Neutral Citation Number: [2008] EWCA Civ 150

Case No: A3/2007/0985 & A3/2007/0984

IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM QUEEN'S BENCH DIVISION
COMMERCIAL COURT
THE HONOURABLE MR JUSTICE SIMON
2005 Folio 928

Royal Courts of Justice
Strand, London, WC2A 2LL
Date: 29/02/2008

Before :
THE RIGHT HONOURABLE LORD JUSTICE PILL
THE RIGHT HONOURABLE LORD JUSTICE SEDLEY
and
THE RIGHT HONOURABLE LORD JUSTICE LONGMORE

- -

Between :

WASA INTERNATIONAL INSURANCE COMPANY LTD	**First Respondent**
- and -	
LEXINGTON INSURANCE COMPANY	**Appellant**
-and-	
AGF INSURANCE LTD	**Second Respondent**
-and-	
LEXINGTON INSURANCE COMPANY	**Appellant**

- -

Mr Christopher Butcher QC (instructed by **Chadbourne & Parke**) for the **Appellant**
Mr Alistair Schaff QC & Siobán Healy (instructed by **Addleshaw Goddard**) for the **First Respondent**
Mr Neil Calver QC & Mr Stephen Midwinter (instructed by **Charles Russell**) for the **Second Respondent**

Hearing dates : 31st January & 1st February 2008

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Judgment

Lord Justice Longmore:

Introduction

1. In the United States the maxim that the polluter must pay is now being seriously enforced. The Aluminium Company of America ("Alcoa") has been forced to remove waste caused by pollution and to restore sites from which waste has been removed. Some such sites have a long history of pollution going back as far as the end of World War II. Alcoa has incurred substantial expenditure by way of what it has called the "costs of remediation". Not unnaturally it has looked to its property damage insurers for reimbursement of those costs. Between 1st July 1977 and 1st July 1980 Lexington Insurance Company ("Lexington") were one of Alcoa's property damage insurers in an insured sum of US $20,000,000 per occurrence. Lexington reinsured that risk on the London reinsurance market on the same terms and conditions "as original" including, specifically, the insured period of 1st July 1977 to 1st July 1980.

2. It was necessary for Alcoa to institute proceedings against Lexington. Alcoa chose, as it was entitled to do, to bring those proceedings in the state of Washington. The judge at first instance (Learned J) held that pollution had caused property damage at several of Alcoa's sites in the United States and that at each relevant site there had been two occurrences. She also held that the damage increased year by year in a more or less linear progression. It was, therefore, possible to divide the total costs of remediation by the number of years over which the pollution had occurred. She then decided it was also possible to attribute specific remediation costs to the damage which occurred during the particular years during which Lexington provided insurance to Alcoa. On all these questions she purported to apply the law of Pennsylvania, the law of the State where Alcoa was incorporated and had its centre of business.

3. Some of Alcoa's other insurers seem to have escaped liability because there were relevant exceptions or limitation provisions in the policies. Alternatively Alcoa may have been uninsured for some years or may have had difficulty in tracing insurers for each of the many years during which property damage due to pollution had occurred. It decided to appeal Judge Learned's decision and argued that, as a matter of the law of Pennsylvania, it could recover the full costs of remediation at any particular site provided only that some damage had occurred at the relevant site during the years when Lexington was at risk. The Supreme Court of Washington State (sitting en banc as a court of 9 judges) decided that that was indeed the law of Pennsylvania. The court accordingly declared that Lexington was liable on that basis. Lexington was then faced with a claim of about US$180 million which they settled for a figure of US$103 million. That was a proper settlement on that interpretation of the law.

4. Lexington then looked to their reinsurers and, in particular to Wasa International Insurance Company Ltd ("Wasa") and AGF Insurance Ltd ("AGF") who had taken 2.5% of the reinsurance. Wasa and AGF ("the reinsurers") have declined to pay on the basis that the reinsurance policy was governed by English law and that, as a matter of English law, reinsurers can only be liable for the costs of remedying damage to property which actually occurred between 1st July 1977 and 1st July 1980. Thus it is said that they cannot be liable for the cost of remedying damage which occurred before or after that date. Simon J [2007] EWHC 896 (Comm); [2008] 1 AER (Comm) 286 has upheld that contention and Lexington now appeal to this court.

5. It is, of course, necessary to set out the relevant terms of both Alcoa's policy with Lexington and Lexington's contract with the reinsurers and to say a little bit more about the Supreme Court of Washington's decision.

The Contracts

Insurance Contract

6. Lexington insured Alcoa in respect of loss or damage to property (and business interruption risks) under a Policy on Lexington's Special Floater form signed and dated at Boston, Massachusetts on 22nd August 1977. The insurance, referred to as DIC (Difference in Conditions) Insurance, provided for the insurance of Alcoa from noon on 1st July 1977 until noon on 1st July 1980. The Limit of Liability was stated to be:

> $20,000,000 loss or damage arising from any one occurrence.

The '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.

7. Although there was no express choice of law clause, the Insurance Contract contained a standard US Service of Suit clause:

> In the event of the failure of this Company 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.

