[HOUSE OF LORDS]

*HILL AND OTHERS . . . . . RESPONDENTS

AND

MERCANTILE AND GENERAL REINSURANCE CO. PLC. . . . . APPELLANT

BERRY AND OTHERS . . . . . RESPONDENTS

AND

SAME . . . . . APPELLANTS

[CONJOINED APPEALS]

1996 March 18, 19; July 24

Lord Mackay of Clashfern L.C., Lord Goff of Chieveley, Lord Mustill, Lord Slynn of Hadley and Lord Hoffmann

Insurance—Reinsurance—Follow settlement clause—Excess of loss reinsurance—Reinsurers obliged to follow loss settlements "within the terms and conditions" of original policies and of reinsurance—Whether bound by reassured's conclusions of law as to extent of cover

Aircraft insured under a policy of war risks insurance with various Kuwaiti insurers were lost or damaged in consequence of the Iraqi invasion of Kuwait in August 1990. The Kuwaiti insurers had reinsured the aircraft with primary reinsurers in the London market on identical terms to the original policy. The plaintiff syndicates wrote a large number of excess of loss reinsurance contracts which, either directly or indirectly, provided cover for those risks, and the defendants reinsured the syndicates under various reinsurance contracts incorporating a follow settlement clause which provided:

> "All loss settlements by the reassured including compromise settlements and the establishment of funds for the settlement of losses shall be binding on the reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts ... and within the terms and conditions of this reinsurance."

A dispute having arisen between the parties, the syndicates issued writs claiming against the defendants the appropriate proportions of the full insured value under the reinsurance contracts and declarations that the defendants were in any event bound to follow settlements made by the syndicates, and applied under R.S.C., Ord. 14 for summary judgment. The judge gave the defendants unconditional leave to defend. The Court of Appeal allowed the syndicates' appeals.

On appeals by the defendants:—

Held, allowing the appeals, that the effect of the two provisos to the follow settlement clause, whereby it applied only to settlements "within the terms and conditions" of the original policies and of the reinsurance, was to draw a distinction between the facts generating the claims, the reassured's conclusions as to which bound the reinsurers, and the legal extent of the respective covers; that the purpose of the distinction was to prevent a settlement binding the reinsurers to a definition of cover different from that which they had contracted to accept, and so on a true construction of the follow settlement clause the defendants were entitled to defend the syndicates' claims on the basis that any loss settlements made by them were not within the legal extent of the cover which it had contracted to provide; that, further, the clause

applied to settlements made by the syndicates rather than by the primary reinsurers, and there were issues which ought to be tried as to whether the syndicates had made any such settlements; and that, accordingly, summary judgment ought to be refused (post, pp. 1240H–1241A, 1252H–1253D, D–E, G–H, 1254B–C, G–H, H–1255B).

Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd. [1985] 1 Lloyd's Rep. 312, C.A. distinguished.

Decision of the Court of Appeal [1995] L.R.L.R. 160 reversed.

The following cases are referred to in the opinion of Lord Mustill:

Chippendale v. Holt (1895) 1 Com.Cas. 197

Hiscox v. Outhwaite (No. 3) [1991] 2 Lloyd's Rep. 524

Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd. [1985] 1 Lloyd's Rep. 312, C.A.

The following additional cases were cited in argument:

Biggin & Co. Ltd. v. Permanite Ltd. [1951] 2 K.B. 314; [1951] 2 All E.R. 191, C.A.

Gurney v. Grimmer (1932) 44 Ll.L.R. 189, C.A.

Insurance Co. of the State of Pennsylvania v. Grand Union Insurance Co. [1990] 1 Lloyd's Rep. 208

Street v. Royal Exchange Assurance Co. (1914) 19 Com.Cas. 339, C.A.

APPEALS from the Court of Appeal.

These were appeals by the defendants, Mercantile and General Reinsurance Co. Plc. ("M. & G."), pursuant to leave granted on 16 May 1995 by the Appeal Committee of the House of Lords (Lord Jauncey of Tullichettle, Lord Slynn of Hadley and Lord Hoffmann) from a decision of the Court of Appeal (Nourse, Hirst and Waite L.JJ.) dated 7 July 1994. The Court of Appeal had allowed appeals of the plaintiffs in one action, Clarence Roy Hill and members of Lloyd's Syndicates 2, 176 and 372 and John Robert Charman and members of Lloyd's Syndicates 488 and 532, and of the plaintiffs in the other action, Tony Robert Berry and members of Lloyd's Syndicates 536 and 539 and other plaintiffs members of 22 other syndicates ("the syndicates"), from a decision of Rix J. dated 31 January 1994. The judge had refused them summary judgment under R.S.C., Ord. 14 in two actions commenced by writ in which they had sought orders against M. & G. for, inter alia, (i) payment of the appropriate proportions of the full insured value under reinsurance contracts in respect of damage to 15 aircraft owned by the Kuwait Airways Corporation, in August 1990, in consequence of the Iraqi invasion of Kuwait and taking over those aircraft and (ii) declarations that M. & G. were bound to follow settlements made by the syndicates, and had given M. & G. unconditional leave to defend.

The facts are stated in the opinion of Lord Mustill.

V. V. Veeder Q.C. and *George Leggatt* for M. & G.

Jonathan Sumption Q.C. and *Andrew Popplewell* for the syndicates.

Their Lordships took time for consideration.

24 July. LORD MACKAY OF CLASHFERN L.C. My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Mustill, and for the reasons he gives I would allow the appeals.

LORD GOFF OF CHIEVELEY. My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Mustill, and for the reasons he gives I, too, would allow the appeals.

LORD MUSTILL. My Lords, these are the latest in a series of appeals arising from heavy losses in the London reinsurance market. On this occasion, although the notorious "LMX spiral" forms part of the history it did not found or enhance the claim, nor are there allegations of negligent underwriting, the question at the present stage being one of construction alone.

