HOUSE OF LORDS SESSION 2008–09

[2009] UKHL 40

on appeal from:[2008] EWCA Civ 150

OPINIONS
OF THE LORDS OF APPEAL
FOR JUDGMENT IN THE CAUSE

Lexington Insurance Company (Respondents) *v* AGF Insurance Limited (Appellants) and one other action
Lexington Insurance Company (Respondent) *v* Wasa International Insurance Company Limited (Appellants) and one other action

Appellate Committee

Lord Phillips of Worth Matravers
Lord Walker of Gestingthorpe
Lord Brown of Eaton-under-Heywood
Lord Mance
Lord Collins of Mapesbury

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LORD PHILLIPS OF WORTH MATRAVERS

My Lords,

1. I have had the benefit of reading in draft the opinions of my noble and learned friends Lord Mance and Lord Collins of Mapesbury. I agree with their conclusion that this appeal should be allowed and the reasons that each gives for that conclusion, for those reasons are in harmony. I propose to explain shortly why I agree with their reasoning.

2. Essentially the result of this appeal is dictated by the agreed fact that the reinsurance contract that is the subject of the appeal is governed by English law and by the well established principle, not challenged in this case, that under English law a contract of reinsurance in relation to property is a contract under which the reinsurers insure the property that is the subject of the primary insurance; it is not simply a contract under which the reinsurers agree to indemnify the insurers in relation to any liability that they may incur under the primary insurance – *British Dominions General Insurance Co Ltd v Duder* [1915] 2 KB 394 at p. 400.

3. The following matters are common ground:

   i) There is no significant difference between the terms of the primary insurance and the reinsurance.

ii) Under English principles of construction, the reinsurance covers only damage to property caused during the period of the cover.

iii) The Supreme Court of Washington, applying Pennsylvanian law to the construction of the primary insurance, has held that it covers incremental damage to property that includes damage that occurred both before and after the period of cover, provided only that part of the damage occurred during the period of cover.

iv) The decision of the Supreme Court of Washington is not perverse.

4. This last agreed fact is significant. The principle of the English law of construction that confines recovery to damage occurring during the period covered by the policy is no more nor less than the fundamental principle that the words of a contract should normally be given the meaning that they naturally bear. It has not been suggested, nor could it, that the alternative construction given to the policy by the Supreme Court of Washington is an alternative meaning that the words of the policy can naturally bear. The reason why the Washington Supreme Court has reached such a radically different interpretation of the scope of cover is because it has adopted a principle of construction that has been applied to contracts of insurance of property by the courts of Pennsylvania, and a minority of other American States. That principle, as Lord Collins has demonstrated, has its origin in the approach to insurance claims for the consequences of asbestos. I suspect that this may, in its turn, be derived from a similar approach to claims in tort.

5. It is unlikely that those who were party to the contract of reinsurance in 1977 can have anticipated that the interpretation of the wording common to the primary insurance and the reinsurance would differ so radically dependent on the law applied to its interpretation. Did the parties agree, or are they to be implied to have agreed, that in such an event the principles of interpretation adopted in respect of the primary insurance should be adopted, in preference to the principles of English law?

6. I agree with Lord Mance, for the reasons that he gives, that the "full reinsurance" clause in this case, and "follow the settlements" clauses in general, did not and do not have the effect of bringing within the cover of a policy of reinsurance risks that, on the true interpretation of the policy, would not otherwise be covered by it.

7. Longmore LJ concluded that, at the time that the reinsurance was written those parties to it would have anticipated that the interpretation of the primary insurance would be determined according to the law of Pennsylvania and implicitly agreed that the same law would apply to the interpretation of the reinsurance. For the reasons given by Lord Mance and Lord Collins, I do not consider that this finding was justified.

8. The vital issue is, I think, reduced to this. Did the parties to the reinsurance implicitly agree that whatever law might be applied to interpretation of the primary cover, and whatever result this might produce, would apply equally to the reinsurance? An affirmative answer to this question would, effectively, treat the contract of reinsurance as one to indemnify the primary insurer in respect of any liability sustained under the primary cover. There might, as Sedley LJ considered, be much to be said for adopting this approach, and it is an approach that it would be open to the market, by appropriate contractual terms, to follow. Those who, in 1977, were party to this reinsurance did not do so.

9. It is for these reasons that I agree with Lord Mance and Lord Collins that this appeal should be allowed and the judgment of Simon J restored.

LORD WALKER OF GESTINGTHORPE

My Lords,

10. I have had the privilege of considering in draft the opinion of my noble and learned friend Lord Collins of Mapesbury. I am in full agreement with it and for the reasons given by Lord Collins I would allow this appeal.

LORD BROWN OF EATON-UNDER-HEYWOOD

My Lords,

11. I have had the advantage of reading in draft the opinion of my noble and learned friend Lord Collins of Mapesbury. I entirely agree with it and add a brief opinion of my own only to stress the comparatively narrow basis on which I conclude that this appeal ought to succeed. All the relevant facts, law and argument I gratefully adopt from my Lord's opinion and none of these shall I repeat.

12. That the respondent insurers ("Lexington") were liable under the terms of their policy ("the insurance contract") to the insured ("Alcoa"), as held, however surprisingly to English eyes, by the Supreme Court of Washington, cannot now be disputed. This liability was for the clean-up costs of pollution and contamination damage to Alcoa's sites occurring during the 44-year period 1942-1986. No matter that the insurance contract was against the risk of "all physical loss of or damage to" Alcoa's property only for the three-year period 1 July 1977 to 1 July 1980, the Supreme Court, applying Pennsylvania law, held that:

> "It seems clear from the policy language that any physical loss or damage manifesting itself during the time a . . . policy was in effect was covered by the policy, including pollution damage starting before the policy inception."

The language of the policy, the Court said, "is very broad and contains no limitation as to time of the physical loss or damage to property. There is no exclusion in the policy for physical loss or damage that may have begun spreading before the policy inception."

13. That was the basis of Lexington's liability to Alcoa and that Lexington was properly held thus liable is not in issue before your Lordships. What *is* in issue is the appellant reinsurers' liability to Lexington under the reinsurers' policies ("the reinsurance contracts"). The reinsurance contracts provided cover in respect of the same three-year period as the insurance contract and ostensibly in respect of the same loss: "All Risks of Physical Loss or Damage" (to the relevant property). In all material respects, save one, the terms of the reinsurance contracts mirrored those of the insurance contract. That one respect, central to the resolution of these appeals, was with regard to the

applicable law respectively governing them. The insurance contract was subject to Pennsylania law (albeit, as Lord Collins explains, not predictably so at the date these contracts were entered into); the reinsurance contracts were subject to English law. Under Pennsylvania law, as already stated, the fact that cover was expressly provided only for the three years 1 July 1977 to 1 July 1980 was of no relevance in limiting the extent of the recoverable loss provided only that *some* physical damage became manifest during the three-year period. Plainly, however, that is not the position under English law. Under English law nothing could be clearer than that a contract providing cover for loss and damage occurring only during a specified three-year period could not be construed as covering in addition damage occurring before (or for that matter after) that three-year period.

14. Lexington's response I understand to be essentially this. The all-important question is what constituted the insured damage under the respective contracts. The insured damage under the insurance contract was held to be that resulting from all damage to the property whensoever occurring providing only that some of it became manifest during the actual period of cover. It is, submit Lexington, possible to construe the reinsurance contracts similarly and, because of the strong presumption that liability under a proportional facultative reinsurance policy is co-extensive with liability under the primary policy, that, therefore, is the construction which the reinsurance contracts should be found to bear.

15. For my part I would reject this argument. Were it correct, indeed, it would follow, as Mr Sumption QC rightly acknowledged in the course of his submissions, that Lexington would be entitled to recover to the self same extent as they now claim even had the reinsurance cover extended not for the coincident period of three years but, say, for only three months (provided always, as stated, that some damage became manifest during that period). Given the fundamental importance under English law of the temporal scope of a time policy, I find it impossible to construe the reinsurance contracts in the way contended for.

16. "Physical loss or damage" under a policy providing cover for three years simply cannot be construed under English law to include pre-existing damage. The respective contracts are not, of course, back to back as to their governing laws. However powerful and far-reaching the presumption that reinsurance is intended to respond to claims payable under the primary policy, it could not avail Lexington here unless English law were to regard it in effect as tantamount to a rule of

law—unless, in short, English law were to dictate that reinsurance must always respond. English law does not, in my opinion, go so far. *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350, clearly the decisions closest in point, are authority for the presumption. They do not warrant its application in all circumstances, certainly not so as to override so clear a temporal limitation as the reinsurance contracts stipulated here with regard to the risks covered.

17. I too therefore would allow these appeals.

LORD MANCE

My Lords,

Introduction

18. The long-term effects of damage to the environment are debated worldwide. The issue in this case is whether certain financial consequences can be passed by a Massachusetts insurer, Lexington Insurance Company ("Lexington"), to two London reinsurers, Wasa International Insurance Company Limited ("Wasa") and AGF Insurance Limited ("AGF"). Lexington insured Aluminum Company of America ("Alcoa") of Pennsylvania and its subsidiary, Northwest Alloys, Inc. ("NWA") of Delaware under an American "all risks difference in conditions" ("DIC") property damage insurance policy issued for the period from 1st July 1977 to 1st July 1980. Under this policy, Lexington has paid Alcoa and NWA some US$103 million in respect of environmental damage to property. It paid this sum in settlement of an even larger potential liability flowing from a decision of the Supreme Court of Washington. That decision exposed Lexington to liability to Alcoa and NWA for contamination occurring at particular sites over periods much longer than the three year policy period. Wasa and AGF had a 2½% line on a London market slip reinsuring Lexington for the three year period. They maintain that, whatever the position under the insurance, the reinsurance as a matter of construction only covered property damage occurring during that period. The issue in short is whether the English law reinsurance mirrors or follows the American

insurance, so as to oblige Wasa and AGF to pay their relevant percentages of what Lexington have paid.

The insurance and reinsurance

19. There is an almost complete absence of background to the placing of the insurance and reinsurance. "Information", said in the reinsurance slip to be "on file C.E. Heath & Co. Limited", has not been located. The insurance was formalised on Lexington's Special Floater form signed and dated at Boston, Massachusetts on 22nd August 1977. The Limit of Liability was $20 million for loss or damage arising from any one occurrence, subject however to an aggregate limit of $20 million any one policy year in respect of the peril of flood and surface waters and $20 million any one policy year in respect of the peril of earthquake. "Occurrence" was defined as "any one loss(es), disaster(s), or casualty(ies) arising out of one event or common cause". There was a property damage deductible of $250,000 per occurrence. The premium was a total of $818,000 (payable in three annual instalments) for the policy's three year term from 1st July 1977 to 1st July 1980 "beginning and ending at noon standard time at the location of the property involved". Against the heading "Perils Insured", the wording stated that: "This policy insures against all physical loss of, or damage to, the insured property …..". Under the next heading "Coverage excluded", the wording, reflecting the nature of DIC insurance, excluded a substantial number of risks, including those which might be expected to be insured under other policies. Although there was no express choice of law clause, the insurance contained a standard US Service of Suit clause:

> "In the event of the failure of [Lexington] to pay any amount claimed to be due hereunder, [Lexington] at the request of the Insured, will submit to the jurisdiction of any Court of Competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court."

20. The reinsurance slip read as follows:

> "TYPE: Contributing Facultative Reinsurance

FORM:	J.1. or N.M.A. 1779 covering All Risks of Physical Loss or Damage excluding Fire and Allied Perils &/or as original.
REASSURED:	Lexington Insurance Company
ASSURED:	Alcoa Aluminum
PERIOD:	36 months at date 1.7.77 …. and/or pro rata to expiry of original.
INTEREST:	All property of every kind and Description and/or Business Interruption and O.P.P. &/or as original
SUM INSURED:	Policy to pay up to $20,000,000 each occurrence and in the aggregate annually in respect of Flood and Earthquake.
SITUATED:	Worldwide and/or as original
CONDITIONS:	Retention $1,675,000 subject to excess of Loss and/or Treaty R/I Full R/I Clause No. 1 amended C.C. as original plus 30 days
PREMIUM:	Calculated at GOR [Gross Original Rate]
BROKERAGE:	25% and 1% tax
INFORMATION:	On file C.E. Heath & Co. Limited"

21. No amended Full reinsurance clause No. 1 has been identified, but the slip condition has been taken as referring to the Reinsurance Warranty Clause (Full R/I Clause No. 1) dated 3rd June 1943, which provided:

> "Being a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the Company and that said Company retains during the currency of this Policy at least ….. on the identical subject matter and risk and in identically the same proportion on each separate part thereof, but in the event of the retained line being less than as above, Underwriters' lines to be proportionately reduced."

