to decompose is one of fact, but I respectfully part company from the weight he attaches to the form of the statement of agreed facts. After all, Mr. Vallance himself did not seek to take a stand on the wording of the agreed facts. In my view, this was a right and proper course for him to take, since they are not to be considered as if they were a pleading. They tell a continuous narrative; and par. 2 is not labelled "Method of Disposal" followed by particulars. If pars. 2 and 3 are read together they make perfect sense and they set out the means by which the waste was disposed of. Consequently the form in which the agreed facts were set out does not lead me to reverse my view that the production, and consequent seepage of gas, was part of the method of disposal of the waste.

I would, therefore for my part dismiss the appeal.

COURT OF APPEAL

July 26, 27 and 30, 1993

ARBUTHNOTT
v.
FAGAN
DEENY
v.
GOODA WALKER LTD.

Before Sir THOMAS BINGHAM, M.R., Lord Justice STEYN and Lord Justice HOFFMANN

Lloyd's litigation — Standard agency agreement — Construction — Names claimed damages for breach of contract and tort in the conduct of underwriting — Agents alleged Names who had not complied with cash calls not entitled to bring proceedings — Whether claims arising from negligent underwriting related to cash calls.

All the plaintiffs were Lloyd's Names and the relevant defendants were those Names' members' agents and (in the Gooda Walker action) their managing agents.

The Names and members' agents were parties to a standard agency agreement in the form mandatorily prescribed by Lloyd's Agency Agreements Byelaw 1 of 1985 which provided inter alia:

> 9 Undertaking by the Name to pay all liabilities and outgoings.
>
> . . . (c) It shall be a condition precedent to the issue of proceedings . . . by the Name in respect of any matter arising out of or in any way connected with the making of [the] requirement by the Agent [that the Name shall keep the Agent at all times in funds available for the payment of the liabilities expenses and outgoings of the underwriting business] . . . that the Name shall have duly complied with any such requirement made or purported to be made by the Agent . . .

Sub-clause (a) provided that the Name had to keep the agent in funds to enable the agent to meet the liabilities expenses and outgoings of the underwriting business and that it was for the agent alone to decide what sum was needed for those purposes. Sub-clause (b) obliged the Name promptly to pay any sum required by the agent in full and without deduction of any kind; and should the agent issue proceedings to enforce any requirement the Name agreed to forgo any right to plead any set-off, counterclaim or deduction or to claim a stay of execution or to resist the enforcement of any judgment.

In the Feltrim action the Names sued their members' agents claiming damages for breach of contract in the conduct of underwriting for four syndicates relating to the underwriting years 1987-1989 inclusive.

In the Gooda Walker action the Names sued their members' agents for damages for breach of contract

and tort in the conduct of underwriting for four (different) syndicates during the years 1988 and 1989. The same form of agreement as in the Feltrim action governed relations between the Names and their members' agents during that period. A further claim was made by these Names relating to the 1990 year, against the Names' members' agents and also their managing agents. Against the former it was made under the Standard Members' Agents Agreement prescribed by Lloyd's Agency Agreements Byelaw 8 of 1988, and against the letter under the Standard Managing Agents Agreement prescribed by the same byelaw. These forms of agreement came into force for the year 1990 onwards and cl. 7.1 of the 1990 form of standard agreement was of similar effect to cl. 9 of the 1985 agreement.

The agents submitted that the Name's claims in the action for loss and damage related directly to and were founded on the cash requirements made upon the Names for the purposes of the underwriting business and that by virtue of cl. 9(c) the Names were precluded from bringing proceedings in respect of such claims, when the damages they sought to claim related to a requirement for underwriting liabilities or expenses made on them which they had not met.

The Names argued that although cl. 9(c) precluded a Name from making any legal challenge to the requirement or to its substance (i.e., the agent's assessment of the liabilities, expenses and outgoings of the underwriting business) until he had paid the sum called for, their claims arising from negligent underwriting were not related to cash calls made against them.

——*Held*, by SAVILLE, J., that the Names were entitled to bring the actions; the claims arising from negligent underwriting were not related to cash calls made against them.

The agents appealed.

——*Held*, by C.A. (Sir THOMAS BINGHAM, M.R., STEYN and HOFFMANN, L.JJ.), that (1) the purpose of cl. 9(c) was to protect policyholders; the objective was that valid claims of policyholders should be paid promptly; and the duty of the Name to pay sums required by the agent without prevarication or deduction or delay was stated clearly and unequivocally (*see* p. 138, col. 2; p. 139, col. 1; p. 140, col. 1; p. 141, cols. 1 and 2);

(2) sub-cl. (a) empowered the agent to create the autonomous obligation; sub-cl. (b) prevented the Name from using matters arising between him and the agent as a defence and sub-cl. (c) prevented the Name from actively impugning the validity or enforceability of the obligation; the proceedings brought by the Names did not fall within sub-cl. (c); they were not calculated to challenge, invalidate or block the enforcement of cash calls; the Names applied to pursue claims for negligence by the agents in the conduct of the underwriting business; these claims were not for the purposes of cl. 9 connected with the cash calls and the appeal would be dismissed (*see* p. 139, cols. 1 and 2; p. 141, cols. 1 and 2; p. 142, cols. 1 and 2);

(3) although there were differences between cl. 9(c) and cl. 7.1(e), those differences were immaterial and the appeal in the Gooda Walker action in respect to the 1990 year would be dismissed (*see* p. 139, cols. 1 and 2; p. 141, col. 2).

The following cases were referred to in the judgments:

Attorney-General v. Prince Ernest Augustus of Hanover, (H.L.) [1957] A.C. 436;

Boobyer v. Holman & Co. Ltd., [1993] 1 Lloyd's Rep. 96;

Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen, (H.L.) [1976] 2 Lloyd's Rep. 621; [1976] 1 W.L.R. 989.

This was an appeal by the members' agents in the Feltrim action represented by Mr. Patrick Feltrim Fagan and in the Gooda Walker action, Gooda Walker Ltd, and the managing agents in the Gooda Walker action Gooda Walker Ltd. from the decision by Mr. Justice Saville given in favour of the Names, represented by Mr. Hugh Sinclair Arbuthnott in the Feltrim action and by Mr. Michael Eunan McLarnon Deeny in that Gooda Walker action and holding in effect that the Names were not precluded by cl. 9 of the Standard Agency Agreement from bringing claims against the members' agents for damages for breach of contract and tort in the conduct of underwriting for four syndicates.

Mr. Bernard Eder, Q.C. and Mr. D. Foxton (instructed by Messrs. Elborne Mitchell) for the Feltrim agents; Mr. Bernard Eder, Q.C. and Mr. Simon Bryan (instructed by Messrs. Elborne Mitchell) for the Gooda Walker agents; Mr. Anthony Boswood, Q.C. and Mr. S. Moriarty (instructed by Messrs. Richards Butler) for the Arbuthnott Names; Mr. Jonathan Mance Q.C. and Mr. David Lord (instructed by Messrs. Wilde Sapte) for the Deeny Names.

The further facts are stated in the judgment of Sir Thomas Bingham, M.R.

JUDGMENT

Sir THOMAS BINGHAM, M.R.: This appeal, against a decision of Mr. Justice Saville given on May 13, 1993, raises an issue of construction. All the plaintiffs are Lloyd's Names. The relevant defendants are these Names' members' agents and also (in the Gooda Walker action) their managing agents. The issue of construction arises from the agreements between the Names and these agents.

In the Feltrim action the Names sued their members' agents claiming damages for breach of contract in the conduct of underwriting for four syndicates. The claim related to three underwriting years (1987–89 inclusive). During that period the

Names and the members' agents were parties to a standard agency agreement in the form mandatorily prescribed by Lloyd's Agency Agreements Byelaw No. 1 of 1985. For purposes of this appeal the crucial provision of that agreement is cl. 9. After 1989 that form of agreement was superseded.

In the Gooda Walker action the Names sued their members' agents for damages for breach of contract and tort in the conduct of underwriting for four (different) syndicates during the years 1988 and 1989. The same form of agreement as in the Feltrim action governed relations between the Names and their members' agents during that period and the construction of cl. 9 is accordingly in issue in this action also. But a further claim has been made by these Names relating to the 1990 underwriting year. It has been made against the Names' members' agents and also their managing agents. Against the former it was made under the standard members' agents' agreement prescribed by Lloyd's Agency Agreements Byelaw No. 8 of 1988 and against the latter under the standard managing agents' agreement prescribed by the same byelaw. These forms of agreement came into force for the year 1990 onwards. In this action an issue also therefore arises on the construction of cl. 7.1 of the 1990 form of standard managing agents' agreement.

Although these factual distinctions exist between the Feltrim and Gooda Walker actions, and although cl. 7.1 of the later agreement does not exactly reproduce the language of cl. 9 of the earlier agreement, it is only very faintly suggested that the two clauses are, for any purpose relevant to this appeal, to be differently construed and I do not think there is any ground for doing so. It is therefore convenient to confine attention to one of the clauses and I turn to cl. 9 as the clause under which most of the pleaded claims have been made.

Clause 9 is headed "Undertaking by the Name to pay all liabilities and outgoings" and its first three sub-clauses read as follows:

> (a) The Name shall keep the Agent at all times in funds available for the payment of the liabilities, expenses and outgoings of the underwriting business. All such funds and any other monies for the time being held on the Name's behalf may in the absolute discretion of the Agent be paid or applied in or towards the discharge of such liabilities, expenses and outgoings provided that in the case of expenses and outgoings incidental to the conduct of the underwriting business they are proper and reasonable in incidence and amount. The Agent shall have an unfettered discretion in determining the funds from time to time required from the Name for the purpose of making any such payments as aforesaid, and the Agent shall be the sole judge both as to the existence and as to the amount (or the estimated amount) of any such liability, expense or outgoing. The Agent shall be under no liability to make any such payments otherwise than out of assets for the time being held for the account of the Name; but should the Agent nevertheless do so, the Name shall reimburse the Agent in respect thereof.
>
> (b) The Name shall pay any funds required by the Agent under sub-clause (a) of this Clause free from and clear of any set-off, counterclaim or other deduction on any account whatsoever and promptly within such period for payment as the Agent may in its discretion specify in its requirement; and in respect of such payment time shall be of the essence. The Name hereby agrees that no such set-off, counterclaim or deduction shall be a defence to any proceedings instituted by the Agent to enforce a requirement, and the Name waives stay of execution and consents to the immediate enforcement of any judgment obtained in such proceedings.
>
> (c) It shall be a condition precedent to the issue of proceedings or the making of any reference to arbitration by the Name in respect of any matter arising out of or in any way connected with either the making of such requirement by the Agent or the subject matter thereof, or the preparation or audit of the accounts referred to in Clause 6, that the Name shall have duly complied with any such requirement made or purported to be made by the Agent, and no cause of action in respect of any such matter shall arise or accrue in favour of the Name until such requirement shall have in all respects been duly complied with. At no time shall the Name seek injunctive or any other relief for the purpose (or which has the result) of preventing the Agent from making or enforcing any such requirement or of preventing the Agent or any sub-agent from applying any money or assets for the time being held by them respectively on behalf of the Name in or towards the discharge of the liabilities, expenses and outgoings of the underwriting business.

"The underwriting business" referred to in sub-cl. (a) is defined in cl. 2(a) of the agreement to mean:

> . . . underwriting at Lloyd's for the account of the Name such classes and descriptions of insurance business, other than those prohibited by the Council, as may be transacted by the Syndicate.

"The Syndicate", by virtue of cl. 1(a), means the syndicate or syndicates of which the Name is a member.

Sub-clauses (a) and (b) are not directly in issue in this appeal, but they provide the essential prelude to sub-cl. (c), which is. Sub-clause (a) contains two important stipulations: that the Name must keep the agent in funds to enable the agent to meet the liabilities, expenses and outgoings of the underwriting business as defined; and that it is for the agent alone (subject no doubt to a duty of honesty: *Boobyer v. Holman & Co. Ltd.*, [1993] 1 Lloyd's Rep. 96) to decide what sum is needed for those purposes. Sub-clause (b) obliges the Name promptly to pay any sum required by the agent in full and without deduction of any kind. Should the agent issue proceedings to enforce any requirement, the Name agrees to forgo any right to plead any set-off, counterclaim or deduction or to claim a stay of execution or to resist the enforcement of any judgment.

So one comes to sub-cl. (c). The agents draw attention to the Names' claims in the actions and suggest that the loss and damage claimed relate directly to and are founded upon the cash requirements made upon the Names for purposes of the underwriting business. They accordingly submit (1) that a Name who has not met a requirement made for a particular syndicate for a particular year of account has no cause of action and cannot bring proceedings for breach of contract or negligence in respect of that syndicate and that year of account; and (2) that in any event a Name has no cause of action and is precluded from bringing proceedings in respect of claims for breach of contract or duty when the damages which he seeks to claim relate to a requirement made upon him for underwriting liabilities or expenses which he has not met.

It appears that before the Judge the agents put their case more broadly, but I have quoted the submission as put in the skeleton argument provided to this Court.

The Names contend that sub-cl. (c) has an altogether more limited purpose: to preclude the Name from making any legal challenge to the making of a requirement or to its substance (i.e., the agent's assessment of the liabilities, expenses and outgoings of the underwriting business) until he has paid the sum called for. But while accepting that such a challenge is precluded the Names deny that their claims arising from negligent underwriting are, or need be, related to cash calls made against them.

Mr. Justice Saville preferred the Names' construction, basing himself both on the language of the sub-clause and on its wider commercial purpose.

As always on an issue of this kind, the parties have, very properly, analysed the precise language of cl. 9(c) in great detail in order to identify every possible pointer to the true construction of the sub-clause. I do not in any way disparage this exercise, but nor do I think it necessary to rehearse the detailed arguments advanced. For in my view the construction of the sub-clause is plain and is that for which the Names contend.

Access to funds with which to settle valid claims by policyholders is the life-blood of any insurance business. Under the Lloyd's régime the members' or managing agent has a wide discretion to determine the sum necessary to fund the conduct of the underwriting business, including the payment of claims, which he may demand from the Name and the Name must pay at once. The settlement of claims is not to be deferred while Names and members' or managing agents squabble among themselves. So the Name agrees, if sued, to forgo all defences and all procedural devices which may defeat or delay enforcement of the claim for the sum demanded. So far, as already stated, the draftsman's intention is clear and uncontroversial. But the draftsman was plainly alive, as any experienced lawyer would be, to another risk: that the Name might himself initiate legal proceedings to challenge the demand, whether on procedural or substantial grounds, or attack the audit on which it was based, or might have recourse to the Courts to seek to prevent such demand being made in the first place. These possible escape routes also the draftsman was, as I infer, plainly determined to block. Clause 9(c) was his way of doing so.

Mr. Eder, for the members' and managing agents, argued that the Names' construction failed to give effect to the full terms of the sub-clause, part of which would on that basis be superfluous. He may have been right, but I do not find the point persuasive even if correct. In drafting a clause of this kind a draftsman's primary concern is not to avoid repetition (he may even think it desirable to make explicit what would anyway be implicit) but at all costs to avoid leaving loopholes which an unscrupulous party might exploit, even if this does lead to repetition.

Much more persuasive, to my mind, is the care taken by the draftsman to define the rights of suit which the Name is precluded from making until he has paid. These are "in respect of any matter arising out of or in any way connected with either the making of such requirement by the agent or the subject matter thereof", and "the preparation or audit of the accounts," and "in respect of any such matter" and "preventing the making or enforcing any such requirement". In other words, the Name is precluded from exercising litigious rights relating to the agent's requirement (whether as to procedure or substance) and its accounting basis. Had the intention been to restrict the rights of the Names in the sweeping manner contended for by the agents

much broader and less specific language would have been appropriate and would, I feel sure, have been used.

As it is, the scheme of the clause seems to me to be clear and sensible. The duty of the Name to pay sums required by the agent without prevarication or deduction or delay is stated clearly and unequivocally. That reflects the overriding need, acknowledged on all sides, to ensure that funds are available for the prompt settlement of the claims of those who have insured or reinsured at Lloyd's. But that need does not require that Names should forgo all rights to complain of negligent underwriting while there are still calls outstanding and unpaid. There is no necessary connection between forgoing rights to challenge requirements until payment has been made and forgoing rights to complain of negligent underwriting not involving a challenge (on grounds of procedure or substance) to the requirement, and far from seeking to link them the text of the sub-clause is on my reading of it clear in its intention to treat them separately by directing its prohibition to the former situation and not the latter. I am fortified in my preference for the Names' construction by the recognition that the agents' would, as I think, deprive the Names of valuable rights without doing so clearly or for any obvious reason, would in certain situations work severe hardship to the Names without corresponding benefit to the market and would give rise to offensive anomalies.

I would accordingly echo the observation of the learned Judge:

> In my judgment, bearing in mind the purpose of the "pay now, sue later" provisions and the words the parties have chosen to use, neither of the constructions suggested by Mr. Eder is correct.

I agree, on the somewhat different formulation advanced to this Court, both as to cl. 9(c) and cl. 7.1(c). I would accordingly dismiss this appeal and affirm the Judge's answers to the questions put to him.

Courts will never construe words in a vacuum. To a greater or lesser extent, depending on the subject matter, they will wish to be informed of what may variously be described as the context, the background, the factual matrix or the mischief. To seek to construe any instrument in ignorance or disregard of the circumstances which gave rise to it or the situation in which it is expected to take effect is in my view pedantic, sterile and productive of error. But that is not to say that an initial judgment of what an instrument was or should reasonably have been intended to achieve should be permitted to override the clear language of the instrument, since what an author says is usually the surest guide to what he means. To my mind construction is a composite exercise, neither uncompromisingly literal nor unswervingly purposive: the instrument must speak for itself, but it must do so in situ and not be transported to the laboratory for microscopic analysis.