The issue arises on assumed facts in proceedings for summary judgment under R.S.C., Ord. 14. Four sets of contracts are involved. First, there was a contract between Kuwait Airways Corporation ("K.A.C.") and a number of Kuwaiti insurance companies whereby the latter insured K.A.C. against loss or damage to 15 aircraft for the period between 1 July 1990 and 30 June 1991 caused by, inter alia

> "(a) War, invasion, acts of foreign enemies, hostilities (whether war be declared or not) ... (e) Confiscation, nationalisation, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any government ..."

The 15 aircraft were insured on agreed values totalling U.S. $692m. The policy also provided that "the maximum sum insured in respect of ground risks is U.S. $300m. any one occurrence ..." and also

> "It is noted and agreed that the indemnity provided by this policy other then paragraph (a) of section one is extended to include loss of or damage to aircraft spares and equipment which is the property of the assured or for which they are responsible ..."

Also concerned in this dispute was a single aircraft belonging to British Airways. No separate point arises in relation to the insurance and reinsurance of this aircraft, and for simplicity I will concentrate on the aircraft owned by K.A.C.

The second contract was a policy whereby syndicates or companies in the London market ("the primary reinsurers") reinsured the Kuwaiti insurers in respect of the direct insurances on terms said be identical to those of the direct insurance. The contract gave the primary reinsurers complete control over negotiations and settlement of losses. Whether this was the reflection of a "fronting" arrangement between them does not appear, but the two sets of insurers, and the two contracts of insurance and reinsurance, were treated for present purposes as a single transaction. Since this is convenient and raises no difficulties in principle, I will refer to them collectively as "the direct contracts" and "the direct insurers/reinsurers," respectively.

Next, there were chains of excess of loss reinsurances ("the intermediate reinsurances") which started with the primary reinsurers and came to rest, evidently after many circles through the spiral, with syndicates or companies whose identities are not in evidence, and whom I will call "the inward reinsured." It has been assumed that these contracts were written on terms identical (except of course as to the definitions of the layers of cover, the premiums and the like) as those of the "inward contracts," to which I will come in a moment.

The penultimate set of contracts comprised further excess of loss reinsurances made between the inward reinsured and certain syndicates

("the syndicates") represented in this litigation by the individual respondents to the two conjoined appeals now before the House. These contracts have been called "the inward contracts." According to the agreed statement of facts and issues prepared for this appeal: "It is believed that each of the [the syndicates'] inwards contracts of reinsurance were in materially identical terms." I will assume this belief to be correct, and that the specimen contract in the appeal papers (No. 900745112) is typical of the others. It is important to note that in contrast to the direct contracts the period of cover was for 12 months from 1 January 1990. The contract included the following term, described as "Settlements Clause 1987 (XL on XL) 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 . . . and within the terms and conditions of this reinsurance."

I will call this the "follow settlements" clause.

Finally, there were the "outward contracts." These were excess of loss policies, made by the syndicates with various companies and syndicates, including the appellants, in respect of the risks reinsured under the inward policies. It is under these contracts that the present dispute has arisen. It is agreed that they all incorporated the follow settlements clause. They also included the joint excess loss committee clauses 1 January 90 but since in my opinion these add nothing relevant to the present appeals I will not set them out. The tranche of cover was expressed by reference to the net loss suffered by the reinsured, the definition of which stipulated that "loss" meant loss, damage, liability or expense "arising from any one event:" a formula different from that employed in the direct insurance/reinsurance.

The provisions in the outward contracts concerning the duration of the cover are of cardinal importance. According to the agreed facts, in the case of all but three of these contracts the period of cover was (like the inward contracts) from 1 January 1990 to 31 December 1990. In the case of two contracts protecting one of the syndicates the period of the reinsurance was from 1 April 1990 to 31 March 1991, and in the case of another syndicate it was from 1 October 1989 to 30 September 1990.

In summary, therefore, the insurances were as follows. 1. The direct contracts between K.A.C. and the direct insurers/primary reinsurers, for 12 months ending 30 June 1991, covering war, hostilities, seizure etc. (paragraph (a)) and seizure etc. (paragraph (e)), with ground risks limited to U.S. $300m. "any one occurrence," and with additional cover for spares under paragraph (a) above. 2. Chains of intermediate reinsurances, with the primary reinsurers at one end and the inward reinsured on the other, on terms not precisely known. 3. The inward contracts between the inward reinsured and the syndicates, for cover between 1 January and 31 December 1990, on terms including the follow settlements clause. 4. The outward contracts between the syndicates and the appellants, Mercantile and General Reinsurance Co. Plc. ("M. & G."), for cover in most instances between 1 January and 31 December 1990, on terms including the follow settlements clause, and with the layer of cover defined in terms of "any one event."

I now turn to the events which are said to found claims under the policies along the chain. On 2 August 1990, Iraqi invading forces seized

control of the 15 aircraft on the ground at Kuwait airport. Within the following few days, the aircraft were flown to Iraq. During January 1991 six of the aircraft were removed to Iran, and one to Jordan. Of the aircraft remaining in Iraq seven were destroyed on the ground by allied attacks during January and February 1991. The eight surviving aircraft were later recovered and returned to K.A.C.

It will be seen that the events of August 1990 took place during the cover of the direct contracts and of all the reinsurances. As regards the later events they occurred—(i) during the period covered by the direct contracts; (ii) after the expiry of the inward contracts, and (apparently) of the unknown intermediate insurances; (iii) during the period covered by two of the outward contracts and after the expiry of the remainder.

