

## **BILL PERRY and CARTER PERRY BAILEY WIN IN THE HOUSE OF LORDS FOR AGF**

On 5 and 6 May, Bill Perry, representing AGF, instructed Neil Calver QC and Stephen Midwinter, both of Brick Court Chambers, to appear before the House of Lords in an appeal on behalf of our client AGF.

The principal issue was whether London reinsurers AGF (and Wasa) had to follow the reinsured's (Lexington's), settlement of \$103m with Alcoa for insurance of environmental liabilities.

Lexington's (American) insurance contract with Alcoa was for 1 July 1977 to 1 July 1980. There was no express choice of law clause, but the insurance contained a standard US service of suit clause. In the early 1990s, the US Environmental Protection Agency ("EPA") compelled Alcoa to clean up pollution at various sites. Alcoa claimed on its insurance policies, ultimately suing Lexington (and others) in the State of Washington. On appeal, the Supreme Court of Washington found Lexington was jointly and severally liable for the clean-up costs of pollution found during the policy period at sites covered by its policy, regardless of whether or not that pollution damage actually occurred during the policy period. Lexington then negotiated the settlement of the claim.

Lexington sought to recover from AGF (and Wasa) their share of this settlement. Its reinsurance policy contained a follow the fortunes clause. The reinsurance policy was governed by English law. It was for the period of "36 months from 1 July 1977 ... and/or pro rata to expiry of original".

Lexington said that, following the principle in *Vesta v Butcher* and *Groupama v Catatumbo*, English law should interpret the reinsurance as meaning that reinsurers had to pay anything that Lexington had to pay as a result of the decision of the Supreme Court of Washington. AGF said that it was only liable for damage that occurred during the period of its policy, that is for 36 months after 1 July 1977.

AGF succeeded at first instance in the Commercial Court (part of the High Court) before Mr Justice Simon. Subsequently Lexington prevailed in the Court of Appeal (by a unanimous judgment of Lords Justices Longmore, Pill and Sedley). The Court of Appeal refused AGF leave to appeal. However, the House of Lords granted it and AGF duly appealed to the House of Lords.

The House of Lords (Lords Phillips, Walker, Brown, Mance and Collins) on 30 July (in a decision the specialist press in London has labelled "historic") unanimously agreed with AGF. (The decision was in fact doubly historic because it was handed down on the very last day that the House of Lords was sitting as the

United Kingdom's highest Appellate Court. It will be replaced by the new UK Supreme Court, which opens its doors on 1 October, and will give judgment in any cases heard in the House of Lords but not decided by them before 31<sup>st</sup> July.)

No one doubted that, for example, the Courts would ensure that the difference in time zones would be elided to provide back to back coverage. But things are different on a point of principle of this type.

Delivering the leading Judgment, Lord Collins said that "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 market."

Lord Collins continued by making clear that: "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 of 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."

Lord Collins emphasised that "... there is no principled basis for treating the scope of the 3 year reinsurance as the same as the insurance, which has been interpreted ... not to contain any 'limitation as to time of the physical loss or damage to property' ... [Lexington's argument] ... seems ... to be wholly uncommercial and outside any reasonable commercial expectation of either party".

Lord Mance, agreeing with Lord Collins, held that: "It may not ... 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."

He added that: "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 upon 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 basis terms of the English law contract into which they entered.”

Lord Mance concluded that he found it: “impossible to adopt [the Court of Appeal’s views] 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 a large number of other independent insurances and claims”.

Lord Brown held that “ ‘Physical loss or damage’ under a policy providing cover for three years simply cannot be construed under English law to include pre-existing damage ... 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. English law does not ... go so far. *Vesta v Butcher* and *Groupama v Catatumbo* ... do not warrant its application in the all the circumstances, certainly not so as to override so clear a temporal limitation as the reinsurance contracts stipulated here with regard to the risks covered”.

The other Law Lords concurred with Lord Collins.

The reference to the judgments is 2009 UKHL 40 for those who seek the full text.

Bill’s view following this decision is that plainly English reinsurers must still be careful if they wish to ensure that they do not under the Vesta principle accidentally import into an English law reinsurance contract foreign law terms that they do not want, particularly if there is an express choice of foreign law in the original insurance and the reinsurance is as original. Conversely foreign reinsureds must be careful that there is matching law if that is what they want, especially in something as fundamental as the time limits. Of course each case will turn upon its own facts; it is not safe to assume that “Vesta” is now wholly excluded in some areas. Advice on a case by case basis will be needed.

The decision is an important one for the London and international reinsurance market, setting limits to the Vesta principle and re-confirming that a choice (express or implied) of English law will still have a meaningful effect when it comes to following the fortunes. Precisely because of the different law, an

English law policy may not be back to back with an underlying policy governed by a different law. Both the reinsured and the reinsurer need to take note and ensure that they agree what they want.