Reinsurance Contract

8. The reinsurance provided cover in respect of all risks of physical loss or damage to the property reinsured occurring in the period of 36 months from 1st July 1977, subject to a limit of $20,000,000 per occurrence. The terms were set out in a Slip:

TYPE:	Contributing Facultative Reinsurance
FORM:	J1 or NMA 1779 covering All Risks of Physical Loss or Damage excluding Fire and Allied Perils and/or as original.
REASSURED:	Lexington Insurance Company
ASSURED:	Alcoa Aluminium

PERIOD:	36 months 1.7.77 L/U and/or pro rata to expiry of original.
INTEREST:	All property of every kind and Description and/or Business Interruption and O.P.P. and/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 tax

The 25% brokerage was divided, with 10% payable to Lexington and 15% to CE Heath who were the brokers for the reinsurance.

9. On 1st June 1977 Sentry Underwriting Agencies Ltd subscribed to a 2.5% line of the Reinsurance Contract on behalf of WASA in respect of 1% and on behalf of AGF in respect of 1.5%.

Features of the Reinsurance Contract

10. The judge emphasised certain features of the reinsurance contract.

i) The risk was placed in London with London reinsurers by London insurance brokers in 1977, prior to the coming into force of the Rome Convention. It was common ground that the governing law was to be determined in accordance with English common law principles. It was also common ground that by the proper application of those principles, the Reinsurance Contract was subject to one of two alternative London forms. It followed that the construction and legal effect of the Reinsurance Contract was governed by English Law.

ii) Since no contract was ever drawn up, the terms of the Reinsurance Contract are deemed to be contained in the Slip.

iii) The Slip referred to a choice of forms (J1 or NMA 1779). This reflected an administrative practice in the London market for the issue of formal policy documentation. The J1 form was a 'policy jacket' containing a policy, which was then put to various underwriters for subscription. The NMA 1779 form was generally used as an attachment to a Slip, obviating the need to issue a formal Policy.

iv) The J1 form contained the words:

> Being a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the [reassured].

The NMA 1779 form did not have a follow settlements clause. However it contained an obligation:

> … to pay or to make good to the Reinsured 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.

v) Although the 'Full R/I Clause No. 1 as amended' referred to in the 'Conditions' had not been identified, it was common ground that the 'Full R/I Clause No. 1' was a standard clause used in the London market and that it was in the following terms:

> 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.

Since the J1 form contained a similar provision, it can reasonably be inferred that the Full Reinsurance clause was specifically referred to in the Slip in case the NMA 1779 form was to be used.

The Insurance claim and the settlement

11. It was in the early 1990s that the US Environmental Protection Agency and various state environmental agencies required Alcoa to clean up pollution and contamination of groundwater, surface water and soil at numerous manufacturing sites in the United States used by Alcoa. On 2nd December 1992 Alcoa began its proceedings in the Superior Court of the State of Washington (King County) against various insurance companies which had provided liability or all risks property insurance to Alcoa during the period 1956-1985. In this litigation Alcoa sought a declaration of entitlement to insurance coverage in respect of the clean-up costs at 35 manufacturing sites in the USA. Lexington was one of the defendants. A second action against first party property carriers, including Lexington, was commenced on 31st May 1996 in relation to 23 manufacturing sites worldwide. The two actions were subsequently consolidated.

12. The Superior Court selected 3 of the 58 manufacturing sites, Massena in New York, Vancouver in Washington State, and Point Comfort in Texas ("the Phase 1 test sites") to be the subject of an initial trial, with trials on the other sites to follow. In March 1996 the Phase 1 trial commenced before a jury. In due course most of the insurers

sued by Alcoa were found not to be liable, either because the claim was time barred under suit limitation provisions in the policies or because the losses were excluded by pollution exclusions.

13. The trial then moved on to the second stage at which evidence was heard as to the existence, the extent and the time of occurrence of damage at each of the Phase 1 test sites. At the conclusion of the evidence the jury were provided with a Verdict Form containing 13 questions, and with written instructions on each question.

    i) Question 1 required the jury to answer "yes" or "no" to the question whether there was property damage at each area of each of three Phase 1 test sites.

    ii) Question 2 required the jury to identify each year in which property damage occurred at each area of the three sites under headings: 1977-1978, 1978-1979 up to 1983-1984.

    iii) Question 11 required the jury to state the costs of repair of fortuitous property damage at each area of each site without allocating repair costs to specific years.

    iv) Question 12 asked the jury to say whether or not there was a reasonable basis to allocate to each separate policy year the costs related to the property damage that occurred during that year.

    v) Question 13 asked, in relation to any damages and repair costs which the jury concluded could be allocated on a year by year basis, what portion of the total repair cost was attributable to the various policy years, with answers to be given either in percentage terms or dollar figures.

14. The jury's verdict form was returned only partially completed on 3rd October 1996, following 60 days of deliberations. The jury was then discharged. The verdict form included decisions that there had been property damage at the three Phase 1 test sites, which had occurred in each of the policy years and which contributed to the costs of repair (Question 1-3). The jury provided monetary figures for repair costs for some but not all of the areas where it had found that property damage had occurred, totalling just under US$20 million. However, the jury did not answer Questions 12 and 13, leaving blank these spaces on the form. Judge Learned answered these questions favourably to Lexington but the Supreme Court (998 P2d. 856 (2000)) overruled her and decided in Alcoa's favour that provided some damage at the site had occurred in the relevant year, all the damage could be recovered from Lexington. This can be seen in the following citation from the judgment of the court delivered by Talmadge J:-

> "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 filled 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 and remand the case for further proceedings relating to Alcoa's judgment for insurance coverage."