Lord Justice STEYN: I have had the advantage of reading the judgments of the Master of the Rolls and Lord Justice Hoffmann, and I agree with their reasons for concluding that the appeals before us ought to be dismissed. In view, however, of the great importance of the matter for the Lloyd's insurance market, and for those who are involved in it, I will briefly explain why I entertain no doubt that the construction of the "pay now, sue later" provision put forward by the agents in the Feltrim and Gooda Walker actions is demonstrably wrong.

A study of the two sets of points of claim show, and the agents concede, that both actions are based on the premise that the agents acted within their authority and validly committed the Names to insurance liabilities. And the fact that the carrying on of the underwriting business resulted in expenses and outgoings is common ground. The validity of the cash calls made under cl. 9 is not challenged directly or indirectly by the Names. The cases pleaded in the points of claim are confined to assertions that in breach of contract or in breach of the common law duty of care the agents negligently committed the Names to imprudent insurance liabilities, or, alternatively negligently failed to protect the Names by appropriate reinsurances when it would have been prudent to do so. In his careful and incisive speech Mr. Eder, Q.C. emphasized that the fact of cash calls, and the payments made by Names pursuant to the cash calls, must necessarily be part of the evidential material which will be placed before the Court in aid of the quantification of the Names losses. That may be right. But the very deployment of such evidence by the Names will presuppose the acceptance by the Names of validity of the cash calls.

Against this characterization of the proceedings, I turn first to the question whether cl. 9 of the standard agency agreement which is scheduled to the Agency Agreements Byelaw, No. 1 of 1995, Mar. 11, 1985, is apt to preclude such proceedings until the Names have paid the relevant cash calls. The critical provision is cl. 9(c). It adopts a twofold technique: it stipulates for a condition precedent to certain proceedings, and provides that no cause of action "in respect of any such matter shall arise", until the relevant cash call has been paid. It creates a contractual prohibition against the taking of certain proceedings by the Name against the agent. The question is: what proceedings? As the Master of the Rolls has pointed out the answer to that

question is to be found in the meaning of the following words in cl. 9(c):

> ... in respect of any matter arising out of or in any way connected with either the making of such requirement by the Agent or the subject matter thereof, or the preparation or audit of the accounts referred in clause 6 ...

The question is whether these words properly construed cover the proceedings as I have described them.

There are two rival interpretations before the Court. The interpretation advanced on behalf of the plaintiff Names, which was accepted by Mr. Justice Saville, treats cl. 9(c) as creating a prohibition against proceedings challenging the validity of a cash call until the cash call has been paid. The interpretation put forward on behalf of the agents treats cl. 9(c) as prohibiting all proceedings relating to a Names' membership of a particular syndicate for a particular year of account until the Name has paid all cash calls in respect of that syndicate for that year of account.

Mr. Eder emphasized the width of the words —

> ... in respect of any matter arising out of or in any way connected with.

I was unimpressed with this semantic analysis. These words are merely descriptive of the connection between the proceedings and "the making of such requirement by the Agent or the subject matter thereof", the latter being the words upon which Mr. Eder relies. The "making of such requirement" plainly refers to the issue and despatch of a cash call. It cannot assist the agents' argument. That leaves the words "the subject matter thereof". What does "the subject matter of the requirement" mean? On one view it might mean the actual details of the cash call. The Judge concluded that it means the agents' assessment of liabilities, expenses and outgoings which led to the cash call. As a matter of first impression and common sense that is how I would also interpret cl. 9(c) read in the context of cl. 9 as a whole. And the detailed textual analysis undertaken by Mr. Eder does not suggest to me that the agents' extensive interpretation is to be preferred. I am, however, confident that even if cl. 9(c) is capable as a matter of language of accommodating the agents' interpretation it must nevertheless be rejected. In my view the context excludes it as a feasible interpretation.

I regard the purpose of cl. 9(c) as a matter of prime importance. It was common ground at first instance, and again before us, that the only purpose of the provision is to protect policyholders. The objective is that valid claims of policyholders should be paid promptly. It is conceded on behalf of the agents that it was not even a subsidiary purpose of cl. 9(c) to confer a protection on agents for breaches committed by them in and about the underwriting of insurance business.

I readily accept Mr. Eder's submission that the starting point of the process of interpretation must be the language of the contract. But Mr. Eder went further and said that, if the meaning of the words is clear, as he submitted it is, the purpose of the contractual provisions cannot be allowed to influence the Court's interpretation. That involves approaching the process of interpretation in the fashion of a black-letter man. The argument assumes that interpretation is a purely linguistic or semantic process until an ambiguity is revealed. That is wrong. Dictionaries never solve concrete problems of construction. The meaning of words cannot be ascertained divorced from their context. And part of the contextual scene is the purpose of the provision. In the field of statutory interpretation the speeches of the House of Lords in *Attorney General v. Prince Ernest Augustus of Hanover*, [1957] A.C. 436 showed that the purpose of a statute, or part of a statute, is something to be taken into account in ascertaining the ordinary meaning of words in the statute: see Viscount Simonds' speech, at p. 461, and Lord Somervill of Harrow's speech, at p. 473. It is true that such a purpose may also be called in aid at a later stage in the process of interpretation if the language of the statute is ambiguous but it is important to bear in mind that the purpose of the statute is a permissible aid at all stages in the process of interpretation. In this respect a similar approach is applicable to the interpretation of a contractual text. That is why in *Reardon Smith Line Ltd. v. Yngvar Hansen Tangen* [1976] 2 Lloyd's Rep. 621; [1976] 1 W.L.R. 989 Lord Wilberforce, speaking for the majority of their Lordships, made plain that in construing a commercial contract it is always right that the Court should take into account the purpose of a contract and that presupposes an appreciation of the contextual scene of the contract.

Corbin on Contracts, 1960, vol. 3, Section 545, explains the role that the ascertainment of the purpose of a contract should play in the process of interpretation:

> In order to determine purposes we are obliged to interpret their words in the document of agreement and their relevant words and acts extrinsic to that document. It may seem foolish, therefore, to say that the words of a contract should be interpreted in the light of the purposes that the parties meant to achieve, when we can turn on that light only by process of interpretation. Nevertheless, it is believed that such an admonition serves a useful purpose. As the evidence comes in and as interpretation is in process, the court may soon form a tentative

conviction as to the principal purpose or purposes of the parties. As long as that conviction holds (and the court must be ready at all times to be moved by new evidence), further interpretation of the words of contract should be such as to attain that purpose, if reasonably possible.

In the same section of this seminal work the author added that if the Court is convinced that it knows the purpose of the contract, however vaguely expressed and poorly analysed, it should be loath to adopt any interpretation of the language that would produce a different result. In my judgment these observations accurately state the approach to be adopted. And in the present case the purpose of cl. 9(c) is not in doubt.

Given the acknowledged purpose of cl. 9(c) I take the view that it only created a prohibition on legal proceedings calling in question a cash call until that cash call was paid. That is a meaningful interpretation since in the absence of a provision such as cl. 9(c) a Name could challenge a cash call on the ground that it was not made in good faith or upon reasonable grounds. See *Boobyer v. Holman & Co.*, [1993] 1 Lloyd's Rep. 96, at p. 97. And the Names' interpretation ensures that the underlying purpose of cl. 9(c) is fully achieved. After all cl. 9(c) effectively precludes a challenge to a cash call until it is paid. Cash calls directed to Names to pay for liabilities, expenses and outgoings of the underwriting business will therefore be readily collectible by summary judgment.

The implications of the agents' argument that cl. 9(c) precludes the Names from suing the agents for negligence so long as a cash call in respect of the syndicate and year of account remains outstanding generates immediate scepticism. This is an invitation to adopt an interpretation which is at variance with the purpose of cl. 9(c). This interpretation achieves something that is commercially unnecessary and different from the acknowledged purpose of cl. 9(c). It amounts to saying that cl. 9(c) has the co-incidental or collateral effect that the agent is protected against actions in negligence while a cash call remains unpaid. Furthermore, as Mr. Boswood, Q.C. said, the agent's interpretation leads to the extraordinary result that if the agent ruins a Name by negligent underwriting, so that the Name cannot pay the cash call, the contract breaker or tortfeasor goes scot-free. And that result is inimical to the interests of policyholders and the Lloyd's market since the claim against the agent may be an asset available to meet the policyholders' claims. That is so uncommercial and unreasonable a result that words of the greatest precision would be required to achieve it. Clause 9(c) plainly comes nowhere near this.

I would therefore dismiss the appeal in the Feltrim action and in the Gooda Walker action so far as it involves the interpretation of cl. 9(c).

In the Gooda Walker action a similar issue arises in respect of the 1990 underwriting year under cl. 7.1(e) of the standard managing agent's agreement, which is in a form scheduled to the Agency Agreements Byelaw No. 8 of 1988, Dec. 7, 1988. While there are differences between the wording of cl. 9(c), which I have considered, and cl. 7.1(e), the differences are plainly immaterial. For the reasons already given I would also dismiss the appeal in the Gooda Walker action in respect of the 1990 underwriting year.

Lord Justice HOFFMANN: It does not seem to me sensible, or indeed possible, to try to construe cl. 9(c) without regard to the purpose of the clause as a whole. This is particularly true when one is trying to construe so vague an expression as "connected with". Connections may exist in an infinite variety of forms and degrees. Only the context can indicate which of these connections is meant. The need to examine the context is not obviated by the use of intensifiers like "in any way". I accept Mr. Eder's submission that such words indicate an intention that the concept of connection should be broadly construed. But they cannot be read literally, or else they will include connections such as Fluellen found between Harry Monmouth and Alexander of Macedon:

> There is a river in Macedon, and there is also moreover a river at Monmouth . . . and there is salmons in both.

It is therefore still necessary to limit the connections to those which are relevant for the purpose in hand.

The purpose of cl. 9 is clear and uncontroversial. It is designed to insulate the liability of the Name to provide whatever funds are necessary for the underwriting business from the state of accounts between himself and the agent. Such insulation is necessary for the purposes of enabling the Lloyd's market to meet its liabilities. Otherwise the flow of funds needed to pay policyholders' claims may be clogged by disputes within Lloyd's between Names and their agents, to the detriment of the market as a whole.

Clause 9 achieves this result by making a cash call an autonomous source of liability, insulated from the underlying relationship of principal and agent in much the same way as a documentary credit is insulated from the underlying commercial transaction. Clause 9(a) requires the Name to pay whatever sum the agent in his discretion decides is needed to discharge the liabilities of the underwriting business. Clause 9(b) prevents the Name from raising a set-off or counterclaim by way of

defence. Clause 9(c) makes compliance with a cash call a condition precedent to the issue of proceedings—

> . . . in respect of any matter arising out of or in any way connected with the making of such requirement by the Agent or the subject-matter thereof.

The "making of such requirement" means the act of making the call. Its "subject-matter" is the contents of the demand: the amount which the Name is asked to pay and any further information which it contains. What kind of connection do the words "in any way connected with" connote? This is where assistance must be found in the purpose of the clause as a whole. In my view the relevant connection is one which makes the proceedings a challenge to the validity or enforceability of the call. This construction enables the three sub-clauses to constitute a coherent and rational structure: sub-cl. (a) empowers the agent to create the autonomous obligations; cl. (b) prevents the Name from using matters arising between him and agent as a defence and cl. (c) prevents him from actively impugning the validity or enforceability of the obligations.

On this view, the proceedings brought by the Names do not fall within (c). They are not calculated to challenge, invalidate or block the enforcement of the cash calls. The Names acknowledge their liability in respect of those which remain unpaid. In some cases at least, the reason for non-payment is that they have no more money. But they wish to pursue claims for negligence by the agents in the conduct of the underwriting business. In my judgment these claims are not for the purpose of cl. 9 "connected with" the cash calls. The whole purpose of the clause in making the cash call an autonomous obligation is to ensure that there is no such connection.

It seems to me legitimate to test the plausibility of a given construction by examining what the consequences would be. The construction for which the agents contend means that if they are going to be negligent, they should rather ruin their Names entirely than leave them with enough resources to pay their calls. In the latter case they will be exposed to an action for negligence whereas in the former case they will be immune. Mr. Eder said that his startling consequence had to be accepted in the interests of maintaining discipline at Lloyd's and inducing the Names to pay their calls. But his argument cannot apply to those who have no money. And in cases of contumacious refusal to pay, it is hard to see why denial of the right to sue for negligence will be more effective than the undisputed right of Lloyd's to obtain judgment for the unpaid calls.

I think that the construction adopted by the Judge gives full effect to the policy of insulating the call liability from the other rights and duties of Name and agent inter se. I accept that it may also mean, if one analyses the various phrases in detail, that parts of the clause overlap with the effect of other parts and are redundant. In a document like this, however, little weight should be given to an argument based on redundancy. It is a common consequence of a determination to make sure that one has obliterated the conceptual target. The draftsman wanted to leave no loophold for counter-attack by the recipient or intended recipient of a call. It is no justification for construing the language so as to apply to a situation which, on a fair reading of the general purpose of the clause, was not within the target area.

I would therefore dismiss the appeal.

[*Order: Appeal dismissed. Taxed costs to be paid to both sets of plaintiffs forthwith. Leave to appeal to the House of Lords refused.*]

A

[HOUSE OF LORDS]

CHARTER REINSURANCE CO. LTD. . . . . . RESPONDENTS

AND

FAGAN . . . . APPELLANT

B

1995 May 22, 23, 24, 25; June 23 — Mance J.

1995 Sept. 12, 13, 14; Oct. 25 — Nourse, Staughton and Simon Brown L.JJ.

1996 Feb. 21, 22, 26; May 22 — Lord Goff of Chieveley, Lord Griffiths, Lord Browne-Wilkinson, Lord Mustill and Lord Hoffmann

C

Insurance—Reinsurance—Excess of loss—Reinsurers' liability for ultimate net loss in excess of specified amount—Ultimate net loss defined as sum "actually paid" by insurers—Insurers in provisional liquidation—Whether reinsurers liable in respect of claims agreed but not paid—Whether liability of reinsurers dependent on insurers having transferred funds to insured

D

Under two whole account excess of loss reinsurances, the reinsurers undertook to indemnify the insurers against "all losses howsoever and wheresoever arising" during the period of the reinsurance on any interest under policies and contracts of insurance or reinsurance underwritten by the reinsured in their whole account. Under a third policy, an aviation risk policy, the reinsurer agreed to cover the liability of the insurers in respect of the reinsured's aviation excess of loss underwritings during a specified period. All three contracts provided that the reinsurer was to be liable for the losses of the insurers in excess of an ultimate net loss of a specified amount. The term "net loss" (or in the aviation risk policy "ultimate net loss") was defined as meaning "the sum actually paid by the reinsured in settlement of losses or liability after making deductions for all recoveries, all salvages and all claims upon other reinsurances whether collected or not and shall include all adjustment expenses arising from the settlement of claims . . ." The insurers, who were in provisional liquidation, applied, pursuant to R.S.C., Ord. 14A, for determination of the question whether in order for the reinsurers to become liable under the three excess of loss reinsurance agreements, it was necessary for the insurers first to have made payment of the relevant claim by way of transfer of funds to its insured. Mance J. held that it was not. On appeal by the reinsurers, the Court of Appeal (by a majority) dismissed the appeal.

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On appeal by the reinsurer:—

Held, dismissing the appeal, that the words "actually paid" in the context of the ultimate net loss clause did not have the purpose of introducing a temporal precondition to recovery by way of disbursement or other satisfaction of the precise net commitment between the insurer and reinsured but were there merely for the purpose of measurement; and that, accordingly, the question raised by the summons should be answered in the negative (post, pp. 381A–B, 386E–G, 390G–H, 392C–D, 395A–B).

H

Dictum of Lord Reid in *Wickman Machine Tool Sales Ltd. v. L. Schuler A.G.* [1974] A.C. 235, 251, H.L.(E.) considered.

Decision of the Court of Appeal, post, pp. 353F et seq.; [1996] 1 All E.R. 406 affirmed.

A

The following cases are referred to in their Lordships' opinions:

Allemannia Fire Insurance Co. of Pittsburgh v. Firemen's Insurance Co. of Baltimore (1908) 209 U.S. 326

B

British Dominions General Insurance Co. Ltd. v. Duder [1915] 2 K.B. 394, C.A.
Chippendale v. Holt (1895) 1 Com.Cas. 197
Eddystone Marine Insurance Co., In re; Ex parte Western Insurance Co. [1892] 2 Ch. 423
Fidelity & Deposit Co. v. Pink (1937) 302 U.S. 224
Firma C-Trade S.A. v. Newcastle Protection and Indemnity Association (The Fanti) [1987] 2 Lloyd's Rep. 299, Staughton J.; [1991] 2 A.C. 1; [1990] 3 W.L.R. 78; [1990] 2 All E.R. 705, H.L.(E.)

C

Gurney v. Grimmer (1932) 44 Ll.L.Rep. 189, C.A.
Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd. [1985] 1 Lloyd's Rep. 312, C.A.
Stickel v. Excess Insurance Co. of America (1939) 23 N.E.2d 839
Uzielli & Co. v. Boston Marine Insurance Co. (1884) 15 Q.B.D. 11, C.A.
Western Assurance Co. of Toronto v. Poole [1903] 1 K.B. 376
Wickman Machine Tool Sales Ltd. v. L. Schuler A.G. [1974] A.C. 235; [1973] 2 W.L.R. 683; [1973] 2 All E.R. 39, H.L.(E.)

D

The following additional cases were cited in argument in the House of Lords:

Antaios Compania Naviera S.A. v. Salen Rederierna A.B. (The Antaios) [1985] A.C. 191; [1984] 3 W.L.R. 592; [1984] 3 All E.R. 229, H.L.(E.)
Arbuthnott v. Fagan (unreported), 30 July 1993; Court of Appeal (Civil Division) Transcript No. 1024 of 1993, C.A.