Thus, on any view of the facts, the losses occurred whilst the aircraft were on-risk under the direct contracts. Further, on the basis that the origin of the ultimate destruction was the invasion of Kuwait and the removal of the aircraft it would be arguable that the whole matter constituted "any one occurrence," for the purposes of the aggregate limit of the direct contract insurance/reinsurance, thus confining the recovery to the U.S. $300m. limit for ground risks under paragraph (a).

As to the outward contracts, if the aircraft should be regarded as lost when they were seized in Kuwait and soon afterwards taken away to Iraq the losses happened whilst the aircraft were on-risk under the outward contracts; and it would be arguable that the losses were "arising from any one event," within clause 3.1 of the joint excess loss clauses, for the purpose of calculating the "net loss." But if the losses did not happen until the aircraft were actually destroyed, this would (as regards the majority of the contracts) have been after the expiry of the cover, and the argument for aggregating them all into a single loss would be much less strong.

Finally, I must describe the claims, so far as they emerge from the agreed facts. On 12 September 1990 the brokers of K.A.C. wrote to underwriters notifying a claim in respect of 15 aircraft, under "paragraph e of the policy wording." On 18 September the leading underwriter endorsed the letter as follows:

> "Agree settle war loss under section 1(a) with reference to 2.8.90, for this slip's proportions of the maximum ground limit of $300m. (subject to leading underwriters having been satisfied as to entitlement/legitimacy of claimants' appropriate safeguards on payment of claim). Basis of claims as presented on detention/seizure/confiscation . . . on various dates rejected. Any claim in excess of U.S. $300m. rejected. Position fully reserved on any further claims as intimated."

In circumstances not in evidence the direct insurers/reinsurers paid $300m. to K.A.C. in respect of the loss of the 15 aircraft. By a letter dated 8 January 1991 and headed "form of receipt release and subrogation" whereby K.A.C. agreed, amongst other matters, to

> "(1) confirm that the reinsurers named herein have acquired pro tanto such rights of subrogation as would otherwise devolve upon the reassureds by operation of law; . . . (3) acknowledge formal receipt of the payments so made, and confirm the reassureds are released from further liability in respect of the loss *only* to the extent of such payment."

The schedule to the letter gave the date of payment as 21 December 1990, the identity of the payers as the Institute of London Underwriters, and the amount as U.S. $22,761,162·22.

A further letter from K.A.C. of 17 January 1991 was in identical terms, except that the payers were Lloyds, the date of payment was 11 January 1991, and the amount of the payment was U.S. $138,662,238·64. It will be seen that the total amount covered by the letters was barely more than half of the $300m. which the parties to the present dispute agree to have been paid. This is not explained.

Leaving aside the point just mentioned, the position as at mid-January 1991 was as follows. 1. The primary insured had claimed under a policy which covered the aircraft against loss or damage occurring between 1 July 1990 and 30 June 1991. 2. The claim was made under clause 1(e) of the policy, that is as a loss by "Confiscation, nationalisation, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any government . . ." 3. The reinsurers had agreed to settle the loss under clause 1(a) of the policy, that is as a loss by "War, invasion, acts of foreign enemies, hostilities (whether war be declared or not) . . ." 4. The reinsurers had refused to acknowledge a loss under clause 1(e) or any loss in excess of $300m. 5. The reinsurers recognised that a further claim might be made, and reserved their position about it. 6. Before the payment of U.S. $300m., and the issuing of the letters of subrogation, the aircraft had been seized by the Iraqi forces on the ground at Kuwait airport and they had been flown to Iraq. Also, they had been, or were about to be, severally removed to Iran and Jordan, or destroyed in Iraq. 7. All these events occurred during the currency of the primary insurance/reinsurance. But as regards most of the excess of loss reinsurances now sued upon only those events happening before 1 January 1991 were covered.

It can be seen therefore that so far as the primary insurance/reinsurance was concerned there was no doubt that an insured loss had occurred, and that the amount was at least U.S. $300m., the limit of the ground risks cover for "any one occurrence." There was however an issue about whether the loss was payable under clause 1(a) or 1(e) of the conditions, which was important both because it would be much easier for the direct reinsurers to contend for a single "occurrence" if the loss of the aircraft was by war etc. than by detention etc., and because the cover under paragraph (a) extended to spares and equipment, whereas that under paragraph (e) did not.

The position under the more distant reinsurances was different. Whereas there was no doubt that all the events which might have constituted losses under the direct insurance/reinsurance happened during the currency of the policy, this was not the case with the inward and outward contracts and (we are asked to assume) the numerous intermediate contracts, where the cover terminated before some of the aircraft were destroyed. Moreover, the deductible in the contracts further up the chain was for "each and every loss," defined as a loss "arising from any one event," which opened the way to an argument that each aircraft suffered a loss arising from an independent event.

Furthermore, not only was there a discontinuity between the direct insurance/reinsurance on the one hand and the remaining reinsurances on the other in relation to the terms of the cover, but the ways in which the claims were handled were also entirely different. As already described, at the direct level there were explicit negotiations between the opposing