Submissions to this Court

15. For Lexington Mr Butcher QC submitted:

i) The reinsurance and insurance contracts were intended to be, and were in fact, back-to-back.

ii) Although the reinsurance contract was governed by English Law and the insurance contract was not, that fact alone was not sufficient to disturb the back-to-back nature of the insurances.

iii) It was necessary to look at the reinsurance contract (and its factual background) in order to identify the presumed intention of the parties. On this basis the parties would have acknowledged the likelihood that disputes between Alcoa and Lexington (two companies incorporated in the United States) would have been litigated in the United States; and might reasonably assume (since Alcoa was based Pennsylvania and there was a favourable Service of Suit Clause) that a dispute would be decided according to Pennsylvania law in whatever state litigation might take place.

iv) The Period Clause in the reinsurance contract was one of a number of provisions which reflected the back-to-back nature of the reinsurance; and there was no reason to read a limitation into the provision. In a facultative reinsurance there was no special feature of a period clause which required it to be treated differently to any other type of clause.

v) If the judge was right to say that the reinsurance contract had to have an ascertainable meaning in 1977 it was easily possible to formulate a declaration as to the extent of recovery under the reinsurance contract which could then have been sought. Such declaration would have been wide enough to embrace the sums which were claimed in this action.

vi) The reinsurance contract did not indicate with precision what was covered. It was the construction of the insurance contract which provided the definition of what constituted an occurrence and the financial consequences of there having been an occurrence; and it could have been anticipated that the scope of the original policy would be determined by the law of any state within the United States.

vii) Where the meaning and effect of the terms of an insurance contract have been determined as between the insured and the insurer by a court of competent jurisdiction, the presumed intent of the parties to the reinsurance contract must have been that, in relation to the same claim, the same meaning and effect would bind the reinsurer, absent any provisions to the contrary in the reinsurance contract.

16. For Wasa, Mr Schaff QC submitted:

i) Mr Butcher's assertion that the reinsurance was back to back with the original insurance assumed what he wanted to prove. The true position was that Wasa reinsured Lexington in respect of the risk of loss and damage to the Alcoa plant for a three year period, not a fifty year period. The period of cover was fundamental to the scope of the bargain between reassured and reinsurer. Notwithstanding the existence of a 'follow the settlement' provision and the decision of the Supreme Court as to the effect of Lexington's insurance contract as a matter of Pennsylvania law, Wasa did not contract to indemnify Lexington against any liability that might be incurred under the insurance contract. In order to be recovered the relevant loss must be within the scope of the reinsurance contract.

ii) If Wasa was correct in that overarching submission, two consequences followed.

a) Wasa was not bound to follow the Settlement Agreement since the settlement (and the claims recognised by the settlement) did not fall within the risks covered by the reinsurance contract as a matter of law.

b) Lexington's claim for indemnity failed since Lexington did not advance its claim against Wasa on the basis that, if the reinsurance only responded to the cost of remedying damage caused during the three year period of cover, the cost of remedying that damage would (after

> exhaustion of the relevant retention and deductibles) give rise to a claim under the reinsurance contract.

17. For AGF, Mr Calver QC made broadly similar and supportive submissions to those of Mr Schaff.

Consideration

18. One difficulty with the case is that each side starts (and almost ends) by making assertions which tend to be self-proving. Lexington argue that the reinsurance is intended to be back to back with the original insurance and, therefore, it must recover. Reinsurers say that it was never the intention that the reinsurance should respond to loss and damage occurring outside the reinsurance period and that, although a United States Court might take a different view, it was always the case that the reinsurance was governed by English law which does not permit recovery for loss or damage occurring outside the policy period. Even the judge found it difficult to elaborate his conclusion beyond saying when he came to the point of decision (para. 45):-

> "The reinsurance contract cannot be construed as if it provided cover in respect of the cost of remedying damage whenever such damage occurred (both before and after the policy period) solely on the basis that some damage occurred within the policy period."

As Mr Schaff observed when he rose to his feet in response to the appeal "It all depends which end of the telescope one picks up first".

19. It is common ground that the "presumed intention" of the parties is the starting point of the inquiry but one has to identify the question to which the presumed intention is to supply the answer. Rather than asking whether the reinsurance was intended to be back to back or whether the reinsurance was intended only to apply to loss and damage occurring within the policy period (affirmative answers could be given to both questions), it is probably better to ask whether the parties intended that, to the extent that they used the same or equivalent wording in the reinsurance as in the underlying insurance they intended that wording to have the same meaning in both contracts. This is not quite the same as asking merely whether the intention is a back to back contract because

i) it is still a question what that meaning is to be; and

ii) it is always possible that the reinsurance, while containing wording that is the same as or equivalent to wording in the underlying contract, will contain wording that belongs exclusively to the reinsurance.

It is for this reason that one has to focus on the particular phrase in issue.

20. In this case Lexington undertook to provide insurance "on property" as described "from the 1st day of July 1977 to the 1st day of July 1980 beginning and ending at noon". The reinsurance was on "all property of every kind and description and/or as original" for a period "36 months at date 1.7.77". The period, although expressed in slightly different words, is thus effectively identical. If one asks whether the parties

intended that the wording should have the same meaning in each contract, it seems to me that that the natural answer is that they did. If, to take a perhaps unlikely example, a loss occurred in the last few hours of the policy period in the United States at a time when it was after midday on 1st July 1980 in the United Kingdom according to GMT, any rational person would expect the reinsurance policy to respond. (The reinsurance contract in fact contains no reference to noon on either 1st July 1977 or 1st July 1980 and, as a matter of English law, would no doubt expire at midnight on 30th June 1980, but it might be equally difficult to suppose that a loss occurring between midnight and noon on 1st July 1980 would not be covered by the reinsurance).

