two terms, for example, where the definition of "loss" refers to "all losses and/or occurrences and/or series of losses and/or occurrences arising out of one event".

1. [2003] 2 All ER (Comm) 190; [2003] Lloyd's Rep IR 696.

Mismatch between underlying policy and reinsurance cover

1.127 There may have been a presumption in the market that the underlying commercial purpose of the parties to any reinsurance contract was that there would be back-to-back cover i.e. that the reinsurance was intended to mirror and provide cover for the underlying policy. However, in *Axa Re* v. *Field*[1] the House of Lords held that, in the context of a treaty excess of loss reinsurance of a liability account, it is wrong to assume

that where the underlying insurance contract and the reinsurance contract both contain provisions which allow losses to be aggregated, the parties are likely to have intended the effect of those provisions to be much the same. An excess of loss treaty covering a direct insurer's whole account (i.e. a reinsurance covering the whole portfolio) is not in any real sense back-to-back with the underlying individual insurance policies (although the position might be different with proportional or facultative reinsurance).

1. [1996] 1 WLR 1026.

1.128 The position is even more problematic where the underlying policy (and, therefore, its aggregation provisions) is governed by a different law from the reinsurance contract. For instance, the policies in question in the *Silverstein*[1] litigation were governed by New York law. If some of the reinsurance policies that are likely to be affected are governed by English law, then even if the underlying policies and the reinsurance policies contain the same or similar aggregation language, the definition of an occurrence/event under New York law may be different from the definition under English law. For instance, if inwards claims of any nature are settled under New York law on the basis that they constitute multiple occurrences/events, but English law holds (or is likely to hold) that a one-occurrence approach is appropriate (or vice versa), a question will arise as to whether the reinsured is precluded from aggregating those losses as arising out of one occurrence/event and presenting them to reinsurers as a single loss. In other words, is the reinsured entitled (irrespective of whether or not there is a "follow the settlements" clause) to look at the question of aggregation afresh?

1. *Swiss Re* v. *World Trade Center Properties LLC*, Civ Action No. 01 CV 9291 (Judge Chin).

1.129 The reinsurer faces a similar question too. It might equally argue that, irrespective of the number of losses paid under the underlying contracts, it is liable only in respect of a single aggregate loss at reinsurance level.

1.130 The judgment of Mr Justice Moore-Bick in *ACIC* v. *INSCO*[1] is informative. In that case, claims against 14 directors and officers were settled by payment of a global sum which was then allocated (for the purpose of the D&O policy) in equal amounts between the 14 individuals. The insurer presented its claim to its reinsurer as one claim. The reinsurance policy provided, among other things, that:

"The liability of the Reinsurer hereunder shall, in all instances, follow the liability of the Reinsured for business the subject matter hereof . . . [Article V.3]

The liability of the Reinsurer shall follow that of the Reinsured in every case and shall be subject in all respects to the general and special stipulations, clauses, waivers and modifications of the Reinsured's policy [Article XIX]".

1. [1996] LRLR 407.

1.131 Moore-Bick J held that the effect of these articles was to preclude the insurer from presenting claims to its reinsurer on a different basis from that on which it settled under the underlying policy. Moore-Bick J went on to say:

"One of the primary purposes of these articles is to bind the reinsurer to the acceptance by the reinsured of liabilities under the underlying policies. A liability does not exist in a vacuum, however; it is owed to a particular person or persons and arises out of particular facts. If the reinsured has accepted or settled a claim on a particular basis, art. XIX makes that binding as between him and the reinsurer; it is not open to the reinsured to pursue a claim against the reinsurer on the basis that the liability was incurred on a different basis. Having settled 14 claims,