E

Birmingham Corporation v. Barnes [1935] A.C. 292, H.L.(E.)
Black King Shipping Corporation v. Massie [1985] 1 Lloyd's Rep. 437
Glasgow Assurance Corporation v. Symondson (1911) 16 Com.Cas. 109
Hill v. Mercantile and General Reinsurance Co. Plc. [1995] L.R.L.R. 160, C.A.
Home and Overseas Insurance Co. Ltd. v. Mentor Insurance Co. (U.K.) Ltd. [1990] 1 W.L.R. 153; [1989] 3 All E.R. 74; [1989] 1 Lloyd's Rep. 473, C.A.

F

Kingsley v. Sterling Industrial Securities Ltd. [1967] 2 Q.B. 747; [1966] 2 W.L.R. 1265; [1966] 1 All E.R. 37; [1966] 2 All E.R. 414, McNair J. and C.A.
Law Guarantee Trust and Accident Society Ltd., In re; Liverpool Mortgage Insurance Co.'s Case [1914] 2 Ch. 617, C.A.
Leader v. Duffey (1888) 13 App.Cas. 294, H.L.(I.)
Palm Shipping Inc. v. Kuwait Petroleum Corporation [1988] 1 Lloyd's Rep. 500

G

Pioneer Shipping Ltd. v. B.T.P. Tioxide Ltd. [1982] A.C. 724; [1981] 3 W.L.R. 292; [1981] 2 All E.R. 1030, H.L.(E.)
Rex v. Inhabitants of St. Nicholas, Rochester (1834) 3 L.J.M.C. 45
Smith v. Cooke; Storey v. Cooke [1891] A.C. 297, H.L.(E.)
Thompson v. Reynolds (1857) 26 L.J.Q.B. 93

The following cases, although not cited in argument, were referred to in the printed cases:

H

Attica Sea Carriers Corporation v. Ferrostaal Poseidon Bulk Reederei G.m.b.H. [1976] 1 Lloyd's Rep. 250, C.A.
Burnand v. Rodocanachi Sons & Co. (1882) 7 App.Cas. 333, H.L.(E.)

A

Castellain v. Preston (1883) 11 Q.B.D. 380, C.A.
Glynn v. Margetson & Co. [1893] A.C. 351, H.L.(E.)
Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen (trading as H.E. Hansen-Tangen) [1976] 1 W.L.R. 989; [1976] 3 All E.R. 570, H.L.(E.)
Société Anonyme Marocaine de l'Industrie du Rauffinage v. Notos Maritime Corporation [1987] 1 Lloyd's Rep. 503, H.L.(E.)
Tarrabochia v. Hickie (1856) 1 H. & N. 183

B

Versicherungs und Transport A.G. Daugava v. Henderson (1934) 49 Ll.L.Rep. 252, C.A.

The following cases are referred to in the judgments of the Court of Appeal:

Allemannia Fire Insurance Co. of Pittsburgh v. Firemen's Insurance Co. of Baltimore (1908) 209 U.S. 326
Antaios Compania Naviera S.A. v. Salen Rederierna A.B. (The Antaios) [1985] A.C. 191; [1984] 3 W.L.R. 592; [1984] 3 All E.R. 229, H.L.(E.)

C

Arbuthnott v. Fagan (unreported), 30 July 1993; Court of Appeal (Civil Division) Transcript No. 1024 of 1993, C.A.
Bahamas International Trust Co. Ltd. v. Threadgold [1974] 1 W.L.R. 1514; [1974] 3 All E.R. 881, H.L.(E.)
Bremer Handelsgesellschaft m.b.H. v. Vanden Avenne-Izegem P.V.B.A. [1978] 2 Lloyd's Rep. 109, H.L.(E.)
British Dominions General Insurance Co. Ltd. v. Duder [1915] 2 K.B. 394, C.A.

D

British Eagle International Airlines Ltd. v. Compagnie Nationale Air France [1975] 1 W.L.R. 758; [1975] 2 All E.R. 390, H.L.(E.)
Eddystone Marine Insurance Co., In re; Ex parte Western Insurance Co. [1892] 2 Ch. 423
Fidelity & Deposit Co. v. Pink (1937) 302 U.S. 224
Firma C-Trade S.A. v. Newcastle Protection and Indemnity Association (The Fanti) [1987] 2 Lloyd's Rep. 299; [1989] 1 Lloyd's Rep. 239, C.A.; [1991] 2 A.C. 1; [1990] 3 W.L.R. 78; [1990] 2 All E.R. 705, H.L.(E.)

E

Gether v. Capper (1855) 15 C.B. 696
Home and Overseas Insurance Co. Ltd. v. Mentor Insurance Co. (U.K.) Ltd. [1990] 1 W.L.R. 153; [1989] 3 All E.R. 74; [1989] 1 Lloyd's Rep. 473, C.A.
Johns, In re; Worrell v. Johns [1928] Ch. 737
Law Guarantee Trust and Accident Society, In re; Godson's Claim [1915] 1 Ch. 340

F

Law Guarantee Trust and Accident Society Ltd., In re; Liverpool Mortgage Insurance Co.'s Case [1914] 2 Ch. 617, C.A.
Palm Shipping Inc. v. Kuwait Petroleum Corporation [1988] 1 Lloyd's Rep. 500
Prenn v. Simmonds [1971] 1 W.L.R. 1381; [1971] 3 All E.R. 237, H.L.(E.)
Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen (trading as H.E. Hansen-Tangen) [1976] 1 W.L.R. 989; [1976] 3 All E.R. 570, H.L.(E.)

G

Segovia Compagnia Naviera S.A. v. R. Pagnan & Fratelli [1977] 1 Lloyd's Rep. 343, C.A.
Utica City National Bank v Gunn (1918) 222 N.Y. 204
Versicherungs und Transport A.G. Daugava v. Henderson (1934) 49 Ll.L.Rep. 252, C.A.
Wickman Machine Tool Sales Ltd. v. L. Schuler A.G. [1974] A.C. 235; [1973] 2 W.L.R. 683; [1973] 2 All E.R. 39, H.L.(E.)

H

The following additional cases were cited in argument in the Court of Appeal:

Attica Sea Carriers Corporation v. Ferrostaal Poseidon Bulk Reederei G.m.b.H. [1976] 1 Lloyd's Rep. 250, C.A.
Black King Shipping Corporation v. Massie [1985] 1 Lloyd's Rep. 437

Dynamics Corporation of America, In re [1976] 1 W.L.R. 757; [1976] 2 All E.R. 669 A
Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd. [1985] 1 Lloyd's Rep. 312, C.A.
Lines Bros. Ltd., In re [1983] Ch. 1; [1982] 2 W.L.R. 1010; [1982] 2 All E.R. 183, C.A.
Tarrabochia v. Hickie (1856) 1 H. & N. 183
Toomey v. Eagle Star Insurance Co. Ltd. [1994] 1 Lloyd's Rep. 516, C.A. B
Vitol B.V. (formerly trading as Vitol Trading B.V.) v. Compagnie Européene des Petroles [1988] 1 Lloyd's Rep. 574

The following cases are referred to in the judgment of Mance J.:

Allemannia Fire Insurance Co. of Pittsburgh v. Firemen's Insurance Co. of Baltimore (1908) 209 U.S. 326 C
Antaios Compania Naviera S.A. v. Salen Rederierna A.B. (The Antaios) [1985] A.C. 191; [1984] 3 W.L.R. 592; [1984] 3 All E.R. 229, H.L.(E.)
Arbuthnot v. Fagan (unreported), 30 July 1993; Court of Appeal (Civil Division) Transcript No. 1024 of 1993, C.A.
Attica Sea Carriers Corporation v. Ferrostaal Poseidon Bulk Reederei G.m.b.H. [1976] 1 Lloyd's Rep. 250, C.A.
Black King Shipping Corporation v. Massie [1985] 1 Lloyd's Rep. 437 D
Boden v. Hussey [1988] 1 Lloyd's Rep. 423, C.A.
British Dominions General Insurance Co. Ltd. v. Duder [1915] 2 K.B. 394
British Eagle International Airlines Ltd. v. Compagnie Nationale Air France [1975] 1 W.L.R. 758; [1975] 2 All E.R. 390, H.L.(E.)
Chippendale v. Holt (1895) 1 Com.Cas. 197
Company No. 0013734 of 1991, In re A [1992] 2 Lloyd's Rep. 415
Dynamics Corporation of America, In re [1976] 1 W.L.R. 757; [1976] 2 All E.R. 669 E
Eddystone Marine Insurance Co., In re; Ex parte Western Insurance Co. [1892] 2 Ch. 423
Fidelity & Deposit Co. v. Pink (1937) 302 U.S. 224
Firma C-Trade S.A. v. Newcastle Protection and Indemnity Association (The Fanti) [1989] 1 Lloyd's Rep. 239, C.A.; [1991] 2 A.C. 1; [1990] 3 W.L.R. 78; [1990] 2 All E.R. 705; [1990] 2 Lloyd's Rep. 191, H.L.(E.)
Home and Overseas Insurance Co. Ltd. v. Mentor Insurance Co. (U.K.) Ltd. [1990] 1 W.L.R. 153; [1989] 3 All E.R. 74; [1989] 1 Lloyd's Rep. 473, C.A. F
Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd. [1985] 1 Lloyd's Rep. 312, C.A.
Law Guarantee Trust and Accident Society, In re; Godson's claim [1915] 1 Ch. 340
Law Guarantee Trust and Accident Society Ltd., In re; Liverpool Mortgage Insurance Co.'s Case [1914] 2 Ch. 617, C.A. G
Leader v. Duffey (1888) 13 App.Cas. 294, H.L.(I.)
Lines Bros Ltd., In re [1983] Ch. 1; [1982] 2 W.L.R. 1010; [1982] 2 All E.R 183, C.A.
Miliangos v. George Frank (Textiles) Ltd. [1976] A.C. 443; [1975] 3 W.L.R. 758; [1975] 3 All E.R. 801; [1976] 1 Lloyd's Rep. 201, H.L.(E.)
Napier and Ettrick (Lord) v. Hunter [1993] A.C. 713; [1993] 2 W.L.R. 42; [1993] 1 All E.R. 385, H.L.(E.) H
Palm Shipping Inc. v. Kuwait Petroleum Corporation [1988] 1 Lloyd's Rep. 500
Pine Top Insurance Co. Ltd. v. Unione Italiana Anglo Saxon Reinsurance Co. Ltd. [1987] 1 Lloyd's Rep. 476

A *Société Anonyme Marocaine de l'Industrie du Raffinage v. Notos Maritime Corporation* [1987] 1 Lloyd's Rep. 503, H.L.(E.)
Socony Mobil Oil Co. Inc. v. West of England Ship Owners Mutual Insurance Association (London) Ltd. (No. 2) [1989] 1 Lloyd's Rep. 239, C.A.; [1991] 2 A.C. 1; [1990] 3 W.L.R. 78; [1990] 2 All E.R. 705; [1990] 2 Lloyd's Rep. 191, H.L.(E.)
Smith v. Cooke; Storey v. Cooke [1891] A.C. 297, H.L.(E.)
B *Stickel v. Excess Insurance Co. of America* (1939) 23 N.E.2d 839
Tarrabochia v. Hickie (1856) 1 H. & N. 183
Toomey v. Eagle Star Insurance Co. Ltd. [1994] 1 Lloyd's Rep. 516, C.A.
Uzielli & Co. v. Boston Marine Insurance Co. (1884) 15 Q.B.D. 11, C.A.
Ventouris v. Mountain [1992] 2 Lloyd's Rep. 281
Versicherungs und Transport A.G. Daugava v. Henderson (1934) 49 Ll.L.R. 252, C.A.
C *Wickman Machine Tool Sales Ltd. v. L. Schuler A.G.* [1974] A.C. 235; [1973] 2 W.L.R. 683; [1973] 2 All E.R. 39, H.L.(E.)

SUMMONS

By a writ and points of claim dated 1 March 1995 the plaintiff insurers, Charter Reinsurance Co. Ltd. (in provisional liquidation), brought an action against the defendant reinsurers, Patrick Feltrim Fagan and all the D other members of Lloyd's Syndicates 540 and 542 for the 1989 and 1990 underwriting years of account, claiming to be indemnified for sums which the insurers had not yet been paid, but which amounts had already been agreed.

By a summons dated 22 May 1995 the insurers applied, pursuant to R.S.C., Ord. 14A, for the determination of the question whether the terms of three excess of loss reinsurance agreements meant that, in order for the E reinsurers to become liable under those contracts, it was necessary for the insurers to have first made payment of the claim by way of transfer of funds to their insured. The summons was heard in chambers, but judgment was given in open court.

The facts are stated in the judgment.

F *Sydney Kentridge Q.C.*, *John Rowland* and *Andrew Neish* for the insurers.

Gordon Pollock Q.C., *Robert Hildyard Q.C.* and *Stephen Ruttle* for the reinsurers.

Cur. adv. vult.

G

28 June 1995. MANCE J. delivered the following judgment.

Introduction

This case concerns the effect of three excess of loss reinsurances incorporating ultimate net loss clauses in standard form in circumstances H where the reinsured is insolvent. The issue is short and I am asked by both parties to determine it under R.S.C., Ord. 14A. Neither party has formally adduced any expert evidence, although I have been shown various sets of standard clause. The reinsurances contain arbitration agreements,

but these have evidently been waived, and did not contain "honourable engagement" clauses. A

The plaintiff is the Charter Reinsurance Co. Ltd. ("Charter") in respect of which provisional liquidators were appointed by order of Blackburn J. on 23 June 1994. The defendant, Mr. Fagan, represents Syndicates 540 and/or 542 ("the syndicates") whose members reinsured Charter for relatively small percentages under the relevant reinsurances. B The issue is whether Charter is entitled to recover under the reinsurances in respect of claims received from its original insureds (or reinsureds) to the extent that Charter has either agreed or been held liable to meet the same, in circumstances where, due to its insolvency, it has not "made payment . . . by way of transfer of funds" to its original insureds or reinsureds. Since insurance and reinsurance claims may be settled in account through market clearing offices, I shall refer in this judgment to C disbursement or other satisfaction, to identify what I perceive to be the real point. The syndicates submit that their liability to indemnify Charter is conditional upon disbursement or other satisfaction of such claims by Charter.

The issue has been raised though not decided in at least two previous cases in recent years involving reinsurances incorporating ultimate net loss clauses reinsuring other insolvent companies. It arose in *Home and* D *Overseas Insurance Co. Ltd. v. Mentor Insurance Co. (U.K.) Ltd.* [1990] 1 W.L.R. 153 and in a subsequent arbitration (the award in which was not put before me), in both of which cases I was myself counsel. It was considered in *In re A Company No. 0013734 of 1991* [1992] 2 Lloyd's Rep. 415, a decision of Mr. Roger Kaye Q.C. sitting as a deputy judge of the Chancery Division. The syndicates' skeleton argument records that the E point is of fundamental market importance, that it involves very large sums of money and that it has wide repercussions; and also that the hearing of this summons has been expedited as a test case and that the Department of Trade and Industry is taking a keen interest in the outcome. One can understand why all of this should be so. Viewed generally the reinsurances appear to be in very typical wordings; the ultimate net loss clauses are in a form originating it appears in the 1930s; F the point raised by the syndicates goes to the root of the application of the reinsurances on an excess of loss basis, particularly, though not exclusively in circumstances where the reinsured may be in financial difficulty, and it has potential regulatory and accounting significance. Insurance company insolvency is no new phenomenon, but its prevalence in recent years and the scale of liabilities and potential reinsurance G recoveries currently involved are probably unprecedented. In the light of these matters, this judgment is given in open court.

The reinsurance contracts

In the last analysis the issue before me is one of construction of each of the three reinsurances, although the ultimate net loss clause is in general use in excess of loss reinsurances. The three reinsurances were underwritten H on a "losses occurring" basis to cover losses occurring during 1989 in the case of the first two and during 1990 in the case of the third. The first two reinsurances, to which both syndicates were party, were evidently part of

A a structure of layered reinsurances and were closely linked by number, date and drafting. In summary, the first gave cover of £2m. (or U.S.$4m. or Can.$4m.) excess of £3m. (or U.S.$6m. or Can.$6m.) each and every loss, while the second gave cover at a higher level of £2·5m. (or U.S.$5m. or Can.$5m.) excess of £7·5m. (or U.S.$15m. or Can.$15m.) each and every loss. They can be taken together since their wording is effectively identical, and accordingly I will set out only relevant extracts from the B first:

"Reinsuring clause

"This Reinsurance is to pay all losses howsoever and wheresoever arising during the period of this Reinsurance on any Interest under Policies and/or Contracts of Insurance and/or Reinsurance underwritten by the Reinsured in their Whole Account. Subject C however to the following terms and conditions.

"Liability clause

"The Reinsurers shall only be liable if and when the Ultimate net Loss sustained by the Reinsured in respect of interest coming within the scope of the Reinsuring Clause exceeds £3,000,000 or U.S. or D Can.$6,000,000 each and every loss and/or Catastrophe and/or Calamity and/or Occurrence and/or Series of Occurrences arising out of one event and the Reinsurers shall thereupon become liable for the amount in excess thereof in each and every loss, but their liability hereunder is limited to £2,000,000 or U.S. or Can.$4,000,000 each and every loss and/or Catastrophe and/or Calamity and/or Occurrence and/or Series of Occurrences arising out of one event.

E "Warranted Reinsurers hereon to have benefit of Specific Reinsurances as per Schedule attached.

