INSURANCE AND REINSURANCE ARBITRATIONS: GIVING EFFECT TO THE INTENTIONS OF THE PARTIES

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1. INTRODUCTION

Recent trends in arbitration law

The use of arbitration to resolve disputes arising out of reinsurance and commerical insurance agreements is of course widespread. The English courts, encouraged by the Arbitration Act 1979, have in the last decade relinquished their previous interventionist attitude to arbitrations and have sought to encourage the parties to adhere to their agreement to arbitrate. There are four manifestations of this in recent decisions. First, the English courts will be most reluctant to hear any action involving a dispute which the parties have apparently agreed is to be arbitrated. Secondly, the courts have not been prepared to admit technical challenges to the qualifications of the arbitrator nominated by one of the parties. Thirdly, once the arbitration has commenced, the English courts are not prepared to interfere with the arbitrators' conduct of the hearing: the rule is now very firmly that arbitrators are masters of their own proceedings. Finally, once an award has been made, the English courts will resist attempts by the losing party to appeal on the basis that the arbitrators have erred in law.

It would not be possible in a short article of this nature to consider all of these aspects of modern arbitration law. Instead, it is proposed to concentrate on a small number of recent insurance and reinsurance cases which illustrate the first of the three trends noted above, namely, the desire of the courts to hold the parties to their agreement.

Statutory framework

At common law the courts are empowered to hear an action on a dispute which the parties have agreed is to be referred to arbitration, but this has always been subject to a discretion to stay judicial proceedings in favour of the arbitration. The power to stay is now statutory, although the legislation draws a distinction between domestic and non-domestic arbitration agreements. The term 'domestic agreement' is defined by s.1(4) of the Arbitration Act 1975: the result of this poorly-drafted definition is that an agreement is domestic if it is held in the UK between persons resident or incorporated in the UK.

In the case of a domestic agreement, s.4 of the Arbitration Act 1950 provides that the court is to stay its own proceedings and to allow the matter to proceed to arbitration unless there is sufficient reason for a stay to be refused. In the case of a non-domestic agreement, s.1(1) of the Arbitration Act 1975 removes the discretion and *requires* the court to stay its proceedings.

The two sections operate in more or less identical fashion, as the discretion under s.4 of the 1950 Act to refuse a stay is very rarely exercised. Consequently, a party who wishes to evade his obligations to arbitrate must challenge the very jurisdiction of the arbitrators. This may be done by arguing, as the case may be, that:

(a) there is no arbitration agreement

(b) there is no dispute

(c) the dispute falls outside the ambit of the arbitration clause.

2. HAVE THE PARTIES AGREED TO ARBITRATION?

The general position

Consider the scenario. A dispute arises between parties A and B. B commences judicial proceedings. A seeks a stay on the basis that there is an arbitration agreement between the parties. A asserts that there is no such agreement; indeed, he may assert that there is no agreement whatsoever between the parties, a problem which raises somewhat special issues considered below. In these cases the court must consider for itself whether an arbitration agreement exists, although there is plainly a strong presumption in favour of validity.

EC cases

The position becomes impossibly complex where, as is common in insurance and reinsurance cases, the matter takes on an international aspect. Here, the parties may encounter the notorious Brussels Convention of 1968, which has in the past featured in the pages of this journal. In *Marc Rich & Co v. Societa Italiana Impianti PA. The Atlantic Emperor (No. 1)*[1] a dispute arose under a contract of sale between an English buyer and an Italian seller. The seller commenced judicial proceedings in Italy, which the buyer contested on the basis that the parties had agreed to go to arbitration. The buyer subsequently commenced proceedings in England under the Arbitration Act 1950 for the appointment by the High Court of an arbitrator. This application required the High Court to consider whether the parties has agreed to go to arbitration. However, this very question was under consideration by the Italian court. As is well

known, under the Brussels Convention the court 'first seised' of an action has exclusive jurisdiction over it, although the Convention does not apply to arbitration agreements. As there was no doubting that the Italian court has been first seised of the action, the question for the High Court was whether the exclusion of arbitration agreements from the 'first seised' rule permitted it to consider whether there was a valid arbitration agreement in order to allow it to appoint an arbitrator.