21. It was therefore (with respect) not quite enough for the judge to remind himself of the dictum of Lord Mustill in Hill v Mercantile & General [1991] 1 WLR 1239, 1253B in support of the conclusion in para 46 of his judgment. That dictum is in the following terms:-

> "Here, the reinsurers are entitled to say that they rated the policy by reference to its chronological and geographical extent, to the types of casualty insured, to the boundaries of the insured layer, the mode of calculating the loss and so forth."

There is no doubt at all that reinsurers are entitled to do exactly what Lord Mustill says they are entitled to do. The question is whether they have. The judge omitted the word "Here" and understandably emphasised the words "chronological" and "extent". But there was no doubt in Hill's case that the chronological extent of M & G's liability under both their own contract, and the contracts which they were reinsuring ("the inward contracts") was different from the chronological extent of the underlying contracts of insurance and reinsurance so that it was arguable that Mr Hill was never truly liable and that, therefore, M & G could not be liable either, see page 1242 F-H. There was thus no controversy that there were different periods of cover in issue. Here, however, the same period of cover is in issue and the question is whether that same period of cover should receive the same interpretation in both the original insurance and the reinsurance. In my judgment it should.

22. For the same reason, the decision of this court in Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd [1998] Lloyds 1 & R421, a case much relied on by reinsurers, is distinguishable. In that case MMI insured the port of Sunderland in respect of loss and damage to the port on a yearly basis for a number of years. Numerous claims were made for pilferage and property damage, in respect of which it was difficult to be certain when the loss had been incurred but, since MMI had afforded cover for the whole period, they paid the claims. Their reinsurance was structured on the same yearly basis but, since each of the possible years in which the loss was incurred was covered by different reinsurers in the relevant years or by the same reinsurers in differing proportions and on differing terms, it was held that MMI had to prove that the loss in respect of which they were claiming was assignable to a specific reinsurance year. Waller J had held (assuming one could concentrate on the date a claim was made on the port) that MMI were entitled to aggregate their losses and, because most of the loss had happened in the second year, could recover their loss, subject to the excess for that year. This court, reversing him, held first that the losses incurred in the first and third years had not been proved to overtop the excess for those years and secondly that it was possible to say that two-thirds of the total loss and damage had occurred during the second year; only that loss was recoverable (after

deduction of the excess for that year) from the reinsurers of that year. As Hobhouse LJ said (pages 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. The words "conditions as underlying" cannot contradict either the period or limit provisions of the individual reinsurance contracts ….
>
> 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."

These statements are, of course, entirely in line with Lord Mustill's observations in Hill v M & G but they are of no direct help in resolving the issue in the present case since there was no issue raised on the question whether the same words should be given the same interpretation in the insurance and reinsurance. No wording in the original insurance fell to be construed at all; the only question was whether the original insurer could prove that all its loss fell within a reinsurance year and it was held that it could only prove that some of its loss so fell. It is no doubt true that the stated period of time is fundamental; the question is, however, whether that fundamental provision is, if it is the same in both contracts, to receive the same interpretation or a different interpretation.

23. Hobhouse LJ added that he was not assisted in the resolution of what he called "the much simpler questions raised by the present case", by reference to United States judgments in relation to

> "the special problems of liability for asbestosis claims arising from long periods of potential exposure."

The long periods of potential pollution damage exemplified in the present case present similar problems, and, as the judgment of the Supreme Court of Washington shows, the attempts of the United States courts to grapple with damage occurring over a very long time cannot be as readily dismissed as in MMI v Sea Insurance Ltd.

24. I do not consider therefore, that either of the main authorities relied on by reinsurers compels the conclusion that the same or equivalent wording in each of the contracts should not be given the same construction; on the contrary, they should generally be given the same construction, unless there are clear indications to the contrary. I do not consider that phrases in incorporated forms (e.g. the NMA 1979) such as "during the period of this insurance" add anything since they only repeat at one remove the same words as are in the contractual document.

25. There are, moreover, authorities which strongly support the proposition that the same or equivalent wordings should be given the same meaning in the reinsurance contract as in the insurance contract. In Vesta v Butcher [1989] AC 852 both the insurance and the reinsurance warranted that a 24 hour watch would be kept over the site (a Norwegian fish farm) and both contracts expressly provided that "failure to comply" with the warranty would "render this policy null and void." English law would have given effect to that wording but Norwegian law provided that there had to be a causal

nexus between the failure to comply with the warranty and the loss. Vesta as the reinsured were therefore liable to the owners of the fish farm but were able to recover under the reinsurance because, as Lord Templeman put it (page 892B):-

> "… in the absence of any express declaration to the contrary in the reinsurance policy, a warranty must produce the same effect in each policy. 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 underwriter to indemnify Vesta against liability under the insurance policy."

Lord Griffiths concurring said (page 895C):-

> "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 natural 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."

Lord Lowry said (page 911C):-

> "The original insurance contract was governed by Norwegian law. Consequently the word "failure" in the phrase "failure to comply …" meant "relevant failure" that is "causative failure" because that contract was governed by Norwegian law. "Failure to comply" had, despite the general rule of English law, the same meaning and effect in what I shall without compromise call the English contract of reinsurance. The parties to that contract are deemed to have used the same dictionary, in this case a Norwegian legal dictionary, to ascertain the meaning of the terms and conditions … including the condition relating to the 24 hour watch warranty and the words "failure to comply."

