Neutral Citation Number: [2011] EWCA Civ 1570

Case No: A3/2011/0365

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT
QUEEN'S BENCH DIVISION
COMMERCIAL COURT
THE HONOURABLE MR JUSTICE SMITH
[2011] EWHC 91 (Comm)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 15/12/2011

Before :

THE RIGHT HONOURABLE LORD JUSTICE LONGMORE
THE RIGHT HONOURABLE LORD JUSTICE TOMLINSON
and
THE RIGHT HONOURABLE SIR ROBIN JACOB

- -

Between :

TEAL ASSURANCE COMPANY LIMITED	**Appellants**
- and -	
W. R. BERKLEY INSURANCE (EUROPE) LIMITED & ANR	**Respondents**

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- -

Mr Christopher Butcher QC & Ms Rebecca Sabben-Clare (instructed by **DAC Beachcroft LLP**) for the **Appellants**
Mr Colin Edelman QC (instructed by **Clyde & Co**) for the **Respondents**

Hearing dates : 4th November 2011

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Approved Judgment

Lord Justice Longmore:

Introduction

1. This appeal is about the professional indemnity insurance of a firm of (mainly American) architects and engineers known as the Black and Veatch Group. The Group has a "tower" of insurance contracts providing it with worldwide cover for any one claim (and in an annual aggregate) of US$60 million in excess of the deductible and self insured retention. The first layer of this tower was written by Lexington Insurance Co Ltd; above this were three further layers of excess of loss insurance written by Teal Insurance Co Ltd ("Teal") who were the claimants in the proceedings and are now the appellants. (The Lexington policy is referred to in the Teal contracts as "the primary policy"). There is then what is known as "top and drop" insurance which provides additional cover up to £10 million per claim once the tower is exhausted. This top and drop cover is also written by Teal and is reinsured with the defendants (the respondents to the appeal). It is not, however, world wide because it excludes claims emanating from the USA and Canada.

2. In general terms in English law a liability insurer's liability only arises when (and does not arise until) the liability of the insured to the third party is established (whether by agreement, judgment or award), see Post Office v Norwich Union Insurance Co Ltd [1967] 2 QB 363 and Bradley v Eagle Star Insurance Co Ltd [1989] 1 AC 957. Thus Lexington will be liable to Black and Veatch, subject to any express term of the insurance contract to the contrary and any defence Lexington may have, when Black and Veatch agree to pay any sum to the third party to whom they are liable or when the third party obtains a judgment or award against them. The question in this case is whether Teal as first excess of loss insurer can say that they are not liable until Lexington have themselves agreed to settle with or have been adjudged to be liable to Black and Veatch or whether Teal become liable at the same time as Lexington. If the former argument is correct, then the question arises whether Teal as second excess of loss insurer can say that they are not liable until liability is established against the first excess of loss insurer and so on back up the tower so that Teal as top and drop insurer (and reinsured) can say that they are not liable until liability has been established against the insurers in the tower.

3. The particular difficulty giving rise to the dispute stems from the fact that the tower gives worldwide cover but the top and drop insurance/reinsurance excludes what I may call for short American claims. If, say, a non-American claim for $80 million is made against the Group and the Group agrees to pay that claim or is found liable to do so (and the claim is, therefore, established) on 1st January of a given year and an American claim is agreed to be paid or is otherwise established in the same amount on 1st February, does that mean that the tower is exhausted on 1st January so that the top and drop insurers/reinsurers become exposed but can deny liability for the later claim since it is an American claim? Similarly, if an American claim is established against the Group on 1st January and a non-American claim is established on 1st February, is the tower exhausted on 1st January so that the top and drop insurers/reinsurers then become liable for the non-American claim?

4. Alternatively, is the position that Teal can say that the tower is not exhausted until first Lexington and then Teal themselves have agreed that there is a liability on them or they have been found liable by judgment or award so that Teal can effectively

decide to pay the American claims first (in the tower) and non-American claims subsequently, looking to their reinsurers for reimbursement for such (deferred) non-American claims?