"Ultimate net loss clause

"The term 'Net Loss' shall mean the sum actually paid by the Reinsured in settlement of losses or liability after making deductions for all recoveries, all salvages and all claims upon other Reinsurances F whether collected or not and shall include all adjustment expenses arising from the settlement of claims other than the salaries of employees and the office expenses of the Reinsured.

"All Salvages, Recoveries or Payments recovered or received subsequent to a loss settlement under this Reinsurance shall be applied as if recovered or received prior to the aforesaid settlement G and all necessary adjustments shall be made by the parties hereto. Provided always that nothing in this clause shall be construed to mean that losses under this Reinsurance are not recoverable until the Reinsured's Ultimate net Loss has been ascertained.

"Notwithstanding anything contained herein to the contrary, it is understood and agreed that recoveries under all Underlying Excess Reinsurance Treaties and/or Contracts (as far as applicable) are for H the sole benefit of the Reinsured and shall not be taken into account in computing the Ultimate net Loss or Losses in excess of which this Reinsurance attaches nor in any way prejudice the Reinsured's right of recovery hereunder.

"Period of reinsurance clause

"This Reinsurance covers Losses Occurring during the period commencing with 1 January 1989 and ending with 31 December 1989 both days inclusive, Local Standard time at the place where the loss occurs.

"If this Reinsurance should expire whilst a Loss and/or Catastrophe and/or Calamity and/or Occurrence and/or Series of Occurrences arising out of one event is in progress, it is agreed that subject to the other conditions of this reinsurance, the Reinsurers shall pay their proportion of the entire loss or damage provided that the Loss and/or Catastrophe and/or Calamity and/or Occurrence and/or Series of Occurrences arising out of one event commenced before the time of expiration of this Reinsurance.

"Currency clause

"Losses (if any) paid by the Reinsured in currencies other than Sterling, shall be converted into Sterling at the rate of exchange ruling at the date of the settlement of loss or losses by the Reinsured other than losses paid in U.S. or Can. Dollars which will be paid in those currencies.

"Losses discovered or claims made clause

"It is understood and agreed that as regards losses arising under Policies and/or Contracts covering on a 'losses discovered' or 'claims made' basis, that is to say policies and/or contracts in which the date of discovery of the loss or the date when the claim is made determines under which policy or contract the loss is collectible such losses are covered hereunder irrespective of the date on which the loss occurs provided that the date of the discovery of the loss, in respect of Policies and/or Contracts on a 'losses discovered' basis or the date the claim is made in respect of Policies and/or Contracts on a 'claims made' basis, falls within the period of this Reinsurance.

"For the purpose of the foregoing the date of the first discovery of a loss occurrence or the date a claim is first made shall be the date applicable to the entire loss and the Reinsurers shall be liable for their proportion of the entire loss irrespective of the expiry date of this Reinsurance provided that such date falls within the period of this Reinsurance.

"Aviation settlements clause (in respect of Aviation business)

"All loss settlements by the Reassured including compromise settlements and the establishment of Funds for the settlement of losses shall be binding upon the Reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts (or as provided for in the Extra Contractual Obligations Clause hereof) and within the terms and conditions of this Contract. However, where the Reinsured acts in the capacity as a Leading Underwriter on the business protected by this Contract and is called upon to establish a Fund in respect of a loss or losses which may form the whole or part of a claim within the terms and conditions of this Contract (including provisional collections in respect of Claims

A which ultimately may not be recoverable hereon) such Fund shall only be binding upon the Reinsurers subject to prior notice being given and agreement obtained from Leading Lloyd's Underwriter and Leading Company hereon if this Contract is affected by the establishment of such Fund.

"For the purposes of this clause the term 'Leading Underwriter' shall be understood to mean those underwriters involved in negotiating B the establishment of the Fund.

"Claims clause

"In the event of loss which may cause a claim under this Policy, the Reinsured shall give immediate notice to the Reinsurers, but inadvertent error or omission of such notification shall not prejudice this Policy. All loss settlements by the Reinsured shall be binding C upon the Reinsurers provided that such settlements are within the terms and conditions of the Original Policies and within the terms and conditions of this policy and the Reinsurers shall pay the amounts due from them upon reasonable evidence of the amounts paid being given by the Reinsured.

"The amount of the Reinsurers' liability hereunder in respect of D any loss or losses shall not be increased by reason of the inability of the Reinsured to collect from any other Reinsurers (whether specific or general) any amounts which may have become due from them whether such inability arises from the insolvency of such other Reinsurers or otherwise."

E The third reinsurance for 1990, to which Syndicate 540 alone was a party (presumably because it concerned aviation business), is different in important respects. It reads as follows:

"Article 1—Interest clause

"This Reinsurance is to cover the liability of the Reinsured arising under Policies and/or Contracts of Reinsurance in respect of the Reinsured's Aviation Excess of Loss Underwritings, including the F risks of War, Civil War and Allied Perils as and if in original.

"Notwithstanding the foregoing, this Reinsurance shall exclude:
Aviation Losses emanating from other departments.
Satellite business other than Liability.

"Article 3—Period clause

G "This Reinsurance attaches and covers in respect of all losses occurring during the period 12 months commencing with the 1st January, 1990 and ending with the 31st December, 1990 both days inclusive.

"Article 4—Extended expiration clause

"Reinsurers agree that if this Reinsurance should expire whilst a H loss, as defined herein, is in progress, then it is agreed that subject to the other conditions of this Reinsurance, Reinsurers shall be liable as if the Whole Loss had occurred during the currency of this Reinsurance.

"Article 6—Territorial scope A

"This Reinsurance shall apply in respect of all losses wheresoever occurring.

"Article 7—Reinsuring clause

"This Reinsurance is to Indemnify the Reinsured, subject to its provisions, for all losses which may be sustained by the Reinsured in excess of an Ultimate net Loss of £28,000,000 or U.S. or B Can.$56,000,000 or equivalent in other currencies each and every loss, as defined herein, up to a further £2,500,000 or U.S. or Can.$5,000,000 each and every such loss.

"Notwithstanding the foregoing Reinsurers shall also be liable for any amount up to the sum reinsured hereunder by which the Reinsured's Ultimate net Loss exceeds £6,000,000/$12,000,000 each C and every loss etc. as defined after all possible recoveries have been made under the Reinsured's underlying Excess Loss Programmes as Schedule.

"Article 8—Original aviation loss warranty clause

"This Reinsurance shall only apply to a claim (or claims) where the 'Total Original Incurred Aviation Loss' (or Losses) is equal to or D exceeds U.S.$50,000,000 or the equivalent in any other currency based upon the reserve in the London Aviation Market, as defined hereunder, at the time of the claim hereunder.

"Nothing in this clause shall mean that loss (or losses) are not recoverable hereon until the 'Total Original Incurred Aviation Loss' has been finally determined and paid. The Reinsured specifically agrees to return all claims monies received from Reinsurers hereon as E soon as practicable, in respect of any loss (or losses) which (a) is finally determined at below U.S.$50,000,000 or equivalent in any other currency or (b) when the reserve, as defined hereunder, is reduced to below U.S.$50,000,000 or equivalent in any other currency, whichever the sooner.

"The term 'Total Original Incurred Aviation Loss' shall mean the F insured loss of the Hull (or Hulls) involved in the loss (or losses), whether insured in the Aviation Market or otherwise, before the deduction of any excess or co-insurance retained by the Original Insured, if any, plus the total of all liabilities to passengers and third parties (excluding Personal Accident Insurance and Workman's Compensation Act payments) whether the amounts have been paid or promised to be paid or reserved whilst under negotiation or dispute G with the original Claimant(s). Such amounts being determined by the Leading London Aviation Market Slip Insurers or Reinsurers in conjunction with their Adjusters, Attorneys or Solicitors and shall be inclusive of all loss costs and expenses of adjustment, defence or representation directly or indirectly attributable to the Original Loss (or Losses) coming within the definition of loss hereunder. In the H event of no London Aviation Market reserve, the reserve for the purposes of this clause shall be that amount as advised to the Original Underwriters as an estimate of their liability by their Adjusters, Attorneys or Solicitors.

A "Notwithstanding anything contained herein to the contrary all loss reserves, as defined above, are to be agreed by the Leading Underwriter hereon.

"This clause shall be subject to the general terms, limits and conditions of this Reinsurance and the foregoing provisions shall take precedence in the event of any inconsistency.

B "Article 9—Definition of loss clause

"For the purposes of this Reinsurance the term 'each and every loss' shall be understood to mean loss and/or accident and/or occurrence and/or catastrophe and/or calamity and/or series thereof arising out of one event.

"Article 10—Ultimate net loss clause

C "The term 'Ultimate net Loss' shall mean the sum actually paid by the Reinsured in settlement of losses or liability after making deductions for all recoveries, all salvages and all claims upon other Reinsurances whether collected or not and shall include all adjustment expenses arising from the settlement of claims other than the salaries of employees and the office expenses of the Reinsured.

D "All Salvages, Recoveries and Payments recovered or received subsequent to a loss settlement under this Reinsurance shall be regarded as if recovered or received prior to the said settlement and all necessary adjustment shall be undertaken by the parties hereto.

"Nothing, however, in this clause shall be construed to mean that losses are not recoverable from Reinsurers until the Ultimate net Loss to the Reinsured has been determined.

E "Notwithstanding anything contained herein to the contrary, it is understood and agreed that recoveries under all underlying Reinsurances (as far as applicable) are for the sole benefit of the Reinsured and shall not be taken into account in computing the Ultimate net Loss or Losses in excess of which this Reinsurance attaches, nor in any way prejudice the Reinsured's right of recovery hereunder.

F "Article 14—Notification of loss and settlements clause

"In the event of a loss which may give rise to a claim hereunder the Reinsured shall give notice to the Reinsurers through the Broker for this Reinsurance as soon as practicable.

G "All loss settlements by the Reinsured including compromise settlements and the establishment of funds for the settlement of losses shall be binding upon the Reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts (or as provided for in the Extra Contractual Obligations Clause hereof) and within the terms and conditions of this Reinsurance.

H "Article 15—Currency conversion clause

"All transactions hereunder shall be conducted in Sterling, United States Dollars and Canadian Dollars, the limit and retentions hereunder in United States and Canadian Dollars being the equivalent

of the relevant amounts as set forth in Article 7 exchanged at the rate of $2 = £1. A

"For the purpose of this Reinsurance all claims paid by the Reinsured in currencies other than Sterling, United States Dollars or Canadian Dollars shall be converted into Sterling at the rates of exchange at which such items are entered in the Reinsured's books.

"Where a loss involves payments in both United States and Canadian Dollars, the total number of dollars payable hereunder shall first be determined with the Reinsured's loss in the two currencies added together. The amount so determined shall then be paid by the Reinsurers in the two currencies in the proportion that the United States and Canadian Dollar loss bears to the Total Ultimate net Loss. B

"Where a loss involves payments in United States and/or Canadian Dollars and Sterling, the total amount payable hereunder shall first be determined in Sterling with the Reinsured's Ultimate net Loss in United States and/or Canadian Dollars converted at the rate of $2 = £1. The amount due from Reinsurers having been thus determined the Reinsurers shall pay that amount in United States Dollars, Canadian Dollars and Sterling in the same proportion as the Dollar and Sterling Loss bears to the total Ultimate net Loss. C D

"Article 18—Reinsurance clause

"This Reinsurance shall be deemed to be subject to the same terms, clauses and conditions as the Original Policies as far as they may be applicable hereto, and shall pay as may be paid thereon, but subject nevertheless to the terms and conditions of this Reinsurance. E

"Article 22—Special cancellation clause

"Either party shall have the right to terminate this Reinsurance immediately by giving the other party notice by Telex or Telegram and shall be deemed to be served upon despatch or where communication between the parties are interrupted upon attempted despatch. (i) If the performance of the whole or any part of this Reinsurance be prohibited or rendered impossible de jure or de facto in particular and without prejudice to the generality of the preceding words in consequence of any law or regulation which is or shall be in force in any country or territory or if any law or regulation shall prevent directly or indirectly the remittance of any payments due to or from either party. (ii) If the other party has become insolvent or unable to pay its debts or has lost the whole or any part of its paid up capital. (iii) If there is any material change in the management or control of the other party. (iv) If the country or territory in which the other party resides or has its head office or is incorporated shall be involved in armed hostilities with any other country whether war be declared or not or is partly or wholly occupied by another power or be in a state of civil war. (v) If the other party shall have failed to comply with any of the terms and conditions of this Reinsurance. F G H

"All notices of termination served in accordance with any of the provisions of this Article shall be addressed to the party concerned at

A its head office or at any other address previously designed by the party.

"The Reinsurer shall remain liable for losses occurring up to and including the date of termination. Thereafter the liability of the Reinsurers shall cease outright other than so far as outstanding claims are concerned.

"In the event of this Reinsurance being terminated in accordance B with the provisions of the Article the exact premium payable hereunder shall be based on the premium income figure for the period from inception to the effective date of termination and shall be subject to a minimum premium calculated on the amount specified in Article 17 pro rata for the effective period."

C *The correct approach to construction*

The parties' submissions adopt different approaches to the issues of construction which arise. The syndicates say that the words of the contracts alone are so clear that any further thought about their implications or aid to their true construction is not only unnecessary but wholly inappropriate; they cite words of Lord Halsbury L.C. in *Leader v. Duffey* (1888) 13 App.Cas. 294 (a case concerning a marriage settlement) D and *Smith v. Cooke; Storey v. Cooke* [1891] A.C. 297 (a case concerning a deed of assignment of a partnership business and property). Charter submit that construction should never be a wholly abstract or literal exercise, divorced from any consideration of context or practical implications. On the one hand, the court should not approach the construction of any contract with notions of principle or reasonableness E conceived in the abstract and seek to force the provisions of a particular contract into that straitjacket: *per* Saville J. in *Palm Shipping Inc. v. Kuwait Petroleum Corporation* [1988] 1 Lloyd's Rep. 500, citing an earlier dictum of Lord Goff of Chieveley to like effect in *Société Anonyme Marocaine de l'Industrie du Raffinage v. Notos Maritime Corporation* [1987] 1 Lloyd's Rep. 503, 506. On the other hand, there is a wealth of authority, which is of particular relevance in the commercial context, that the court F should seek to place itself in the same matrix as the parties were when contracting and to understand their general aim, objectively assessed, and that considerations of reasonableness or "commerciality" can play an important role in this exercise. Mr. Kentridge cited passages from *Antaios Compania Naviera S.A. v. Salen Rederierna A.B. (The Antaios)* [1985] A.C. 191, 200–201 and *Wickman Machine Tool Sales Ltd. v. L. Schuler* G *A.G.* [1974] A.C. 235, the familiarity of which in no way detracts from their forcefulness on rereading in the present connection.

For my part, I adopt and apply recent guidance given in the Court of Appeal in the unreported authority in *Arbuthnott v. Fagan* (unreported), 30 July 1993; Court of Appeal (Civil Division) Transcript No. 1024 of 1993 where a similar issue about the correct approach to construction arose. The context was the wording of the standard form of agency H agreement prescribed by Lloyd's byelaw prior to 1989; the language made it, according to the underwriting agencies, a condition precedent to the accrual of any cause of action against a particular agency in respect of a particular syndicate and year that the Name must first pay all calls made

upon him or her for underwriting expenses or liabilities in respect of that syndicate and year. This defence failed. Sir Thomas Bingham M.R. said, on construction:

"Courts will never construe words in a vacuum. To a greater or lesser extent, depending on the subject matter, they will wish to be informed of what may variously be described as the context, the background, the factual matrix or the mischief. To seek to construe any instrument in ignorance or disregard of the circumstances which gave rise to it or the situation in which it is expected to take effect is in my view pedantic, sterile and productive of error. But that is not to say that an initial judgment of what an instrument was or should reasonably have been intended to achieve should be permitted to override the clear language of the instrument, since what an author says is usually the surest guide to what he means. To my mind construction is a composite exercise, neither uncompromisingly literal nor unswervingly purposive: the instrument must speak for itself, but it must do so in situ and not be transported to the laboratory for microscopic analysis."

Steyn L.J. said:

"I readily accept Mr. Eder's submission that the starting point of the process of interpretation must be the language of the contract. But Mr. Eder went further and said that, if the meaning of the words is clear, as he submitted it is, the purpose of the contractual provisions cannot be allowed to influence the court's interpretation. That involves approaching the process of interpretation in the fashion of a black-letter man. The argument assumes that interpretation is a purely linguistic or semantic process until an ambiguity is revealed. That is wrong. Dictionaries never solve concrete problems of construction. The meaning of words cannot be ascertained divorced from their context. And part of the contextual scene is the purpose of the provision. In the field of statutory interpretation the speeches of the House of Lords in *Attorney-General v. Prince Ernest Augustus of Hanover* [1957] A.C. 436 showed that the purpose of a statute, or part of a statute, is something to be taken into account in ascertaining the ordinary meaning of words in the statute: see Viscount Simonds's speech, at p. 461, and Lord Somervell of Harrow's speech, at p. 473. It is true that such a purpose may also be called in aid at a later stage in the process of interpretation if the language of the statute is ambiguous but it is important to bear in mind that the purpose of the statute is a permissible aid at all stages in the process of interpretation. In this respect a similar approach is applicable to the interpretation of a contractual text. That is why in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen (trading as H.E. Hansen-Tangen)* [1976] 1 W.L.R. 989, 996 Lord Wilberforce, speaking for the majority of their Lordships, made plain that in construing a commercial contract it is always right that the court should take into account the purpose of a contract and that presupposes an appreciation of the contextual scene of the contract. *Corbin on Contracts* (1960), vol. 3, section 545, explains the role that the ascertainment of the purpose of a contract

should play in the process of interpretation: 'In order to determine purposes we are obliged to interpret their words in the document of agreement and their relevant words and acts extrinsic to that document. It may seem foolish, therefore, to say that the words of a contract should be interpreted in the light of the purposes that the parties meant to achieve, when we can turn on that light only by process of interpretation. Nevertheless, it is believed that such an admonition serves a useful purpose. As the evidence comes in and as interpretation is in process, the court may soon form a tentative conviction as to the principal purpose or purposes of the parties. As long as that conviction holds (and the court must be ready at all times to be moved by new evidence), further interpretation of the words of contract should be such as to attain that purpose, if reasonably possible.' In the same section of this seminal work the author added that if the court is convinced that it knows the purpose of the contract, however vaguely expressed and poorly analysed, it should be loath to adopt any interpretation of the language that would produce a different result. In my judgment these observations accurately state the approach to be adopted. And in the present case the purpose of clause 9(c) is not in doubt."

