

News flash

Following the Settlements: A Second Chance to Come Clean

In June 2007, Simon Gildener reviewed the High Court decision of *Wasa v Lexington* in “Following the Settlements: How not to clean up!” in 2008 the Court of Appeal has revisited the decision, and Simon examines the higher court’s different approach.

Background

Alcoa is a very large producer of aluminium. Between 1942 and 1986, Alcoa’s waste management and pollution containment procedures had been defective. These deficiencies caused environmental damage at a number of its industrial sites across the United States. In the early 1990s, the US Environmental Protection Agency forced Alcoa to take remedial action.

Alcoa was insured by Lexington (and a number of other insurers) for a three year period between 1977 and 1980. It was during this period that much of the environmental damage had manifested itself. Alcoa tried to recover all of the clean-up costs from Lexington. Lexington argued that it should not be responsible for everything. The cause of the damage was a continuing state of affairs, and Lexington was on risk only for three of the forty (plus) years involved. Alcoa asked a Washington State court (applying

the law of Pennsylvania) to rule on when the relevant damage occurred and whether the clean-up costs should be allocated pro-rata across the years.

In 1997, the trial judge decided that the environmental damage had occurred on a gradual, linear basis. Therefore the remedial costs could be pro-rated across all of the years during which the damage occurred. However, in May 2000, the Washington Supreme Court reversed the decision. It held that the insurance policy language was broad enough to provide cover for any damage manifesting itself during the policy period, including pollution damage that had started before the policy inception. Lexington found itself liable to Alcoa for all of the clean-up costs, not just that proportion attributable to the three year policy period. Lexington tried to reduce its financial exposure to Alcoa but eventually settled for just over \$100 million. ▶

► The Reinsurance

In 1977, Lexington had reinsured the Alcoa risk on a facultative basis. Wasa International Insurance Company ('Wasa') and AGF Insurance ('AGF') had small lines (2.5% and 1.5% respectively) on this reinsurance. Lexington asked Wasa and AGF for their contribution to the settlement. Wasa and AGF issued proceedings in the London High Court for a declaration that they were not liable to pay.

The relevant slip provided that the contract was "...a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the [reassured]." The key question was whether Wasa and AGF were obliged to follow the settlement.

Wasa (by which we mean Wasa and AGF for these purposes) argued that the reinsurance contract did not cover Lexington for losses arising out of long-term damage, only physical damage actually occurring during the three year period. If that was right, then the settlement would not fall within the legal scope of the reinsurance contract. Lexington argued that the reinsurance was 'back-to-back' with the original insurance, even though the original insurance was subject to US law and the reinsurance was subject to English law. As a result, it said the intent of the parties in 1977 must have been to incorporate the same meaning and effect of the insurance policy into the reinsurance.

The High Court Decision

At first instance, Mr Justice Simon held that Wasa had agreed to cover Lexington only for damage occurring during the policy period applicable to the reinsurance. This meant that the Alcoa settlement largely fell outside the scope of the reinsurance contract. Wasa therefore did not have to follow Lexington's settlement.

A key factor in the judge's decision was the lack of a uniform rule of law applicable across the whole of the US and the lack of an express law/jurisdiction clause in the original insurance. In his view, neither Wasa

nor Lexington could have foreseen in 1977 that there would be a coverage dispute 20 years later which would be litigated in a Washington court applying Pennsylvanian state law. On that basis, neither party could have intended the English reinsurance contract to be interpreted in the same way. There was no "*consistent contractual intent*" between the insurance and the reinsurance contracts. To say otherwise would, in the judge's view, have made the reinsurance contract "*back-to-front*", rather than "*back-to-back*".

The Appeal

Lexington's appeal went before Lord Justices Longmore, Sedley and Pill in the Court of Appeal in early 2008. Longmore LJ gave the leading judgment.

As his starting point, Longmore LJ stated that where contractual terminology was the same or similar in both contracts in issue, it was important not to ask whether the parties intended the provisions to be "*back-to-back*" as such, but to ask whether they intended the provisions to have the same meaning in both contracts. Explaining this apparent exercise in semantics, he argued that his own formulation left it open for the court to go on to determine what that meaning was.

On reviewing the period clauses in both contracts, he noted that they were effectively identical, even though expressed in slightly different words. And, after applying his test, he considered the natural answer was that the parties must have intended the words to have the same meaning in both contracts. Lending support to this view, he noted that the Lexington had ceded the entirety of the Alcoa premium. This, he felt, was indicative that the parties to the reinsurance intended the entirety of the risk to be ceded.