I doubt if Lord Lowry meant that there had actually to be a legal dictionary in which one could look up the words "failure to comply" and discover that they meant "causative failure to comply" before his deeming principle were to apply. 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.

26. Groupama Navigation v Catatumbo CA Seguros [2000] 2 Lloyd's Rep 350 was a similar case where both insurance and reinsurance contained a promise that class be maintained, such promise being a "garantia" in the original Venezuela insurance and a "warranty" in the English reinsurance contract. This court held that the warranty in the reinsurance had to take its meaning and application from any equivalent warranty incorporated in the original insurance, see in particular Mance LJ at para 30.

27. The judge said that the present case was different because (para. 43):-

> "There was no identifiable US law interpretation that could be placed on the Period Clause; and I reject the submission that the period provision in the Reinsurance Contract can properly be construed by reference to the particular interpretation that was subsequently placed upon a similar period provision in the original insurance by a particular US State Court which happened to be seised of the underlying insurance dispute over twenty years later."

There are, I think, two strands to this reasoning. The first is that there was no way in which it could be ascertained how an American court would interpret the period clause – no equivalent of Lord Lowry's "legal dictionary"; the second is that, even if there was a way of ascertaining it in the year 1977, it would not have been the way chosen by the Supreme Court of Washington in the year 2000.

28. For my part, I do not find either of these distinctions convincing. Before one could ascertain the meaning of the period clause if one was concerned to do so, it would be necessary to decide what law was to answer the question. If one were to adopt the principle that the law of a contract is that with which it has its closest and most real connection, one would probably conclude that it was the law of the state of Pennsylvania since that is where Alcoa was incorporated and had its centre of business. Not surprisingly the Supreme Court of Washington adopted Judge Learned's conclusion that the insurance contract was governed by the law of Pennsylvania although she had, no doubt, expressed herself somewhat differently from the way in which an English judge would have reached that decision. Unless (which I cannot accept) a "legal dictionary" is actually required for this purpose, any competent Pennsylvanian lawyer could have taken a view, by reference to text-books and decided cases in Pennsylvania, about the meaning of the clause. That must surely be enough to render the meaning ascertainable, even granted that no two lawyers can always be guaranteed to take an identical view for the identical reasons; any such dispute between lawyers is, in any event, capable of final resolution by a court.

29. One suspects that it was the second strand of his reasoning that the judge found more compelling since it is perhaps more likely that, before the line of asbestosis cases such as Keene Corporation v Insurance Co. of North America 667 F. 2d 1034, a Pennsylvania (or other American) lawyer would have interpreted the period clause in the same (traditional) way as would an English lawyer. Nevertheless it is impossible to be sure since, as I have already said, long-term pollution of real property raises similar problems to long-term exposure to asbestos. The difficulty of the problem would have influenced any advice being given.

30. Even if, however, it were to be the case that one could be confident that in 1977 it was not the law of Pennsylvania that remediation costs could be recovered in full merely because it was shown that some damage had occurred during the period of cover, the fact is that we know now that it is the law since it has been so stated by the Supreme Court of Washington after an analysis of the Pennsylvanian authorities. Mr Schaff boldly asserted that the law had changed and reinsurers did not take the risk of change of law in any one of a large number of American jurisdictions. But it seems to me that reinsurers must themselves take that risk if they reinsure an American Insurance Company just as the insurers must take the risk. It would have been nothing to the

point if the relevant Norwegian statute had been enacted after the inception of the policy in Vesta v Butcher but before the loss.

31. Mr Calver QC sought to draw some assistance from a passage in the 14th edition of Dicey Morris and Collins (para 32-090) which draws a distinction between contracts governed by a foreign law (when both parties must take the risk of change in the law) and contracts which incorporate by reference a specific provision of foreign law (when, even if the law changes, it is the law at the time of the contract which continues to govern the contractual relationship). But I do not consider that to be an illuminating distinction in a case in which neither of these eventualities has occurred. In the present case one has to determine whether as a matter of construction of the contract the parties intended the period clause to have the same meaning, whatever that meaning may be. It seems to me that they did and that they intended the "harmonious result" thought to be desirable by Mance LJ in Groupama v Catatumbo (paras. 30).

32. Reinsurers also sought to say that Vesta and Catatumbo were distinguishable because in those cases there was a warranty or promise which had to be performed by the original insured whereas here there was not. That seems to me to be a distinction of fact rather than principle. As Hobhouse J observed at first instance in Vesta the promise was one given by the insurer to the reinsurer even though it had to be performed by the insured see [1986] 2 All E.R. 478, 496-7.

33. Moreover some support for the view that relevant wording, which appears in both contracts, is to be given the same meaning can be derived from the fact that the premium as stated in the reinsurance slip was G.O.R. (Gross Original Rate). The fact that, on the face of it, Lexington cede to reinsurers the entirety of the premium (or would have done if the entirety of the slip had been subscribed) is at any rate some indication that the parties likewise intended that the entirety of the risk was to be ceded (subject to the retention as to which more needs to be said in a moment). This argument cannot be carried too far since we now know that the brokerage due to the brokers C.E. Heath & Co (stated on the slip to be 25%) was in fact to be divided between Heath (15%) and Lexington (10%). It is not apparent that reinsurers were aware of that fact at the time, however, and that is why, as it seems to me, G.O.R. is somewhat more consistent with the argument of Lexington than that of reinsurers.