Steyn L.J.'s application of this approach is of note:

"The implications of the agents' argument that clause 9(c) precludes the Names from suing the agents for negligence so long as a cash call in respect of syndicate and year account remains outstanding generates immediate scepticism. This is an invitation to adopt an interpretation which is at variance with the purpose of clause 9(c). This interpretation achieves something that is commercially unnecessary and different from the acknowledged purpose of clause 9(c). It amounts to saying that clause 9(c) has the coincidental or collateral effect that the agent is protected against actions in negligence while a cash call remains unpaid. Furthermore, as Mr. Boswood Q.C. said, the agents' interpretation leads to the extraordinary result that if the agent ruins a Name by negligent underwriting, so that the Name cannot pay the cash call, the contract breaker or tortfeasor goes scot-free. And that result is inimical to the interests of policyholders and the Lloyd's market since the claim against the agent may be an asset available to meet the policyholders' claims. That is so uncommercial and unreasonable a result that words of the greatest precision would be required to achieve it. Clause 9(c) plainly comes nowhere near this."

Finally, Hoffmann L.J. said:

"It seems to me legitimate to test the plausibility of a given construction by examining what the consequences would be. The construction for which the agents contend means that if they are going to be negligent, they should rather ruin their Names entirely than leave them with enough resources to pay their calls. In the latter case they will be exposed to an action for negligence whereas in the former case they will be immune. Mr. Eder said that his startling

> consequence had to be accepted in the interests of maintaining discipline at Lloyd's and inducing the Names to pay their calls. But his argument cannot apply to those who have no money. And in cases of contumacious refusal to pay, it is hard to see why denial of the right to sue for negligence will be more effective than the undisputed right of Lloyd's to obtain judgment for the unpaid calls."

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In *Toomey v. Eagle Star Insurance Co. Ltd.* [1994] 1 Lloyd's Rep. 516 Hobhouse L.J. giving the judgment of the court referred to *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen (trading as H.E. Hansen-Tangen)* [1976] 1 W.L.R. 989 for the relevance, in the context of a commercial contract, of its commercial purposes objectively ascertained, and then said, at p. 520:

B

> "It is also necessary that the court should have regard to previous decisions of the courts upon the same or similar wording. Parties to a commercial contract are to be taken to have contracted against a background which includes the previous decisions upon the construction of similar contracts."

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There are features of previous decisions of the courts from which both parties in the present case seek to derive assistance, either by way of confirmation of their position or by way of contrast with the present case.

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Mr. Kentridge further referred me to *Black King Shipping Corporation v. Massie* [1985] 1 Lloyd's Rep. 437, 462–467 for authorities on the principles determining whether a stipulation will be treated as a condition precedent. Hirst J., at p. 462, cited words of Lord Denning M.R. in *Attica Sea Carriers Corporation v. Ferrostaal Poseidon Bulk Reederei G.m.b.H.* [1976] 1 Lloyd's Rep. 250, 253:

E

> "The parties can, by clear words, provide that complete performance of a particular stipulation can be a condition precedent. But, in the absence of clear words the court should look to see which of the rival interpretations gives the more reasonable result."

Lord Denning M.R. then cited Lord Reid's words in *Wickman Machine Tool Sales Ltd. v. L. Schuler A.G.* [1974] A.C. 235. A number of other authorities were cited by Hirst J. from different contexts to the present; many of them, such as *Tarrabochia v. Hickie* (1856) 1 H. & N. 183 to which Mr. Kentridge made particular reference, concern the question whether a particular term should be construed as a condition, warranty or innominate term. I will consider at a later stage to what extent these authorities may assist in the construction of the present contracts.

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Previous English authorities on reinsurance

Whilst the present reinsurances and the issues of construction raised by their terms must be approached without preconceptions, it would be inappropriate to approach them without any awareness of previous English decisions in the field of reinsurance. Some words and phrases used in the present reinsurances have been the subject of authority. Others may be directed to problems which existed or were perceived as existing either when the reinsurances were made or when standard clauses incorporated into them were developed for general use.

H

A Charter relies upon two particular authorities: *In re Eddystone Marine Insurance Co.; Ex parte Western Insurance Co.* [1892] 2 Ch. 423 and *In re Law Guarantee Trust and Accident Society Ltd; Liverpool Mortgage Insurance Co.'s Case* [1914] 2 Ch. 617. They submit that these cases give guidance as to the objects which parties to reinsurance contracts may, at least prima facie, be expected to share, as well as identifying certain commercial considerations to which the courts have in the past attached B significance. In these authorities, on the wordings there under review, courts rejected suggestions that a reinsurer's duty to pay was conditional upon disbursement or satisfaction by its reinsured of incoming insurance claims. The syndicates point to (a) the fact that the wordings there under consideration were in very different form to the present, and (b) the different basis of reinsurance there involved (quota share instead of excess C of loss). In their submission, the present wordings contrast starkly, and in all likelihood quite deliberately, with those the subject of any decided authority, and one reason for this is, they submit, the differing bases of the present reinsurances. The most obvious difference in wording, at the forefront of the syndicates' case, is the incorporation in the present reinsurances of ultimate net loss clauses in standard wording only introduced in the 1930s. But the syndicates also submit that the first two D reinsurances contain other indications of careful drafting designed to make prior disbursement or satisfaction a precondition to any reinsurance recovery, and that the wording of the third reinsurance, though less precise, has the like result. The object of these reinsurances is in their submission clear from the language itself, and should be taken at face value without preconceptions or further debate.

E In the *Eddystone* case [1892] 2 Ch. 423 both parties were in liquidation. Whilst the two companies were going concerns, the former had reinsured the latter for the whole or part of its exposure as insurer of various vessels. In the test case tried the reinsurance was for half the exposure. The reinsurances were expressed, at p. 424, to be "subject to the same terms and conditions as the original policy or policies, and to pay as may be paid thereon." Stirling J. recited the contention of the liquidator that F those words made payment by the reinsured a condition precedent to payment by the reinsurer, and said, at p. 427:

> "Now, a main object of reinsurance is to relieve the reinsured from a portion of the risk previously undertaken by him; and the result of giving effect to the liquidator's contention would be that, before the reinsured obtains the benefit of his reinsurance, he must G himself have paid on the original insurance, even though bankruptcy might be the result. I think that this could not be intended, and that such a construction ought not to be put on the language of the policy unless it is clearly called for. In my opinion the words do not clearly require to be so construed. They would be satisfied if they were held to amount simply to this—that the payment to be made on the reinsurance policy is to be regulated by that to be made on the H original policy of insurance."

Charter relies on these words; it submits that a similar approach is applicable to the present wordings.

In the *Law Guarantee* case [1914] 2 Ch. 617 the company in liquidation had, whilst a going concern, undertaken to debenture holders that principal and interest would duly be paid by the issuer of the debentures. It had then entered into a contract with a mortgage guarantee company for a yearly premium, whereby the latter company guaranteed it in turn to the extent of two-elevenths of its exposure. On the assumption that the original undertaking was an insurance, the latter contract was a reinsurance. Otherwise it was a simple indemnity. The mortgage guarantee company argued that its liability was limited to paying whatever dividend the Law Guarantee Co. might pay in its liquidation to the debenture holders. Whichever view of the contracts with debenture holders was appropriate, the court held that the company in liquidation was entitled to recover in full from the mortgage guarantee company. Dealing with the case as one of insurance and reinsurance, the court pointed out that in the *Eddystone* case no one appeared even to have suggested any contrary argument. All members of the court evidently regarded the consequences of the contrary argument as extreme and unacceptable. The force with which they expressed their views may be of some materiality and I quote some extracts. Buckley L.J. said, at p. 634:

> "I am anxious to point out some consequences which would ensue if the view I have expressed were not the right one. The contrary view is one which makes it to the interest of the company that the society should be insolvent. For to such extent as the society cannot pay in full the argument is that the company are not liable to make payment. It is obvious that such a consideration cannot have entered into the contemplation of the parties in fixing the premium. The company has received a certain premium upon the terms that in an event it shall pay a certain sum. If its liability is reduced to 10s. in the pound, it has received payment of premium as the price of an obligation to pay 20s., but is, by reason of circumstances not material at all so far as the company is concerned, relieved of one half of the liability. If this were true a society whose credit was bad ought to pay a less premium than a society whose credit was good, because the obligation would in the former case result in a smaller liability. The fact is, I suppose, that as matter of business if the credit of the society were bad a larger, not a less, premium would be demanded as the price of the guarantee."

Kennedy L.J. put the matter as follows, at p. 638:

> "As Neville J. points out in the course of his judgment in this case [1913] 2 Ch. 612, if it be held that payment is a condition precedent to recovery, the contract may be of little value to the person to be indemnified, who may be unable to meet the claim in the first instance. If this is true in regard to a contract of indemnity in general, it is certainly true of contracts of insurance and reinsurance, which are essentially contracts of guarantee against loss by an event."

He continued, at pp. 639–640:

> "How the person who receives payment of a sum of money under a contract of insurance or reinsurance, or, I will add, of indemnity,

A B C D E F G H

A deals with that sum is, in general and apart from special considerations, no concern of the party who, in fulfilment of his contract, has made the payment to him. Upon what grounds of equity or legal logic can it be argued that, because the law, on grounds of public policy, compels the creditor, the liability to whom is the event upon which the right of a bankrupt or of an insolvent company to payment of the sum covered by the contract arises, to be content with B such share of the assets of the bankrupt or the company in liquidation as a pari passu distribution between creditors will give, those assets are not to include the payment due under the contract? If the discharge of the liability, against which the contract of insurance or reinsurance was the protection, is not (and I think that it is not) a condition precedent to the right to claim payment of the amount of C the insurance or the reinsurance, upon what ground ought it to be held that, if the person entitled to that payment becomes bankrupt, or, if a company, goes into liquidation, the trustee of the bankrupt or the liquidator of the insolvent company does not have the right to the payment of that amount in full which the bankrupt before his bankruptcy or the company before its liquidation possessed because, when he has received the amount, the law intercepts the asset in his D hands, and compels him to apply it in a particular way as part of the estate divisible amongst all the creditors?"

He continued:

"I do not think that it is true to say that in such a case as the present the party who is entitled makes a profit; he gets only the E amount for the payment of which he bargained in the event which has occurred, and he has paid a premium based upon the risk, in such event, of that amount having to be paid. Buckley L.J. has dwelt in his judgment upon the strange consequences that, as pointed out by the appellants' counsel in their argument before us, would ensue if the argument put forward in the present case on behalf of the company were held to prevail. I agree with him in these criticisms."

F The third member of the court, Scrutton J., said, at pp. 646–647:

"For the insurance company it was said that their contract, whatever it was called, was a contract of indemnity, and that they indemnified the society if they paid it what it had to pay: to pay it more would be to enable the society, or its general creditors, to make G a profit. For the society it was said that the whole object of reinsurance might be to save oneself from bankruptcy in case of claim, but that the contention of the insurance company involved that a person with no assets other than full reinsurance against his insurance liabilities would yet be driven into bankruptcy, and only recover from his reinsurers the nominal dividend his general assets could pay. Premiums on such reinsurances would have to be regulated H not only by the solvency of the original principal debtor, but also by the solvency of the person whose risk was reinsured; the more insolvent the latter was the less the reinsurer would have to pay. And, it was said, how is what the reinsurer is to pay, that is the dividend,

to be ascertained until you know his contribution? His contribution when made will increase the general dividend, and this increase will again increase his contribution. To this it was answered that the rule would be: find what dividend the general assets apart from claims on reinsurers would pay the general creditors apart from those whose claims were reinsured; collect this dividend from such reinsurer. It is perhaps sufficient to say there is no trace of this complicated rule in the policy, and it would not apply to cases where there were no general creditors whose claims were not reinsured. For instance, for simplicity take a man who has only insured one risk of £1,000 and, having no assets, has reinsured his whole risk. He becomes insolvent, and a claim for a total loss accrues on his policy. Left to himself his dividend to his creditor will be nil, and on the argument of the insurance company the amount payable by his reinsurer will be nil. Yet in fact he should remain solvent, his reinsurer providing the funds to satisfy his only debt. The same result would follow if he had 10 fully reinsured policies and 10 losses. If it be said that the society's argument enables the general creditors to make a profit, the answer appears to be that it is not the society's argument, but the operation of law which, though a creditor has a claim which the debtor has reinsured, takes the contribution of the reinsurer and divides it between the general body of creditors, because the creditor has no privity with the reinsurer, and no charge, lien, or equitable security, on his payment to the debtor."

Later, after citing from the *Eddystone* case, he said, at pp. 649–650:

"The judgment may appear to be ambiguous, for the phrase 'the payment to be made' might mean liability or might mean actual payment. It has, however, been held that actual payment without legal liability will not do: *Chippendale v. Holt* (1895) 1 Com.Cas. 197; and Stirling J. says that the contention of the Western Company must prevail. The amount paid before the original insurer has paid can only be the whole liability, and the case is treated by the editors of Arnould on Marine Insurance, 8th ed., p. 422, para. 324, as deciding that the whole amount of liability and not the dividend only is payable. This view of the case has to my knowledge been taken in practice and business. The law in the United States seems to be the same. In *Herckenrath v. American Mutual Insurance Co.*, 3 Barb. Ch. N.Y. 63 in 1848, the Chancellor held that the original assured had no claim for the whole sum received by his insurer from a reinsurer, but only to a dividend. The argument deals with the suggestion that the insurer makes a profit, pointing out that he makes no profit, but the state requires his assets to be distributed in a particular way; he parts with them all. 'It is none the less a loss because they are unable to pay it in full.' The Chancellor cited and apparently approved a decision of the Commercial Court of Marseilles in 1748, cited by Émérigon [Traité des Assurances, vol. i., cap. 8, s. 14, p. 253; translation by Meredith, 1850, p. 202], where the insolvent insurer paid 60 per cent. of the loss, but recovered 100 per cent. of the loss from his reinsurer, the court holding that the reinsurer was bound to

A pay what the original assurer became liable to pay, not what he had actually paid . . . It was suggested in argument that marine policies stood in a peculiar position. Having some acquaintance with them, I do not see why. The insurer reinsures a subject matter, the ship, in which he has an insurable interest, in that if she is lost he will have to pay under his policy. The measure of his loss is not what he pays but what he is liable to pay: *Chippendale v. Holt*."

B

Scrutton J.'s judgment directs attention to another line of authority which is of unquestionable significance to certain parts of the present reinsurances. He had been unsuccessful counsel in *Chippendale v. Holt* (1895) 1 Com.Cas. 197 and was at pains to point out that it established that a simple provision for reinsurers "to pay as may be paid" does not affect the prima facie rule at common law that recovery under a C reinsurance depends upon proof of legal liability (as well as the ascertainment of the reinsured's financial commitment to his original insured by agreement, judgment or award: see e.g. *Versicherungs und Transport A.G. Daugava v. Henderson* (1934) 49 Ll.L.R. 252, 253, 254, *per* Scrutton and Maugham L.JJ.). The subsequent development of ever more comprehensive "follow the settlements" clauses shows however D that insurers generally required, and were able to obtain, cover on a broader basis. This has been analysed in *Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd.* [1985] 1 Lloyd's Rep. 312, (where Scrutton L.J.'s continuing involvement in this area is outlined, at pp. 319–321) and subsequent cases, and was also considered in *Toomey v. Eagle Star Insurance Co. Ltd.* [1994] 1 Lloyd's Rep. 516. Its general purpose and effect is that the reinsured recovers for no more and no less than that for E which he settles with his original insured. He neither profits, nor (provided he acts in a business-like manner) can he face arguments that he has settled with his original insured in circumstances where he had in law or in fact no actual liability. Scrutton J.'s remarks about "actual payment" in the *Law Guarantee* case [1914] 2 Ch. 617, 649 were thus designed to emphasise that, at that date, insurers could not look to their reinsurers F (using modern terminology) "to follow their settlements," but had to establish legal liability; he was not concerned with the distinction between settlement and satisfaction which is material in the present case.

Detailed analysis of the present reinsurance contracts

(a) The subject matter of reinsurance

G I turn to the wording of the reinsurances. Each starts with a clause identifying the general nature of the cover afforded, described as a reinsuring clause in the first two contracts and an interest clause in the third. Charter submits that in each case reinsurance is granted of Charter's interest, described in the first two contracts by the words "to pay all losses . . . on all interest under policies and/or contracts or insurance and/or reinsurance underwritten by the reinsured," and in the third by the simple H words "to cover the liability of the reinsured arising under policies and/or contracts of reinsurance." The third contract is therefore expressly a cover on liability. In the case of the first two, it is possible for the syndicates to submit that "all losses howsoever and wheresoever arising during the

period of this reinsurance on any interest" refers to original losses in the same sense as in the later period of reinsurance clause, rather than the reinsured's loss in the same sense as in the ultimate net loss clauses. I doubt whether this argument is correct, since the reinsuring clause refers to "losses . . . on all interest," which must, it appears to me, refer to Charter's insurable interest under the relevant policies which it underwrites, as it also does in the liability clause. The reinsuring clause in the first two contracts makes the cover expressly "subject to the following terms and conditions." Article 1 in the third contract has no such express qualification. I do not think that this makes any real difference. The point which Charter can properly make on all three contracts is that the subject matter of reinsurance is not directly or expressly defined so as to be related, or limited by reference, to the disbursement of moneys. The primary expression of cover under these reinsurances is against liability or loss affecting the reinsured's interest under original contracts, not against outlay.