5. The question needing resolution arises between Teal as the original insurer under the top and drop policy and their reinsurers; it asks whether the tower is to be regarded as exhausted once claims which amount to $60 million are settled by the Group or only when the liability of the insurers in the tower has been determined whether by agreement or award or judgment. Andrew Smith J decided that the former solution is correct; the answer must, of course, depend on the terms of the reinsurance contract but the true construction of those terms may be influenced by the terms of (a) the top and drop, (b) the intermediate (Teal) or (c) the primary (Lexington) contract(s) of insurance.

Policy Terms

6. The obligations of Teal as top and drop insurers are:-

> "To indemnify the Insured for claim or claims first made against the Insured during the Period of Insurance hereon up to this Policy's amount of liability (as hereinafter specified) in the aggregate, the excess of the Underlying Policy(ies) limits (as hereinafter specified) or any Policy(ies) issued in substitution or renewal thereof for the same amount effected by the Insured and hereinafter referred to as "the Underlying Policy(ies)".

This Policy's amount of liability:	GBP 10,000,000 or its equivalent in other currencies each and every claim including claims emanating from or brought anywhere in the world excluding USA, its territories or possess ions, or Canada.
Underlying Policy(ies) limits:	USD 20,000,000 any one claim in the annual aggregate emanating from or brought anywhere in the world, including Claims Expenses
	USD 30,000,000 any one claim and in the annual aggregate emanating from or brought anywhere in the world, including Claims Expenses

	Only to pay excess of; USD 5,000,000 any one claim and in the annual aggregate emanating from or brought anywhere in the world, including Claims Expenses Only to pay excess of: USD 5,000,000 any one claim and in the general aggregate emanating from or brought anywhere in the world, including Claims Expenses for Claims Only to pay excess of a retention of: USD 10,000,000 any one claim, including Claims Expenses for Claims emanating from or brought anywhere in the world USD 20,000,000 in the annual aggregate, including Claims Expenses for Claims emanating from or brought anywhere in the world Which in turn in Excess of: USD 100,000 each and every claim including Claims Expenses
Underlying Policy(ies) Number(s):	i) Lexington # 0101085 ii) 2007-009 iii) 2007-010 iv) 2007-011”

7. There are then relevant conditions:-

> "1. Liability to pay under this policy shall not attach unless and until the Insurers of the underlying policy(ies) shall have paid or admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses.
>
> …
>
> 3. If by reason of the payment of any claim or claims or legal costs and expenses by the insurers of the underlying policy(ies) during the period of this insurance, the amount of indemnity provided by such underlying policy(ies) is:-
>
> a) Partially reduced, then this policy shall apply in excess of the reduced amount of the underlying policy(ies) for the remainder of the period of insurance;
>
> b) Totally exhausted, then this policy shall continue in force as underlying policy until expiry hereof.
>
> 4. In the event of a claim arising to which the insurers hereon may be liable to contribute, no costs shall be incurred on their behalf without their consent being first obtained (such consent not to be unreasonably withheld). No settlement of a claim shall be effected by the insured for such a sum as will involve this policy without the consent of insurers hereon.
>
> 5. Any claim(s) made against the insured or the discovery by the insured of any loss(es) or any circumstances of which the insured becomes aware during the subsistence hereof which are likely to give rise to such a claim or loss, shall, if it appears likely that such claim(s) plus costs and expenses incurred in the defence or settlement of such claim(s) or loss(es) may exceed the indemnity available under the policy(ies) of the primary and underlying excess insurers, be notified immediately by the insured in writing to the insurers hereon."

These conditions are also present in the intermediate Teal contracts of insurance.

8. The substantive clause of the reinsurance contract provides:-

> "the reinsurer's liability under this agreement shall follow that of the reinsured for losses under all terms, conditions and limits to the reinsured original policy or policies specified therein."