It is unnecessary to consider whether this clause alone would incorporate into the reinsurance all the terms of the insurance which could be germane in that context. The slip's references "&/or as original" against the headings FORM and INTEREST on any view incorporate the relevant insurance provisions relating to the subject matter and risks into the reinsurance.

22. As between the brokers and Lexington, 10% of the 25% brokerage was returned to Lexington. Perhaps surprisingly, this was not disclosed on the slip, whether as ceding commission or in any other way. How far reinsurers were aware of it is unclear. Unless they were, they must, in view of Lexington's retention of $1,675,000, have thought that Lexington was for some reason prepared to enter into a reinsurance which would be loss-making if Lexington had to pay any claims at all under the insurance. That, though possible, seems unlikely. Simon J and the Court of Appeal were asked to consider as a secondary issue whether the retention of $1,675,000 was agreed as a simple aggregate sum or on a per occurrence basis. On this, I agree with the Court of Appeal, rather than the judge. The retention was a simple aggregate sum for the whole three year reinsurance period. This is what the slip on its face provides. The absence of any provision for the retention to be either "per occurrence" or on an annual aggregate basis contrasts with the slip provisions relating to the sum (re)insured. Secondly, the reinsurance cover would not make much commercial sense if the retention were on a per occurrence basis. A retention of $1,675,000 per occurrence equates with 8.375% of the maximum sum reinsured in respect of each occurrence (or with 8.375% of the maximum annual aggregate reinsured in the case of the perils of flood and earthquake). Although Lexington, through its share in the brokerage, was retaining 10% of the premium, in practice each occurrence would be very unlikely to give rise to the maximum loss reinsured. So, if the retention operated on a per occurrence basis, Lexington would in reality be retaining more than 10% of the risk for only 10% of the reinsurance premium.

History

23. For determination of the main issue argued on this appeal, it is necessary to know more of the history. Alcoa and NWA commenced proceedings against Lexington in the State of Washington in December 1992 in respect of damage involving 35 sites within the United States (18 owned by Alcoa or NWA, 17 not so owned) and in May 1996 in respect of damage involving a further 23 owned sites, some outside the United States. The proceedings were brought not only under Lexington's DIC policy, but also against numerous other DIC insurers (some 67, including "Underwriters at Lloyd's") participating in policies for various periods between 1st July 1980 and 1st July 1984 and against numerous insurers (some 98, including Lexington during a ten-year period from 1974 to 1984, and "Underwriters at Lloyd's") issuing comprehensive general liability policies for various periods between 29th March 1956 and 1st March 1985. The explanation of these periods is uncertain, but it may be that Alcoa did not have (or perhaps could no

longer locate) any relevant insurances outside such periods or that any relevant insurers outside such periods had ceased to be in business.

24. The proceedings related to contamination of the 58 sites by waste products generated and disposed by Alcoa and NWA over periods going back to the 1940s. Alcoa and NWA pleaded that "in recent years" the United States Environmental Protection Agency ("EPA") had made claims against Alcoa and NWA for the clean up of such contamination, as a result of which Alcoa and NWA would incur loss. (It appears that Comprehensive Environmental Response, Compensation, and Liability Act of 1980 - "CERLA" or "Superfund" – rendered those responsible for past as well as future contamination liable for its remediation.) The pleading instanced contamination in the State of Washington at Alcoa's L-Bar Products site in respect of which Alcoa and NWA were sued by the State of Washington in 1988 and at Alcoa's Vancouver Facility, in respect of which the Washington Department of Ecology issued various orders from 1986 to 1990, leading to the discovery of contamination of the soil and groundwater beneath landfill.

25. The proceedings against insurers were tried before Judge Learned. She selected for "Phase 1" of the trial three sites (the Vancouver Facility and sites in New York and Texas). In a preliminary ruling dated 10th June 1994 she held that the law of Pennsylvania should be applied to "those issues of contract interpretation which raise conflict-of-law issues" under the policies.

26. At an early stage during the trial, and in the light of written jury answers the judge further ruled on 15th May 1996 that most if not all of the claims on insurers were barred under the combination of the relevant contractual or statutory limitation provisions. Condition 17 in the DIC policy provided:

> "**Suit against Company.** No suit, action or proceeding for the recovery of any claim under this policy shall be sustainable in any court of law or equity unless the same be commenced within twelve (12) months next after discovery by the Assured of the occurrence which gives rise to the claim. Provided, however, that if by the laws of the State within which this policy is issued such limitation is invalid, then any such claim shall be void unless such action, suit or proceeding be commenced within the shortest limit of time permitted by the laws of such State to be fixed herein."

Massachusetts law provides that

> "No company ….. shall make, issue or deliver any policy of insurance ….. containing any condition, stipulation or agreement …. limiting the time for commencing actions against it to a period of less than two years from the time when the cause of action accrues …. Any such condition, stipulation or agreement shall be void".

Judge Learned's ruling was evidently based on the jury's findings that Alcoa had learned of property damage by the late 1970s and early 1980s, and discovered the occurrence which gave rise to its claims then. That ruling was set aside as regards Lexington's DIC insurance by the decision of the Supreme Court of Washington dated 4th May 2000. Although at an early point in its judgment the Supreme Court recited that "[t]he trial court determined the law of Pennsylvania applied, largely because Alcoa's headquarters are located in Pittsburgh", and that "[o]n appeal, no party disputes the trial judge's Order on Choice of Law applying Pennsylvania law to resolve the issues before us", when it came to deal with the suit limitation, the Supreme Court said that, the Lexington DIC policy having been issued in Massachusetts, "The parties agree Massachusetts law controls for the interpretation of these policies"; applying the relevant Massachusetts statute as interpreted by Massachusetts case-law, it held that no time bar applied since the cause of action against Lexington only accrued when Lexington denied coverage. In consequence of this ruling, Lexington appears to have been one of few insurers not entitled to the benefit of a contractual or statutory time-bar.

27. At a later stage in the trial before Judge Learned, the jury made further findings in written answers given on 3 October 1996. In answer to question No. 2, the jury found both that some portion of the relevant property damage occurred in each area of each of the three sites in each of the years from 1st July 1977 through to 1st July 1984, and that each portion so occurring during each year contributed to the costs of the repair in each such area. In its answer No. 4, the jury held that Alcoa knew of property damage or became substantially certain such damage would incur in many of such areas before 1st July 1977 or after 1st July 1984. In a few cases it held that Alcoa acquired such knowledge during the period of the Lexington DIC policy, and in yet others it made no finding. It found itself largely unable to answer question No. 5, which asked it to give the proximate cause of any damage unknown to and unintended by Alcoa as of 1st July 1977. In answer to question No. 12

the jury found itself also unable to say whether there was "a reasonable basis or bases on which to allocate to each separate policy year the costs related to the property damage that occurred during that policy year".

28. Judge Learned issued two further rulings dated 3rd March 1997. In the first, she concluded that there were "two cause(s) of the property damage at each of the three Phase I sites", being in the case of "property damage surrounding the manufacturing units at each plant …. releases from such units" and in the case of "property damage in and around the treatment, storage and disposal units …. the placement and release of wastes in such units or areas". In the second, she held, in the absence of any answer from the jury to question No. 12, that there existed in law a reasonable basis for allocating to each separate policy year the costs related to the property damage that occurred during that policy year. She said that Alcoa could reasonably expect the insurer on risk when the damage occurred to pay for the repair of whatever damage occurred during the policy year, even if the damage was a continuous process occurring over a number of years and even if it was not discovered until much later, but that it could not reasonably expect that the insurer would cover the entire loss, much of which occurred outside the policy period. As a matter of fact, she held that the best estimate of actual damage in any policy period was reached by simply dividing the damage over the time it took to develop.

29. On appeal on 4th May 2000 Judge Learned's second ruling was emphatically disapproved by the Washington Supreme Court. The Supreme Court held as follows, at (2000) 998 P 2d 856, 882-884:

> "G. Allocation
> The final issue we address in this case is the damages available to Alcoa upon a finding of coverage under the DIC policies. The jury found pollution damage to all three test sites occurred during the entire time the various DIC policies were in effect. The jury also found, however, pollution damage had occurred to portions of the three sites prior to the inception of insurance coverage. Because the pollution damage occurred both before and during the various policy periods, a question arose as to how to attribute the remediation costs of the pollution damage. The jury was unable to reach a verdict on whether there is a reasonable basis or bases to allocate to each separate policy year costs related to the property damage that occurred during that policy year….

Missing from the trial court's analysis of this issue is a close examination of the applicable policy language. The insuring clause in the DIC policy states: "PERILS INSURED: This policy insures against all physical loss of, or damage to, the insured property as well as the interruption of business, except as hereinafter excluded or amended."… This language is very broad and contains no limitation as to time of the physical loss or damage to property. There is no exclusion in the policy for physical loss or damage that may have begun spreading before the policy inception. The policy definition of occurrence likewise compels a broad reading of the policy: "The word 'occurrence' shall mean any one loss(es), disaster(s), or casualty(ies) arising out of one event or common cause(s)". There are no words of limitation here. It seems clear from the policy language that any physical loss or damage manifesting itself during the time a DIC policy was in effect was covered by the policy, including pollution damage starting before the policy inception. The trial court's written decision does not indicate why the court chose to allocate coverage on a pro rata basis rather than simply reading the policy as it is written and ordering full policy coverage for the damage Alcoa incurred.

In *J. H. France Refractories Co v Allstate Ins. Co.* 534 Pa. 29, 626 A. 2d 502 (1993), the Pennsylvania Supreme Court considered the issue of multiple insurance coverage over time in the case of asbestos disease. France was an asbestos manufacturer and seller from 1956 to 1972. The wife of a person who had died from asbestos exposure to France's products that occurred between 1948 and 1978 sued France. France sought a defence and indemnification from its insurers for those years, but the insurers denied any duty to defend or indemnify France. France then filed a declaratory judgment action to force the insurers to defend and indemnify.

The six insurers at trial had provided policies at varying times and all the policies contained the same general liability language:

> "[The Insurer] will pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of bodily injury … to which this insurance applies, caused by an occurrence, and [the Insurer] shall have the right and duty to defend any suit against the Insured seeking damages on account of such bodily injury."

One of the issues the trial court in that case considered was whether and how to allocate coverage among the six insurers. The trial court prorated the obligations of the insurers based on the time their respective policies were in effect (the *France* court did not explain the details of this proration).
On appeal, the Pennsylvania Supreme Court rejected the proration approach:-

> "First, and most compelling, is the language of the policies themselves. Each insurer obligated itself to "pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of bodily injury to which this insurance applies." We have already ascertained that any stage of the development of a claimant's disease constitutes an injury "to which this insurance applies" under each policy in effect during any part of the development of the disease. Under any given policy, the insurer contracted to pay all sums which the insured becomes legally obligated to pay, not merely some pro rata portion thereof".

Likewise, in the "perils insured" clause of the DIC policies here, the insurers obligated themselves to insure "against all physical loss of, or damage to, the insured property," not merely to some prorated portion thereof. The trial court attempted to distinguish this case from *J.H. France* by describing the difference between asbestos disease and environmental contamination:

> “Asbestos that has been inhaled may have no adverse effects for years and then may suddenly cause myriad physiological problems which are not necessarily related to the length of exposure or the number of asbestos fibres taken into the body. Asbestos disease is not merely a corollary of the volume ingested. Environmental contamination, on the other hand, is merely the sum of all its parts – each part per million of a particular contaminant that is discharged to the environment equally damages the insured property either by increasing the concentration of a particular area (if movement of the pollutant is retarded) or by increasing the size of the impacted area (if the pollutant readily migrates).”
> …

> It may be true, as the trial court stated, that the progression of pollution damage can be measured and apportioned more certainly year to year than can the progress of asbestos disease, but that understanding begs the question of whether the express DIC policy language compels proration. It is the policy language that determines the scope of coverage. The policy language here does not provide for any limitations to the scope of damage. …
>
> The insurers vigorously contend that while *J. H. France* may be correct as to third party coverage, it is not appropriately applied to first party coverage, citing the "all sums" language from the policy in *J. H. France*. We are not persuaded by this distinction. The language of the insuring agreement in the DIC policies is exceedingly broad, covering all physical loss or damage to Alcoa's property. This language is at least as broad as the policy language in *J. H. France*. Moreover, if DIC policies mean what the insurers claim they mean, the policy language should reflect that meaning. The policies in this case do not, and we decline to write a proration of coverage into the policies when the insurers failed to do so themselves. The trial court erred in its decision to prorate coverage according to the years the various DIC policies were in force. We reverse the trial court on this issue ……."