(b) The timing of reinsurance recoveries

The liability clause in the first two contracts contains phrases with temporal connotations—"shall only be liable if and when" and "shall thereupon become liable." However, the focus of the clause is not on timing but on the scope and limits of the financial responsibility accepted on an excess of loss basis under the contracts. The equivalent clause in the third contract (article 7—reinsuring clause) has no phrases with any temporal connotations at all. The phrases quoted must anyway be approached with caution. Both the liability clause in the first two contracts and article 7 in the third employ the concept of "ultimate net loss" sustained by the reinsured, and both contain ultimate net loss clauses. In the case of the first two contracts, the ultimate net loss clause defines "net loss," whereas in the third it defines "ultimate net loss." Taking the liability clause literally, it provides that reinsurers are only to be liable "if and when the ultimate net loss sustained" exceeds the specified limit. But the ultimate net loss clause itself provides always "that nothing in this clause shall be construed to mean that losses under this reinsurance are not recoverable until the reinsured's ultimate net loss has been ascertained." The "industrious and anxious" draftsman who Mr. Hildyard suggested as the author of the first two contracts cannot have meant exactly what he was apparently saying in the liability clause in the first contracts. The draftsmanship of the third contract is different but also open to comment. Article 7 provides for indemnification by reference to ultimate net loss and article 10, the ultimate net loss clause, defines this to mean the sum actually paid by the reinsured in settlement of loss or liability. But article 10 then provides that nothing in it shall mean that losses are not recoverable from reinsurers until the ultimate net loss has been determined. Even reading this contract literally (as the syndicates invite) recovery cannot therefore depend on ultimate net loss as defined. Under all three contracts, the cover should no doubt be read as being (a) ultimately, against ultimate net loss as then "ascertained" or "determined," to use the words of the provisos, and (b) at any intermediate stage, against such "net loss" as may at that stage have been ascertained or determined. That is

A part of a process of sensible rather than uncompromisingly literal interpretation.

(c) The object(s) of the ultimate net loss clause

In their skeleton agument, counsel for the syndicates suggested that the ultimate net loss clause is not a "measure of loss clause," because of B the proviso in its third sentence. There is no doubt that the clause is a measure of loss clause. It measures the ultimate liability of the reinsurers. It provides for provisional measurement of loss at earlier stages. The most obvious purpose of its extensive wording is to provide clear criteria for such measurement. Many of the criteria may now appear commonplace but insurance and reinsurance have over the years frequently generated disputes in this area about apparently fundamental matters. I need only C instance disputes as to whether and when a reinsurer is bound to follow settlements without proof of liability; whether an insurer, if he settles for less than his actual liability, can recover from his reinsurer the full amount of his liability; and whether it makes any difference if a recovery is effected before or after indemnification by an insurer or reinsurer. In the first of these areas a real degree of certainty has only quite recently been provided D through the Court of Appeal's decision in the *Scor* case [1985] 1 Lloyd's Rep. 312 and subsequent authorities. The second of these matters was the subject of two conflicting Court of Appeal decisions: *Uzielli & Co. v. Boston Marine Insurance Co.* (1884) 15 Q.B.D. 11 and *British Dominions General Insurance Co. Ltd. v. Duder* [1915] 2 K.B. 394. In the *Uzielli* case the Court of Appeal held that the underwriter could recover up to £1,000 under a reinsurance in that sum against total loss although he had E himself settled with the original assured for 88 per cent. of the hull value, whilst also incurring sue and labour expenses to which the reinsurance did not apply, reliance being placed by the court on the "pay as may be paid" clause. In the *Duder* case the court reached an opposite conclusion, expressing its difficulty in understanding the *Uzielli* case. The third matter was the subject of litigation to the House of Lords as recently as 1992 in F the context of stop loss insurance: *Lord Napier and Ettrick v. Hunter* [1993] A.C. 713. The caution exhibited by reinsurance draftsmen in the ultimate net loss clause in the 1930s and subsequently is understandable. In his oral submissions, Mr. Ruttle was ready to accept that the clause is substantially a "how much" clause, concerned with the measurement of reinsurance recoveries. The question is whether it also has what would be a further, and most significant, role in requiring disbursement or other G satisfaction of amounts ascertained by insurers' settlements as a precondition to the availability of any reinsurance recovery at all.

(d) "Actually paid . . . in settlement of losses or liability"

The phrase "actually paid by the reinsured in settlement of losses or liability" is at the core of the syndicates' submissions, although they H submit that the wording of the liability clause and claims clause in the first two contracts would alone establish their construction. The phrase looks necessarily, they say, to some disbursement of moneys. The syndicates' submission is reinforced by the presence of the word "actually."

Had the clause spoken simply of "the sum paid by the reinsured in settlement," Charter could have founded itself more directly on authority like the *Eddystone* case [1892] 2 Ch. 423 in its submission that the intention was simply to regulate the payment to be made by the reinsurer by that to be made on the original policy. The syndicates have other reasons why in their submission such authority affords no assistance, but the word "actually" is by itself an obvious difference. They say that this is particularly so when the summary of the argument of counsel in the *Eddystone* case contains a submission that the wording there did not make "actual payment" to the original assured a condition precedent to reinsurer's liability. On the syndicates' submission the draftsman of the ultimate net loss clause should be taken to have had this very submission in mind, although I think that references to the submissions of counsel go beyond anything which Hobhouse L.J. had in mind in his observations in the *Toomey* case [1994] 1 Lloyd's Rep. 516 or which would in this context usually be appropriate.

The word "actually" is emphatic. Taking a definition from the *Oxford English Dictionary (Compact Edition)* cited by the syndicates, it means "in act or fact; as opposed to possibly, potentially, theoretically, ideally; really, in reality." But it remains to identify what it is that is intended to be emphasised and why. If references to sums paid are otherwise made in the reinsurances to ensure that the payment to be made by the reinsurer is regulated by that to be made on the original policy, the word "actually" may simply be employed to make this more emphatically clear. This would be consistent with the main thrust of the ultimate net loss clause, that is the measurement (interim and final) of the recovery available under the reinsurance. It can be objected that the word "actually" was on that basis unnecessary, but this is an argument with limited force in the context of a reinsurance clause which shows anxiety to deal with every aspect of the measurement of recovery in detail. The fact that timing is dealt with in this way by a proviso or qualification in the third sentence of the clause appears to me to be at least consistent with the possibility that the earlier part of the clause may not have been directed to matters of timing at all.

(e) Condition precedent?

A similar comment applies to the syndicates' repeated submission that the contracts contain the clear condition precedent that was lacking in authorities such as the *Eddystone* case [1892] 2 Ch. 423 and the *Law Guarantee* case [1914] 2 Ch. 617. The ultimate net loss clause on any view expresses some form of condition: recovery depends upon there being a "sum actually paid by the reinsured in settlement of losses or liability," whatever that may in context involve. The issue is whether the phrase was intended not merely to establish a condition in the sense of a threshold and quantum of ascertained exposure, but also to introduce (i) considerations of disbursement or other satisfaction and (ii) in conjunction therewith, a temporal condition precedent to recovery consisting of prepayment by insurers. It is in my view legitimate to consider this issue with the expectation that, if (i) and (ii) had been intended, they would have been made clear. The authorities cited in *Black King Shipping Corporation v. Massie* [1985] 1 Lloyd's Rep. 437 do not

A specifically relate to circumstances where the clause in question is on any view a condition of recovery of one sort or another, but they provide general support for Charter's case, in so far as the syndicates' interpretation involves reading the ultimate net loss clause as introducing a condition of a more expansive and onerous nature than Charter's construction.

(f) Payment and settlement

B When the ultimate net loss clause speaks of "the sum actually paid by the reinsured in settlement," the syndicates submit that it contemplates two distinct stages in time: settlement first and payment second. In my view there is no reason to read the phrase as concerned with timing at all. However, even if it is, a two-stage analysis does not appear to me to be intended by the wording. The phrase is "actually paid . . . in settlement."
C This on its face, either treats the two as concomitant or treats payment as an aspect of settlement. The second paragraph of the clause refers to salvages, recoveries or payments recovered or received subsequent to a "loss settlement." The word "settlement" in the reinsurance context has a possible spread of meaning, but I accept the syndicates' submission that it here embraces the establishment or ascertainment of the original assured's claim (including its quantum) in particular by agreement or admission,
D or, it seems likely, by judgment or award. This is the same sense in which it is generally understood in the context of a "follow the settlements" provision: see the *Scor* case [1985] 1 Lloyd's Rep. 312. It also reappears in this sense in the claims clause in the first two contracts, in article 14 (notification of loss and settlement of claims) in the third contract, and in the aviation settlements clause in the first two contracts. This last clause is
E a special provision for aviation business which contains no reference to amounts "paid" at all but caters specifically for situations in which a reinsured has to establish a fund to meet a prospective claim (see *Boden v. Hussey* [1988] 1 Lloyd's Rep. 423 where the court did not have to focus on the question whether the reinsured would have in the first instance to establish the fund out of his own funds before looking to reinsurers).

F Looking at other clauses in the contracts, payment may again either be equated with or treated as an aspect of settlement in the currency clause and the claims clause in the first two contracts. Indeed, there might be some anomalies if the currency clause were read as distinguishing between settlement and payment as different temporal stages: an insurer reaching an agreement with a Frenchman to settle a sterling claim at date A could, if the French franc declined, transfer at date B an equivalent
G number of francs at date B, which converted into sterling at the rate at date A would give a larger number of pounds than the original settlement. Whilst this sort of remote possibility may be of little assistance in the interpretation of the contracts, it also seems unlikely that the currency clause was concerned to draw a distinction between settlement and payment which would itself appear to be of relevance only on remote occasions.

H The claims clause in the first two contracts makes provision for notice of losses which may cause a claim under the reinsurance, and goes on to provide for all loss settlements to be binding upon the reinsurers, provided that they are within the terms and conditions of the original insurance

and the reinsurance. It then says that "the reinsurers shall pay the amounts due from them upon reasonable evidence of the amounts paid being given by the reinsured." The syndicates rely on this as confirming an intention to require satisfaction of the original claim before any obligation arises on the part of reinsurers; and they point out that this particular clause does introduce some form of trigger or condition precedent to reinsurers' obligation to indemnify, consisting of a requirement to submit certain evidence. Here, it is to be noted, the word "actually" is not used. The wording of the claims clause "shall pay . . . upon reasonable evidence of the amounts paid" is capable in my view of referring to payment in a sense and manner analogous to that in which it appears in the phrase "pay as may be paid thereon" (used in the *Eddystone* case [1892] 2 Ch. 423 and in article 18 in the third contract) whilst introducing an additional requirement of "reasonable evidence" of such payment. Since both the claims clause and the third contract also include "follow the settlements" provisions, there is the further difference from the position under a simple "pay as may be paid" provision that the syndicates are bound by the reinsured's settlements; such settlements determine "the amounts due from them [the syndicates]" irrespective of the reinsured's liability apart from any settlement. The phrase "amounts paid" on this basis connotes the amounts ascertained for payment on the reinsured's settlements with its original insured. There is a further reason for construing it in this sense. Since it is the settlement, not the disbursement or satisfaction by which the reinsured is bound, one would expect the reinsured to have to make available reasonable evidence of the commitment constituted by the settlement, not—or certainly not only—reasonable evidence of disbursement. Yet on the syndicates' two-stage analysis, the parties must have provided for the latter alone, and failed to provide for the former at all.

(g) Specific clauses in the third contract

It is convenient to take first article 8 (original aviation loss warranty clause). This is a provision which limits the scope of the reinsurance to circumstances where the "total original incurred aviation loss" is equal to or exceeds $50m. It is not an excess, but a requirement that the total hull and liabilities claims (inclusive of adjustment, defence and representation costs and expenses) under direct insurances at the original level should be of that size. For this purpose the "total original incurred aviation loss" is defined in very expansive terms, providing not merely that it need not have been finally determined and paid, but also that its computation should include amounts "whether . . . paid or promised to be paid or reserved whilst under negotiation or dispute with the original claimant(s)" and that "in the event of no London aviation market reserve, the reserve for the purposes of this clause shall be that amount as advised to the original underwriters as an estimate of their liability by their adjusters, attorneys or solicitors." This clause does identify payment as a separate matter to a promise to pay, though only for the purpose of making clear that they are both in this context to be equated with a reserve or even an adjusters,' attorneys' or solicitors' estimate. This is clearly a special clause, whether it is tailor made or in a wording in more general use in the

A aviation market. It assists the syndicates' case that it speaks of payment in the sense of disbursement and separates this from a promise to pay. This is however in the context of the original insurance level and of claims by original insureds against original insurers, who may not include Charter at all. Further, the language and subject matter of the clause in no way cross-relate to the standard language of the ultimate net loss clause, and it is notable that it does not mention the concept of loss settlement at all. B I do not therefore regard the expanded and explicit wording of article 8 as carrying the syndicates' case on construction of the reinsuring and ultimate net loss clauses very far.

I come now to a most striking feature of the third contract, which has no parallel in the first two contracts. Article 22 (the special cancellation clause) gives either party the right to terminate if the other has become C insolvent or unable to pay its debts. It then continues:

> "The Reinsurer shall remain liable for losses occurring up to and including the date of termination. Thereafter the liability of the Reinsurers shall cease outright other than so far as outstanding claims are concerned."

This must, on the syndicates' case, be a false friend. The message conveyed D is that a reinsurer's liability for outstanding losses remains unchanged despite the reinsured's insolvency or inability to pay, even if reinsurers terminate cover in respect of future losses and a fortiori if reinsurers do not. It is irrelevant that there was in the present case no termination and that no issue directly arises under the special cancellation clause. What matters is the message conveyed by the clause about the position in case E of the reinsured's insolvency or inability to pay. The syndicates say that the message is true enough—their liability remains unchanged (in the amount presumably of nil in the event of inability to pay moneys reaching the excess point), because it has always been a term that they would not have to pay unless and until the reinsured disbursed or otherwise satisfied its obligations arising from any loss settlement. The syndicates can of course point to situations where insolvency or inability to pay debts in full F does not prevent some recovery being made under an excess of loss reinsurance; as Scrutton J. pointed out in the *Law Guarantee* case [1914] 2 Ch. 617 there are situations where a partial dividend can be paid to all creditors, which is sufficient to enable a partial excess of loss reinsurance recovery which will enable a further partial payment to all creditors, and so on: there will then be an indefinite series of ever diminishing tranches G until payment in full or until the amounts involved fall below the limits of legal tender. But I do not think for a moment that this can be accepted as the true significance of the words of article 22. The message implicitly conveyed is in my view straightforward. It is specifically directed to the events of insolvency and inability to pay, and it also suggests that the position in insolvency is no different from the position as it was before. The syndicates' case under the third contract rests essentially on what they H submit to be the general intention of the ultimate net loss clause, not specifically directed to situations of insolvency or inability to pay. The third contract lacks those clauses in the first two on which the syndicates rely to draw a distinction between settlement and payment. Whatever may

be the purpose or effect in other situations of the ultimate net loss clause, the third contract in my judgment contains a clear indication that a reinsured who is insolvent or unable to pay his debts is not required to disburse or satisfy the amount of any loss settlement before acquiring a right to reimbursement under this reinsurance. If and in so far as this conflicts with the ultimate net loss clause, this indication is entitled to priority over that clause. It may however be that the situation is not one of conflict but of consistency, if the ultimate net loss clause is to be interpreted in the way in which Charter submits.

The history of the ultimate net loss clause

As a standard form the ultimate net loss clause derives, as the syndicates showed, from the 1930s and it has, with some expansion and amendment, been used in substantially the same form ever since. On the syndicates' case, it can hardly have been intended as anything other than a deliberate departure from the approach identified with the *Eddystone* case [1892] 2 Ch. 423 and the *Law Guarantee* case [1914] 2 Ch. 617. If the clause was there to fulfil not merely its basic role of establishing the measure of indemnity, but also that of a condition precedent requiring satisfaction by the reinsured of the amount involved in any loss settlement, then it might, in this light, have been expected that this would have been stated in very positive terms.

If I look at the origin and history of the drafting of the ultimate net loss clause, as the syndicates invited me to do, then the departure also seems to have been unheralded. I must assume that the extracts put before me by the syndicates from contemporaneous publications of these clauses are complete as far as relevant. So far as appears, nothing whatever was said about any departure from past authority or about the purpose which the syndicates now ascribe to the clause. On the contrary, the revision of the original clause in 1937 to add its second sentence was accompanied by a letter dated 9 December 1937 from Lloyd's Underwriters Fire and Non-Marine Association referring to three newly worded clauses, the salvage and recovery clause, the ultimate net loss (excess reinsurance) clause—as it was then known—and the costs clause. The titles and wording of the second and third of these clauses with their definitions of "net loss" indicate that they were designed for use in excess of loss reinsurance. The letter simply stated that the existing clauses were to be withdrawn and that:

> "Your committee have adopted these new clauses in order to make the position of underwriters more secure in the matter of the proper apportionment of salvages and other recoveries received after the payment of a claim. Owing to the fact that without one of these alternative clauses underwriters might find salvages and recoveries apportionable in a manner they did not intend when writing a direct risk or a reinsurance containing an excess condition, your committee strongly recommend that members should protect themselves by specifying the appropriate one of these clauses in all new risks and in all renewals which contain an excess, particularly in those cases where 'wording as before' appears in the slip."