parties. For practical reasons this could not happen as the claims originating from the direct reinsurers made their way up and around the LMX spiral, the artificial complexity of which is well illustrated by the fact that Mr. Hill paid out over 10,000 claims in respect of this particular casualty or set of casualties. Ultimately, it seems that claims arrived at the inward policies, and that some payments were made by the syndicates to the inward reinsured. We know nothing of these in the particular, but the general course of events was the subject of affidavit evidence by Mr. I. R. Fisher, who was at the material time the manager and adjuster of the syndicate excess of loss group on the establishment of the Lloyd's Claims Office (hereafter "L.C.O."). His evidence is crucial to the syndicates' case on "settlement" under paragraph (a) of the clause. No application was made to cross-examine Mr. Fisher on his statement, so that not only his candour (which I would very surprised to hear doubted) but also the accuracy of his recollection is not challenged. Nevertheless, there are problems in applying what he says to paragraph (a). A full appreciation of them, such as would be required at a trial, would require extensive quotation from the evidence. This is however an application for summary judgment, and since the statement of Mr. Fisher is extensively reported in the judgment of Hirst L.J. [1995] L.R.L.R. 160 it is enough to give the gist. On the occurrence of circumstances which might give rise to a claim an insurer/reinsured considered what would be his exposure if and when a claim was settled, and notified it to his reinsurers. The details were then entered in an electronic database, which constitutes notice to the market generally. The physical files were not normally retained by L.C.O. In the case of excess of loss claims the details would be entered in the database, at which point "the market" considered questions such as aggregation. It seems that in situations such as the present "the market" was represented by L.C.O. In the case of the K.A.C. aircraft Mr. Fisher and his colleagues gave thought to the question whether there was one single event (the invasion of Kuwait) or several events arising out of that invasion.

Mr. Fisher then went on to describe the test which he and his experienced deputy Mr. E. A. Andrews employed to answer this question. This need not be described, since the correctness of Mr. Fisher's conclusion, reached in January 1991, is not in issue at the present stage. In the event, he decided that the K.A.C. loss was to be regarded as one event, and he circulated his staff to that effect. Mr. Fisher continued:

> "When we had satisfied ourselves of the [ultimate net loss] the claim would be agreed and paid as long as all other contract terms of the contract on which the claim was being made were complied with . . . Our system enables us to ensure that the settlement upon which a claimant is attempting to recover was considered by us to be a proper and correct settlement in the first instance. The L.P.S.O. settlement number and date is proof positive that a claim has been vetted by L.C.O. (if appropriate) and/or by the interested underwriter/s and part of that vetting procedure would have involved a consideration of all material aspects of the claim being made on Lloyd's."

It seems therefore that the issues of law and construction arising under the reinsurances, starting from the first of the intermediate contracts (and perhaps starting from the direct insurance/reinsurance) and ending with the inward reinsurance, were all decided by Mr. Fisher in consultation with his assistant, and that the thousands of claims were paid or not paid in accordance with Mr. Fisher's opinion.

All these matters related to the inward contracts and those below them in the chain. At the same time M. & G. were reflecting on the legal position under the outward contracts, and ultimately sent out a market circular stating that:

> "Whilst we are still keeping an open mind on the situation and are prepared to consider any comments, it seems increasingly clear that no losses or event occurred during 1990 so that nothing is payable under 1990 covers."

The syndicates were not satisfied and in due course issued a series of writs under the outward contracts seeking: (a) the appropriate proportions of the full insured value of the relevant aircraft; (b) a declaration that M. & G. was

> "liable i. to follow the [syndicates'] settlement in respect of the claim made by the original assured and settled by the original insurers on the basis of one event occurring on 2 August 1990 in so far as subsequently claimed on that basis against the . . . plaintiff; . . ."

(c) a declaration that M. & G. was

> "liable. . . ii. to pay to the [syndicates] any claims calculated in accordance with [the subject matter of the previous declaration] notwithstanding that whether the loss was one event and/or occurred on 2 August has not yet been finally determined in the litigation between the original insured/insurer."

It will be seen that the relief claimed was of two kinds. First, a monetary payment, on the straightforward basis that on the facts and the wording of the outward contracts M. & G. were unanswerably liable under those policies, whatever might be the position under the direct contracts. Secondly, a claim founded on the follow settlements clause, the settlement in question being the outcome of the exchanges between the primary reinsurers and K.A.C. between September 1990 and January 1991, coupled with the payment of U.S. $300m.

When these claims came before Rix J. on the application for summary judgment they were differently expressed. As to the first contention it was accepted by counsel for the syndicates that, leaving aside the settlements clause, there were triable issues fatal to any claim for summary judgment. This is still the position. For the purposes of this appeal it is conceded that the following contentions raise triable issues. (1) There was no immediate loss of any aircraft on 2 August 1990 by reason of the invasion of Kuwait: if there was any loss, it took place later. (2) Whatever losses there may have been were individual losses of individual aircraft. There was no single loss, nor did the losses arise "from any one event," within the meaning of the outward contracts. (3) At the most, only eight aircraft have been lost (seven K.A.C. and one B.A. aircraft); the remaining K.A.C. aircraft have been recovered; and (4) these eight aircraft, if lost at all, were lost during 1991, not 1990, and hence were outside the periods of cover of all except two outward contracts.

Secondly, as the proceedings continued it came to be recognised, as was undoubtedly correct though not perhaps obvious at first sight, that for the purpose of the follow settlements clause in the outward contracts the search for a relevant settlement should be directed, not to the dealings between K.A.C. and the direct insurers/reinsurers but to whatever settlement within the meaning of the clause may have been reached

between the inward reinsured and the syndicates under the inward contracts.

The matter accordingly came down to this. Was the effect of whatever settlement had been reached between the syndicates and those immediately below them in the chain (of which the only evidence was that given in the general by Mr. Fisher) to make M. & G. either finally or in the alternative provisionally liable for the amounts paid by the syndicates under the inward contracts, to the exclusion of the potential grounds of defence summarised above?

It is convenient once more to give the terms of the follow settlements clause, on this occasion dividing it into lettered paragraphs:

> "[a] 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, [b] providing such settlements are within the terms and conditions of the original policies and/or contracts [c] and within the terms and conditions of this reinsurance."

Paragraphs [b] and [c] of this clause have been called the first and second provisos.