Analysis

30. Wasa and AGF do not submit that the decision of the Supreme Court of Washington on the extent of Lexington's liability under the law of Pennsylvania as insurers of Alcoa and NWA was perverse or wrong under that law. For the purposes of this appeal, they accept it as correct. Its effect was that Lexington was liable for all damage "manifesting" itself during the three year insurance period, although such damage had, in the Supreme Court's words, "occurred both before and during" that period or had "begun spreading" or "start[ed]" before that period. The force of the word "manifesting" is unclear, in the light of the jury's findings that Alcoa did not know of some of the property damage or become substantially certain that it would occur until after well after the expiry of that period (indeed until after 1st July 1984). Mr Sumption QC for Lexington submitted that all that the Supreme Court meant by "manifesting" was "in being". Further, the Supreme Court did not expressly address property damage occurring after the expiry of the three year period of Lexington's insurance. However, its judgment appears to have been read as rendering Lexington liable for all aspects

or consequences of any property damage in any area at any site, whenever occurring, any part of which could be said to have occurred during the three year insurance period. In response to this last point, Mr Sumption submitted that any property damage occurring after the three year period could only be responsible for a small part of the overall loss suffered by Alcoa and NWA, and, critically (as he submitted), that Lexington had, following the Supreme Court's judgment settled for only $103 million potential claims for over $180 million and that it was common ground that this was an honest and business-like settlement.

31. Lexington accepts that the reinsurance was and is subject to English law, while the insurance was an American policy. But it submits that this can and should make no difference. Reinsurers would and should have expected claims under the insurance to be brought in a court of competent jurisdiction in the United States under the Service of Suit clause. The Washington Court was such a court, and Judge Learned selected the law of Pennsylvania to govern the issue of policy interpretation under principles of private international law recognised in Washington. The language of the English law reinsurance should be read in the same sense as that which the American insurance was by this process authoritatively established to have. The Washington Court had done no more than decide what constituted damage occurring within the three year insurance period, and the reinsurance should respond on a like basis. The last submission involves a verbal gloss which I would not accept. The Washington Court acknowledged that its ruling enabled recovery under the insurance in respect of pollution damage occurring both before and during the policy period. Instead of identifying whether and how far such damage, or the disposal or leakage of waste causing it, occurred during the insurance period, it treated all pollution damage "manifesting" itself, or as Mr Sumption submits "in being", at any site during the policy period as covered by the insurance, whether it occurred before, during or, it appears, after that period.

32. The appeal can in my judgment be resolved by reference to certain propositions which are as such largely undisputed. First, a reinsurance is a separate contract, which may contain its own independent terms requiring to be satisfied before insurers can claim indemnity under it. To take an obvious example, the present reinsurance was not a perfectly proportional reinsurance, by virtue of the retention of $1,675,000. More fundamentally, even a perfectly proportional reinsurance is not an insurance against liability, still less against any liability which the reinsured may be held to incur under the insurance. Statements were made in the Court of Appeal by Sedley LJ, in para 49, to the effect that the "need for the fiction that reinsurance covered the

primary risk and not the insurer's own potential liability" is "long spent" and that the "reality" is that "what is reinsured is the insurer's own liability". Sedley LJ appears to have thought that a contrary view might have enabled Lexington to claim its percentage of $180 million, rather than $103 million, from its reinsurers. I do not consider these thoughts well-founded.

33. Reinsurance is a settled business conducted worldwide by experts, often (even if past experience indicates not invariably) possessing very considerable legal knowledge and expertise. The well-recognised analysis which neither side gainsaid before your Lordships is that a reinsurance such as the present is an independent contract, under which the subject-matter reinsured is the original subject-matter. The insurable interest which entitles the insurer to reinsure in respect of that subject-matter is the insurer's exposure under the original insurance. The principle of indemnity limits any recovery from reinsurers to the amount paid in respect of that insurable interest. See generally *Forsikringsaktieselskabet National of Copenhagen v. Attorney General* [1925] AC 639, 642, per Visc. Cave LC; *Charter Reinsurance Co. Ltd. v Fagan* [1997] AC 313, 392E-H, per Lord Hoffmann; *Toomey v Eagle Star Insurance Co. Ltd.* [1994] 1 Ll.R. 516, 522, per Hobhouse LJ and Marine Insurance Act 1906, s.9. (As noted in *Toomey*, a stop-loss or similar policy taken out by an insurer is not a reinsurance in this sense and operates as a whole account protection on a different basis.) Reinsurance business is classified in accordance with this well-settled analysis for regulatory purposes: Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544). Reinsurance slips are underwritten identifying the subject-matter insured (here, against the headings INTEREST and SITUATED) as the original insured's property, rather than the insurer's exposure or liability under the original insurance. On Sedley LJ's analysis, the decision in *Mackenzie v. Whitworth* (1875) 1 Ex. D. 36, that an insurer "on goods" may reinsure by the same description without disclosing that he is a reinsurer rather than the goodsowner, could not stand. There is no basis or justification for courts to throw unnecessarily into doubt an accepted analysis with business significance.

34. The first proposition is not critical to the resolution of this appeal. Both sides in fact accepted its correctness before the House. A conclusion that "what is insured is the insurer's own liability" would not entitle the insurer to indemnity against whatever liability it might be found to have in any court in which it was sued, under whatever law was there applied. Insurance against liability may, like any other insurance,

be subject to specific terms which have to be satisfied before any indemnity can be sought.

35. That leads to the second point: an insurer seeking indemnity under a reinsurance must, in the absence of special terms, establish both its liability under the terms of the insurance and its entitlement to indemnity under the terms of the reinsurance. In practice, the former task is eased by express terms in a proportional reinsurance: originally, these took the form of a provision "to be paid as may be paid", but courts gave this a limited interpretation which confined it to questions of quantum, so that it would only assist insurers once they had proved that they had some liability to their insured; there thus developed "follow the settlements" clauses or the "full reinsurance" clause appearing in the present reinsurance. As interpreted by the Court of Appeal in *The Insurance Company of Africa v. Scor (UK) Reinsurance Co. Ltd.* [1985] 1 Ll.R. 312, the effect of these clauses is to bind the reinsurer to follow settlements of the insurer (whether made by admission or compromise or, as in *Scor* itself, following a judgment against the insurer). The Court of Appeal in *Scor* identified two provisos: the first, that the claim so recognised falls within the risk covered by the policy of reinsurance and, the second, that the insurers acted honestly and took all proper and business-like steps in making the settlement: see per Robert Goff LJ (p.330).

36. In *Assicurazioni Generali SpA v. CGU International Insurance Plc* [2004] EWCA Civ 429; [2004] Lloyd's Rep IR 457, Deputy High Court Judge Gavin Kealey QC and the Court of Appeal considered how the principle in the *Scor* case might apply when the relevant terms of the insurance and reinsurance are identical. They considered whether and how the second proviso applied to an insurer who, acting honestly and taking all proper and business-like steps, settled an insurance claim under insurance terms which were identical to those of the reinsurance. They concluded that the insurer remained obliged to show that the basis on which the claim had been settled was "one which fell within the terms of the reinsurance as a matter of law or arguably did so" (per Tuckey LJ at para 17). The last three words must be read in the context of that case, where the insurance and reinsurance incorporated materially identical terms with materially identical effect (and the issue was whether and on what basis the facts fell within such terms). It is less obvious that they could apply in a case like the present where, if reinsurers are right, the like terms in the insurance and reinsurance have different effects due to the application of different governing laws.

37. Thirdly, the present appeal is to be determined on the basis that reinsurers were and are bound by the follow the settlements provision to accept that Lexington's settlement of Alcoa's and NWA's claims fairly reflected Lexington's liability under the original insurance; and, accordingly, that, if and so far as the loss was insured and reinsured on the same basis, the reinsurer must indemnify the insurer (subject only to the second *Scor* proviso, that the insurer acted honestly and took proper and business-like steps in making the settlement). In his case (though not, I believe, in oral submissions) Mr Sumption supported the view that, even without the follow the settlements clause, reinsurers would, as a matter of contractual implication, have been bound by the Washington Supreme Court's interpretation of the scope and application of the original cover. His case cited in this respect the obiter rejection by the Court of Appeal of submissions which Mr Sumption had made on the same point in *Commercial Union Assirance Co. v NRG Victory Reinsurance Ltd.* [1998] 2 Ll. Rep. 600. It is unnecessary to decide upon the correctness or otherwise of the Court of Appeal's obiter observations on the effect under reinsurance of a judgment against the insurer. I note only that there was no suggestion in the *Scor* case, where there was such a judgment, that this judgment could be binding in the absence of a follow the settlements clause; and that the basis for such a contractual implication has been questioned by a powerfully constituted Bermudian arbitration panel in an interim award dated 12th December 2000 in *Gold Medal Insurance Co. v Hopewell International Insurance Ltd.*, as well as by specialist writers: O'Neill and Woloniecki, *The Law of Reinsurance in England and Bermuda* (Sweet & Maxwell(2nd ed., 2004), pp 191-193. Here, there is a follow the settlements clause, and any issue which might have arisen regarding the actual settlement (see paragraph 30 above) was not canvassed below or before the House. The only issue raised by reinsurers is whether the loss arising from Lexington's settlement with Alcoa falls within the terms of the indemnity provided by the reinsurance slip.

38. Fourthly, it is common ground that, if the present reinsurance slip, including such terms of the original insurance as it incorporates, is to be construed according to purely English law principles, it does not have a meaning or effect similar to that which the Washington Supreme Court gave to the insurance. The only property damage which the reinsurance, construed according to purely English law principles, covers is property damage occurring during the three year reinsurance period. This is under English law clear beyond argument upon its wording. It insures property against risks during a stated period. The reference in the slip to the use of form J.1 (designed for use with a full policy wording) or NMA 1779 (designed for use with the slip to constitute a slip policy) is itself not without interest, even though neither

a formal nor a slip policy has been identified (one may question how premium was ever closed, unless at least the latter at some time existed). The understanding must have been that any formal policy would be on terms consistent with those of any slip policy. Form NMA 1779 provides for reinsurers "to pay …. all such Loss as aforesaid as may happen to the subject matter of this Reinsurance, or any part thereof during the continuance of this Policy" - confirmation of the basic nature of the reinsurance.

39. This construction of the slip also reflects the basic principle of English property insurance law, that "the insurer is liable for a loss actually sustained from a period insured against during the continuance of the risk": *Knight v Faith* (1850) 15 QB 649, 667 per Lord Campbell CJ. (The emphasis in that case was on the need for the peril insured against to occur during the continuance of the risk – damage materialising or developing from it after the policy period would still be covered. Usually, the occurrence of the peril and of loss concur, although one may contemplate the disposal or leakage of waste causing spreading contamination over a period.) Hobhouse LJ summarised the legal principle in *Municipal Mutual Insurance Ltd. v Sea Insurance Company Ltd.*[1998] Ll. R.I.R. 421, 435-436:

> "The judge came to the surprising conclusion that each reinsurance contract covered liability in respect of physical loss or damage whether or not it occurred during the period covered by the reinsurance contract and he went on expressly to contemplate that the same liability for the same physical loss or damage might be covered under a number of separate contracts of reinsurance covering different periods. This is a startling result and I am aware of no justification for it. When the relevant cover is placed on a time basis, the stated period of time is fundamental and must be given effect to. It is for that period of risk that the premium payable is assessed. This is so whether the cover is defined as in the present case by reference to when the physical loss or damage occurred, or by reference to when a liability was incurred or a claim made. Contracts of insurance (including reinsurance) are or can be sophisticated instruments containing a wide variety of provisions, but the definition of the period of cover is basic and clear".

The insurance in this case was not against liability incurred or claims made. It is clear that the Washington Supreme Court approached it as property damage insurance, and held Lexington liable on that basis, because of its conclusion that the insurance should be seen as covering

all contamination whenever caused or occurring at any site, so long as any part of it could be said to have manifested itself (or been in being) at the site during the three year insurance period.