34. Reinsurers also submitted that Lexington's argument overlooked the vital jurisprudential fact that reinsurance was an insurance on the subject – matter of the primary insurance and not an insurance of the insurer's own liability, British Dominions General Insurance Co v Duder [1915] 2KB 394, 400 per Buckley LJ. But that is a misconceived submission. It does not advance the argument to say that reinsurers are reinsuring property liable to be damaged by pollution. No doubt that is true but the question whether any damage suffered is covered by either the insurer or the reinsurer depends on whether the parties intended to afford cover only for damage occurring during the policy period or for all damage provided that some of it occurred during the policy period. Whatever the answer is, it should be the same and it cannot differ according to whether the reinsurance is reinsurance of the original subject – matter insured or of the reinsured's liability in respect of it.

35. It is no doubt true to say that the Supreme Court of Washington has not focussed on the period of cover and the original insurance in quite the way an English court

would. The Supreme Court asked whether the policy contemplated that the damage (and costs of remediation of that damage) would be pro-rated, but such pro-rating only makes sense by reference to the existence of different periods of cover or different years of cover. The policy period was thus an important part of the policy being construed by the court and must, in my view, bear the same construction in both policies.

36. It might be suggested that, even if the insurance contracts should bear the same meaning, that same meaning should be the English rather than the Pennsylvania meaning. It might indeed be possible to imagine a case where the insurance was put together in London and the interposition of a "front" or a "captive local insurer" might be in truth something of a formality in which the "tail" of the front or captive insurer should not be allowed to wag the reinsurance "dog". That is how the position appeared to Mr Kenneth Rokison QC as arbitrator in CGU v Astrazeneca [2006] Lloyds IR 409 where be coined the aphorism that to construe the words "property damage" according to the law of the captive

> "Would not be "back-to-back" so much as "back-to-front"."

His dissenting opinion was upheld on appeal by Cresswell J who then refused leave to appeal to this court, so that Mr Rokison's view could not be tested at an appellate level [2007] 1 Lloyds Rep 142. But that is a long way from this case where Lexington as a major United States insurer sought and obtained facultative reinsurance in respect of their worldwide insurance of Alcoa.

37. Twenty years ago Lord Lowry in Vesta v Butcher said (page 912E) that he had derived considerable assistance from Mr Robert Merkin's article at [1988] LMCLQ 5. Likewise I have derived similar assistance from the now Professor Robert Merkin in his article of October 2007 in Insurance Law Monthly where he has concluded his critique of the judge's decision:-

> "What was really at stake in Lexington was that the US judgment against Lexington was not one which the reinsured or the reinsurers had expected. It was nevertheless a possibility. The question was whether the reinsurers had agreed to cover that possibility. By accepting premium on the same basis as the reinsured, and by using words which were more or less indistinguishable from those in the direct policy, the arguments put forward by Lexington appear to have great cogency."

38. For all these reasons I consider that Lexington's appeal on the main issue should be allowed.

Retention

39. As the judge said this is a short point and is one of impression. The first condition on the slip provides:-

> "Retention $1,675,000 subject to [irrelevant matters]"

The question is whether, when the sum insured has been expressed as:-

> "Policy to pay up to $20,000,000 each occurrence and in the aggregate annually in respect of Flood and Earthquake,"

the retention is $1,675,000 in total or $1,675,000 per occurrence. This matters because the Supreme Court of Washington has upheld Judge Learned's conclusion that there were two occurrences at each site.

40. It seems to me that the parties have agreed a single retention not a retention for each occurrence. In the first place they have not said "$1,675,000 per occurrence" which they could have done; in the second place if they had meant a retention per occurrence, they would have to have made some provision for the special case of floods and earthquakes for the purpose of the retention when it is apparent that such arguments were to be avoided in relation to the sum insured. Thirdly Heath's on behalf of Lexington in drafting the slip would be unlikely to offer a retention per occurrence; if that is what reinsurers wanted they could always counter-offer and see what the response would be.

41. The judge thought the matter was concluded by the fact that that the cover was a per occurrence cover and not an aggregate cover. That is not as forceful as it might be once one appreciates that the cover is in fact an aggregate cover (not a per occurrence cover) in respect of flood and earthquake. The fact is that the cover is partly a per occurrence cover and partly an aggregate cover and what the judge called reinsurers' primary argument, on analysis, goes nowhere. I would allow Lexington's appeal on this point also.

Postscript

42. No one can pretend that the decisions of United States courts in relation to asbestosis and pollution claims are remotely satisfactory from the point of view of insurers let alone reinsurers. Reinsurers' arguments in the present case had a whiff of an assertion (although they were careful not to say so expressly) that Lexington were an American Corporation and had therefore to take unsatisfactory American decisions on the chin, while reinsurers were English (or doing business on an English market) and could not be expected to do so. That, of course, will not do. The appellant's very name is apt to remind one of the opening shots of the War of Independence but that conflict has long since receded into history and must remain there. The insurance and reinsurance market have been adept over many decades in coming up with solutions to apparently insuperable difficulties. One such solution has been the evolution of the Bermuda Form in which the parties agree to English or Bermuda arbitration but agree also that the substantive law of the insurance (or reinsurance) is to be that of New York, see C v D [2007] EWCA Civ 1282. This sensible arrangement might avoid some, at least, of the problems thrown up by this difficult case.

Lord Justice Sedley:

43. I agree that this appeal succeeds on both issues. I take the liberty of adding my own reaction to some of the arguments which have been advanced on behalf of the respondents.

