It will be recalled that the Law Reform Committee made similar suggestions for changes in our law in 1957. Nothing happened.

The Law Commission Report 1980 reinforced the 1957 recommendations - nothing has happened.

In a few lines of legislation Australia has removed the effects of those blots on insurance intermediary law made by the Court of Appeal in 1929 with *Newsholme v. Road Transport and General Insurance.*

My worry is that while I believe there is little chance in this country of legislative reform in general insurance law, what chances may have existed will have been well and truly scuppered by the nightmares caused by the Financial Services Act 1986 and the lingering after-effect that it will have for general insurance.

3. REINSURANCE LAW
by Stephen Ruttle, Barrister

1. There have been a number of recent decisions of considerable importance to the reinsurance market. I shall concentrate on two of these cases:

(a) *Boden v. Hussey* (1988) 1 Ll. R. 84 (Adrian Hamilton Q.C.): (1988) 1 Ll. R. 423 (Court of Appeal); This was the *Air India* reinsurance case which in essence concerned the definition of "loss" in a standard excess of loss reinsurance wording.

(b) *Home & Overseas Insurance Co. Limited v. Mentor Insurnace Co. (UK) Limited* Financial Times, 10th August 1988, Hirst J.

There are two important matters discussed in this decision.

(i) Whether on a standard excess of loss reinsurance wording payment by the reassured is a condition precedent of the reassured's right to recover against the reinsurer.

(ii) The effect of the "honourable engagement" provision in a standard Arbitration clause in a Reinsurance Treaty wording.

Boden v. Hussey

2. **The facts**

(i) June 1985: crash of Air India Boeing 747 Jumbo.

(ii) Air India had *combined All Risks and War Risks cover with GIC* which had settled claims.

(iii) At the time of the action it had still not been determined whether the loss was due to sabotage (War Risks) or structural fatigue (Hull Risk). (It has since been determined to have been a War Risk peril).

(iv) GIC had reinsured its All Risks and War Risks exposure separately on the London market.

(v) Both the War Risks and the All Risks reinsurance slip contained a 50-50 claims agreement clause which provided, in part,

> "Each policy shall advance, without prejudice to the ultimate settlement, the agreed percentage of the interested underwriters' liability as quantified under such policy."

(vi) London market reinsurers (both All Risks and War Risks) had paid GIC not on the basis of 50-50 claims agreement, but on the basis of a separate agreement concluded between respective leading underwriters. This agreement was similar to but not identical with 50-50 claims greement.

(vii) London reinsurers having paid GIC then sought indemnity from the Defendant under excess of loss wordings.

(viii) The XL reinsurances were in standard form: Article I provided:

> "This Agreement is to cover the liability of the reassured for losses..."

Article IV (ultimate net loss clause) provided:

> "The term ultimate net loss shall mean the sum actually paid by the reassured in settlement of losses or liability after making deductions for all recoveries..."

Article VII (loss clause) provided:

> "All loss settlements made by the reassured shall be binding upon the reinsurers provided that such settlement are within the terms and conditions of the original policies and within the terms and conditions of this Agreement".

3. The litigation

It was accepted by the Plaintiff XL reassureds that the payments that they had made to GIC were in the nature of a loan - albeit a loan that they were obliged to pay - which would be repayable in the event that the market arbitration - before Lord Roskill - found that the cause of the casualty was a non-insured peril. In the light of this, the Defendant contended:

(i) such a payment by the Plaintiff reassured was not "a loss" or "a settlement" within the meaning of those phrases in the XL wording;

(ii) any payment by the Plaintiff XL reassureds had not been made "under" the policy: instead it had been made under the Leaders Agreement which was a separate agreement.

4. The Plaintiff began High Court proceedings and sought Summary Judgment. The Defendant responded by an application for the stay of the proceedings under Section 4 Arbitration Act 1950 on the basis of the arbitration clause (not an equity clause) between the parties. The Plaintiff won on both points both before the Deputy Judge and in the Court of Appeal and Summary Judgment was granted in its favour. Both at first instance and on appeal it was held that Order 14 proceedings and applications to stay "on the back of "arbitration clauses were two sides of the same coin - see *Sethia Limited v. India Trading Corporation* (1985) 1 WLR 1398.