40. Viewing the reinsurance through purely English law eyes, it cannot therefore be construed as a contract to indemnify Alcoa in respect of all contamination of Alcoa sites, whenever caused or occurring, provided that part of such contamination manifested itself or was in being during the reinsurance period. That would involve reinsurers in an unpredictable exposure, to which their own protections might not necessarily respond. It would mean that the same exposure would arise, even if they had granted the reinsurance for a shorter period than the three year period matching the original – since the original itself would, even if in force for only one year, have had effectively the same exposure as that for which the Washington Supreme Court held it answerable. Under the approach taken by the Washington Supreme Court, reinsurers must have incurred liability (in practice probably up to the reinsurance limits), as soon as they wrote the reinsurance. The retention must likewise have been exhausted before the reinsurance period began, and cannot have fulfilled any object of introducing an element of discipline into insurers' handling of the insurance. These represent as fundamental and surprising changes in the ordinary understanding of reinsurance and of a reinsurance period as those to which Hobhouse LJ was referring in the *Municipal Mutual* case.

41. The reference in the reinsurance slip to the retention as "subject to excess of loss &/or Treaty R/I" is a reminder that an insurance and reinsurance such as the present are likely to be part of a larger programme of protections. Excess of loss reinsurance is underwritten on either a losses occurring or risks attaching basis: *Balfour v Beaumont* [1984] 1 Ll.R. 272. In other words, it is fundamental that such a reinsurance will respond in the one case to losses occurring during the reinsurance period, in the other to losses occurring during the period of policies attaching during the reinsurance period. To treat excess of loss policies as covering losses through contamination occurring during any period, so long as some of the contamination occurred or existed during the reinsurance period, would be to change completely their nature and effect. The reference in the slip to excess of loss reinsurance underlines the difficulty about interpreting the terms of the reinsurance as covering the losses which the Washington Supreme Court have held to be recoverable under the insurance.

42. Fifthly, and crucially to the outcome of this appeal, it is said that all objections to treating the reinsurance as covering Lexington's liability are dispelled by giving appropriate recognition to the fact that the reinsurance was placed expressly to cover the original DIC insurance; the relevant language of the insurance and reinsurance was identical; and Lexington's evident intention in reinsuring was to cover itself in respect of the whole risk after the exhaustion of the retention. The two contracts should be treated as back to back, and a mere difference in governing law should not lead to any other result. On the contrary, English law should read the language of the reinsurance in the sense given it by the Washington court.

43. Mr Sumption submits that this line of reasoning is supported, indeed compelled, by the House's decision in *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and the Court of Appeal's decision in *Groupama Navigation v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350. In *Vesta*, a 90% reinsurance of a Norwegian insurance company was placed before, and on wording which was later copied into, the insurance. The reinsurance was however subject to English law, while the insurance was subject to Norwegian law. Both included a 24-hour watch warranty, as well as a claims control clause which expressly provided that failure to comply with any warranty was to "render the policy null and void". Despite these express words, under Norwegian law, breach of warranty was only relevant if causative of the loss, while under general English law (reinforced in *Vesta* by the claims control clause) breach automatically discharges reinsurers. The House held that, by virtue of the "back to back" nature of the reinsurance, the 24-hour watch warranty was to be read in the English law reinsurance as having the same significance as it had in the Norwegian reinsurance. *Catatumbo* was also concerned with proportionate reinsurance, in this case written facultatively in circumstances where London market reinsurers had no sight or direct knowledge of the terms of the insurance issued under Venezuelan law by the Venezuelan insurers who they undertook to reinsure. The reinsurance contained a guarantee of class maintained and was treated as incorporating the terms of the insurance, which itself contained a Spanish language "garantia" in like terms. Again, under Venezuelan law, a warranty was irrelevant unless causative of loss. Again, this was the effect to be given to the warranties contained or incorporated in the English law reinsurance.

44. Ultimately, however, the issue is one of construction of the particular reinsurance contract against its relevant background and surrounding circumstances. In both *Vesta* and *Catatumbo*, it was possible at the time when the insurance and reinsurance were placed to

identify the foreign law which would govern the insurance. The parties entering into the English law reinsurance could be taken to have had access to what Lord Lowry in *Vesta* described as a foreign "legal dictionary" to interpret the language of the reinsurance. Lord Templeman, in discussing in *Vesta* (at p.892B-E) the extent to which the two contracts had the like effect, did so by reference to the circumstances and terms in which they were entered into, not on the basis that the reinsurance was bound to respond to whatever liability the insurers might subsequently be held to incur. As Longmore LJ put it in the present case (para. 25): "It must be sufficient if there is a way in which it would be possible to ascertain the legal position under the original insurance contract". That was so when the reinsurances were placed in *Vesta* and *Catatumbo*.

45. Sixthly, under English law, a contract has a meaning which is to be ascertained at the time when it is concluded, having regard to its background and the surrounding circumstances within the parties' knowledge at that time. Mr Sumption submits that this is so here. The meaning is to be derived from reading the reinsurance terms in the sense they bore under Pennyslvanian law. The parties must have contemplated that any claim under the insurance issued to Alcoa would, if contentious, be litigated and determined before the courts of one of the United States under the Service of Suit clause. Alcoa having exercised this right to bring suit in Washington, Judge Learned did no more and no less than what an English court would have done. She decided, under the conflict of laws rules of the State of Washington, what State's law governed the insurance contract. Having determined that the law of the State of Pennsylvania applied, she interpreted and applied the jurisprudence of that State. This was, in short, a foreseeable and conventional exercise. Indeed, Longmore LJ considered that an English court would, if its own conflicts rules had been applicable, also have concluded that the law of the State of Pennsylvania applied, on the basis that the insurance contract had its closest and most real connection with that State where Alcoa was incorporated and had its principal place of business.

46. I am unable to agree with Longmore LJ on this last point. Applying English law conflicts principles, I think that the insurance would fall to be treated as governed by the law of the State of Massachusetts. The insurance policy was headed with Lexington's name followed by "Boston, Massachusetts", where Lexington's head office was, it was recorded as countersigned by Lexington at the same place, and as broked by Fairfield & Ellis, also of Boston. It was issued in Massachusetts to insure Alcoa and its subsidiaries and affiliates whose address was given as Pittsburgh, Pennsylvania. It covered property in

and in various countries outside the United States. For reasons given by my noble and learned friend, Lord Collins of Mapesbury in paragraphs 91 to 93 an English court applying English law would, I consider, have concluded that Massachusetts law governed the insurance.

47. Seventhly, however, Lexington's case does not depend on the attitude in relation to the original insurance of an English court applying English conflicts principles. What matters, in Mr Sumption's submission, is that the Washington court, properly seised of the case under the Service of Suit clause, determined under its conflicts principles that Pennsylvanian law governed. However, that was a decision reached in the context of large scale litigation involving a wide range of insurers, insurances and periods. Judge Learned's decision falls to be viewed in this light. She read the direction in the Service of Suit clause to determine all matters arising under the insurance in accordance with the law and practice of whatever court of competent jurisdiction was selected by Alcoa as a direction to apply the full law of that court, including its choice of law principles. Any other conclusion would clearly have meant that the insurance fell to be interpreted by a substantive law which depended on Alcoa's ultimate choice of jurisdiction. She concluded that Washington had no special interest in applying its own substantive law, and turned to section 193 of The Restatement (2nd) of Conflict of Laws, which pointed towards the law of the site insured as the natural governing law. Having regard to the multiplicity of sites in issue, she rejected that law on the basis that "it is generally presumed that contracting parties mean their contracts to have one meaning" and that, although the same language in different policies might be interpreted differently in different jurisdictions, the parties were unlikely to have expected the same policy to be subject to "multiple interpretations depending on the fortuity of where the damage occurs".

48. The key to Judge Learned's application of Pennsylvanian law lies in her statement that Pennsylvania was "the one commonality between all the sites and all the defendants". This was on the basis that placement originated from Alcoa's headquarters and was "in most cases …. coordinated through the Pennsylvania broker or other brokers". She added:

> "Analysis of each policy for the details of contract formation to "count" contacts in the formation of the contract would not be particularly fruitful. The coverage scheme was comprehensive, multilayered. The place of signature of the contract, or domicile

> or headquarters of the various defendants or other factors are of less significance than those associated with Pennsylvania. Overall, the record reflects that the meaningful center of gravity for contract formation is Pennsylvania, for most, if not all of the contracts."

She also refused submissions made by some insurers that she should "defer ruling on choice of law and decide issue by issue and defendant by defendant", and concluded:

> "The court determines as a general rule that for those issues of contract interpretation which raise conflict-of-law issues, Pennsylvania law is deemed to have the most significant relationship and the court will apply Pennsylvania law. However, if specific or unique issues arise regarding one or more defendants or one or more sites, that raise significant considerations that override the general rule, they can be brought to the court's attention at that time."

As recorded above, the Supreme Court stated that there was no appeal against this conclusion by Lexington.

49. It is clear that Judge Learned's conclusion about the governing law was an overall conclusion, based on a general consideration of the "comprehensive, multilayered" insurance scheme arranged by Alcoa over the years and a reluctance to engage in analysis of the particular circumstances of individual insurances taken out individually and with different insurers at different times and in different places. It was arrived at therefore by taking into account matters and events extraneous to the policy issued by Lexington to Alcoa or the claims arising under that policy. The choice of the law of the State of Pennsylvania to govern Lexington's insurance of Alcoa cannot, as a result, be regarded as in any sense predictable at the time when the reinsurance was placed, or as following from the operation of the terms of the insurance as a contract independent of all the other insurance contracts held by Alcoa over several decades. This point is underlined by the reference in condition 17 of the policy issued by Lexington to Alcoa to the law of the place of issue of the policy as the appropriate law to govern the validity and period of the time limit for proceedings and the parties's agreement in this connection that the policy was subject to Massachusetts law: paragraph 26 above. Lexington's case depends on the application of a Pennsylvanian legal dictionary. Lexington has not advanced its case on the basis that a Massachusetts legal dictionary could be relevant to or assist Lexington's position. In my view, the present case is materially

different from both *Vesta* and *Catatumbo*. The reinsurance has a clear English law meaning. There was here no identifiable legal dictionary (formal or informal), still less a Pennsylvanian legal dictionary, which can to be derived from the interaction or operation of the terms of the insurance and reinsurance and which could lead to any different interpretation of the reinsurance wording. For reasons I have already given, the reinsurance is an independent contract, with its own terms which fall to be construed under English law, and I see no basis for interpreting it as covering any liability which might subsequently be held to arise under the insurance in any State whose law might, after disputes had arisen under it and other separate insurances, be applied by reference to factors extraneous to the particular insurance to which alone the reinsurance related It follows that there is no basis for construing the two contracts as back to back in the present situation.

Other points

50. That is sufficient to dispose of this appeal. But I would make some short observations in relation to two further submissions advanced by Mr Schaff QC for Wasa, with the support of Mr Calver QC for AGF. First, *Vesta* and *Catatumbo* were both cases concerned with the effect of breaches of warranty. This is an area where English law has long been recognised as unduly stringent and in need of review. It was, as I said in *Catatumbo* (para. 30), commercially and legally unattractive to treat the concept of warranty in the reinsurance as retaining "a stubbornly domestic English significance, trumping any limited significance of such a warranty included in the original and also incorporated by reference into the reinsurance"; a "harmonious result" could be achieved relatively easily by treating warranty in the reinsurance as taking its precise meaning and application from any equivalent warranty incorporated in the original. Like considerations would no doubt mean in relation to the present contracts that the reinsurance period (expressed as a unitary period of 36 months at 1st July 1977) would be understood to run back to back with the insurance term of 36 months "beginning and ending at noon standard time at location of property involved": see *Knight v Faith* (1850) 15 QBD 649. Similarly, any doubt about the meaning of the sum reinsured of $20 million in the aggregate in respect of Flood and Earthquake would be clarified by reference to the original, which makes clear that such aggregate applies to each of these perils separately. In each case, there is no doubt about the terms or effect of the original insurance wording and there would be no problem about making the necessary minor assimilation.

51. It may not, perhaps, always be so easy to assimilate an original insurance and reinsurance, when one is concerned with as fundamental an aspect of a reinsurance as its definition of the risks and period insured and the period for which they are insured (see paras. 38 to 40 above). The almost complete absence of any context to the two placements in the present case is furthermore no assistance to such an exercise. Mr Sumption asked rhetorically: what more could Lexington have done to reinsure themselves on a fully back to back basis? The market has in the past adapted the nature of the protections arranged or their wordings to achieve the results which it believed appropriate. But another answer, under the present course of business, is to ensure that insurance and reinsurance are subject to one and the same identifiable or predictable governing law. Failing that, steps could at least be taken to make the insurance subject to an identifiable governing law, though this would not necessarily foreclose all argument. Absent a common governing law, reinsurers may still sometimes be entitled to respond, with reference to the clear meaning that their contract has under the law governing it: what more could we as reinsurers have done to make clear the basis of reinsurance? A sensible principle of construction, established in *Vesta* and *Catatumbo*, cannot be made into an inflexible rule of law, which would impose on reinsurers a liability for which, under the law applicable to the reinsurance, they did not bargain. The consideration that Lexington probably did not reckon on the liability which it was held to have in America is not by itself a conclusive reason for passing that liability to reinsurers who were, on the face of it, also entitled to be confident that no such liability could arise under the clear and basic terms of the English law contract into which they entered.