44. Mr Schaff QC made it the predicate of his written case that the contractual obligations of the reinsurer must be capable of ascertainment at the time when the contract is

entered into. I found this formulation puzzling, for it seemed to me to assert both too little and too much. Too little, because the obligations must not simply be capable of ascertainment: they must be ascertained, however opaque, contradictory or intractable the language of the contract or its relation to events; the court will give up only where the contract is so badly drawn as to be void for uncertainty. Too much, because in the nature of things no dispute is going to arise, and no litigation be launched to resolve it, until some time – possibly a long time – after the contract has been entered into.

45. What emerged in argument, however, was a more modest proposition: that what a contract means is what it meant at the time it was entered into – in other words that its meaning does not change over time, though in the light of events its working out may well do so. This may be right, but it seems to me to afford no support to the case Mr Schaff seeks to build upon it - that in 1977 nobody could have foreseen that a claim under the primary policy would be tried according to the law of Pennsylvania in the state courts of Washington and that these courts would ultimately reject a prorating construction of the contract. It is by this argument that Mr Schaff seeks to break the circle of reasoning to which Lord Justice Longmore has referred in §18 above and to establish that the two contracts of insurance are not back to back; but it is an argument which in my respectful view cannot succeed.

46. No court – at least no secular court – claims to be infallible. Both here and in the United States courts of first instance and courts of appeal do their best, within the applicable procedural and substantive law, to arrive (if they are Dworkinians) at the right answer or (if they take the less ambitious approach that most of us take) at the least problematical one. It is the rule of law and the principle of finality which forms part of it which make the meaning and effect of a contract whatever a court of competent jurisdiction holds them to be. In reinsurance, of course, this throws up the problem that reinsurers may find themselves liable to satisfy a judgment to which they were not a party. But this, for good reasons, has not formed any part of Mr Schaff's case. His case is that his clients as reinsurers never contracted to cover such a liability.

47. This can have nothing to do with what, if anything, the parties in 1977 anticipated would be the forum and the proper law of any dispute that might arise on the primary policy. Their only anticipation can have been that, absent a compromise, a court of competent jurisdiction would decide it according to law. To contend, as Mr Schaff does, that it was also part of the mutual intent that any such dispute should be determined according to the law of England and Wales, since this was the proper law of the reinsurance contract, is to overstate the nature of reinsurance. Even if it were the case today that reinsurance covers not the primary insurer's liability but the original risk, the eventuation and extent in time of that risk remain independently justiciable under the primary policy in any court with jurisdiction to try an action on the policy. The policy terms here included such things as retention of moneys, but they did not include either a conduct of claims clause or an explicit proration provision. Save to the limited extent that the terms of reinsurance pushed them apart, the two contracts were back to back, because that, as Lord Griffiths pointed out in Vesta, is what reinsurance prima facie is. As is explained in 25 Halsbury *Laws of England*, §774, the 'back-to-back' presumption was adopted precisely because of the problems which arose where the two contracts were governed by different applicable laws.

48. However, the reason why a contract of reinsurance was said to insure the same risk as the primary contract rather than the insurer's liability under it (see Charter Reinsurance Co. Ltd v Fagan [1997] AC 313, 392, per Lord Hoffmann) is indicated by Lord Hoffmann's introductory remark - that until 1864 contracts of reinsurance were unlawful. By the Marine Insurance Act 1745, s.4, contracts of marine reinsurance were banned in Great Britain, apparently because such contracts (in inexplicable distinction from primary insurances, and subject to some eccentric exceptions) were regarded as gaming contracts. This appears to be why it became useful to ascribe non-marine contracts of reinsurance, which were not expressly forbidden, to the insured risk itself and not to the primary policy. It was not until the passing of the Revenue (No 2) Act 1864 that the ban was lifted. See generally O'Neill and Woloniecki *The Law of Reinsurance* (2nd ed, 2004).

49. The need for the fiction that reinsurance covered the primary risk and not the insurer's own potential liability is thus long spent. The practice and vocabulary of reinsurance law have for a long time now reflected the reality that what is reinsured is the insurer's own liability. One has only to imagine the respondents' reaction had Lexington claimed the full judgment sum of $180m rather than the settlement figure of $103m to see why. Thus in Vesta v Butcher [1989] AC 852 Lord Lowry (at 908) said: "… the reinsurer indemnifies the original insurer against the …. risk which the latter himself has insured." Halsbury *Laws* (loc. cit., §766-7) explains that, in this light, there is no privity of contract between reinsurer and insured: the two policies are "entirely separate contracts". The submissions of specialist counsel to this court have all adopted this approach. So did the successful submission of counsel (Mr Andrew Longmore QC, the then editor of McGillivray on *Insurance*) in Vesta v Butcher (at 886): "…the essential feature of reinsurance is the right on the part of the reinsured to recover in respect of his own liability to the insured."

50. If a contract of reinsurance were truly an independent insurance of the same risk as the primary contract covers, it would be easier to argue that it covers only what its own proper law holds it to cover. If, on the other hand, its purpose is to cover the primary insurer against an agreed proportion of such loss as it may incur under its own policy (and that is plainly its purpose) then one aspect of the assured risk is that a court of competent jurisdiction will hold the primary insurer liable when it believes itself not to be liable.

51. For these no doubt tangential reasons, as well as for those fully explained by Longmore LJ, I too would allow the appeal on both issues.