Hirst J took the view that the Brussels Convention did not preclude consideration of the validity of the arbitration agreement. The Court of Appeal was less sure, and referred the matter to the European Court of Justice for a preliminary ruling. That Court, confirming Hirst J's approach, held that the exclusion from the Convention of arbitration agreements 'extends to litigation pending before a national court concerning the appointment of an arbitrator, even if the existence or validity of an arbitration agreement is a preliminary issue in that litigation'.[2]

The ECJ's ruling is clearly correct, as its undoubted object is to prevent one party from evading an obligation to arbitrate by commencing pre-emptive judicial proceedings in one member state and thereby precluding any attempt by the other to initiate arbitration proceedings elsewhere.[3]

There was, however, a less than happy ending. Pending the ruling of the ECJ, the buyer had taken the step of defending the Italian proceedings on substantive as well as jurisdictional grounds. This was a necessary precaution in order to avoid an Italian default judgment. By the time the ECJ had ruled that the English court was empowered to appoint an arbitrator if satisfied that an arbitration agreement existed, the Italian court had ruled that there was no arbitration agreement between the parties. Thus, by the time the matter came before the English courts on reference back from the ECJ,[4] the buyers were in the unfortunate position of having entered an appearance before the Italian court other than merely to contest its jurisdiction, and thus had, as a matter of English law, submitted to the jurisdiction of the Italian court. The Court of Appeal held that such submission required it to recognise the judgment of the Italian court that there was no arbitration agreement, with the result that the High Court had no jurisdiction to appoint an arbitrator.

The English buyers in *The Atlantic Emperor* were unlucky, in that had they been able to predict that the ECJ would uphold the right of the English court to pronounce on the validity of the arbitration agreement, they might have refrained from submitting substantive defences to the Italian court and thereby avoided submitting to its jurisdiction.[5]

Practical problems

A dispute arises between insurer A and reinsurer B under a reinsurance agreement containing an English arbitration clause. Reinsurer B commences judicial proceedings in (say) Italy for a ruling that there is no agreement to arbitrate. Insurer A subsequently applies to the High Court for an order appointing an arbitrator on B's behalf.

(i) If insurer A merely contests the jurisdiction of the Italian court, *The Atlantic Emperor (No. 3)* tells him that any ruling by the Italian court will not preclude the English court from considering the matter. However, if the Italian court holds that it has jurisdiction and goes on to give a default judgment against insurer A, the English court is probably bound to recognise the judgment. Insurer A can avoid this possibility only by also putting up a substantive defence, in which case he has submitted to the Italian court's jurisdiction so that any ruling by it is binding in England. Plainly, insurer A must move quickly to commence arbitration proceedings in England before the Italian court has given any ruling.

(ii) Suppose that insurer A chooses merely to contest the jurisdiction of the Italian court and not to defend himself. In insurer A persuades the High Court that there is an arbitration agreement, it will appoint an arbitrator and arbitration (presumably undefended by reinsurer B) will commence in England. In such circumstances the chance of an award in favour of insurer A are very strong. However, suppose further that the Italian court has concluded that there is no arbitration agreement and has given judgment for reinsurer B. This resolution of this particular conundrum is awaited with interest.

3. IS THERE A DISPUTE BETWEEN THE PARTIES?

Let us take another simple scenario. The assured under an insurance contract suffers a loss, and claims from the insurer. The insurer refused to pay, albeit without putting forward any particularly convincing reason for its conduct. The assured then commences judicial proceedings for summary judgment,[6] arguing that the insurer has no defence. In these proceedings, the insurer points out that there is an arbitration clause in the insurance agreement, requiring any dispute to be referred to arbitration, so that the judicial proceedings should be stayed. The assured's riposte is simple: there is no dispute, merely a refusal by the insurer to meet its obligations.

This very situation arose in *Hayter v, Nelson (No. 2),*[7] in the context of retrocession. Here, the retrocedant's liability had been established, but the retrocessionnaire refused to provide an indemnity despite its apparent contractual obligation - in the

form of a 'follow the fortunes' clause - to do so. Saville J held that the matter had to go to arbitration despite the retrocedant's plea that the retrocessionaire had no justification for its refusal to pay. The learned judge noted that there was no English authority on the meaning of 'follow the fortunes', so that there was a 'disputable issue' as to liability between the parties. That issue was for the arbitrators, in accordance with the arbitration clause apparent exception, namely that if the dispute between the parties relates to the initial validity of the main agreement, the ancillary arbitration agreement cannot as a matter of law apply to that dispute because if the agreement is void then there can be nothing about which to arbitrate. In the insurance context the matter may be illustrated as follows. Assured A claims from insurer B, and initiates arbitration proceedings. Insurer B's defence is that there never was a concluded contract of insurance between the parties, and in the absence of any contract of insurance there cannot be any contract to arbitrate disputes arising under it. Accepted orthodoxy is that assured A cannot proceed by way of arbitration, and must bring his action in the courts.

The initial invalidity exception has long been criticised on the basis that it undermines the concept of separability of arbitration. Indeed, it is indeed the case that in all other instances in which the jurisdiction of the arbitrators is called into question the law permits them to give a ruling on the matter while allowing either party to challenge their ruling by means of declaration or injunction.

