



Court of Appeal decides on the order of losses in an excess tower programme.

Teal Assurance Company Limited v W R Berkley Insurance (Europe) Limited & Anr [2011] EWCA Civ 1570

Court of Appeal – 15 December 2011

Background

The Claimant (Teal) was the captive insurer of Black & Veatch Corporation (BV), a major US engineering company. The case concerned the correct sequence in which to present losses to primary and excess insurers, and whether or not this can effectively be manoeuvred by the insured to maximise its obtainable cover.

BV purchased a tower programme of professional indemnity insurance, providing worldwide cover of US\$60 million in excess of the deductible and self-insured retention. The 'PI Tower' consisted of a primary layer (underwritten by Lexington) and three further intermediate layers of insurance above that (underwritten by Teal).

Teal also provided BV with 'top and drop' insurance, up to £10 million per claim, for liability in excess of the PI Tower (the 'Excess Policy') – but, significantly, this excluded claims emanating from the US or Canada (American claims). The Defendant Reinsurers underwrote the Excess Policy (reinsuring Teal), which also provided cover limited to £10 million per claim and excluded liability for American claims.

The Dispute

The dispute concerned two American claims collectively worth over US\$200 million and two non-American claims

worth approximately US\$45 million. Teal claimed that the American losses would exhaust cover provided by the PI Tower so they would be liable for the non-American losses under the Excess policy. In turn, Teal could recover £10 million for each claim from Reinsurers, thereby maximising BV's recoveries.

The Reinsurers contended, however, that the non-American losses should be recovered under the PI Tower because these were suffered prior to the American claims. Since the Excess Policy would not attach at all, in the absence of any further non-American claims, the reinsurers would not be liable for any payments.

At the heart of the dispute was how 'Clause 1' in the primary (and each underlying) policy should be interpreted. In wording common to market form, Clause 1 provided that: "Liability to pay under this Policy shall not attach unless and until the Underwriters of the Underlying Policy/ies shall have paid or admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses".

The first instance decision

The judge's decision centred on whether BV/Teal could present losses to its (re)insurance programme in whatever order it wished. The Reinsurers submitted that BV's losses eroded the PI Tower in the order in which they were suffered, and that loss is suffered once liability had been established and ascertained in amount. Teal relied on Clause 1, arguing that whether losses had eroded the PI Tower depended on when Teal became liable to pay for them. Since

the conditions in Clause 1 had not been satisfied in relation to non-American losses, those losses could not have eroded the PI Tower.

At first instance, Smith J accepted the Reinsurers' contention that claims were to be allocated to the PI Tower according to the chronological order in which the losses were ascertained by BV. Whilst the judge acknowledged that he had not been required to consider whether an insured is free to allocate claims in order to maximise its recoveries, Smith J noted the uncertainty that would be introduced into reinsurance arrangements if Teal's Clause 1 submission had succeeded.

Court of Appeal

The Court of Appeal has upheld the first instance decision. The Excess Policy provided that once the indemnity under the PI Tower was exhausted then "this policy shall continue in force as underlying policy". The insurance in excess of US\$60 million dropped down and became the underlying policy. Lexington, the primary layer insurer, was liable from the point that claims were established against BV. Once their layer had been exhausted, the next policy became the underlying policy so Teal were liable once the liability of BV was established by agreement judgment or award – as per the principles in *Post Office v Norwich Union Fire Insurance Society Ltd (1967)*.

The Court held that Clause 1 should be read in the context of multiple excess layer policies, which included other terms that made apparent the manner in which they were designed to "drop down" and replace the primary policy upon exhaustion of the underlying policies. In essence, Clause 1 did no more than determine the inter-relationship between the layers of cover, and was irrelevant to the fundamental question of attachment. Longmore LJ held that this was the more sensible commercial approach. Alternatively, Teal would be able to organise the lower levels itself and leave the Reinsurers to face non-American claims that would otherwise have eroded the PI Tower.

Comment

The case is one of the first authorities to look at the order in which losses attach to a layered programme of excess coverage. It reiterates that there is no scope for losses to be prioritised according to the

order the claims are presented by the insured or paid by the insurers. Commercially it is a common sense approach to Clause 1 wording that is common in insurance agreements. The dismissal of the Appeal provides certainty and an orderly procedure by which layers are eroded, emphasising that clear words are required in order to supersede established principles derived from case law. The ability to artificially manipulate liabilities would unlikely have been the parties' intention at the outset.

If you require any further information in relation to the way in which these developments impact upon your business please contact Nicholas Bradley, David Breslin or Antony Woodhouse on 020 7379 0000 at Lawrence Graham LLP.

These notes are intended only as a summary of developments and not as a definite statement of the law.

© Copyright 2012 Lawrence Graham LLP.