Lord Justice Pill:

52. I gratefully adopt Longmore LJ's recital of the facts. For Lexington, Mr Butcher QC accepted that the reinsurance contract was governed by English law and that a court in this jurisdiction would be very unlikely to construe the contract of insurance in the way it was construed by the Supreme Court of the State of Washington.

53. On behalf of Wasa (and AGF), it was conceded that the Supreme Court was a court of competent jurisdiction to construe the contract of insurance and that its decision was not perverse. It was accepted that, knowing as they did the nature and scope of Alcoa's operations, they would have known that there were a number of jurisdictions in which Alcoa might seek relief from their insurers. In a unanimous judgment

delivered by Talmadge J, the Supreme Court held that "any physical loss or damage manifesting itself during the time [the] policy was in effect was covered by the policy including pollution damage starting before the policy inception" (Aluminium Company of America, et al v Aetna Casualty & Surety Co, et al, 998 P2d. 856 (2000)*)*. It may have been asbestosis litigation, considered in the Supreme Court, which has given rise to an approach to pollution damage we are told is followed in some, though far from all, State jurisdictions in the United States, but there is no need to speculate about that.

54. I agree with Longmore LJ's comment that, by using the expression "back-to-back" (an expression described by Lord Lowry in Vesta v Butcher [1989] AC 852 at 909B as "insurance jargon"), to cover the contract of reinsurance, Lexington are asserting what they seek to prove. The nature of a contract of reinsurance was described in Vesta. Lord Templeman stated, at page 892B:

> "… in the absence of any express declaration to the contrary in the reinsurance policy, a warranty must produce the same effect in each policy. 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 underwriter to indemnify Vesta against liability under the insurance policy."

55. Lord Lowry stated, at page 908G:

> "Reinsurance is prima facie a contract of indemnity . . . under which the reinsurer indemnifies the original insurer against a specific amount or proportion . . . of the risk which the latter has himself insured".

In paragraph 25 of his judgment Longmore LJ has also cited the speech of Lord Griffiths at page 895C.

56. When considering Vesta in this court in Groupama v Catatumbo [2000] 2 Lloyd's Rep 350, at 353, Tuckey LJ stated:

> "I did not understand Mr Donaldson to quarrel with the presumption that in a proportionate reinsurance of the kind with which this case is concerned, there is a presumption that, in the absence of clear words to the contrary, the scope and nature of the cover afforded is the same as the cover afforded by the insurance. That at least I think is the effect of Vesta and it makes obvious commercial sense."

57. In Commercial Union Assurance Co Plc v NRG Victory Reinsurance Limited [1998] 1 Lloyd's LR 80, Clarke J stated, at page 84:

> ". . . in circumstances where it was permissible for the insured under the underlying insurance to sue in any of a number of jurisdictions, the reinsurers were in my judgment reinsuring the insurers' liability in the jurisdiction in which they were in fact

> sued. It is in my judgment irrelevant what view an English court might have taken if Exxon Corporation had sued the plaintiffs in England".

58. Though the appeal was allowed on other grounds, that approach was followed in the Court of Appeal ([1998] 2 Lloyd's LR 600). Potter LJ, with whom Lord Woolf MR and May LJ agreed, stated at 611:

> "In my view, the matter is better treated as a question of implication into the Reinsurance Contract, the implied term being that, absent any provision to contrary effect, the insurer will treat the decision of a foreign Court of competent jurisdiction as to the liability of the reinsured to his original insured as binding, subject only to reversal on appeal and the limits which I have mentioned".

59. In the course of argument, the respondents have veered between emphasising the Englishness of the contract of reinsurance, the lapse of time between the contract of reinsurance and the finding of liability against Lexington and the uncertainties of and changes in the law on liability for damage caused by pollution since 1977. (The arguments are not inconsistent with each other.) Wasa argued that they should not now be liable on an English reinsurance contract by reason of the construction of an insurance contract, which could not have been predicted in 1977, on a claim heard in the courts of the State of Washington applying the law of Pennsylvania. The findings of the judge, at paragraph 43, reflect those submissions:

> "I reject the submission that the period provision in the Reinsurance Contract can properly be construed by reference to the particular interpretation that was subsequently placed upon a similar period provision in the original insurance by a particular US State Court which happened to be seised of the underlying insurance dispute over twenty years later".

60. I agree with Longmore LJ's analysis of the particular contract of reinsurance in this case in relation to the contract of insurance. I agree with his analysis of the other authorities cited. The question to be answered is that posed by Longmore LJ at paragraph 21: "here, however, the same period of cover is in issue and the question is whether that same period of cover should receive the same interpretation in both the original contract and the reinsurance". In the light of the authorities, I also agree with Longmore LJ that it should. I accept that the policy period was a fundamental part of the policy being construed by the Supreme Court. Since it is the same in both contracts, it must bear the same construction in both contracts. Wasa took the risk of changes in the law in a relevant United States jurisdiction.

61. I agree with Longmore LJ, in his postscript at paragraph 42, that Wasa's case had the whiff of an assertion that whereas the American insurers, Lexington, had to take on the chin American decisions considered to be unsatisfactory, English reinsurers could not be expected to do so, a state of mind which may have contributed to the misunderstanding at Lexington in 1775, recalled by Longmore LJ. In my view, the reinsurers, like the insurers, took the risk of a change of the law in a competent

American jurisdiction. It may be added that it is not only in US State jurisdictions that the law has taken unexpected turns during the last 30 years.

62. I agree with the conclusion and the reasoning of Longmore LJ on the retention issue.

63. I agree that, on both issues, the appeal should be allowed.