52. At times during the argument, Mr Schaff submitted that no-one, even in the United States, could at the time of placement, have predicted that an American court would put on the insurance the construction adopted by the Washington Supreme Court. It is unnecessary to express any view about the factual basis for this submission, although the cases themselves tell at least part of the story. Asbestosis litigation was in its relative infancy in 1977, although a principle of joint and several liability of manufacturers to whose products a worker had been exposed over a period of years was developed in *Borel v Fibreboard Paper Products Corp.* 493 F.2d 1076 (5th Cir. 1973). This was on the basis that, "where the tortious acts of two or more wrongdoers join to produce an indivisible injury, that is, an injury which from its nature cannot be apportioned with reasonable certainty to the individual wrongdoers, all of the wrongdoers will be held jointly and severally liable for the entire damages" (p.1095). In *Insurance Company of North America v Forty-Eight Insulations Inc* 633 F.2d 1212 (6th Cir. 1980) it was affirmed that liability insurance policies taken out for various terms over a period of

years were triggered by an asbestosis sufferer's exposure to asbestos over that period, but that insurers' liability for defence costs as well as for the policy indemnity should be apportioned pro rata among insurers, with the insured asbestos manufacturer itself bearing a pro rata share of any liability arising from the victim's exposure to asbestos during years when the manufacturer had no liability insurance. The court said (p 1225) that: "Neither logic nor precedent support" a contrary view according to which "a manufacturer which had insurance coverage for only one year out of 20 would be entitled to a complete defence of all asbestos actions the same as a manufacturer which had coverage for 20 years out of 20". However, in the famous case of *Keene Corp. v Insurance Company of North America* 667 F.2d 1034 (US Court of Appeals, District of Colombia. 1981), the court developed the triple trigger theory according to which liability attached to all liability insurances which were in force at the time of injurious exposure, at the time of manifestation of disease or at any time inbetween (i.e. the time of "exposure in residence"). Further, in *Keene* and certain other cases, such as *J.H. France Refractories Soc. v Allstate Insurance Company* 534 Pa. 29 (cited by the Washington Supreme Court in the present case) some courts differed from the *Forty-Eight Insulations* case by holding that all such liability insurers were liable to the insured jointly and severally in full, rather than on a pro rata basis, and that any period when the insured manufacturer had no insurance was irrelevant to such liability. During the 1990s it appears that some courts began to apply similar reasoning to pollution damage resulting in remediation claims under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980: see e.g. *B & L Trucking & Construction Co., Inc. v. Northern Insurance Co. of N.Y.*, 134 Wash. 2d 413, 951 P. 2d 250, (Washington Supreme Ct. Feb. 19, 1998), indicating that "[I]n a continuing damage situation, each insurer is held jointly and severally liable for the full amount of damage, regardless of the amount that occurred during its policy period." The Washington Supreme Court's present decision cited this case and followed the same approach in relation to the property damage insurance issued by Lexington to Alcoa.

53. Assuming that Mr Schaff were to be right in his submission that no-one, even in the United States, could at the time of placement, have predicted that an American court would put on the insurance the construction adopted by the Washington Supreme Court: would that matter? Longmore and Pill LJJ thought not, on the basis that reinsurers must take the risk of any change in the law (paras. 30 and 60). It would have been "nothing to the point", Longmore LJ said, "if the relevant Norwegian statute had been enacted after the inception of the policy in the *Vesta* case, but before the loss" (para. 30). Here, moreover, one is only talking at most about a change in the construction put at common

law on a particular contract wording. However, it is unnecessary to say more about any such points in this case. They may, and one certainly hopes will, rarely arise, and the market may be advised to amend its reinsurance wordings to make it even less likely that they will.

Conclusion

54. Although I see the general attraction of the answer which the Court of Appeal gave in the present case, I find it impossible to adopt in circumstances where Lexington's liability has been held to arise under a system of law which was applied to the insurance not by reason of the terms of the insurance or their operation, but in the context of a choice of law on a blanket basis to cover also a large number of other independent insurances and claims. I note that Longmore LJ reached his opposite conclusion after taking an opposite view about the feasibility of identifying Pennsylvanian law as the law which would have been taken as governing the original insurance (paras. 27-28). In the upshot, I consider that this appeal should be allowed, and the decision of Simon J restored. I have also had the benefit of reading in draft the full and instructive judgment prepared by Lord Collins and I agree with the reasoning by which he reaches the same conclusion.

LORD COLLINS OF MAPESBURY

My Lords,

55. After banking, insurance is the United Kingdom's largest invisible export, of which reinsurance forms a large part, and amounted to at least £1.2 billion in 2007: Office for National Statistics, *United Kingdom Balance of Payments: The Pink Book*, 2008, p 52. These appeals raise the question of the extent to which the coverage under a proportional facultative reinsurance contract is, or should be construed as being, co-extensive with the coverage under the insurance contract. The reinsurer takes a proportional share of the premium and bears the risk of the same share of any losses. Consequently, the starting point is that normally reinsurance of that kind is back-to-back with the insurance, and that the reinsurer and the original insurer enter into a bargain that if the insurer is liable under the insurance contract, the reinsurer will be liable to pay the proportion which it has agreed to reinsure. In the usual case, any loss within the coverage of the insurance will be within the coverage of the reinsurance. This is so, whether or not

(as is often the case) the reinsurance is put in place before the insurance is put in place or written. It is not necessary to characterise the reinsurance policy as liability insurance to achieve this result, which is essentially a question of commercial intentions and expectations.

56. Those commercial intentions and expectations should not be frustrated by allowing reinsurers to take uncommercial and technical points based on the difference between the effect given to terms in the insurance and the reinsurance under their respective governing laws. That was the basis of the decision in *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852, when the relationship between a contract of insurance and a contract of reinsurance in the international context was considered by this House twenty years ago. But these appeals raise more difficult and fundamental questions than those in *Vesta v Butcher*.

57. In the present case the insurer has become liable in the United States to the insured for losses suffered by the insured which could not have been anticipated in 1977, when the contracts of reinsurance and reinsurance were entered into. But insurers and reinsurers have to accept liability for losses which are not anticipated, and it is not that feature which distinguishes this case. What is unusual about this case is that the court which imposed the liability on the insurer, the Supreme Court of Washington, applied the law of a State (Pennsylvania) which is one of those States which imposes joint and several liability for the whole of the clean-up costs in environmental claims on all insurers at risk during the period when pollution occurred (which may be 50 years or more), provided that some pollution has occurred during the policy period in the relevant policy (in this case from 1977 to 1980). The reinsurance covered the same 1977 to 1980 period. It is common ground that under English law those losses would not be covered by a policy providing cover for losses occurring during that period. In the judgment under appeal the Court of Appeal (Pill, Sedley and Longmore LJJ, with Longmore LJ giving the main judgment) held that the reinsurance had to respond because the wording relating to the period of cover, which appeared in both the insurance and reinsurance, was to be given the same meaning in each of these contracts, namely the meaning which the Supreme Court of Washington had ascribed to it.

58. The solution to the question on these appeals, and the reasons why they should be allowed, seem to me to be found in these steps:

(1) In order to establish liability against a reinsurer, the reinsured has to establish that the loss is within the risk assumed under the underlying insurance contract; and that the relevant risk has been assumed under the reinsurance contract.

(2) Whether the relevant risk has been assumed under the reinsurance contract is a question of construction of that contract.

(3) In principle the relevant terms in a proportional facultative reinsurance – and in particular those relating to the risk – should be construed so as to be consistent with the terms of the insurance contract on the basis that the normal commercial intention is that they should be back-to-back.

(4) Where the insurance contract and the reinsurance contract are governed by different laws, it remains a question of construction of each contract under its applicable law as to what risk is assumed, and there is no special rule of the conflict of laws which governs the consequences of any inconsistency.

(5) Both the insurance contract and the reinsurance contract were "losses occurring during" (or "LOD") policies (or "occurrence policies" as they are known in the United States), which in English law means that an insurer (or reinsurer) is liable to indemnify the insured (or reinsured) in respect of loss or damage which occurs during the policy period.

(6) There was not in 1977, when the insurance contract and the reinsurance contract were concluded, any identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract of reinsurance in a manner different from its ordinary meaning in the London insurance market.

(7) The effect of the decision of the Supreme Court of Washington is to impose liability on Lexington under the contract of insurance for loss and damage which

occurred both before and after (as well as during) the policy period in the reinsurance contract.

(8) It is common ground that under English law an insurer (or reinsurer) would not be liable for losses occurring before and after the policy period.

(9) Although normally any loss within the coverage of the insurance will be within the coverage of the reinsurance, there is no rule of construction, and no rule of law, that a reinsurer must respond to every valid claim under the insurance irrespective of the terms of the reinsurance.

(10) The reinsurance contract cannot reasonably be construed to mean that it would respond to any liability which "any court of competent jurisdiction within the United States" (the phrase in the Service of Suit clause) would impose on Lexington irrespective of the period of cover in the reinsurance contract.

Insurance, reinsurance and the construction of contracts

59. It is elementary and obvious that a reinsurer cannot be held liable unless the loss falls within the cover of the underlying insurance contract and within the cover created by the reinsurance: *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239, at 1251, *per* Lord Mustill. It is equally elementary that what falls within the cover of a contract of reinsurance is a question of construction of that contract.

60. In the case of proportional facultative reinsurance the obvious commercial intention is for the original insurer to reinsure part of its own risk and for the reinsurer to accept that part of the risk, and it is therefore equally obvious that the relevant terms in the reinsurance contract should be construed so as to be consistent with the contract of insurance. This is simply commercial common sense. Consequently, in proportional facultative reinsurance the starting point for the construction of the reinsurance policy is that the scope and nature of the cover in the reinsurance is co-extensive with the cover in the insurance. As Staughton LJ said in *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127, 132: "One can … readily assume that a reinsurance

contract was intended to cover the same risks on the same conditions as the original contract of insurance, in the absence of some indication to the contrary."

61. An early example of this principle is *Joyce v Realm Marine Insurance Co* (1872) LR 7 QB 580. The insurance covered (inter alia) cargo from ports in West Africa with outward cargo to be considered homeward interest 24 hours after the ship's arrival at her first port of discharge. The reinsurance was at and from West African ports "to commence from the loading of the goods." Goods shipped at Liverpool were lost 24 hours after the ship's arrival at the port of Cabenda. It was held by the Court of Queen's Bench that "loading" in the reinsurance applied to outward cargo from Liverpool to West Africa which was left on board and considered as homeward cargo under the insurance. The terms in the reinsurance in the light of the insurance showed that "what was meant between the parties was not the actual loading, but a constructive loading, which was what the original underwriters had agreed to treat as a loading on board for the purpose of the homeward voyage": at 586, per Lush J.

62. More than a hundred years later *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep. 350 affirmed the continuing significance of the principle. In *Vesta v Butcher* Lord Griffiths said (at 895):

> "In the ordinary course of business reinsurance is referred to as 'back-to-back' with the insurance, which means that the reinsurer agrees that if the insurer is liable under the policy the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure. A reinsurer could, of course, make a special contract with an insurer and agree only to reinsure some of the risks covered by the policy of insurance, leaving the insurer to bear the full cost of the other risks. Such a contract would I believe be wholly exceptional, a departure from the normal understanding of the back-to-back nature of reinsurance and would require to be spelt out in clear terms. I doubt if there is any market for such a reinsurance."

The effect of different governing laws

63. Where the potential conflict between the insurance contract and the reinsurance arises from the fact that they are governed by different laws, the question whether the conflict can be resolved remains a question of construction. The solution cannot be found in any rules of the conflict of laws.