9. The primary (Lexington) policy provides:-

> "1. INSURING AGREEMENT – COVERAGE
>
> The Insurance afforded by this policy applies to claims, as defined in Section IV A(ii) and B of this part of the policy,

> which allege any negligent act, error or omission provided the claims are either (i) first made against the Insured during the Policy Period and reported in writing to the Company during the Policy Period or within sixty (60) days after the expiration date of this policy; or (ii) first made against the Insured during the Policy Period in accordance with the provisions of paragraph IV AI(ii) of this Part of the Policy and reported in writing to the Company within sixty (60) days after the Chief Counsel of the Named Insured first receives notice of the Claim, providing in either event that the insured, in the person of Chief Counsel, was not aware of such Claims at the inception date of this Policy.
>
> The Company will indemnify the Insured all sums up to the Limits stated in the Declarations, in excess of the Insured's Deductible and/or Self-Insured Retention, which the Insured shall become legally obligated to pay as Damages if such legal liability arises out of the performance of professional services in the Insured's capacity as an architect or engineer and as stated in the Application. …"

Endorsement 8 extends the cover to the costs and expenses of rectifying defects and condition VI provides:-

> "No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured at the actual trial, arbitration or by written agreement of the insured and the claimant, to which agreement the company has consented"

Submissions

10. Mr Butcher QC for insurers under the top and drop contract and the reinsured under the reinsurance contract submits:-

    i) the reinsurance contract incorporates the terms of the top and drop insurance contract;

    ii) the top and drop insurance contract provides that there is no liability on Teal as top and drop insurer until the intermediate insurers have admitted liability or been held liable to pay;

    iii) so far the intermediate insurers have not admitted liability or been held liable and indeed have not even been asked to admit liability;

    iv) no cause of action has therefore accrued against either the intermediate insurers or the top and drop insurer; the Black and Veatch group can choose the order in which they present claims to Teal and Teal can likewise choose the order in which the claims are settled;

v) Teal can therefore settle the American claims first pursuant to their obligations under the intermediary contracts of insurance and postpone the settlement of any non-American claim so that it is settled by Teal under the top and drop insurance contract and liability can be passed to the reinsurers of that contract;

vi) This is not an odd or undesirable consequence because any insured claimant who has more than one claim can always present his claims in any order he chooses just as any claimant can pursue any one of any potential defendants, against whom he has claims see Merryweather v Nixon (1799) 8 T.R. 186.

11. Mr Edelman QC for the reinsurers of the top and drop contract submits:-

i) Teal's arguments begin at the wrong end of the telescope; and must begin by considering the Lexington policy at the bottom of the tower;

ii) that policy contains no clause equivalent to condition 1 of the top and drop policy;

iii) Lexington is therefore liable (and there is a cause of action against it) as soon as Black and Veatch settle a claim; if an American claim is settled that will be payable but so will a non-American claim; any such claim which exceeds the self insured retention and the deductible has to be met. If the claim exceeds $5 million it penetrates to the next layer;

iv) Once the intermediate insurance of $60 million in the tower is exhausted, the top and drop insurance drops down to become the primary layer; in its capacity as the primary layer it insures on the same terms as Lexington did and Teal is liable once a claim against Black and Veatch is established in the sense of being admitted or the subject of judgment or award;

v) Teal cannot therefore choose when to present claims to (effectively) themselves but claims must be met in the order in which they are established against Black and Veatch.

Discussion

12. The answer to the problem cannot depend on whether one starts by looking at the Lexington policy and proceeds up the tower to the top and drop insurance contract and its reinsurance contract or starts with the reinsurance contract and the top and drop insurance contract and descends to the Lexington contract. The key to resolution in my judgment is to be found in the third condition of the top and drop insurance contract which provides that once the indemnity provided by the underlying policies is exhausted, then "this policy shall continue in force as Underlying policy". This is the provision for the "drop" in the "top" and drop" insurance. The insurance in excess of $60 million "drops down" and becomes the underlying policy, or is, at least, on the same terms as the underlying (namely, ultimately, the Lexington) policy, as identified towards the end of the long clause cited in paragraph 6 above. It may be said that this begs the question of when the underlying policies are exhausted but, in fact, it does not. Lexington are liable whenever claims are established against Black and Veatch on Post Office v Norwich Union principles. Once their layer has been exhausted, the next policy (009) becomes the underlying policy and Teal are, therefore, liable (as

Lexington were) once the liability of Black and Veatch is established by admission, judgment or award; and so on up the tower.