So what was that common meaning? Did Wasa's English interpretation (in effect, pro-rated damage across the three years only) or Lexington's Pennsylvanian interpretation (all damage) apply? After distinguishing a number

of legal authorities, all three appellate judges agreed that it made little sense for Wasa's English approach to apply in this case.

Unlike the judge at first instance, Longmore LJ felt that it was eminently possible to imply a consistent contractual intent in circumstances where multiple American state jurisdictions with differing legal approaches might well have come into play. Even in 1977, both Wasa AGF and Lexington would have "probably" concluded that Pennsylvania law would apply to the insurance contract. This would then make it possible to ascertain the meaning of the contract at that stage, even if it were a matter of disagreement between lawyers, eventually requiring a court determination some 20 years later. And even if the law had changed in the intervening period (a point argued by Wasa), reinsurers took the same risk of a change in law in the insurers' country of operation as the insurers did.

He accepted that the Washington State court did not focus on the period of cover in the same way that an English court might have done, but the contract period was still an important part of the policy under judicial construction in the US. On that basis, it had to bear the same construction in both insurance and reinsurance contracts.

Sedley LJ had similar views. He reduced Wasa's failed argument down to the proposition that no-one in 1977 could have foreseen the way in which the coverage case was eventually determined. He considered that where forum and applicable law was concerned, all Wasa and Lexington would have thought about in 1977 would have been the broader proposition that "a court of competent jurisdiction would decide [the dispute] according to law": i.e. whichever court heard the case and whatever law was applicable at the time of determination. It is not entirely clear how he reached this finding – arguably a finding of fact, even one founded in pragmatism – but he admitted that it was merely "tangential" to Longmore LJ's rationale.

Also in agreement was Pill LJ. He dismissed Wasa's emphasis in argument of the "Englishness" of the reinsurance contract, and the lapse of time between contracting and the coverage determination, and the uncertainties of and changes in the applicable law.

Before signing off on his judgment, Longmore LJ had one final, perhaps telling postscript. He wrote, "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." But he went on to say that Wasa's arguments in the appeal had "a whiff of an assertion...that Lexington were an American Corporation and therefore had to take unsatisfactory American decisions on the chin, while [Wasa] were English...and could not be expected to do so." He had little time for this, commenting drily that War of Independence was long over.

Conclusions

Some might argue that this is a pragmatic decision, where the result drives the reasoning, rather than the reasoning driving the result. Longmore LJ said that these cases are always difficult because each side starts (and almost ends) by making assertions that tend to be self-proving – one side arguing one form of contractual intent, the other, the opposite. And as the counsel acting for Wasa pointed out in his submissions to the court, when dealing with "back-to-back" reinsurance, "It all depends which end of the telescope one picks up first."

Certainly the Court of Appeal had little time for Wasa's implied criticism of the Washington Supreme Court's decision. And the invocation of argument recalling 18th Century Anglo-American relations in a modern, global and commercial world does not appear to have helped matters either. Other extraneous factors may have included the fact that Wasa and AGF had such small lines on the risk, and were the only markets

▶ to withhold payment to Lexington. But this can never be more than speculation.

That all said, the lessons from the case remain the same, whoever succeeds. Clear, consistent language in both insurance and reinsurance contracts and careful consideration of jurisdiction at the contracting stage is essential. Longmore LJ also had some useful advice for reinsurers concerned about jurisdictional uncertainties in the Anglo-US arena. He suggested the use of the so-called “*Bermuda Form*” in which the parties agree to English or Bermuda arbitration but adopt New York law. Citing the recent *C v D*

case¹ (in which lawyers from Robin Simon LLP acted), he considered this would be a “*sensible arrangement*” which might avoid some of the problems in this case.

¹ [2007] EWCA Civ 1282

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Summary of Key Points

- Where the same or equivalent wording is used in both insurance and reinsurance contracts, then they should be given the same construction unless there are clear indications to the contrary.
- It is possible that provisions which are not “*a fundamental part*” of the original insurance policy under judicial construction may be treated differently.
- Clear and consistent language and careful consideration of jurisdiction is essential in back-to-back reinsurances.

We can put together a seminar/talk or panel discussion on the issue above, or any of the issues featured in our publications to be held at any of our offices, or yours. If you are interested, please contact any one of our lawyers or David Simon at david.simon@robinsimonllp.com.

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