64. An early example of such a conflict is *St Paul Fire and Marine Insurance Co v Morice* (1906) 11 Com Cas 153. St Paul insured under a United States policy a bull shipped from New York to Buenos Aires against (inter alia) "all risks of mortality". The bull was infected with foot and mouth disease and slaughtered on board on arrival in Argentina pursuant to Argentine law and regulations. A Lloyd's policy of reinsurance ("subject to the same terms … as original policy ...") insured the bull against all risks "including mortality". The reinsured settled the claim under the United States insurance policy and claimed on the English law reinsurance. The policy was issued by a Minnesota insurance company, and referred to the potential liability of the insurer under "the rules and customs of insurance in Boston or New York." The reinsured called expert evidence on United States law, rather than the law of Minnesota, New York or Massachusetts, presumably because this case was decided before the Supreme Court ruled in *Erie Railroad Co v Tompkins*, 304 US 64 (1938) that there was no federal common law, or because there was no difference between the laws of those States. The expert evidence was to the effect that under United States law the reinsured was liable to pay the insured under the words "all risks of mortality". The reinsurers (represented by Mr Scrutton KC) argued that mortality in both the insurance and the reinsurance meant death by such things as accident, but not by intentional killing.

65. In an unreserved judgment, Kennedy J said that after hearing the expert evidence he did not think that there was any strong reason for supposing that the words did include, as a matter of United States law, slaughter of the kind in question: at 163. But if he were wrong in that, he considered whether, as a matter of construction, the reinsurers were bound to pay. On that point, he decided that the natural construction of the reinsurance policy under English law was the same as the construction he had given to the United States policy, namely that mortality did not include death by the intentional act of the officials at Buenos Aires. If there had been no grounds for rejecting the evidence of United States law (or, as it would now be, the law of the State whose law governed the policy), it is likely that the case would have been

decided differently today, and it does not give much support to the appellants' case.

66. *Vesta v Butcher* and *Groupama v Catatumbo* were cases where the insurance contracts and reinsurance contracts contained, or incorporated, the same or similar language, but were governed by different laws. In those cases the apparent conflict between the insurance and the reinsurance arose, not from a difference in wording between the policies, but from the different effect which identical or similar wording had under the different laws governing the insurance and the reinsurance. They were much easier cases than the present one. In each case the reinsurers were taking the wholly unmeritorious point that they were relieved from liability because the original insured (and not the reinsured) had been guilty of a breach of a warranty. In each case the warranty was held to be a term of both the insurance and the reinsurance contracts. In each case the breach was not, or was assumed not to have been, causative of the loss. In each case the governing law of the insurance contract did not afford a defence where the breach was non-causative.

67. In *Vesta v Butcher* the insurance was for loss or damage to a fish farm in Norway. As in the present case, the reinsurance policy was put in place before the original insurance was written. The insurance and the reinsurance were broked as part of a package. London underwriters and brokers had marketed insurance contracts for fish farms across the world. They did not do so directly but made use of a local insurance company to obtain the business. The brokers interested Vesta in the business on the understanding that the brokers would be able to obtain 90% reinsurance of Vesta's risk in the London market.

68. The contract of insurance contained the terms: "It is warranted that a 24 hour watch be kept over the site … Failure to comply with any of the warranties will render this policy null and void." The reinsurance policy form was Form J1, and the slip annexed the original insurance terms. The litigation was conducted on the basis that the warranty in the insurance contract was also a term of the reinsurance. Hobhouse J refused the brokers (who were being sued by Vesta for failure to obtain an effective reinsurance) leave to amend so as to plead that the 24 hour watch clause was not a term of the reinsurance: [1986] 2 All ER 488, 496-497. Lord Templeman (with whom Lords Bridge and Ackner agreed) treated Form J1 as emphasising that the two policies were on the same terms ([1989] AC at 891), and Lord Lowry (with whom Lords Bridge and Ackner also agreed) approved Hobhouse J's statement to the

same effect (at 901). Lord Griffiths expressed doubts (which I have to say have considerable force) about whether the effect of Form J1 was to incorporate the warranty in the reinsurance (at 896). The insurance contract was governed by Norwegian law, and the reinsurance contract was held by the Court of Appeal to be governed by English law (and there was no appeal on that point to this House).

69. In *Groupama v Catatumbo* the insurance gave hull and machinery cover for a fleet of vessels. There was a warranty as to maintenance of existing class in the insurance contract ("guarantee of maintenance of existing class") which had been incorporated in the reinsurance contract in similar but not identical terms ("Warranted existing class maintained"). The insurance policy had been issued in Spanish by a Venezuelan insurance company to a Venezuelan insured providing for jurisdiction of a Venezuelan court if the parties did not agree to arbitration. It was accepted that it was governed by Venezuelan law. It was common ground that the reinsurance contract was governed by English law.

70. In *Vesta v Butcher* the express term that failure to comply with the warranties rendered the policy null and void was ineffective under Norwegian law if the breach was non-causative, whereas a similar term in the reinsurance would be valid under English law. In *Groupama v Catatumbo* breach of warranty affected the insurance cover under Venezuelan law only if it were causative, while English law (Marine Insurance Act 1906, sections 33(3), 34(2)) discharged an insurer from the date of the breach irrespective of whether it had been remedied before the loss.

71. In both cases the reinsurers failed because the reinsurance was held to have the same effect as the insurance. In *Vesta v Butcher* the speeches of both Lord Templeman and Lord Lowry commanded a majority. They were agreed that the question was one of construction of the reinsurance contract. Lord Templeman's conclusion was founded on his view that "the effect of a warranty in the reinsurance policy is governed by the effect of the warranty in the insurance policy because the reinsurance policy is a contract by the underwriters to indemnify Vesta against liability under the insurance policy" ([1989] AC at 892). For Lord Lowry, the main point was that the relevant words in the reinsurance contract ("failure to comply") had the same meaning and effect as they had in the Norwegian insurance contract.

72. In *Groupama v Catatumbo* it was held that the parties to the reinsurance contract must be taken to have intended that the incorporation in the reinsurance contract of terms in the original insurance retained the same significance which they had in the original insurance. It was a question of construction, against the background that "reinsurers conducting international business must be taken to have intended that the warranties in the two contracts will have the same effect" (at [20] per Tuckey LJ) and that the "reinsurance is … a contract which in terms relates to and must be read in conjunction with the terms of the original insurance" (at [26] per Mance LJ).

73. Tuckey LJ rightly emphasised at [20]: "… reinsurers conducting international business must be taken to have intended that the warranties in the two contracts will have the same effect. They will be aware that the laws of some countries give more restrictive effect to warranties than English law, but that is a risk they must be taken to have assumed by writing international business. They will be protected to the same extent as the insurer." Mance LJ warned (at [30]) against a narrow English law-centred approach: "The … submission that the warranty of existing class maintained in the reinsurance retains a stubbornly domestic English significance, trumping any limited significance of such a warranty included in the original and also incorporated by reference into the reinsurance is, to my mind, both commercially and legally unattractive."

The period of cover

74. In English law, where an insurance or reinsurance contract provides cover for loss or damage to property on an occurrence basis, the insurer (or reinsurer) is liable to indemnify the insured (or reinsured) in respect of loss and damage which occurs within the period of cover but will not be liable to indemnify the insured (or reinsured) in respect of loss and damage which occurs either before inception or after expiry of the risk. As Lord Campbell CJ said in *Knight v Faith* (1850) 15 QB 649, at 667, "the principle of insurance law [is] that the insurer is liable for a loss actually sustained from a peril insured against during the continuance of the risk." An early example of a "losses occurring during" insurance policy is *Re London Marine Insurance Association* (1869) LR 8 Eq 176 (Sir William James V-C). I accept that there may be scope for considerable argument as to what would constitute loss or damage within the policy period: cf *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Ltd* [2006] EWCA Civ 50,

[2006] 1 WLR 1492 (mesothelioma in the context of "loss or damage [which] occurs during the currency of the policy").

75. In the present case the contract of insurance is described as a "Special Floater Policy" and is expressed to have been issued by Lexington to Alcoa on August 22, 1977. The printed section (or "policy jacket") has a section for "From the … day of … 19.. To the … day of 19… beginning and ending at noon (Standard Time at the place of issuance of this Policy)" and the dates July 1, 1977 to July 1, 1980 have been added. The rest of the jacket contains standard conditions. The Supreme Court of Washington set out the history of the cover: *Aluminum Co of America v Aetna Casualty & Surety Co*, 998 P 2d 856, at 863 (Wash 2000). The lengthy tailor-made terms were prepared by Alcoa's internal insurance department and its brokers. Large firms of brokers shopped the terms to various insurers. The insurers responded with price quotations, and upon placement of coverage, the insurers sent the policy jackets with standard policy language to the brokers for inclusion in the policies to be added.

76. The reinsurance contract (which was put in place while the insurance policy was being marketed) covered "All Risks of Physical Loss or damage" and provided cover in respect of loss and damage occurring between 1 July 1977 and 1 July 1980 ("PERIOD: 36 months at 1.7.77 .."). Consequently this was reinsurance on the "loss occurring" basis, under which a reinsurer is obliged to pay its share of the loss suffered by the reinsured, if it occurred during the period when the reinsurance contract was in force: *Balfour v Beaumont* [1984] 1 Lloyd's Rep 272, at 274, per Donaldson LJ; *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127, at 131, per Staughton LJ.

77. A case in which there was a mismatch between the periods of cover in the insurance contracts and the reinsurance contracts was *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421, where it was held that the reinsurance did not have to respond to the insurance because the vandalism for which the plaintiff insurers had had to indemnify the Port of Sunderland had occurred outside the policy period in the reinsurance. The importance of the period of cover was rightly emphasised by Hobhouse LJ, at 435-6:

> "… It is wrong in principle to distort or disregard the terms of the reinsurance contracts in order to make them

> fit in with what may be a different position under the original cover…
>
> …When the relevant cover is placed on a time basis, the stated period of time is fundamental and must be given effect to. It is for that period of risk that the premium payable is assessed. This is so whether the cover is defined as in the present case by reference to when the physical loss or damage occurred, or by reference to when a liability was incurred or a claim made. Contracts of insurance (including reinsurance) are or can be sophisticated instruments containing a wide variety of provisions, but the definition of the period of cover is basic and clear. It provides a temporal limit to the cover and does not provide cover outside that period; the insurer is not then 'on risk'…"

The decision of the Supreme Court of Washington

78. In summary, what was decided by the Supreme Court of Washington (*Aluminum Co of America v Aetna Casualty & Surety Co*, 998 P 2d 856 (Wash 2000)) was that under Pennsylvania law (which Judge Learned had found applicable) all insurers were jointly and severally liable for all losses which flowed from the property damage even if the damage occurred before (or after) inception, because the policies were not limited as to time. The decision of the Supreme Court of Washington has to be read in the context of the development of the law in the United States on the liability of successive insurers on policies covering liability for asbestos-related claims and for environmental claims.

The context: joint and several liability or allocation pro rata

79. The central decision in the development of the law in the United States is *Keene Corp v Insurance Co of North America*, 667 F 2d 1034 (DC Cir 1981), cert den 455 US 1007 (1982). The Court of Appeals for the District of Columbia Circuit decided that, in asbestos-related claims, coverage under insurance policies was triggered by any one of: manifestation of disease, inhalation exposure, and exposure in residence (i.e. the subsequent development of the disease). The Court of Appeals then went on to consider the extent of coverage, and held that each insurer was liable to indemnify Keene in full (and not merely pro rata)

for the whole of the damages for which it was liable to the plaintiffs in the underlying actions (more than 6000 actions were pending). The policies typically provided that the insurer would "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury … to which this insurance applies, caused by an occurrence .." "Occurrence" was defined as "an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury …"

80. The Court of Appeals took the view that Keene did not expect, nor should it have expected, that its security was undermined by the existence of prior periods in which it was uninsured, and in which no known or knowable injury occurred. If an insurer were obliged to pay only on a pro rata basis, those reasonable expectations would be violated. There was nothing in the policies which provided for a reduction of the insurer's liability if an injury occurred only in part during a policy period. The court interpreted the policies to cover Keene's entire liability if an injury occurred only in part during a policy period. For an insurer to be only partially liable for an injury which occurred, in part, during its policy period would deprive Keene of insurance coverage for which it paid.

81. Shortly before the decision in *Keene Corp v Insurance Co of North America* the Court of Appeals for the Sixth Circuit had held that the insurers were liable pro rata to the periods of coverage (with the insured being treated as a self-insurer for years when it was not covered): *Insurance Co of North America v Forty-Eight Insulations, Inc*, 633 F 2d 1212 (6th Cir 1980), cert den 454 US 1109 (1981).

82. These two approaches have spawned an enormous number of decisions in asbestos-related claims and in environmental claims, many of which are discussed or referred to in Holmes (ed), *Appleman on Insurance 2d*, 2003, chap 145, and in Ostrager and Newman, *Handbook on Insurance Coverage Disputes*, 13th ed 2006, chap 9 (who point out, at 618, that the joint and several liability approach has been used more frequently in personal injury cases than in property damage).