I return to the actions. Understandably, the judgment of Rix J. was much concerned with an important passage from a judgment delivered by Robert Goff L.J. in *Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd.* [1985] 1 Lloyd's Rep. 312, 330, where the clause in question read: "Being a reinsurance of and warranted same . . . terms and conditions as and to follow the settlements of the Insurance Company of Africa." At the conclusion of an extensive review of the authorities the Lord Justice had said:

> "The intention must, in my judgment, have been to bind insurers to follow settlements, even where the effect was that they could not dispute that there was in fact liability on the insurers under their policy with the assured. In my judgment, the effect of a clause binding reinsurers to follow settlements of the insurers, is that the reinsurers agree to indemnify insurers in the event that they settle a claim by their assured, i.e., when they dispose, or bind themselves to dispose, of a claim, whether by reason of admission or compromise, provided that the claim so recognised by them falls within the risks covered by the policy of reinsurance as a matter of law, and provided also that in settling the claim the insurers have acted honestly and have taken all proper and businesslike steps in making the settlement. This construction seems to me consistent with the approach of Branson J. in *Excess Insurance Co. v. Matthews* (1925) 23 Ll.L.R. 71. In particular, I do not read the clause as inhibiting reinsurers from contesting that the claim settled by insurers does not, as a matter of law, fall within the risks covered by the reinsurance policy; but in agreement with Bigham J., I do consider that the clause presupposes that the reinsurers are entitled to rely not merely on the honesty, but also on the professionalism of insurers, and so is susceptible of an implication that the insurers must have acted both honestly and in a proper and businesslike manner. . . . in my judgment, if insurers have so settled a claim, acting honestly and in a proper and businesslike manner, then the fact that reinsurers may thereafter be able to prove that the claim of the assured was fraudulent does not of itself entitle reinsurers not to follow the settlement of the insurers."

I now turn to the judgment of Rix J. at first instance, where after citing the passage just quoted the judge said [1995] L.R.L.R. 160, 167–168:

> "It follows that what Robert Goff L.J. said about the nature of a follow settlements clause was probably obiter. I regard it as nonetheless authoritative for that, but a consequence is that Robert Goff L.J. did not have to elaborate about how in certain circumstances such a clause would operate. He plainly considered that, had it not been for the claims co-operation clause, the follow settlements clause would have been binding on the reinsurers in that case, despite their allegation of fraud, and even if that allegation had subsequently been proved in fact (at p. 330). Nevertheless, that is arguably different from a situation where the dispute is, not about whether a claim prima facie within the policy is vitiated by the primary assured's fraud, but, about whether the loss in respect of which the reassured claims against reinsurers is within the terms of the reinsurers' policy at all. Moreover, in such circumstances, on which side of the line drawn by Robert Goff L.J. between 'in fact' and 'in law' am I to regard M. & G.'s defences that the losses in respect of which the plaintiffs are in these actions claiming, on the basis of the settlements which they have made, fall below the excess limits to which they have subscribed, or fall within a period for which (save in the case of the Hill contracts) M. & G. have not agreed to cover the plaintiffs? It is not clear to me that these are defences 'in fact' as distinct from defences 'in law.' It seems to me to be at least arguable that the period in respect of which a reinsurer covers his reassured is as essential an element of the risk which he has agreed to bear as a risk defined in terms of, say, fire or theft. It seems to me that the same is arguably true, in the context of excess of loss reinsurance, about the excess limit below which there is no protection: this is not a mere matter of quantum, but arguably an essential part of the reinsurer's bargain. Under a clause, therefore, which binds the reinsurer to his reassured's settlements only subject to those settlements being within the terms of their contract, it seems to me to be at least arguable that the reassured must be entitled to say that he is not bound by settlement of a loss which in law is properly to be regarded as occurring in a year in which he is not a reinsurer, or which in law is to be regarded as made up of several distinct losses, each of which falls below the limit at which he has agreed to accept liability. Indeed, the argument seems to me to be potentially wider than that, in circumstances where there is uncertainty, reflected in the argument before me, as to the nature of the settlements relied upon. Mr. Popplewell pressed upon me that K.A.C.'s claim upon primary insurers had been settled by the primary insurers and reinsurers on the basis of one loss occurring on 2 August 1990, and that that settlement had been reflected by consequent settlements all the way along the line up to and including the plaintiffs. He went on to submit that the settlements with which I, however, am concerned are those made by the plaintiffs—and that would seem to be correct. Nevertheless, it appears to be the case that the primary insurers' and reinsurers' payments of U.S. $300m. were not so much in settlement of K.A.C.'s claim on the basis of one loss, as in settlement of an admitted liability of *at least* U.S. $300m., premised but not settled

upon the basis of there being only one loss. That premise was not agreed between the parties, who have therefore entered into litigation about it. In these circumstances it is not clear to me exactly what the status of the plaintiffs' payments to their assureds is. Mr. Popplewell was willing to describe these payments to me in argument as provisional settlements, submitting that provisional settlements were as much within the settlements clause as any settlements, and indeed pointing out that the settlements clause includes even 'the establishment of funds for the settlement of losses' within the matters which are binding upon reinsurers. However, the plaintiffs' claims before me have not been advanced as consequent upon the establishment of funds for the settlement of losses, and if I am to regard the payments in respect of which the plaintiffs claim as provisional settlements, then it seems to me that it is at least arguable, as Mr. Longmore has submitted, that such payments are not in truth 'settlements' (to use the language of the settlements clause) or sums paid 'in settlement' (to use the language of JELC cl. 1), but rather merely provisional payments consequent upon the primary reinsurers' payment of U.S. $300m., but otherwise subject to the litigation proceeding between K.A.C. and its primary insurers."

