Wasa v Lexington [2009] UKHL 40

Reinsurance: Judgment for reinsurers. A strict and orthodox interpretation of contract terms as to period of coverage. No obligation to follow a settlement not covered by reinsurance contract as matter of law.

Judgments of the House of Lords on insurance but more particularly reinsurance are, of late, a relative rarity. The House of Lords decision in Wasa (July 2009) is therefore to be treasured.

Indeed, to digress briefly, perhaps it is fair to say that there is something of a diminishing stream of legal precedent, particularly in reinsurance. Perhaps this has been because of the widespread use of arbitration clauses in reinsurance contracts or perhaps because of a change in business methods and an increasing willingness to settle reinsurance claims? If the trend persists it may undermine certainty, or at least predictability, where in the Common Law system the law grows and adapts progressively and flexibly by an accumulation of decided cases; and this could be a particular problem if there are disputes on new wordings. On the other hand, is this progressively less of a concern where the fortunes of arbitration, having waxed rich, may have passed the zenith?

In any event, in Wasa, Lexington Insurance issued insurance cover to an American aluminium company Alcoa, providing coverage for loss and damage to property. The policy was for a three year term commencing on 1st July 1977. Lexington in turn purchased facultative reinsurance with Wasa (and AGF). The two contracts were effectively back to back for example as to perils and period of cover; and the reinsurance contract contained a follow the settlements clause. The key difference between them was that the underlying policy was found to be subject to the law of the State of Pennsylvania; the reinsurance contract was subject to English law.

Alcoa was required by the US Federal and State authorities to clean up pollution from certain of its sites. That pollution had occurred between the early 1940s and the mid 1980s; that is before during and after the policy period. Extraordinarily to some eyes, the US Courts, specifically the Supreme Court of Washington, by the application of Pennsylvania law held that Lexington was jointly and severally liable to indemnify Alcoa for the entirety of the cost of pollution clean up whenever it had occurred. Lexington settled the claims of Alcoa for USD 103 Million (put forward at USD 180 million) and sought an indemnity from Wasa and AGF.

Reinsurers commenced proceedings in England, seeking a declaration that they were not liable in respect of that settlement. They were successful at first instance, but not in the Court of Appeal. The decision of the Court of Appeal has now been overturned by the House of Lords. Notwithstanding the fundamentally back to back nature of the two coverages, and the presence of the "follow" provision, the House of Lords has determined that Wasa and AGF are not liable to indemnify Lexington. This decision confirms that reinsurance is not a contract by which reinsurers agree to indemnify the cedant for *any liability* the latter may incur on an underlying policy; reinsurance is a reinsurance of the subject matter insured. Reinsurers are entitled to make their own bargain and had done so here. The scope of cover afforded by that bargain should be determined as a matter of construction, by the meaning of the words used. And this reinsurance contract did not (as a matter of English law) cover damage occurring outside the policy period, whatever the US Court may have decided.

Previous authority on a similar point was distinguished, namely the House of Lords decision in Vesta (1989) and the Court of Appeal decision in Catatumbo (2000). In both cases the law of the underlying policy (Norwegian and Venezuelan respectively) provided that a breach of warranty should (in contradistinction to English law) afford an underwriter no defence to a claim, except where that breach was causative of loss; and this meaning (a stranger to an English eye) was effectively to be "imported" into the reinsurance contract. Had a similar approach been taken in Wasa to the matter of the period of the reinsurance, Lexington would have prevailed. (One wonders what the result would have been had Wasa been referred to arbitration rather than to the courts?).

What are the implications for insurers and reinsurers, particularly local insurers who assume obligations in reliance on back to back coverage from their reinsurers; far-reaching. One solution may be to ensure that all contracts of insurance and reinsurance in a chain from the original to the ultimate risk bearer should be, so far as possible, written on *exactly the same terms* and to subject to the *same system of law and jurisdiction.* But is that feasible? Is it commercially realistic? Alternatively, insurers might wish to devise the most suitable and the clearest possible wording designed to ensure that, whatever the systems of law or jurisdiction, the precise meaning accorded to the particular words in the underlying should be accorded exactly the same meaning and effect in the reinsurance (however they may depart from their ordinary and natural meaning to an English eye); a real test of ingenuity.

867 words

Rhys Clift

Partner
Hill Dickinson LLP
Marine, Insurance & Reinsurance, ADR
Irongate House, Duke's Place, London, EC3A 7HX
Direct tel: + 44 (0) 207 280 9199
Mobile/cell: 07785 356994
www.hilldickinson.com

02.09.09