In what is likely to be one of the most important and influential modern judgments in the field of arbitration, Steyn J in *Harbour Assurance Co (UK) Ltd v. Kansa General Insurance Co Ltd* [8] has ruled that the initial invalidity exception to the separability principle has no sure foundation in English law and it misconceived. In *Harbour* retrocedants sought to have stayed judicial proceedings brought by retrocessionaires for a declaration that the retrocession agreement was illegal under the Insurance Companies Act 1982 as the retrocedants were not authorised to carry on insurance business in the UK.[9] The retrocessionaires contested the stay, arguing that the retrocession was arguably void ab initio as a result of the illegality, so that as a matter of law the arbitration agreement did not extend to the dispute.

Steyn J, having considered the earlier authorities, held that none of them laid down any general principle that the severability principle did not extend to disputes as to initial validity. The learned judge further held that all material considerations pointed away from the restriction of severability in this way: it restricted arbitrarily the principle that the parties may choose their own 'judge'; it rendered arbitrating in England a less desirable option to foreign concerns; and it permitted abuse in that a party not desiring to arbitrate could simply raise a (wholly unsubstantiated) plea of invalidity. This reasoning serves also to resolve earlier conflicting authorities as to

whether an allegation that an insurance contract is voidable and has been set aside is capable of reference to arbitration: after *Harbour*, it very clearly is arbitrable.

Undoubtedly much to the regret of Steyn J, his reasoning did not able him to find in favour of the retrocedants. Earlier Court of Appeal authority, admittedly based on the now discredited notion of the initial invalidity exception to separability, had laid down that allegations of illegality giving rise to voidness ab initio are not arbitrable,[10] and Steyn J felt constrained to accept its correctness. However, it can surely be only a matter of time before this final barrier to the full separability of arbitration clauses is cast aside.

Construction

The question whether an arbitration clause applies, as a matter of construction, to the dispute in question is one which has come before the courts on numerous occasions. There has developed what amounts to a hierarchy of clauses.The widest type of arbitration clause is one which applies to 'all disputes' or 'all disputes arising out of or connected with' the underlying contract. The narrowest of the general clauses refers to 'all disputes arising under' the main contract.[11] The recent approach of the courts has been to adopt an expansive approach when construing the wording of arbitration clauses. Thus in the *Kansa* case itself, Steyn J was of the view that the words 'arising out of' a contract were sufficient to encompass disputes as to initial validity.

1. [1989] 1 Lloyd's Rep 548.

2. *The Atlantic Emperor (No. 2)* [1992] 1 Lloyd's Rep 342.

3. Assuming, of course, that the assistance of the High Court is necessary to get the arbitration proceedings off the ground. This was so in *The Atlantic Emperor*, as each party was required to appoint his own arbitrator; this is indeed the general position in reinsurance cases. However, other forms of arbitration agreement may nominate a named person or organisation, in which case judicial assistance is not required.

4. *The Atlantic Emperor (No. 3) (1992) The Financial Times*, 24th January.

5. If a party appears before a foreign court merely to contest its jurisdiction, he is not deemed to have submitted to that jurisdiction: Civil Jurisdiction and Judgments Act 1982, s 33.

6. Under Order 14 of the Rules of the Supreme Court.

7. [1990] 2 Lloyd's Rep 265

8. [1992] 1 Lloyd's Rep 81

9. The stigma of illegality was removed prospectively by s 132 of the Financial Services Act 1986.

10. *David Taylor & Sons Ltd v. Barnett Trading Co* [1952] 1 Lloyd's Rep 181.

11. See the analysis of Hirst J in *Ethiopian Oilseeds and Pulses Export Corporation v. Rio del Har Foods Inc* [1990] 1 Lloyd's Rep 86

LUNCHTIME TALK

FRIDAY 10 APRIL 1992
"THE CURRENT STATE OF THE AVIATION MARKET."
by Peter Hubert, Aviation Insurance and Reinsurance Consultant.

I'd like to talk today about the present state of the aviation market and its future, excess of loss reinsurance and the so-called "spiral" and "churning", and the lessons learned from recent war losses.

The first two have really become one subject. It isn't possible to discuss the aviation market scene without talking about the part that excess loss reinsurance plays - its capacity and its cost - because aviation insurers, other than perhaps specialist insurers of the smaller risks, light aircraft and so on, are more reliant on excess loss protection than any others. Top hull values today are in the region of $200 million and some major airlines insure liabilities for up to $1,500 million. There are in London 40 specialist aviation Syndicates at Lloyd's plus a (diminishing) number of marine Syndicates who write aviation and 22 insurance companies, or company groups, writing aviation. None of them could operate sensibly without substantial excess loss protection.

The aviation market is emerging from the worst decline it has ever suffered in its history. In 1986 rates were at a high point, perhaps too high, and losses were far below average; handsome profits were made. The business has always been cyclical, but this time there followed a period of rate slashing the like of which has not been seen before and it continued throughout the next four years. The main cause was the one which has dogged it for most of the last 20 years - overcapacity. I have never understood quite why so many insurers want to get into aviation. There is more premium in US