Later, the judge summarised his opinion as follows, at p. 169:

"In these circumstances, whatever may be the position under the settlements clause's first proviso, I am not persuaded that M. & G. do not have an arguable defence under at any rate the second proviso. None of the cases cited above have been specifically concerned with the operation of the second proviso, save (as in *Hiscox v. Outhwaite* [1991] 2 Lloyd's Rep. 524) in the case of circumstances where the reinsurance policy has been expressly made on the same terms and conditions as the original policy. Moreover, it is in issue whether there were any 'settlements' properly so called, or whether such settlements can properly be described as settlements on the basis of only one loss occurring on 2 August 1990. As for the first proviso, I would merely observe that JELC cl. 1.3 states that it is a condition precedent to the reinsurers' liability that any settlement by the reassured shall be 'in accordance with' the terms and conditions of the original policies. The settlements clause uses the language 'within' the terms and conditions of the original policies. Presumably the clauses are to be read, if possible, together. If 'within' is to have the same meaning as 'in accordance with,' the argument that a settlement to be binding has to be in respect of a claim not merely arguably within the original policy's terms but properly in accordance with them seems to be to be open to the reinsurer. In their points of claim the plaintiffs adopt the burden of alleging that the loss settlements relied upon are 'in accordance with' the inward reinsurances. If this goes somewhat to emasculate a follow settlements clause, it is arguably what the parties have agreed."

In the result, Rix J. considered that this was not a proper case for summary judgment, and gave unconditional leave to defend.

The Court of Appeal disagreed. The leading judgment delivered by Hirst L.J., after quoting extensively from the judgments of Robert Goff L.J. in the *Scor* case [1985] 1 Lloyd's Rep. 312 and Evans J. in

Hiscox v. Outhwaite (No. 3) [1991] 2 Lloyd's Rep. 524, 530, expressed his own opinion in the following passages [1995] L.R.L.R. 160, 185–186:

> "[Counsel] submits that, applying the clear words of the majority (Robert Goff and Fox L.JJ.), the clause binds reinsurers to follow the settlement provided the claim on its face falls within the risks covered by the policy of reinsurance as a matter of law, and provided also of course that the insurers have acted honestly and in a businesslike manner. Thus, for example, if an insurer under a burglary policy paid up a claim for arson, the reinsurer would not be liable; but if the insurer paid up honestly and in a businesslike manner under a burglary policy for an alleged burglary, it would not be open to the reinsurer to re-open issues on which the insurer had exercised his own honest judgment, e.g., whether or not there was a breaking and entering. This, [counsel] submitted, was fully in line with the views of Branson J. in *Excess Insurance Co. v. Matthews* (1925) 23 Ll.L.R. 71, quoted above, of which Robert Goff L.J. expressly approved. Here for example a claim arising out of a war between the U.S.A. and China, or out of a nuclear detonation, would by virtue of the general exclusion plainly fall outside the risks covered by the policy. . . . In summary, therefore, I have come to the conclusion that, on its proper interpretation *Scor*'s case delimits the ability of the reinsurer to raise points of law within the very narrow confines submitted by [counsel]; a fortiori, the reinsurer is not entitled to re-open issues of fact, as is manifestly demonstrated by the Court of Appeal's refusal to allow the reinsurers to rely on the owners' alleged fraud."

The Lord Justice then turned to the two provisos. As to the first, he recorded and rejected a contention by counsel for M. & G. that it entitles the reinsurer to take any point, or at least any point of law open to the original insurer, on the grounds that if this had been intended the draftsman would have included an express provision, and that the suggested interpretation would rob the clause of any significant meaning. The same considerations applied, in the opinion of the Lord Justice, to the second proviso.

Next, the Lord Justice came to the meaning of "settlement," as follows, at p. 187:

> "One well-established legal meaning is synonymous with compromise; another is synonymous with payment. [Counsel for M. & G.] submitted that 'settlements' connote arrangements whereby primary insurers or reinsurers disposed or bound themselves to dispose of K.A.C.'s claim either by compromise or admission. In my judgment this meaning cannot apply in the present context, not least because in its second appearance the word 'settlements' is qualified by the adjective 'compromise.' It thus seems to me that, as [counsel for the syndicates] submits, the natural grammatical meaning of 'settlements' in the context is equivalent to payments. [Counsel for M. & G.] nonetheless seeks to circumscribe that meaning by limiting it to final payments, or interim payments where liability is conceded, thus excluding the present case. I can see no rhyme or reason for such an artificial distinction, which is not to be found in the words themselves, and for which [counsel] was unable to suggest any commercial logic."

Finally, Hirst L.J. dealt with an argument that it would be unfair that M. & G. should be tied to a settlement which, if K.A.C. ultimately won

A their case under the direct contracts, would result in a number of losses being established, on none of which would M. & G.'s minimum excess of loss figure be reached, at pp. 187–188:

> "To this there seems to me to be two valid answers . . . Firstly, it is inherent in the present system, as shown by Greer L.J. in his judgment in [*Gurney v. Grimmer* (1932) 44 Ll.L.R. 189], that reinsurers take the rough with the smooth, to their overall advantage, particularly bearing in mind that in the present case, should K.A.C. win their action, the total liability to be borne by the reinsurance market as a whole will more than double, even though as a result M. & G. themselves might go free. Secondly, it seems to me plain that if, as a result of the outcome of the K.A.C. case liabilities up the LMX chain were revised, M. & G. would be entitled to an appropriate re-adjustment reflecting their true liability (if any) on well-established principles of equity and quasi-contract and/or under JELC cl. 2.2; this was not merely conceded but positively asserted by [counsel for the syndicates]. This also meets another criticism advanced by [counsel for M. & G.], which is indeed inherent in the LMX market system, that there may be a conflict of interest between the original insurers on the one hand and the reinsurers up the line on the other, in that a settlement which is to the advantage of the former (since it reduces global liability to the minimum) may be to the disadvantage of the latter (if and in so far as the bottom line of their excess of loss liability is breached)."