83. The position as it was in 2008 was reviewed by the Court of Appeals for the First Circuit in *Boston Gas Co v Century Indemnity Co*, 529 F 3d 8 (1st Cir 2008). In cases such as the present a federal court must apply the law of the State in which it sits. The Massachusetts courts had not yet resolved the allocation question as a matter of law, at

the highest level, although the joint and several liability approach had been adopted by lower courts: see *Rubenstein v Royal Insurance Co of America*, 694 NE 2d 381 (Mass. 1998), affd on other grounds, 708 NE 2d 639 (Mass. 1999); *Peabody Essex Museum, Inc v United States Fire Insurance Co*, 2009 WL 901869 (D.Mass.2009). Consequently, the Circuit Court of Appeals certified the question for decision by the Massachusetts Supreme Judicial Court. In so doing the Circuit Court of Appeals noted (at 13-14) that a "growing plurality have adopted some form of pro rata allocation but a significant number of courts impose joint and several allocation." The Court of Appeals said (at 14):

> "Nor do policy arguments line up solely behind one solution. At first blush it may seem illogical to hold a single insurer, who may have only covered the insured for a single year, fully liable for the costs of environmental damage that may have accrued over the course of a century. But that insurer can seek contribution from other insurers 'on the risk' during the contamination period. … And the alternative may force the insured to sue numerous companies in one suit, if this is possible at all, to avoid inconsistencies.
>
> Either method forces courts to indulge in a probable fiction as to when the event triggering coverage occurred. The pro rata method assumes an ongoing occurrence causing stable amounts of damage over time; the joint and several method pretends, even less plausibly, that a single occurrence caused all the damage, and allows the insured effectively to choose the year in which that happened. Both are crude approximations made under conditions of uncertainty."

84. Pennsylvania is among those States which apply the decision in *Keene.* In *JH France Refractories Co v Allstate Insurance Co*, 626 A 2d 502 (1993), which was also an asbestos-related claim, the Supreme Court of Pennsylvania rejected the insurers' contention that they should share the obligation to indemnify on a pro rata basis apportioned on the amount of time each policy was in effect. That was inconsistent with the terms of the policies which were similar to (but not identical with) the terms in the policies in the *Keene* decision. Each insurer obliged itself to pay on behalf of the insured "all sums" which the insured would become legally obliged to pay as damages, and the definition of "occurrence" (which had no specific reference to the policy period) was inconsistent with a pro rata allocation. In addition, there was no medical

evidence to substantiate the assumption that the progression of asbestos related disease was linear.

85. The States in which there were Alcoa sites which were the subject of the clean-up requirements do not adopt a uniform approach to the coverage question. There were relevant Alcoa sites in the Washington litigation in States which, according to the textbooks referred to above and the decision of the Court of Appeals for the First Circuit in *Boston Gas Co v Century Indemnity Co*, 529 F 3d 8 (1st Cir 2008), have adopted pro rata allocation and rejected the joint and several allocation method: they include New York, California and Illinois: *Stonewall Insurance Co v City of Palos Verdes Estates*, 54 Cal Rptr 2d 176 (Cal 1996); *Outboard Marine Corp v Liberty Mutual Insurance Co*, 670 NE 2d 740 (Ill 1996); *Consolidated Edison Co of New York Inc v Allstate Insurance Co.*, 774 NE 2d 687 (NY 2002). Those States in which the Alcoa sites in the litigation were situated and which had followed *Keene*, apart from Pennsylvania and Washington, included Indiana and Ohio: *Allstate Ins Co v Dana Corp*, 759 NE 2d 1049 (Ind 2001); *Goodyear Tire & Rubber Co v Aetna Casualty & Sur Co*, 769 NE 2d 835 (Ohio 2002).

The decision of the Supreme Court of Washington

86. It is clear that the effect of the decision of the Supreme Court of Washington was to make Lexington liable for loss and damage which occurred both before and after inception (and indeed after expiry). I cannot accept Lexington's argument (Respondent's case in both appeals, para 4) that the Supreme Court did not hold Lexington liable for losses arising from damage occurring outside the period of the original insurance, and that the Supreme Court was simply addressing the question of what insured damage had occurred during the period. Lexington rightly accepted in the statement of facts and issues on these appeals (paras 8, 10-11) that (a) it had been determined at the trial before Judge Learned that the pollution and contamination damage in respect of the clean-up costs of which Alcoa sought indemnity had occurred in the period between 1942 and 1986; (b) the Supreme Court had decided that the policy language covered any physical loss or damage manifesting itself during the time the policy was in force, including pollution damage starting before the policy inception; and (c) Lexington had settled with Alcoa on the basis that it was not possible to limit Lexington's liability to the cost of remedying that part of the damage which could be said to have occurred within the 3 year period of cover.

87. Judge Learned had decided that there was a basis in law for allocating to each separate policy year the costs relating to the property damage which occurred during that policy year. Although environmental contamination was not a purely linear process, the use of an average was reasonable. The reasoning of the Supreme Court of Washington reversing the decision of Judge Learned on the allocation issue was as follows: (a) there had been pollution damage to all three test sites occurred during the entire time the policies were in effect; (b) pollution damage had occurred to portions of the sites prior to the inception of insurance coverage; (c) because the pollution damage occurred both before and during the policy periods the question arose as to how to attribute the remediation costs of the pollution damage; (d) in allocating the pollution damage on a pro rata yearly basis, Judge Learned had not made a close examination of the applicable policy language.

88. The insuring clause in the Alcoa policy was: "PERILS INSURED: This policy insures against all physical loss of, or damage to, the insured property as well as the interruption of business, except as hereinafter excluded or amended." The Supreme Court held that the language was very broad and contained no limitation as to time of the physical loss or damage to property, and there was no exclusion in the policy for physical loss or damage that might have begun spreading before the policy inception. The policy definition of "occurrence" compelled a broad reading of the policy. The Supreme Court concluded: "It seems clear from the policy language that any physical loss or damage manifesting itself during the time a … policy was in effect was covered by the policy, including pollution damage starting before the policy inception."

89. This was not a decision that losses occurring during the policy period encompassed liability or losses flowing from damage which occurred during that period. It was a decision that, provided that there was some damage in the policy period, the insured had a right to an indemnity for liability flowing from damage whenever it occurred.

The relevance of the governing law

90. It is accepted that the contract of reinsurance is impliedly governed by English law. It is in English form and was broked and issued in the English market. The insurance contract was concluded in

1977, and determination of its proper law depended on common law principles, as it still does: see Rome Convention on the law applicable to contractual obligations, Art. 17, providing that the Convention applies only to contracts entered into after it becomes in force with regard to a Contracting State, which was April 1, 1991 for the United Kingdom. The general rule was that, in the absence of an express choice, an intention with regard to the law to govern the contract could be inferred from the terms and nature of the contract and from the general circumstances of the case. When the intention was not expressed and could not be inferred from the circumstances, the contract was governed by the system of law with which the contract had its closest and most real connection: *Whitworth Street Estates (Manchester) Ltd v James Miller and Partners Ltd* [1970] AC 583; *Compagnie Tunisienne de Navigation SA v Compagnie d'Armement Maritime SA* [1971] AC 572; *Amin Rasheed Shipping Corp v Kuwait Insurance Co* [1984] AC 50. The law so identified would have governed questions of construction.

91. Longmore LJ thought that, if in 1977 the question of what law governed the insurance contract had been asked, the answer would have been that Pennsylvania law had the closest and most real connection with the insurance contract: at [28]. For reasons on which I shall elaborate I do not consider that the question what law, by English conflict of laws rules, governed the insurance contract is a relevant question, but in any event there is reason to doubt Longmore LJ's conclusion on this point. So far as insurance contracts in particular are concerned, in England the prevailing view in 1977 was reflected in Dicey and Morris, Conflict of Laws, 9th ed. 1973, Rule 159, which had first been formulated in the 8th edition (1967), in succession to a similar rule in previous editions limited to contracts of marine insurance. By Rule 159(2):

> "If an intention to choose the proper law has not been expressed in the insurance policy and cannot be inferred from circumstances, and if there is nothing to show that the contract is more closely connected with another system of law, the contract is governed by the law of the country in which the insurer carries on his business, and if he carries on his business in two or more countries, by the law of the country in which his head office is situated."

92. Consequently if an English lawyer had been asked in 1977 to advise on what law governed the underlying insurance contract according to the rules of the English conflict of laws, it is likely that the

following questions would have been addressed. The first question would have been whether the provision in the Service of Suit clause that "all matters arising hereunder shall be determined in accordance with the law and practice" of the court in the United States chosen by the insured for suit was an express choice of law. The answer to that would have been in the negative, because the proper law had to be capable of determination when the contract was entered into: *The Iran Vojdan* [1984] 2 Lloyd's Rep 380.

93. The second question would have been whether a choice of law could be inferred from the circumstances. It is not easy in the present case to find a basis for any such inference. The third question would have been with what system of law the policy had the closest and most real connection. It is likely that this would have been the law of Massachusetts where the policy was broked and issued under cover of Lexington's standard policy form, and where Lexington had its head office. As I have said, it appears from *Boston Gas Co v Century Indemnity Co*, 529 F 3d 8 (1st Cir 2008) that the approach in Massachusetts law to the joint and several approach to insurers' liability for damage occurring both within and without the period of cover is not finally settled. There might have been a case for Pennsylvania law on the basis that the bulk of the policy terms originated from Alcoa's head office and were being broked across the United States. But I doubt whether the mere fact that Alcoa was incorporated and had its centre of business in Pennsylvania would have been a basis for concluding (as Longmore LJ did (at [28]) that Pennsylvania law had the closest and most real connection with the insurance contract.

94. But the question of what law governed the insurance contract by the English rules of the conflict of laws is not the relevant question. The issue is one of construction of the reinsurance contract. In order to apply the underlying principle that the effect of terms in a reinsurance contract governed by English law should where possible be interpreted to be in accordance with the effect of the terms of the insurance contract governed by foreign law, the relevant foreign law is not the law which by English conflict of laws rules would have governed the contract, but the law which the parties would have had in reasonable contemplation when the contracts were entered into. In the normal case such as *Vesta v Butcher* there would be no difference between the approaches, but in this case the effect of the Service of Suit clause was that litigation could take place anywhere in the United States.

95. On a narrower view of the case (similar to that in *Vesta v Butcher*) the relevant question would have been: what law would the parties have expected would be applied by a court in the United States had Alcoa taken advantage of the Service of Suit clause, and in particular would the parties to the reinsurance contract have reasonably had in mind that what losses were recoverable under the insurance contract would be determined ultimately by the law of Pennsylvania? That would be a question for a United States lawyer. I would regard the possibility that a coverage dispute might have arisen in one of the countries outside the United States for which coverage was obtained as purely theoretical. Consequently I leave out of account the possibility, canvassed by the appellants, that since the Service of Suit clause was not an exclusive jurisdiction clause, the action by Alcoa against Lexington might have been brought outside the United States, where some of the sites were situated, and where wholly different principles of the conflict of laws may have applied.

96. But the fact that I accept that this is a relevant question does not mean that I accept Lexington's answer. In effect Lexington says that if Lexington and the reinsurers had asked for advice in 1977 as to what law would be applied by a United States court to the construction of the Alcoa insurance policy the answer would likely to have been the law of Pennsylvania. There was no expert evidence on this point before Simon J, but to test whether it is realistic it is necessary to look closely at the reasoning of Judge Learned in her decision that Pennsylvania law applied to the coverage issues.

97. It is clear that Judge Learned was applying in its entirety the approach of the American Law Institute, Restatement Second, Conflict of Laws ("the Restatement Second") to choice of law in contracts (and not simply the provision relating to insurance). Although she did not mention it expressly, it is plain from her reasoning that the starting point for Judge Learned was section 188(1) of the Restatement Second, which is the basic rule about choice of law in contracts. It provides:

> "The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in section 6".

98. Section 188(2) goes on to state that, in the absence of an effective choice of law by the parties, the contacts to be taken into account in applying the principles of section 6 to determine the law applicable to an issue include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject-matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. Those contacts are to be evaluated according to their relative importance with respect to the particular issue. Section 6(2) indicates the factors relevant to the choice of the applicable rule of law, which include the relevant policies of the forum, the relevant policies of other interested States and the relative interests of those States in the determination of the particular issue, the protection of justified expectations, the basic policies underlying the particular field of law, certainty, predictability and uniformity of result and ease in the determination and application of the law to be applied.