5. Before the Judge the Defendant had put in evidence that the market would not regard an XL reinsurer as bound to indemnify a reassured in respect of a *loan* made by it unless there was express wording in the XL Agreement to this effect. The Judge felt some difficulty about this point but in the end disregarded such evidence. As a matter of law he was probably right since unless such evidence amounted to a custom of the market it would be inadmissible to vary the terms of a written Agreement.

6. The Judge had little difficulty in concluding both issues in favour of the Plaintiff. He held that the slips, envisaging as they did, the power of Leading Underwriters to

make agreements on behalf of the following markets, thereby contemplated circumstances in which payments pursuant to those agreements would be payments under the slip. On the "loss" point he took a robust view holding that once a reassured becomes under a liability to make a payment then that payment constituted a loss or a settlement irrespective of whether, at a later date, such payment is recoverable by him in full.

7. The Court of Appeal had little difficulty with the first argument; at page 427 Neill L.J. stated:

"I have no doubt that, though the September Agreement included arbitration provisions, the term which varied the provisional funding from a loan to an outright payment was fully justified by the words "or as mutually agreed" in the 50-50% claims clause."

See also per Dillon L.J., at page 429.

8. The Court of Appeal had much greater difficulty on the other point namely whether a payment in the nature of a loan could constitute a loss or a settlement within the XL wording. In the course of argument Neill L.J. seemed fairly strongly to favour the Defendant's case; Dillon L.J. taking the opposite stance.

9. It was common ground that the function of the Court was to construe the wording. There is nothing in principle that would make it inappropriate for a reinsurer to agree that he would, or would not, indemnify a reassured who has made such a payment.

The Defendant's argument was that the use of the word "loss" and "settlement" in wordings of this nature carried with it the normal meaning of those words in the context of insurance. He relied in particular upon a statement of Lord Justice Maugham in *Versicherungs und Transport A.G. Daugava v. Henderson* (1934) 49 Ll. R. 252 at page 254 that:

"A policy of reinsurance is an agreement by way of complete or partial indemnity of the insurer. That has long been settled and has been stated in more than one case. Like every contract of indemnity, it can only operate if the liability of the insurer is established, and it is necessarily contingent on that liability being established. It follows that the insurer has no causes of action against the reinsurer until the loss for which the former is liable (if any) has been ascertained."

The Plaintiff relied in particular on the ultimate net loss clause arguing that the

scheme that this clause envisaged was "pay now, sort it out later". The Defendant accepted that he would be liable to indemnify the reassured where the liability of the reinsurer has been established and a sum had been paid under a provisional settlement; even though the precise quantum of the reinsurer's liability had not been ascertained and even though the sum paid might on the final settlement prove to have included some overpayment. He contended that if, on the other hand, *it was still uncertain whether on a final settlement any particular reinsurer will be under any liability at all,* it was impossible to treat that insurer as though he had suffered *a loss.* Neill L.J. - at page 427 - states:

> "For my part I see considerable force in the argument put forward for the Appellant."

10. It would appear that it was a policy consideration which eventually persuaded the Court to uphold the Plaintiff's claim. At page 430 Dillon L.J. states as follows:

> "There are many circumstances in insurance where there is provisional funding of a claim pending resolution of a dispute as to which of several parties' insurers ought to foot the bill; e.g. in motor insurance where a passenger has been injured in a collision between several vehicles, and it is not clear which driver is at fault, or whether fault should be apportioned between several drivers. Where a claimant is bound to succeed against some insurer (or some insurer's assured), it is in the interests of the good name of the insurance industry that the claim should be provisonally funded, and the claimant should not be kept out of his money while the insurers squabble among themselves. It does not to my mind make commercial sense that such provisional funding of a claim should be outside normal reinsurance agreements."