My Lords, these quotations, long as they are, do less than justice to the care taken by the courts below to analyse the various forms of settlement clause, the decisions upon them, and the propositions of Robert Goff L.J. in the *Scor* case [1985] 1 Lloyd's Rep. 312. Acknowledging this, I shall take a different and more direct course, for although it is easy to suppose from the difficulty of the reported cases and the eminence of the judges involved that questions of deep principle are involved, this is not so. There are only two rules, both obvious. First, that the reinsurer cannot be held liable unless the loss falls within the cover of the policy reinsured and the within the cover created by the reinsurance. Second, that the parties are free to agree on ways of proving whether these requirements are satisfied. Beyond this, all the problems come from the efforts of those in the market to strike a workable balance between conflicting practical demands and then to express the balance in words.

These practical demands can be seen most easily in the context of traditional reinsurance, where the party reinsured is the insurer under a contract made directly with the person whose property or other interest is at risk. Two impulses act in opposite directions. The first is to avoid the investigation of the same issues twice; and, moreover, an investigation on the second occasion by a reinsurer whose knowledge of what happened when the risk was written, and whose facilities for investigating the claim, are inferior to those of the direct insurer. The second impulse, acting in the other direction, is to ensure that the integrity of the reinsurer's bargain is not eroded by an agreement over which he has had no control.

This conflict is quite easily managed where the insurance and the reinsurance are on the same terms and where the parties are essentially co-adventurers: for example, in participatory reinsurance, or facultative reinsurance with a large retention. Here, the interests of the direct insurers and the reinsurers are broadly the same, and it is not imprudent for the

reinsurers to put themselves unconditionally in the hands of their reinsured for the settlement of claims which will be passed on to them.

The problems are more acute when either or both of two situations exists: (a) the terms of the successive policies are not the same, (b) the reinsurance is of another reinsurer, and stands at one or more remove from the direct cover, so that the reinsured are themselves reinsurers. For example, in the former case it may well happen that a claim under the direct policy does not require the determination of issues which are crucial to liability under the reinsurance: as happened in the "constructive total loss" cases like *Chippendale v. Holt* (1895) 1 Com.Cas. 197; and indeed in the present case where there can be no doubt that the loss, whatever exactly it was, fell within the direct contracts, whereas this was not necessarily the case under the reinsurances. Again, it may happen that where cumulative perils (call them X and Y) are covered by the direct policy, whereas only Y is covered by the reinsurance, a direct insurer, to whom the choice between X and Y is indifferent if he is willing to admit or compromise liability, may even in good faith settle a claim on his own policy which impinges on the mutual rights of himself and his reinsurer under the reinsurance. These are only examples.

Situations of type (b), where the reinsurer is at a distance from the direct insurance, may also cause practical problems. There is an obvious administrative advantage in binding the ultimate reinsurer by a settlement made further down the chain, to avoid a full re-investigation of fact and law at each stage of the chain; and the desirability does of course become even more obvious where the chains suffer from the extravagances of the LMX spiral. On the other hand, a remote reinsurer, who may know nothing beyond the identity of his reinsured, and the terms of his own cover, could hesitate to entrust his liabilities to a stranger, which is what will happen if all the reinsurances down the chain embody unqualified follow settlements clauses.

These tensions have revealed themselves for a century in successive reformulations of the clause. They can also be seen in the strenuous efforts by the courts to maintain some continuity of principle, by applying prior decisions given on one form of clause in one state of facts to another form of clause in a different state of facts. I find this process unfruitful, as shown by the attempts to transfer the reasoning of the *Scor* case [1985] 1 Lloyd's Rep. 312 to the present dispute.

This is well shown by the *Scor* decision itself. Mr. Veeder for M. & G. rightly (in my opinion) made no attempt to argue that the formulation of Robert Goff L.J. was incorrect. He had no need to do so. The clause in question was in the simplest form; it was part of a first-tier reinsurance, apparently on identical terms to the direct cover; and the dispute arose from an allegation that the local judgment satisfied by the direct insurer was wrong in fact. The present case is different in every respect, and I cannot see how the decision in the *Scor* case, or the reasons given for it, can have any decisive bearing on the issues now before the House. I prefer to read the follow settlements clause, see what it says, and apply what it says to the special facts of the present dispute.

I start with the two provisos: paragraphs [b] and [c] of the follow settlements clause. The intent of these seems clear in broad outline, although it may be difficult to apply on the margins. The crucial words are "within the terms and conditions" of the original policies and of the reinsurance. To my mind these draw a distinction between the facts which generate claims under the two contracts, and the legal extent of the

respective covers: the purpose of the distinction being to ensure that the reinsurer's original assessment and rating of the risks assumed are not falsified by a settlement which, even if soundly based on the facts, transfers into the inward or outward policies, or both, risks which properly lie outside them. This restriction is perhaps more clearly visualised in relation to the second proviso. Here, the reinsurers are entitled to say that they rated the policy by reference to its chronological and geographical extent, to the types of casualty insured, to the boundaries of the insured layer, the mode of calculating the loss, and so forth. These variables, defined by the terms of the policy, founded the bargain between reinsurers and reinsured on the basis of which the premium and other terms were set. The purpose of the second proviso is in my view to keep this foundation intact, and it would be undermined if an honest attempt by those further down the chain to ascertain the legal consequences of the facts could impose on the reinsurers responsibilities beyond those expressed in the policies. So also with the first proviso. The reinsurers undertake to protect the reinsured against risks which they have written, not risks which they have not written. To allow even an honest and conscientious appraisal of the legal implications of the facts embodied in an agreement between parties down the chain to impose on the reinsurers risks beyond those which they have undertaken and those which the reinsured have undertaken would effectively rewrite the outward contract: and it is this, in my opinion, which the provisos are designed to forestall.