13. There can, in my judgment, be little doubt that this is the commercial common sense of the top and drop policy. Any other conclusion would mean that Teal (which, as a matter of fact, are an associated company of Black and Veatch, known in the insurance trade as a "captive") could determine when they (Teal) admitted liability further up the layer and could themselves organise the lower levels to pay American claims, leaving reinsurers to face non-American claims where those claims should otherwise have exhausted the tower. Such ability to manipulate liabilities is unlikely to have been the intention of the parties.

14. Mr Butcher, for Teal, relied on the wording of the first condition of the top and drop policy to the effect that liability to pay under that policy was not to attach unless and until the insurers of the underlying policies (namely Teal themselves and ultimately Lexington) had paid or admitted liability or had been held liable to pay the full amount of their respective indemnities. He submitted that establishment of liability as against the underlying insurers (by payment, judgment or award) was a condition precedent to any liability of Teal as top and drop insurers and, as this had not happened, the tower still remained to be exhausted; Teal could thus choose what claims to pay first (the American claims) and what claims to pay later (the non-American claims which could be then claimed from reinsurers). In support he cited the authority of Firma C & Trade v Newcastle P & I Association (The Fanti and The Padre Island) [1989] 1 Lloyds 239, 249 per Bingham LJ and [1991] 1 A.C. 1, 29 E-F per Lord Brandon of Oakbrook and 31 G-H per Lord Goff of Chieveley. It is certainly true that in that case the courts considered that the condition of prior payment by the member of the relevant P & I Association before he could recover from his Association meant that no cause of action accrued to the member before payment had been made. So, if condition 1 had stood alone, Teal could no doubt say that they were not liable until liability on the part of the underlying policies had been established by admission, agreement or judgment. But condition 1 does not stand alone and has to be read alongside condition 3 which provides that, once the tower is exhausted, the policy is "to continue in force as Underlying Policy". As therefore the Lexington policy is exhausted, each excess policy drops down to become the underlying policy and, since the underlying (Lexington) policy has no clause equivalent to condition 1, that condition is either no longer present or has to give way to the terms of the underlying policy by which, as I have already said, insurers are liable once the liability of the relevant Black and Veatch company has been established by agreement, admission, judgment or award as the case may be.

15. Mr Butcher then relied on a provision in the Lexington policy rather obscurely placed in the Definitions clause requiring the deductible and/or self-insured retention to be paid prior to Lexington indemnifying Black and Veatch. But such a clause is not, in my judgment, clear enough to displace the ordinary legal position whereby Lexington are liable (in the sense of a cause of action occurring against them) once Black and Veatch's liability is established. At most it is a procedural bar to recover as in Coburn v Colledge [1897] 1 QB 702.

16. The fact is that the construction of the policies of insurance, for which Mr Butcher contends, does not lead to a sensible commercial result, while the reinsurers' construction (that the policies are exhausted in an orderly manner depending on the

time when liability is established against Black and Veatch) does produce a commercially sensible outcome. In these circumstances, however much one may feel that Mr Butcher's construction is one possible construction, there is no doubt that the policies can bear the construction for which Mr Edelman QC contends on behalf of reinsurers. In these circumstances it is the more sensible commercial construction which is to be preferred, see Rainy Sky S.A. v Kookmin [2011] UKSC 50; [2011] 1 WLR 2900 paras 21-30 per Lord Clarke of Stone-cum-Ebony. The fact that it is also the conclusion reached by an experienced judge of the Commercial Court apparently (para 41) clinches the matter.

Conclusion

17. I would therefore dismiss this appeal.

Lord Justice Tomlinson:

18. I agree that this appeal should be dismissed.

19. I understand that Black and Veatch wishes to maximise the insurance cover available to it. As I understand it, it wishes to ensure, so far as it is able, that the worldwide cover given by the insurance in the "tower" is available to its full extent of US$60M to meet claims emanating from the US and Canada. This would or could have the effect that it could then utilise what the judge called the Original Policy and what Longmore LJ has called the top and drop insurance to meet non-US claims to the full extent of the indemnity available under that cover.