Against that background Dillon L.J. - with little difficulty - and Neill L.J.: "In the end, however" held that on the true construction of the wordings the phrase "loss" included any sum which the reassured was under a legal obligation to pay to its assured.

Neill L.J. stated at page 427:

"I am not persuaded that the fact that the whole of the provisional payment may be recovered ultimately makes that payment different in kind from a provisional payment of which a large fraction is recoverable when the quantum of the loss between the reinsurers has been finally adjusted."

Dillon L.J. at page 430 stated:

"The key question is then whether it is a liability "for losses". It is liability of the reassured in respect of the claim, so the claim of GIC against War Risk reinsurers, which has had to be met, and has been met, under the terms of the policy, albeit only provisionally. Such a liability, when met, is in my judgment fairly to be described as a liability "for a loss" under the policy, even though the loss is only provisional. This is, in my judgment, underlined by the guidance on the meaning of the word "loss", which is to be found in Article IV and in particular the distinction there drawn between "loss or liability" and "the ultimate net loss"."

11. Article IV - upon which both Judges relied heavily in reaching their conclusion - reads as follows:

> "Ultimate net loss clause:
>
> The term "ultimate net loss" shall mean the sum actually paid by the reassured in settlement of losses or liability after making deductions for all recoveries, all salvages and all claims upon other reinsurances, and shall include all adjustment expenses of the reassured.
>
> All salvages, recoveries or payments recovered or received subsequent to a loss settlement under this Agreement shall be applied as recovered or received prior to the aforesaid settlement and all necessary adjustments shall be made by the parties hereto.

Any interest received by the reassured in respect of such salvages, recoveries or payments shall be shared between the reassured and the reinsurers in the proportion that the recovery is apportioned.

Nothing in the Article should be construed to mean that losses under this Agreement are not recoverable under the reassured's ultimate net loss has been ascertained."

12. It is submitted (despite the conclusion of this Court of Appeal)

(i) That the word "loss" in the context of an insurance or reinsurance policy connotes the occurrence of an insured peril for which the insurer is liable to indemnify its assured.

(ii) That the standard XL wording does not permit the Courts to construe the word "loss" in other than its traditional meaning.

At present, however, these submissions do not reflect the law and are unlikely to do so unless much clearer wordings (expressly excluding loans from the computation of "ultimate net loss") are agreed between the parties.

Home & Overseas Insurance Company Limited v. Mentor Insurance Company (UK) Limited

13. **The Facts**
Mentor was the reassured under a large number of excess of loss reinsurances. These reinsurances were on almost identical terms. The Plaintiff in the action was one of the reinsurers. Mentor went into liquidation and the Liquidator claimed from the reinsurers sums for which Mentor was liable to its assureds. It was common ground that Mentor had not actually paid any of these sums.

14. Home & Overseas brought an action for a declaration that it was not liable to Mentor in respect of any sum unless Mentor has first made an equivalent payment to its assured. The principal issue in the action was whether the reinsurance wording made payment by Mentor a precondition of Mentor's right to recover against reinsurers.

15. Home & Overseas issued an Order 14 Summons and Mentor issued a Summons to stay the action under Section 4 Arbitration Act 1950. Home contended that the only issue was a straightforward question of construction of the relevant reinsurance; that this was a point of law and one that the Court ought to decide on Order 14 - see *European Asian Bank A.G. v. Punjab & Sind Bank No. 2* (1983) 1 WLR 642 at page 654. Mentor contended:

(i) that the question of construction of the wording was far from straightforward;

(ii) that if Home was right on its construction of the wording then, to such extent, the wording infringed Section 597 Companies Act 1985 and was thus void;

(iii) that the parties having chosen to refer their disputes to an arbitration who were to interpret "this reinsurance as an honourable engagement" and to make their award "with a view to effecting the general purpose of this reinsurance in a reasonable manner rather than in accordance with a literal interpretation of the language", to arbitration the dispute should go.

The Judge (Hirst J.) held that it was not an Order 14 case and that the dispute should be resolved by Arbitrators. The case has recently (28th - 30th November 1988) been

considered by the Court of Appeal and their decision is awaited.