Before continuing, however, I must record three responses to this conclusion. The first is that the interpretation given to the provisos would emasculate the clause. I cannot agree. There is ample room for the clause to operate in every situation except where the settlement would bind the reinsurer to a definition of cover different from that which he has contracted to accept. Secondly, it is said that if the result proposed had been intended the clause could have said so. In my opinion it does say so. The final objection is that to allow the reinsurers to raise defences like the present would cause chaos in the market. I recognise the force of the submission to this extent, that allowing the defences to be maintained will leave not only the validity but also the size of the claims and their incidence on various claims in suspense, through a large section of the market; an adverse effect which is multiplied by the size of the claims and by the pathological length and self-referring effects of the various spirals. Repercussions of this nature must, however, be inherent in the clause itself, unless the provisos are to be totally ignored and the clause read as delivering the reinsurers into the hands of those down the chain, to modify the terms of the clause as they honestly but mistakenly decide. This result could undoubtedly have been achieved by choosing the right words, but looking back over the decades one can see that the market has understandably shrunk from going so far. The wording of the clause shows that an even less far-reaching result is intended today.

This opinion, combined with the admissions as to arguable defences already recorded, is sufficient to exclude the possibility of summary judgment, based upon the settlements alleged to have been made. Quite apart from this however there is the question whether there was a "loss settlement(s) . . . or compromise settlement(s)" within paragraph [a] of the clause. As already remarked, the instinct is to relate this question to the written exchanges between K.A.C., its brokers and the direct insurers/reinsurers. If this had been so, there would have been good reason to find a settlement by which the parties irrevocably agreed on a loss by

perils insured against, on the occurrence of the loss during the period of the direct contracts, and on the recoverable amount of at least U.S. $300m. That the settlement was to this extent final is apparent not only from the documents themselves, but also from the agreement by K.A.C. to give the insurers rights of subrogation. The settlement was however incomplete, since it left open for negotiation or subsequent proceedings the identification of the relevant peril, and the question of aggregation (which was linked to the date of the loss or losses).

The instinct to concentrate on this transaction is however mistaken, for paragraph [a] of the clause as incorporated in the outward contracts directs attention to a "loss settlement[s] by the reassured," and in the context of those contracts the reassured was the syndicates, not the primary reinsurers at the other end of the chain. Accordingly, the question is whether there was a settlement of a claim by the inward reinsured against the syndicates under the inward contracts: and the only evidence of such a settlement is the account of market practice by Mr. Fisher, on which it appears to be contended that all the thousands of claims round the spirals were settled at one blow by the decision of Mr. Fisher about the dates of the losses and about the extent to which the losses would be aggregated as being, or not being, "from one event." Because this evidence was not explored in cross-examination, it leaves some important questions unanswered. By way of example only, it seems most remarkable for all the participants to have agreed to be unconditionally bound by the opinion of an official of L.C.O. on a question of law, or mixed fact and law, involving such large sums of money, without even having, so far as the evidence goes, an opportunity to persuade him to a different view. It is suggested by the syndicates that the consequences are less striking because the parties were not unconditionally bound, since if the opinion proved incorrect the computations could be re-worked throughout, and reimbursements made of any payments incorrectly demanded. I must own to uncertainty about the legal basis on which repayments could be demanded, but apart from this I do not at present understand how in practice the incorrectness of Mr. Fisher's decision would be established. A judgment in proceedings brought under the direct insurance/reinsurance (such as the judgment given by Rix J.) would shed light on the decision, but would not be conclusive because the parties would be different, and the judgment would not necessarily be sent up the chain as a settlement via whatever follow settlement clauses there may have been in the first of the intermediate contracts, since the terms of the cover were not the same. The only alternative that I can see would be to have the questions of mixed fact and law authoritatively determined by litigation between the parties to the reinsurances, which is precisely the solution which the syndicates by their application under Ord. 14, r. 1(1) are seeking to avoid.

My Lords, I do not suggest that these problems (and there are others) are necessarily insuperable, but I do consider that they require closer scrutiny than is feasible on an application for summary judgment. In other words, under paragraph [a] of the clause, as well as under paragraphs [b] and [c], there is (within the words of Ord. 14, r. 3(1)) an "issue or question in dispute which ought to be tried."

My Lords, I shall not prolong this speech by discussing additional points canvassed in argument. They will all be open at the trial. For the reasons given I would allow the appeals, and restore the order of the judge.

A LORD SLYNN OF HADLEY. My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Mustill. For the reasons he gives I, too, would allow the appeal and restore the order of Rix J.

LORD HOFFMANN. My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Mustill, and for the B reasons he gives I, too, would allow the appeals.

Appeals allowed.

Solicitors: Barlow Lyde & Gilbert; Clyde & Co.; Manches & Co.

C A. R.

D

[CHANCERY DIVISION]

*PRACTICE DIRECTION (COMPANIES COURT: WINDING UP)

[No. 1 of 1996]

E

Insolvency—Winding up—Petition—Advertisement mandatory—Penalty for non-compliance—Insolvency Rules 1986 (S.I. 1986 No. 1925), r. 4.11(2)(b)(5)

The attention of practitioners is drawn to rule 4.11(2)(*b*) of the Insolvency Rules 1986. The rule is *mandatory*, and designed to ensure that F the class remedy of winding up by the court is duly made available to all creditors, and is not used as a means of putting pressure on the company to pay the petitioner's debt. Failure to comply with the rule, without good reason accepted by the court, may lead to the summary dismissal of the petition on the return date: rule 4.11(5). If the court, in its discretion, grants an adjournment, this will be on condition that the petition is G advertised in due time for the adjourned hearing. No further adjournment for the purpose of advertisement will normally be granted.

G. L. PIMM
Chief Bankruptcy Registrar

11 July 1996

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