99. The reference in section 6(2)(c) to the "determination of the particular issue" is a fundamental part of the approach of the Restatement Second. The appellants argued that this necessarily means that the governing law can only be determined at the date of litigation rather than the date of contract, and drew the conclusion that it would have been impossible in 1977 to predict what law would have applied to the insurance contract. This submission was erroneous. What the approach of the Restatement Second entails is that, by contrast with the English approach at common law, different laws may be applied to different issues. It could plainly have been predicted in 1977 that a coverage issue might arise, and that it might have been necessary to determine what law applied to it.

100. The Service of Suit clause provided:

> "In the event of the failure of this Company to pay any amount claimed to be due hereunder, this Company, at the request of the Insured, will submit to the jurisdiction of
>
> any Court of Competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all maters arising hereunder shall be determined in accordance with the law and practice of such Court "

101. The first question was whether there was an express choice of law. Judge Learned rejected the argument that the reference to matters being "determined in accordance with the law and practice of such Court" was a choice of law. The context addressed the venue of litigation and reflected the willingness of the defendants to submit to the jurisdiction and binding judgments of courts in the United States; and the reference to the law of the court did not distinguish between substantive law or the whole of its law including its choice of law rules. To construe the clause as a choice of law clause would allow a plaintiff to forum shop within the United States for substantive law favourable to it. The judge then went on to consider which system of law had the "most significant relationship" between the parties and the involved States. She rejected the choice of Washington law as the law of the forum: (a) Washington did not have the most significant contacts; (b) the fact that a plurality of the sites included in the litigation was in Washington was not particularly significant, since Washington did not have a plurality of the sites covered by the policies, nor of sites potentially subject to the type of claims involved, and even as to the sites included in the litigation the Washington sites had significantly less money at stake than sites in other States; (c) Washington had no public interest at stake in the law suit which was greater than any other State, since each State presumably had a similar interest in and concern about the clean-up of toxic materials within its borders.

102. She did not apply section 193 of the Restatement Second, which points the court in insurance contracts to the law of the location of the insured risk, because a special problem was presented by multiple risk policies which insured against risks located in several States. In particular, the same wording in the policies might be subject to many potentially different meanings from State to State. Her conclusion was that the law of Pennsylvania governed. Although it was not the place of contracting it had more contacts regarding the contract formation than any other State. It was the one State with a common connection between all the sites and all the defendants. It was the headquarters of Alcoa, and the insurance placement originated at the headquarters level rather than at the site level. In most cases insurance was coordinated through the Pennsylvania broker or other brokers and not between Alcoa and an insurer in another State. The coverage scheme was comprehensive, and multi-layered. The place of signature of the contract, or domicile or headquarters of the various defendants, were of less significance than those associated with Pennsylvania. The meaningful centre of gravity for contract formation was Pennsylvania for most, if not all, of the contracts.

103. The approach by Judge Learned to the choice of law issue is, if I may so with respect, very clear and wholly understandable in the context of the litigation which she had to manage. It is, of course, quite different from the English approach, but it is entirely consistent with the approach in those States which apply the Restatement Second: see, e.g. *Certain Underwriters at Lloyd's, London v Foster Wheeler Corp*, 822 NYS 2d 30 (NY Ct App 2007).

104. Judge Learned was considering what law to apply for the purposes of contract interpretation to all claims involving coverage, with some 70 insurers, hundreds of policies and 58 sites, of which 43 were in the United States and 15 were outside the United States. The judge regarded herself as determining that Pennsylvania law applied as a general rule, but she said that if specific or unique issues arose regarding one or more defendants or one or more sites, which raised significant considerations which overrode the general rule, they could be brought to the court's attention.

105. Although there was no expert evidence on United States law, it is doubtful whether Lexington was right to say (Case, para 17(3)) that there is no reason to believe that the choice of law would have been any different depending on the State in which Alcoa had chosen to sue. According to a leading authority in the United States, of the States in which the sites were situated, in 1977 the following States continued to apply the lex loci contractus: Florida, Tennessee, and Pennsylvania: Symeonides, *The American Choice-of-Law Revolution in the Courts: Past, Present and Future* (2006), pp 45-47. Pennsylvania courts have applied the contracts sections of the Restatement Second since 1983 (*Guy v Liederbach*, 459 A 2d 744 (Pa 1983): a case involving third party beneficiaries under a will, but applied in many other contract cases).

No identifiable system of law

106. Longmore LJ in the Court of Appeal (at [21]) identified the question being "whether [the] same period of cover should receive the same interpretation in both the original insurance and the reinsurance" or whether "the same or equivalent wording in each of the contracts should … be given the same construction" (at [24], and also [25], [33]).

107. I consider that it is fanciful to suppose that in 1977 the hypothetical American lawyer asked to advise on what law governed the

contract of insurance, and what law would govern questions of coverage, would have concluded that Pennsylvania law would have applied. To have reached that conclusion the lawyer would have had to advise or assume that (a) there would be claims based on damage to several sites being litigated together; (b) plaintiffs in the environmental litigation would be most likely to sue in a State which applied the principles in the Restatement Second; and (c) the courts of that State would apply those principles to conclude that the law which applied to the issues would be the law of Pennsylvania.

108. In my judgment, in complete contrast to *Vesta v Butcher* and *Groupama v Catatumbo*, in the present case there was in 1977, when the insurance contract and the reinsurance contract were concluded, no identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract of reinsurance in a manner different from its ordinary meaning in the London insurance market. In each of those cases, the substance of the foreign law as to the consequences of a non-causative breach of warranty could be ascertained at the outset, if necessary by recourse to a relevant Norwegian (or Venezuelan) legal source: *Vesta v Butcher*, at 911, per Lord Lowry.

109. This is not a case involving the scope of liability. Nor is it a case about the interpretation of the policy period. I entirely accept Longmore LJ's example (at [20]) of the case in which a loss occurred within the policy period in United States time, but outside the policy period in GMT. That would be a case of interpreting the reference to the date and time in the reinsurance policy to conform with the insurance. But this is a case in which the Washington court held in substance (in common with the courts in those States which impose joint and several liability) that the original insurance contained no relevant time limitation. In 1977 the United States courts had not developed the theory of joint and several liability for all damage, even that occurring outside the policy period.

110. It is elementary that an insurer under the original insurance takes the risk of changes in the law. The insurer cannot escape liability by saying that the liability of the insured has been increased by judicial decisions extending the scope of the insured's duty. Nor, correspondingly, can the reinsurer be heard to say that it rated the risk by reference to the then current scope of the original insured's duty, or by the scope of the insurer's duty to indemnify the original insured, provided that the risk is within the reinsurance.

111. In the present case, however, there is no principled basis for treating the scope of the 3 year reinsurance as the same as the insurance, which has been interpreted under the law of Pennsylvania not to contain any "limitation as to time of the physical loss or damage to property" (998 P 2d 856, at 883). If Lexington were right, some very uncommercial consequences would flow if the reinsurers had agreed to accept only two years of the risk, rather than the three years of the underlying risk accepted by Lexington, leaving Lexington to reinsure the third year of cover elsewhere; or if the London market had elected to reinsure Lexington by way of three separate one year policies (as in *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421). The periods of cover under the insurance and reinsurances would not be back-to-back. But Lexington would still be maintaining that, in the light of the decision of the Washington Supreme Court, if any damage occurred within any relevant policy period, of any duration, the relevant reinsurer would be liable for all of the damage, including damage occurring before inception or after expiry. That seems to me to be wholly uncommercial and outside any reasonable commercial expectation of either party.

112. That applies also to the wider way in which Lexington would support the decision of the Court of Appeal, namely that any loss within the coverage of the insurance is also within the loss of the reinsurance, and a loss is within the loss of the insurance if so held by a court of competent jurisdiction, or if it is the subject of a settlement which cannot be impugned. The case for Lexington is not assisted by those authorities which decide that the reinsurer cannot go behind a determination of the reinsured's liability under the contract of insurance to the original insured, whether it is by way of settlement under a follow settlements clause or by the decision of a court of competent jurisdiction: *Insurance Company of Africa v. SCOR (UK) Reinsurance Co Ltd* [1985] 1 Lloyd's Rep 312, 330, per Robert Goff LJ; *Commercial Union Assurance Co. Plc v. NRG Victory Reinsurance Ltd.* [1998] 2 Lloyd's Rep 600, 610-11, per Potter LJ. The reason is that a reinsurer will only be bound to follow its reinsured's settlement and indemnify the reinsured provided that the claim recognised by them falls within the risks covered by the policy of reinsurance as a matter of law: *Insurance Company of Africa v. SCOR (UK) Reinsurance Co Ltd* at 330, per Robert Goff LJ. This is because the reinsurer cannot be held liable unless the loss falls within the cover created by the reinsurance: *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239, at 1251, per Lord Mustill. Consequently the question remains the same: what is the effect of the policy period in the reinsurance?

113. This conclusion is unaffected by the suggestion by Sedley LJ in the Court of Appeal that if the contract of reinsurance were treated as liability insurance then it would be easier to find that it should respond when the insurer was held to be liable by a court of competent jurisdiction in circumstances where the reinsurer did not believe itself to be liable: at [50]. For historical reasons the subject matter of reinsurance is treated as being the same as that of the original insurance. Lord Hoffmann said in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, at 392:

> "… Contracts of reinsurance were unlawful until 1864. Such a contract [of reinsurance] is not an insurance of the primary insurer's potential liability or disbursement. It is an independent contract between reinsured and reinsurer in which the subject matter of the insurance is the same as that of the primary insurance, that is to say, the risk to the ship or goods or whatever might be insured. The difference lies in the nature of the insurable interest, which in the case of the primary insurer, arises from his liability under the original policy…"

114. All parties to these appeals are agreed that in legal theory reinsurance is not liability insurance, and that in any event it would make no difference to the disposition of these appeals if it were. There is much to be said for the view that in commercial reality reinsurance is liability insurance which provides cover for the reinsured in the event that the reinsured is liable to pay the original insured. The use of liability insurance language correctly emphasises the true commercial nature of reinsurance. Thus in *Vesta v Butcher* Lord Templeman said ([1989] AC at 892): "By the reinsurance policy, the underwriters promised that if Vesta became liable for a loss under the insurance policy, then the underwriters would make good 90 per cent. of the loss. Vesta became liable for a loss under the insurance policy and the underwriters must perform and observe their promise in the reinsurance policy."

115. But the regulatory implications of departing from orthodox legal theory are considerable (see Gürses and Merkin, *Facultative Reinsurance and the Full Reinsurance Clause* [2008] LMCLQ 366, at 370-371). It would be unwise for there to be judicial reconsideration of the question, in the context of litigation between parties who have no interest in the wider consequences, without being fully informed of those consequences, if necessary by submissions from such bodies as

Lloyd's, the Association of British Insurers, or the British Insurance Law Association.

116. I would also accept that it would almost invariably be the case that losses for which the insurer has indemnified the original insured would be within the reinsurance even if the losses are payable under a foreign law or a foreign judicial decision which takes a view different from English law of what losses are recoverable. The presumption that the liability under a proportional facultative reinsurance is co-extensive with the insurance should be a strong one because (as I have said) the essence of the bargain is that the reinsurer takes a proportion of the premium in return for a share of the risk. But this is an unusual case in which the express (and entirely usual) terms of the reinsurance are clear. This is not a case where the reinsurers are relying on a technicality to avoid payment. At the beginning and end of these appeals remains the question whether the provision for the policy period in the reinsurance is to be given the effect it has under English law, or whether the parties must be taken to have meant that the reinsurance was to respond to all claims irrespective of when the damage occurred and irrespective of the period to which the losses related. There is, in my judgment, no principled basis for a conclusion in the latter sense.

117. For the sake of completeness I will mention that I derive no assistance from the contractual provision in the slip that the form of policy was to be J1 or NMA 1779. It was common ground that neither became a contractual document. Form J1 adds nothing material for present purposes to the Full Reinsurance Clause No. 1, which was incorporated. Neither can affect the interpretation of the policy period. Nor do I consider that the references in the slip to "as original" have any bearing on the meaning of the policy period. Without expert evidence it is now too late to take account of the very interesting points made by Weir, *"A matter of Forms and substance"* [2009] LMCLQ 214, in support of the view that NMA 1779 must have been used. But I do not consider that the references in Form 1779 to loss "during the period as specified" or loss "during the continuance of this Policy" add anything to the reference to the period in the slip.

118. I would therefore allow the appeals. I have had the benefit of reading in draft the judgment of Lord Mance, and agree with his reasoning also. On my view of the appeals, the retention issue does not arise. If it had arisen, I would have dismissed the appeals on that issue for substantially the same reasons as those given by the Court of Appeal.