A There is no hint in this letter that the purpose of the ultimate net loss clause or of its variant the costs clause was also to ensure (contrary to what must otherwise have been viewed as the position on authority) that excess of loss reinsurers were not liable unless and until their reinsureds had not only crystallised their position in settlement, but also satisfied it by disbursement or otherwise. It is, I think, a not unreasonable inference, if one looks at this material, that the ultimate net loss clause was conceived B as a tool for accurate measurement and as a protection for reinsurers of a different nature to that now suggested by the syndicates.

Two further points appear to be indicated by the material and submissions before me. First, the precondition for which the syndicates contend would appear, on their case, to have been introduced and to apply generally in the field of excess of loss reinsurance. A measurement C clause is an important feature of an excess of loss reinsurance. But the history of the present ultimate net loss clause and the standard clauses which the syndicates have put before me contain no hint of any alternative form of ultimate net loss clause designed to meet the requirements of insurers arranging excess of loss reinsurance who would need a detailed measurement clause to define "(ultimate) net loss" but who could view the approach of the *Eddystone* case [1892] 2 Ch. 423 and the *Law Guarantee* D case [1914] 2 Ch. 617 as the only safe or appropriate basis of reinsurance. Secondly, any such precondition would appear to have been confined to excess of loss reinsurance. There is no suggestion of any equivalent clause being introduced or in use in the context of quota share reinsurance to alter the position resulting from the *Eddystone* and *Law Guarantee* cases. The syndicates' submissions may therefore appear to suggest an oddly E unbalanced view of acceptable reinsurance arrangements. These two points bring me naturally to the significance which the syndicates attach to the distinction between quota share and excess of loss reinsurance.

The suggested difference between the contexts of proportional and excess of loss reinsurance

F The syndicates submit that it is important to remember that the ultimate net loss clause is a clause designed for use in the context of excess of loss reinsurance. Proportional and non-proportional reinsurances are different forms of reinsurance. Under the former the reinsurer shares pro rata in both premiums and losses on risks ceded whether from ground up or on a surplus basis. Under the latter, the premium may be fixed but is commonly (as under the present reinsurances) a minimum and deposit G premium adjustable by reference to a percentage of the reinsured's net premium income: claims on the risk(s) within the scope of the reinsurance are payable in excess of a specified figure, whether the cover relates to individual losses or to an accumulation of losses on the whole or a particular part of the reinsured's account. The nature of excess of loss reinsurance is that there is a trigger to liability in the form of an excess point. However, this does not mean that disbursement or satisfaction of H original claims is either more likely or more appropriate as a condition precedent to liability. Under a proportional agreement in the *Eddystone* case form reinsurers' liability arises in respect of ascertained liability on the part of the reinsured in respect of business ceded (see *Versicherungs*

und Transport A.G. Daugava v. Henderson (1934) 49 Lloyd's Rep. 252) under a proportional agreement in modern form, it arises in respect of the reinsured's commitment to pay ascertained by his settlement with the original insured. Under excess of loss reinsurances such as the present, reinsurers' liability again arises in respect of the commitment to pay ascertained by settlement, but it is necessary to apply the excess point. None of this makes it more likely in commercial terms that the parties would wish, or that it would be acceptable, to introduce a further precondition of pre-payment in excess of loss reinsurance.

The syndicates submit that there is another fundamental difference, in that proportional reinsurance is designed to protect the solvency of reinsureds and to enable them to "borrow" solvency from their reinsurers and so to write more business, whereas (they submit) excess of loss reinsurance has no such purposes. No evidence was put before me to substantiate this surprising final proposition. The different forms of reinsurance represent different tools which an insurer may deploy, frequently in conjunction with another to pass on or protect exposure either on particular risks or on the whole or part of its insurance account. Much modern reinsurance is done on an excess of loss basis. The purpose is self-evidently to protect the insurer from exposures of the type reinsured which could otherwise either individually or collectively imperil the insurer's solvency or profitability. To suggest that it is natural under an excess of loss reinsurance (as distinct from a proportional agreement) that the insurer should have to fund the entirety of any claim as a precondition to looking to his reinsurers is without warrant in any material before me, or I believe in common sense or experience. If one takes the present reinsurances alone, it is apparent that they cover in layers up to a high level, being for £2·5m. excess of £3m. and for £2·5m. excess of £7·5m. Probably there was an intermediate cover £2·5m. excess of £5·5m. and there may have been covers above £10m. Whether this is so or not, the purpose of the reinsurance must have been to ensure that the reinsured's exposure in respect of a loss of up to £10m. would be protected to a very substantial extent by its reinsurers. To suggest that it is integral to excess of loss reinsurance that an insurer should operate with a capital base or with banking facilities to enable it to be sure of being able to fund the whole of every loss or accumulation of loss before making any recovery from its reinsurers appears to undermine, rather than represent the purpose of, such reinsurance. Nor do I accept the suggestion that pre-payment would be viewed as essential to exclude the possibility that the reinsured might otherwise seize a cash flow advantage, by recovering from its reinsurers and then holding on to the moneys for a period before disbursing them to the original assured. In the ordinary course original assureds would expect their money as soon as any settlement was reached, and one would expect accounting to take place in a way which would ensure as far as possible that payments and recoveries occurred at more or less the same time.

Commercial considerations

On this basis considerations similar to those which influenced the courts in the *Eddystone* case [1892] 2 Ch. 423 and the *Law Guarantee* case

A [1914] 2 Ch. 617 appear to me to have a part to play in the construction of the present contracts. The suggested precondition of prepayment would be detrimental to the aims and expectations which the parties as reasonable commercial people may be taken to have had in mind when effecting the reinsurances, as well as being capricious and potentially unfair in its operation. Stirling J.'s words in the *Eddystone* case also reflect the result of giving effect to the syndicates contention. If I may re-express them B colloquially, excess of loss reinsurance incorporating the ultimate net loss clause would not serve as a direct mechanism for spreading the load; a reinsured would have first to show that he was by himself capable of lifting its full weight before claiming against his reinsurers, even although collapse might be the result. The fuller reasoning in the *Law Guarantee* case reinforces the strength of the commercial considerations militating C against any such conclusion.

The same commercial considerations also provide a forceful answer to the syndicates' contention that Charter's case focuses inappropriately upon Charter's insolvency and upon supposed hardship arising in that situation. Parties to a reinsurance may have in mind precisely the possibility of financial difficulties, and indeed provide for insolvency as the third contract does. In insurance, as much as (if not more than) in any other D business, the matching of exposure and protection to assure both solvency and profitability is absolutely fundamental. Reinsurance—of whatever type—is a principal means to this end. It is unnecessary even to recall some of the recent Lloyd's litigation in this court to see the problems which may emerge in this regard where exposure and reinsurance protection are not or not fully matched.

E I would add that it cannot realistically be suggested, and was not here any more than in the *Law Guarantee* case, that reinsurance premiums under excess of loss reinsurances containing ultimate net loss clauses are weighted or reduced by reference to the strength or weakness of the reinsured's cash flow position to take account of the possibility that reinsurers might not have to pay claims because the reinsured was unable to fund them in advance.

F

Regulatory and accounting considerations

Mr. Kentridge for Charter referred to the solvency and insurance company accounting requirements prepared under the regulations in force when the three reinsurances were written, and, though this cannot be of direct relevance, today. The legislature has repeatedly intervened with G tighter and more comprehensive regulation in this important field. At the time of these contracts Charter was by section 32 of the Insurance Companies Act 1982 required to maintain a margin of solvency, defined as "the excess of the value of its assets over the amount of its liabilities, that value being determined in accordance with any applicable valuation regulations." The regulations in force in 1988–1990 were the Insurance Companies Regulations 1981 (S.I. 1981 No. 1654). Regulation 52(1) H required the amount of the liabilities of an insurance company to be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies. Generally accepted accounting practice in the United

Kingdom contemplated (and contemplates) that incoming claims will be shown gross in the company's revenue account and that reinsurance will be shown as a deduction giving a net cost of claims (cf. the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business, reprinted January 1987). Regulation 41 provided that the value of any debt due to, or other rights in respect of, an insurance company under any contract of reinsurance should be the amount which could reasonably be expected to be recovered in respect of that debt or right.

The form and content of the annual accounts and returns required under section 17 of the Act of 1982 and submitted to the Department of Trade and Industry were governed by the Insurance Companies (Accounts and Statements) Regulations 1983 (S.I. 1983 No. 1811). The forms specified under Regulations 6 and 9 contemplated the entry of amounts outstanding in respect of incoming claims and amounts recoverable in respect thereof from reinsurers.

If the syndicates' interpretation of the standard ultimate net loss clause in use in the market is correct, the solvency and accounting position of insurers would appear significantly complicated. Whilst it can in normal circumstances be presumed that a company is a going concern, generally accepted accounting concepts, bases and policies involve considering, where there is room for doubt, whether this basis remains applicable, and, if it is not or may not be, what effect that has on the company's financial position and how this should be presented or noted. On the syndicates' case, this must give rise to a potential problem of considerable significance—at least for so long as it continued to be the practice or permissible to use the ultimate net loss clause or to take into account for solvency purposes any potential recoveries under any excess of loss reinsurance including that clause. The syndicates submit that insurance company accountants calculating solvency margins and preparing accounts need simply to "factor into" their consideration, when considering whether the going-concern basis remains appropriate and for what reinsurance recoveries the company can take credit, an assessment of its prospects of being able to fund its incoming claims before looking to its reinsurers. I suspect that would add a hitherto unsuspected peril to the conduct of insurance business and to its regulation and accounting. The moment when an insurance company might fall from a plateau of solvency, when full credit could be taken for potential reinsurance recoveries, into an abyss of insolvency as a result of the operation of the precondition of pre-payment would be unpredictable. Any assessment of the prospects of its occurrence would fluctuate according to the size and volume of new claims and of potential reinsurance recoveries in respect of them. The assessment would have to take into account the prospects of well-disposed reinsurers being prepared to support the company by funding claims (on the syndicates' case ex gratia) and to continue such support in circumstances where there could be very large financial benefit in an opposite attitude, which might (particularly if reinsurers themselves had any financial problems or were in liquidation or receivership themselves) be hard to resist. The syndicates submit that all this if true could mean at most that there had been a failure by those involved in insurance business,

A accounting and regulation to appreciate the true nature and effect of the ultimate net loss clause, and to introduce equivalent solvency provisions to those apparently introduced in the United States after the Supreme Court in one case in 1937 accepted the existence of a precondition such as that for which the syndicates contend. It seems to me however that, if it is material to look at the accounting and regulatory background about which insurers and reinsurers in this country must be taken to have B general awareness, it reinforces Charter's submission that the syndicates' construction is unlikely to have been intended. At the end of the day, however, this is not a decisive factor in the conclusion which I reach.

The suggested aim of securing proper administration of the reinsured's affairs in circumstances of insolvency

C The syndicates submitted that, if protection in insolvency is to be assumed as an aim of these reinsurances, there could be valid commercial reasons why reinsurers should wish to limit their exposure to any amounts paid out by way of dividend to the original assured in the liquidation. Quoting counsels' skeleton argument, "the interests of the creditors (for whom in effect the liquidator acts) will be in allowing debatable claims so D as to maximise reinsurance recoveries," whereas, "the reinsured's interest prior to liquidation will have been to scrutinise claims rigorously." This represents a comforting view of the efficiency in claims handling of companies destined for insolvency, and an apparent slur on the objectivity or competence of the professional liquidators and scheme administrators charged with the handling of insurance company insolvencies. I say apparent; counsel assure me that there was and is no such intention. If the E distinction made were accepted, it would not explain why the ultimate net loss clause applies in the same form in all circumstances, before and after any problems of solvency arise. Reinsurers have the same legal protection in both situations, consisting in their right to refuse to follow any settlement not arrived at in a businesslike way: see the *Scor* case [1985] 1 Lloyd's Rep. 312. With most reinsureds, the point is in any event likely F to have a considerable element of artificiality because they act as following companies, on risks where the settlement decision is in effect taken not by individual companies, but by a leading underwriter or company.

Subrogation in insolvency

Another scenario in liquidation which the syndicates raised concerned G the application of principles of subrogation. If incoming claims on which an insolvent insurer pays only a dividend of 10 per cent. entitle the insurer to a full reinsurance recovery, then, the syndicates submit, the reinsurers could lose the benefit of potentially valuable subrogated recoveries. The reinsurance recovery may have been spread (by the mechanism of dividends) across the general body of creditors. If the original insured makes a third party recovery for the whole of his loss, he cannot be called H upon to repay the insurer more than the 10 per cent. dividend which he received. The syndicates question whether there would be any mechanism by which other creditors could be required to repay parts of the dividends which they had received, or by which the reinsurers could recover their

100 per cent. payment, if the insolvent insurer had not retained sufficient other assets in the liquidation. In principle it seems clear that, if the original assured has (viewing the matter retrospectively) suffered no loss, because he has now made a complete third party recovery, he has no insurance claim on the insolvent insurer, who in turn has no reinsurance claim on the reinsurers, who should be repaid. On this basis, the problem suggested only arises if the original insured is paid a claim by the insurer and later makes a third party recovery, and, at the time of the third party recovery, the insurer has no further or future assets whatever out of which the reinsurers may be repaid. During the course of insolvency, one would expect liquidators and scheme administrators to reserve funds to cater for contingencies and not to distribute all available cash by way of dividends.

I must also say that remote circumstances of this kind postulated by the syndicates do not anyway appear to me a helpful guide to the construction of these reinsurances. They do not explain why it should be thought fair that reinsurers' liability should, for practical purposes, be restricted to the amount of any dividend, which is likely in normal circumstances to afford them a windfall benefit for which they cannot have covenanted; and they do not of course provide a rationale for the ultimate net loss clause in situations of solvency. In the last analysis, there may be mechanisms for recovery from other creditors of part of the dividends paid, if it ever became necessary, on grounds of unjust enrichment, although I recognise that their pursuit could face practical difficulties. A final consideration is that it does not appear to me, even on the syndicates' construction, that the ultimate net loss clause could give them the absolute protection which they suggest was intended as regards subrogation recoveries. Suppose that it had not been Charter but an insurer reinsured by Charter (on terms not including any ultimate net loss clause) that had gone into liquidation, and suppose that insurer were to distribute a 10 per cent. dividend to its creditors, and were to make a 100 per cent. recovery from Charter, leading to a full recovery by Charter from the syndicates. If the original assured thereafter made a full third party recovery, precisely the same exposure to possible difficulties in working out the operation of subrogation would apply between the insolvent insurer and Charter and would, if the problems raised by the syndicates have any validity, affect the syndicates notwithstanding the ultimate net loss clause.

Recent English authorities concerning ultimate net loss clauses

I turn to recent authorities in which a similar point to that now before me has been touched on, although in none was it necessary for the court to reach any concluded view. The first is *Pine Top Insurance Co. Ltd. v. Unione Italiana Anglo Saxon Reinsurance Co. Ltd.* [1987] 1 Lloyd's Rep. 476, where Gatehouse J. had to consider a clause in an excess of loss reinsurance in respect of medical and other expenses incurred under travel insurances providing: "All terms, clauses and conditions as original. To pay as paid thereon, but subject nevertheless to the terms, clauses and conditions of this reinsurance." He treated the words "to pay as paid thereon" as by themselves varying "the general rule that the reinsurer is obliged to pay even before his reinsured makes payment, i.e. as soon as

A the latter's liability is assessed or capable or being assessed." I think that this was in error; it does not appear that he was referred to the *Eddystone* case [1892] 2 Ch. 423 or the *Law Guarantee* case [1914] 2 Ch. 617. His judgment goes on to say that this variation was "carried through" to a limit of liability clause providing that "reinsurers shall not be liable for any loss under this reinsurance agreement unless the reinsured have actually paid in respect of each and every loss each and every person, an B amount of £5,000." Since there was nothing to "carry through" and since the policy wording is only briefly extracted and is in quite different terms to the present, I find the dicta in this case of no assistance.

Home and Overseas Insurance Co. Ltd. v. Mentor Insurance Co. (U.K.) Ltd. [1990] 1 W.L.R. 153 simply decided that the dispute under the particular reinsurance contract before the court should be referred to C arbitration, where it would be determined by a tribunal expressly enjoined to interpret the agreement as an honourable engagement and to effect its general purpose in a reasonable manner rather than in accordance with a literal interpretation of the language. There are dicta of Hirst J. at first instance generally unfavourable to reinsurers' present submissions, culminating with the statement that he would only have been prepared to uphold their construction if the words of the agreement as a whole plainly D excluded any other meaning, which in his judgment was not by any means clearly the case. Mr. Kentridge asked me to note these words, and to follow a similar approach. The judgments in the Court of Appeal are in more guarded terms, and do no more than conclude that the question of construction was a serious, difficult and important one, which deserved mature consideration before the appropriate (arbitration) tribunal. E Mr. Kentridge says that, if the point was difficult, that alone shows that there is a choice of meanings and that Charter's construction should be preferred on grounds of policy and reasonableness. But this appears to me to be reading too much into the Court of Appeal's decision which was clearly designed to leave the whole matter open for the arbitrators. Finally, there is *In re A Company No. 0013734 of 1991* [1992] 2 Lloyd's Rep. 415 the statements in which in my view also carry matters no further.