16. **The construction point**

The reinsurance is in standard form.

Clause 1 provides:

> "This reinsurance is only to pay the excess of an ultimate net loss to the reassured of..."

Clause 5 provided:

> "The term "ultimate net loss" shall mean the sum actually paid by the reassured in settlement of losses on liability after making deductions for all recoveries..."

Clause 14 provides:

"... and amounts falling to the share of the reinsurers shall be payable by them upon reasonable evidence of the amount paid being given by the reassured."

17. The closest English decision - *Re: Eddystone Marine Insurance Co.* (1892) 2 Ch. 423 involved the construction of the words "to pay as may be paid thereon". It was held that payment by the reassured was not a condition precedent to its recovering against the reinsurer. Counsel for the reassured stressed the use of the word "as" in the words "to pay as may be paid thereon" - in contradistinction to "if" and "when". Both in this case and in a later case - *Re: Law Guaranty Trust & Accident Society Limited* (1914) 2 Ch. D. 617 the Courts stressed the inequity of permitting a reinsurer to contend that its liability was conditional upon payment having first been made by the reassured.

18. The merits of the argument advanced by Home have generated a certain amount of adverse and generally ill-informed comment in the press and in periodicals. Home is one of more than 80 mainly main-line reinsurers who are taking this point. Its contention is that such a clause, in principle, has a sound commercial purpose. Reinsurers respond to payments by the reassured to underlying assureds; not to third party non-insurance creditors of reassureds such as Banks, the Revenue and the like - which is where much of the reinsurance recoveries would be likely to go in the event of a liquidation of a reassured. Further, to require a reassured to pay before it recovers on the reinsurance is to promote a more careful analysis by the reassured of the

underlying claim; and, more fundamentally, is likely to act as a major brake upon insurers "writing for premium" on the back of substantial reinsurance protections.

19. The American cases tend to go the other way:

(i) *Allemania v. Firemens Insurance* 209 US 326 (1908);

(ii) *Fidelity and Deposit Co. v. Pink* 302 US 224 (1937);

(iii) *Stickel v. Express Insurance Co. of America* 23 NE (2nd) 839 (1939).

(This latter case involved the construction of very similar words "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". Held that payment by the reassured a condition precedent).

20. Home contended that the wording was quite unequivocal and that the language used was language of "condition precedent: c.f. the *"FANTI"* (1987) 2 Ll. R299 and Court of Appeal 30/11/88 and the *"SAMOS GLORY"* (1986) 2 Ll. R. 663.

See also *Beauchamp v. Faber* (1898) 3 Com. Cas. 308. Mentor contended:

(i) It would be inequitable were Home to be right;

(ii) The purpose of the reinsurance was to cover Mentor's "liability" rather than payment;

(iii) It relied upon the proviso in the ultimate net loss clause - Article V - whch states:

> "PROVIDED ALWAYS that nothing in this clause shall be construed to mean that losses under this reinsurance are not recoverable until the reassured's ultimate net loss has been ascertained."

(iv) The word "paid" - to be understood in the context in which it appears - means: "Agreed to be paid". Reliance for this is placed on *Gether v. Caper* (1855).

21. The Judge set out the competing arguments and concluded:

"I would only be prepared to uphold Mr. Ruttle's construction if the words of the Agreement as a whole plainly excluded any other meaning. In my Judgment this is by no means clearly the case for the reasons put forward by Mr. Mance."

22. **Section 597**
This Section reads:

"Subject to the provisions of this Act as to preferential payments, the Company's *property* shall on the winding-up be applied in satisfaction of the Company's liabilities, pari passu and, subject to that application, shall (unless the Articles otherwise provide) be distributed among the members according to their rights and interests in the Company.

Mentor relied upon a majority decision of the House of Lords *British Eagle v. Air France* (1975) 1 WLR 758. Home submitted that the argument was plainly misconceived and that the *British Eagle* case was distinguishable. The Judge declined to decide the question stating:

"I consider the point a difficult one and by no means clear-cut either way so that it would have formed an additional obstacle in the way of judgment under Order 14."