20. Whilst I can understand this desire, I find it very difficult to understand how in practice it can be achieved. I also find this whole approach to the question of the available cover counter-intuitive. Ordinarily, as it seems to me, the availability of cover to meet any particular claim will be dependent upon the extent to which the cover has already been eroded by prior claims. The manner in which the cover is sequentially eroded is, as I understand it, governed by the principles established in Post Office v Norwich Union Insurance Co Ltd, 1967 2 QB 363 and Cox v Bankside Members Agency Limited, 1995 2 Lloyds Law Reports 437, by both of which decisions we are bound. This is not a process over which insurers have any control. It is also not something over which the insured has any control, save to the extent that it may be able to accelerate the establishment of its own liability by prompt agreement, where appropriate, or delay it by, in turn, delaying the processes of litigation or arbitration directed towards the establishment of that liability. Against that background, and subject to the possibilities which it offers, I can see no scope for manipulation of insurance recoveries so as to enable Black and Veatch to access the Original Policy which sits on top of the tower without first establishing that the cover on top of which it sits has burned through. Put another way, which is I hope not an over-simplification, I do not see how a non-US claim can rank for recovery under the Original Policy until such time as the underlying cover has been exhausted. The Original Policy is not a stand-alone cover. Notwithstanding it does not respond to US and Canadian claims, it sits on top of the US$60M worldwide cover.

21. Questions arising as to the relationship between related layers of insurance coverage are, to my mind at any rate, more easily understood and resolved by reference to an actual claim than by reference to hypothetical questions. Perhaps the formulation of

preliminary issues has here served to obscure from my view quite how it is envisaged that Black and Veatch could achieve its aim. However I find compelling Mr Edelman's observation that a claim can only reach the Original Policy or top and drop insurance by one of two routes. Firstly, it can reach it by being a claim which is first presented to the underlying layer or layers but in respect of which the remaining available cover thereunder is insufficient to meet the claim. If so, by virtue of clause 1 of the top and drop insurance, that cover only responds, or in the language thereof liability to pay only attaches, when the underlying insurers have paid or have admitted liability or have been held liable to pay, whatever that may mean. The second route to recovery is on the basis that the Original Policy has dropped down to become the primary layer. That will only occur when the cover under the tower has been exhausted. In such circumstances clause 1 is necessarily of no application, there being no underlying policies. There is thus no scope for presentation of non-US claims to the Original Policy if cover to meet them remains available under the policies comprising the tower of US$60M worldwide cover.

22. In these circumstances the precise meaning of clause 1 does not arise. However I do not accept that it determines the order in which claims exhaust the programme. As Mr Edelman pointed out, clauses 4 and 5 in the same series of provisions are consistent only with the programme being exhausted in the traditional and predictable manner, viz, on *Post Office v Norwich Union* principles. If it were otherwise, those clauses would be unworkable. The purpose of clause 1, as it seems to me, is to determine the inter-relationship between layers of cover. Plainly, clause 1 can have no relevance or function with regard to the ordering of claims within a layer, and it would be odd, indeed wholly unworkable, if the ordering of claims as between layers operated on a different basis from that applicable within layers. I am not sure that clause 1 is in fact strictly necessary. However, as the judge held at paragraphs 36 and 37 of his judgment it performs a readily understandable function in making clear that the obligation to pay falling on layers of insurance above the primary layer is deferred until the resolution of any uncertainty or dispute as to the liability of the underlying insurers. Clause 1 is thus, as Mr Edelman submitted, a condition precedent to payment under the layer in question. The anarchy which would ensue from Mr Butcher's approach can readily be imagined if once it is supposed that the first, second and third excess layers had been underwritten by different insurers, which would incidentally remove the further feature that as it happens all these layers are underwritten by a captive of the insured Black and Veatch.

23. For these brief reasons, which are I believe in substance the same as those given both by the judge himself and by Longmore LJ, and which I fear may do less than justice to the elaborate and skilful argument presented by Mr Butcher, I agree that the appeal should be dismissed.

Sir Robin Jacob:

24. I also agree.