F

"Pay to be paid" clauses in Protection and Indemnity Association Rules

At the time of the Court of Appeal's decision in the *Home and Overseas Insurance* case, the cases of *Firma C-Trade S.A. v. Newcastle Protection and Indemnity Association* [1989] 1 Lloyd's Rep. 239 and *Socony Mobil Oil Co. Inc. v. West of England Ship Owners Mutual Insurance* G *Association (London) Ltd. (No. 2)* [1990] 2 Lloyd's Rep. 191 had been decided in the Court of Appeal, but not yet in the House of Lords. They were referred to by Parker L.J. in the *Home and Overseas Insurance* case as "considerable reinforcement" for reinsurers' arguments there. The syndicates rely on the House of Lords decision as still stronger reinforcement. The *Firma C-Trade* and *Socony* cases concern a very different branch of insurance law and practice to the present. Under the H mutual scheme embodied in the club rules which were there in question, the member was entitled to be indemnified against or in respect of claims, in the one case, "which he shall have become liable to pay and shall in fact have paid" for loss or damages to property carried on board an

entered ship and, in the other case "which they as owners of the entered vessel shall have become liable to pay and shall have in fact paid." The requirement of payment "in fact" was introduced as an essential element of entitlement to indemnity. It appears to have been accepted that the ordinary and natural interpretation of each rule was to make payment to the third party claimant a condition precedent to payment by the clubs to their members; the only contrary argument (raised in the Court of Appeal and developed in the House of Lords) was that it should be read subject to equitable principles or to an equitable jurisdiction to require the club to pay the third party direct or to put the member in funds to do so. This argument foundered on the clear language of the rule: see *per* Lord Brandon, at p. 197, and *per* Lord Goff, at pp. 200–202. In the present case, the issue concerns the proper construction of the ultimate net loss clause and the other clauses in the relevant contracts; the wording (as indeed the context) are different, and the provisions on which the syndicates place greatest reliance do not appear in the basic indemnity clauses, but in other clauses, the most obvious purpose of which is to measure the quantum of reinsurance recovery, rather than to introduce a condition precedent to such recovery. As to the context, in *Ventouris v. Mountain* [1992] 2 Lloyd's Rep. 281, 298 Hirst J. referred to a "pay to be paid" rule of the nature identified in the *Firma C-Trade* case [1991] 2 A.C. 1 and the *Socony* case [1990] 2 Lloyd's Rep. 191 as "entirely inappropriate in the non-club environment of a commercial insurance contract" such as that before him. However, Mr. Ruttle drew to my attention to collision liability clauses in various of the current institute clauses, which appear to be "pay to be paid" clauses, although the implications of that view do not seem to have been considered in any recent authority or in the light of *The Fanti* and the *Socony* case. Collision liability clauses in marine insurance themselves occupy a fairly special area, and the wording relied on was, as in *The Fanti* and the *Socony* case, part of the main indemnity provision. I do not gain any real assistance from the appearance of these clauses in the standard forms designed for use in direct contracts of marine insurance of hulls, freight and other interest.

American authorities

I was also referred by Mr. Ruttle to three American authorities on reinsurance of insolvent insurers. In the first, *Allemannia Fire Insurance Co. of Pittsburgh v. Firemen's Insurance Co. of Baltimore* (1908) 209 U.S. 326, 328 a proportional contract "to reinsure" the reinsured provided by clause 11 that each risk insured should be subject to the same conditions as the original contract reinsured, that losses should be payable pro rata with, in the same manner, and upon the same terms and conditions as paid by the reinsured:

> "and in no event shall this company be liable for an amount in excess of a ratable proportion of the sum actually paid to the assured or reinsured by the said reinsured company under its contracts hereunder insured, after deducting therefrom any and all liability of other reinsurers of said contracts or any part thereof."

A There was also a provision for the reinsured to forward a proof of loss and claim "after said reinsured company shall have adjusted, accepted proofs of, or paid such loss or damage." The Supreme Court rejected the submission that clause 11 was intended to introduce a requirement of prepayment before recovery as "to utterly subvert the original meaning of the term reinsurance and to deprive the contract of its chief value" (p. 336). The reinsurers had failed to show anything in the special B provisions of the particular reinsurance to change the ordinary rule that a reinsured could recover without showing that he had paid the original loss. The purpose of the clause cited was, in effect, to quantify the amount payable by reinsurers.

The second case, *Fidelity & Deposit Co. v. Pink* (1937) 302 U.S. 224, involved a proportional contract providing that "the reinsurer does hereby C reinsure against loss" and subject to conditions and provisions, including in section 4 (see p. 228):

> "The reinsurer's proportionate share of a loss under the bond, of costs and expenses as hereinafter defined, and of interest, shall be paid to the reinsured upon proof of the payment of such items by the reinsured, and upon delivery to the reinsured of copies of all essential D documents concerned with such loss and costs and the payment thereof. The reinsured may, however, give the reinsurer written notice of its intention to pay the loss on a certain date, and may require the reinsurer to have its share of such loss in the hands of the reinsured by such date: provided, however, that the reinsurer in any event shall have a period of 48 hours, after the receipt of such written notice from the reinsured, to mail or otherwise despatch its payment; and E provided further that in any such case the reinsurer, if it desires to do so, may pay its share of the loss by means of a check drawn in favour of the obligee of the bond."

The court said, at p. 229:

> "We do not question the general rules concerning liability of F reinsurers announced in the *Allemannia* case; but the liability under any written contract must be determined upon consideration of the words employed, read in the light of attending circumstances. Here the two insurance companies stood upon an equal footing; both were experts in the field. The language used differs materially from that found in the policy of the Allemannia Company. There is no ambiguity and no circumstance requires disregard of the ordinary G meaning of the language."

Further, at p. 230:

> "As the standard form of 1930 that was adopted twenty years after the *Allemannia* case it fairly may be assumed that the dissimilar language employed was intended to impose liability different from the H one there found to exist."

The Supreme Court's decision in the *Pink* case must be viewed as depending on the very specific language of section 4. This was clearly designed to introduce a condition precedent of disbursement of money by

the reinsured, and it went on expressly to cater for the problems of cash flow which this could involve by providing as an alternative a mechanism by which the reinsured might give notice of its intention to pay the loss on a certain date and to require the reinsurer to have its share of the loss in the reinsured's hands before that date. What it did not do was cater for the situation of insolvency. A

Finally, in *Stickel v. Excess Insurance Co. of America* (1939) 23 N.E. 2d 839 the Supreme Court of Ohio had to consider an excess of loss reinsurance covering "any amounts of ultimate net loss which the company may pay in excess of the first $5,000 on account if any one person injured or killed . . ." By section II (see p. 841): B

> "The term 'ultimate net loss' shall be understood to mean and shall mean the sum actually paid in cash in settlement of losses for which the company is liable, after making proper deductions." C

The court regarded the *Pink* case as more applicable than the *Allemannia* case to the particular wording before it, emphasising that "[i]t would seem superfluous to cite additional authorities for, after all, the decisions turn largely on the language of the particular contract under examination in the particular case." The introduction of the phrase "in cash" in the ultimate net clause in the *Stickel* case showed clearly that the clause was concerned to introduce a requirement of disbursement of money. D

The *Allemannia* case adopts a view of the ordinary objects and consequences of reinsurance not dissimilar to, though even more robustly expressed than, the judgments in the *Eddystone* case [1892] 2 Ch. 423 and the *Law Guarantee* case [1914] 2 Ch. 617. If I were to look to these three cases for guidance in the resolution of the present dispute, I would view the *Pink* and *Stickel* cases as special cases which turn on their particular wordings, which are distinguishable from the present. Every wording must, as these cases emphasised, turn on its own language. E

Conclusion

Adopting an approach to construction which is neither uncompromisingly literal nor unswervingly purposive, I consider that the words of the ultimate net loss clause in all three contracts were intended to ensure that reinsurance recoveries were at each stage and ultimately measured in all conceivable circumstances by reference to the precise net amount of the commitment involved in the settlements achieved between the reinsured and the original assured; and that they did not have an additional purpose of introducing a temporal precondition to recovery in the form of disbursement or other satisfaction of any such amount. The precondition which the syndicates advocate could be achieved by clear words clearly designed for such a purpose, if that were acceptable to the parties. Putting the matter at its very lowest, the words of the ultimate net loss clause were not and are not in my view clearly designed for this purpose. Nor are the words of the contracts taken as a whole. On the contrary, in my judgment, they were designed, and are to be read as designed, for the different purpose of measurement. Indeed, the third contract contains a clause, article 22, which I regard as very specifically confirming that no such precondition can there have been envisaged, and as clear enough by F G H

A itself to prevail there over any precondition in the ultimate net loss clause, had I thought that any was thereby intended. As it is, I regard article 22 in the third contract as confirmation, in the context of that particular contract, that the ultimate net loss clause is not to be read as involving any precondition in the form of disbursement or other satisfaction of amounts ascertained as due under loss settlements. I reach these conclusions upon consideration of each of the three reinsurance wordings B before me and having regard to the general aims and consequences which these parties may be taken to have had in mind. In the latter connection, I have made clear my view that the commercial considerations identified in the *Eddystone* and *Law Guarantee* cases have considerable relevance. Other factors which support the same construction are (1) the history of the ultimate net loss clause, put before me by the syndicates, and C (2) regulatory and accounting considerations. Each appears to me to represent part of the commercial background of which account may also legitimately be taken, but they do no more than confirm a conclusion at which I would anyway have arrived.

Construction of the contracts in situations of insolvency

D Charter submitted that, if (contrary to the view just expressed) the contracts were to be read as involving a precondition of disbursement or satisfaction in situations of solvency, they should nonetheless be differently construed in circumstances of insolvency. The justifications submitted for this were (a) the unjust, uncommercial and arbitrary result of such a precondition in insolvency, and (b) the consideration that such a precondition would be contrary to public policy and void under the E principle in *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France* [1975] 1 W.L.R. 758. As to the first, if the precondition exists in solvent situations despite the evident problems which it could pose for solvency, it seems to me difficult to see how it is to be necessarily implied, in the absence of any positive provision, that the precondition is not to apply in insolvency. That is so at all events under the first two contracts. F There could be an argument for such an implication under the third contract, in view of the provisions of article 22. The second justification appears to me circular. The principle in the *British Eagle* case applies when and if a contract on its true construction is repugnant to principles of insolvency law, because for example it purports to secure a party a greater advantage in bankruptcy or liquidation than previously or provides for the distribution of what are, at least in substance, assets otherwise G than pari passu. It is not itself a canon of construction or means of altering the true construction of a contract in insolvency.

Alternatively, Mr. Kentridge submitted that the principle in the *British Eagle* case was directly applicable in view of the appointment of provisional liquidators in respect of Charter by order of Blackburn J. dated 23 June 1994. The effect of the syndicates' construction of the H contracts was in his submission to require Charter to meet its liabilities in a manner other than pari passu if it was to get in its assets, contrary to the compulsory scheme applicable in liquidation and contrary, he submitted, to a strong public interest (cf. the dictum of Kennedy L.J. in the *Law Guarantee* case [1914] 2 Ch. 617, 639). Mr. Hildyard's response is

twofold: that Charter is not in winding up and the principle can have no application, and that, even if Charter were in winding up, the principle would not apply; any asset was and is, in his submission, "flawed" in that its realisation is subject to a precondition which cannot be fulfilled in insolvency; he says that its diminished economic worth in circumstances where the reinsured cannot pay its claims in full is irrelevant.

The order gives the provisional liquidators powers, inter alia, to get in all the company's property and assets and to administer and settle such claims either by or against Charter as advised in the interests of creditors, as well as to prepare and consider a scheme of arrangement. I understand Mr. Kentridge to accept that the power to administer and settle claims would not embrace the pari passu distribution of assets in relation to claims, which would be a matter for the liquidators after a winding up order. This insolvency may well follow the pattern of other recent insurance company insolvencies and lead not to winding up but to a scheme of arrangement. I see the force of Mr. Hildyard's submission that the *British Eagle* case can have no relevance unless and until there is a winding up order. However, in the view which I take on construction, it is unnecessary for me to go further into this or any issue concerning the scope and application of the *British Eagle* case and I shall not do so.

The effect of insolvency as payment

Finally, Mr. Kentridge raised very shortly the possibility that the making of a winding up order or the admission of a proof thereunder operates as a notional discharge of liability, which would meet any precondition of disbursement or satisfaction to be found in the contracts. Mr. Kentridge referred to the reasoning of Neville J. in *In re Law Guarantee Trust and Accident Society; Godson's claim* [1915] 1 Ch. 340, but found difficulty in supporting this on the authorities, including Scrutton J.'s judgment in the *Law Guarantee* case, cited by Neville J. The judgment of Oliver J. in *In re Dynamics Corporation of America* [1976] 1 W.L.R. 757 is on this point also of potential interest. Oliver J. was dealing with the question at what date a foreign currency claim should be converted into sterling when the defendant is in liquidation, having regard to the rule established by *Miliangos v. George Frank (Textiles) Ltd.* [1976] A.C. 443, that judgment may be entered for a sum in foreign currency or the sterling equivalent at the date of payment, instead of (as previously) in sterling converted at the date of accrual of the cause of action. His judgment includes this passage, at pp. 774–775:

> "What the court is seeking to do in a winding up is to ascertain the liabilities of the company at a particular date and to distribute the available assets as at that date pro rata according to the amounts of those liabilities. In practice the process cannot be immediate, but notionally I think it is, and, as it seems to me, it has to be treated as if it were, although subsequent events can be taken into account in quantifying what the liabilities were at the relevant date. In the context of liquidation, therefore, the relevant date for the ascertainment of the amount of liability is the notional date of discharge of that liability, and . . . that date must, in my judgment, be the same for all creditors and it must be 'the date of payment' for

A the purposes of any judgment which has been entered for the sterling equivalent at the date of payment of a sum expressed in foreign currency."

It is clear that a different statutory scheme takes over on winding up (cf. also *In re Lines Bros. Ltd.* [1983] Ch. 1), but, if the present contracts are otherwise to be construed as including a precondition of prior B disbursement, a "notional" discharge may not suffice. That no winding up order has been made anyway poses an immediate obstacle to Charter's submissions. Once again it is unnecessary for me to go further into, or to express any concluded views on, these matters.

Declarations

C For the reasons given I shall declare that the contracts do not contain the precondition of prepayment for which the syndicates contend, and grant Charter such further relief as may be appropriate after hearing counsel.

Declaration accordingly.

D *Solicitors: Davies Arnold Cooper; Ince & Co.*

B. L. S.

The reinsurers appealed.

E *Gordon Pollock Q.C.*, *Robert Hildyard Q.C.* and *Stephen Ruttle* for the reinsurers.

Sydney Kentridge Q.C., *John Rowland* and *Andrew Neish* for the insurers.

Cur. adv. vult.

F 25 October. The following judgments were handed down.

STAUGHTON L.J. The appeal of Mr. Fagan and his Names ("the reinsurers") raises issues of general interest for the insurance market and in the law of contract generally. To what extent should one depart from the plain meaning of the words in a contract in order to avoid a result G which is unreasonable, or even absurd? Who is to be the judge of reasonableness? And on what material is it to be decided? These issues are also of some difficulty. One of them involves a choice between conflicting decisions of the United States Supreme Court.

Charter Reinsurance Co. Ltd. ("the insurers") are now in provisional liquidation. They formerly carried on the business of insurance and reinsurance. In the course of it they concluded three contracts of H reinsurance with the reinsurers: (1) on their 1989 whole account, for £2m. in excess of £3m. each and every loss and/or catastrophe and/or calamity and/or occurrence and/or series of occurrences arising out of one event; (2) on the same risk, for £2·5m. in excess of £7·5m.; (3) on aviation risks,

for £2·5m. in excess of £28m. each and every loss (as defined). There were also limits in U.S. and Canadian dollars, which I need not mention. In each of the contracts there was a clause saying that it covered "losses occurring" during a period, that is to say the calendar year 1989 for the two whole account contracts and the calendar year 1990 for the aviation contract.

Losses have arisen on business underwritten by the insurers. In particular, the losses with the names of Exxon Valdez, Phillips Petroleum and Australian earthquakes attach to the insurers' whole account; and India Airlines and C.A.A.C. Airways attach to their aviation account. We are asked to assume that claims have been presented to the insurers in respect of those losses, that they have agreed their liability in respect of those claims, but by reason of inability to pay debts as and when they fall due they are at present not able to pay those claims.

In case it be thought that misfortune has fallen only upon the insurers, I would add that Mr. Fagan's two syndicates ceased underwriting in 1990 and are now under run-off management.

The question is whether the reinsurers are liable to indemnify the insurers in respect of sums which the insurers have not yet paid, either by a transfer of funds or by a settlement in account, although the amount of the loss has been agreed. In an agreed statement of facts there is this cri de coeur:

> "Both [the insurers and the reinsurers] recognise that the 'actually paid' issue is a London market-wide problem. The three contracts at issue in these proceedings are but examples of one type of excess of loss reinsurance contract wording in wide usage in the reinsurance market. Both parties wish this issue to be determined for the benefit of the reinsurance market as a whole."

Mance J. decided the question in favour of the insurers; and the reinsurers now appeal. I should say at once that the argument on the appeal has evidently been more closely confined than it was before the judge.

The terms of the contracts

The two whole-account contracts contained the same clauses that are material. [His Lordship then set out the reinsuring clause, liability clause, ultimate net loss clause, currency clause and claims clause, see ante, pp. 319B–320C, 321B–D, and continued:] The third contract, relating to aviation risks, was in somewhat different terms, so far as material. [His Lordship then set out articles 7 to 10, 15, 18 and 22, see ante, pp. 322A–323D, 324A, D–325B and continued:]

Approach to interpretation of the contracts

Like the judge I take this topic first. It is now well settled that no contract is to be construed in a vacuum. Although we may start with the literal meaning of the words, they should not be considered in isolation, but rather in the light of the surrounding circumstances (or, if one prefers it, the background, context or matrix) when the contract was made. That process may even, on occasion, lead one to reject the literal meaning of the words and to adopt some other interpretation.