23. **The Arbitration clause.**
The crucial wording was as follows:

"The Arbitrators and the Umpire shall interpret this reinsurance as an honourable engagement and they shall make their Award with a view to effecting the general purpose of this reinsurance in a reasonable manner rather than in accordance with the literal interpretation of the language."

By far the most contentious issue at the hearing was the true effect of this wording. Mentor contended:

(i) This clause permitted Arbitrators to decide questions of construction of an agreement by criteria other than those that would be applied by the courts;

(ii) that this greater latitude did not prevent the Arbitration Agreement from being an Arbitration Agreement within the meaning of the Arbitration Acts;

(iii) that this wider latitude was a crucial fact to be taken into account on the

exercise of discretion under Section 4 in determining whether or not to stay the action.

Mentor relied heavily upon the decision of the Court of Appeal in *Eagle Star v. Yuval* (1978) 1 Ll. R. 357.

24. Home, on the other hand, contended that even if (which it did not accept) the arbitration clause, on its proper construction, might empower the Arbitrators to determine a construction dispute by criteria other than those that the courts would adopt, the courts would not uphold the validity of an Arbitration Award reached by Arbitrators on such a basis. It relied upon a number of powerful and long-standing authorities. It contended that such an Arbitration Agreement could not be an Arbitration Agreement within the meaning of the Arbitration Acts; and that, accordingly, for the purposes of exercising discretion under Section 4, the "honourable engagement" element of the arbitration clause had to be disregarded.

25. The Judge preferred Mentor's approach. He relied heavily upon *Eagle Star,* the arbitration clause in which enjoined Arbitrators to decide

> "according to an equitable, rather than a strictly legal interpretation of the provisions of the Agreement".

Lord Denning stated that such a clause was valid and that it authorised

> "Arbitrators to depart from the strictnesses of the law";

Goff L.J. stated

> "Arbitrators by the express terms of the clause would be able to view the matter more leniently and having regard more generally to commercial considerations than would be done if the matter were heard in Court."

The Judge touched on some, but not all, of the cases relied upon by Home which the latter contended

> [Set out the principle that the Court would not uphold an Award where the Arbitrators had decided a question of construction other than the manner in which the Court would so decide: see for instance *Czarnikow v. Roth* (1922) 2 K.B. 478; *Orion v. Belfort* (1962) 2 Ll. R. 257; *Hadjitsakos* (1975) 1 Ll. R. 356; *Home v. Das* (1983) 2 Ll. R. 674 and *Overseas Union v. A.A. Mutal* (1988) 1 Ll. R.]

26. The kernel of the Judge's decision on this point in his statement that the Arbitration Act 1979:

> "Effected a sea change in arbitration law sweeping away the old regime of tight control by the courts over arbitrations ... the statutory foundation which underlay the *Czarnikow, Hadjitsakos and Orion* cases thus no longer applies ... consequently ... the honourable engagement clause in the present case does entitle the Arbitrators to view matters of construction more leniently and with regard more generally to commercial considerations than would be permissible in a court of law."

It is submitted that this is an erroneous proposition. It remains to be seen whether the Court of Appeal agrees.

27. The implications of this decision are far-reaching. Many, if not most, reinsurance arbitration agreements contain an equity clause; because the courts, ex-hypothesi, will be unable to apply the criteria that the Arbitrators may apply to questions of construction when they have been enjoined to apply criteria other than those which the Court would apply, it would seem to follow that:

(i) It will be exceedingly hard to obtain leave to appeal from such an arbitration decision;

(ii) It will be very difficult to resist an application to stay an action on the basis of Section 4 of the 1950 Act (technically a discretionary as opposed to mandatory stay);

(iii) The degree to which the Court would be prepared to intervene under the 1950 Act in arbitrations being conducted on such a basis may be substantially curtailed.

The Court of Appeal has indicated that its decision of the appeal will be given prior to 15th December.