Overseas Union Insurance Ltd v Home and Overseas Insurance Co Ltd (No 2) [2002] SGHC 109

Case Number : DA 600020/2001

Decision Date : 20 May 2002

Tribunal/Court : High Court

Coram : Woo Bih Li JC

Counsel Name(s) : Liew Teck Huat (Niru & Co) for the appellant/plaintiff; P Jeya Putra and Wendy Leong (Joseph Tan Jude Benny) for the respondent/defendant

Parties : Overseas Union Insurance Ltd — Home and Overseas Insurance Co Ltd (No 2)

Civil Procedure – Pleadings – Failure to plead contractual provision – Whether such failure entitles party to rely on contractual provision

Insurance – General principles – Reinsurance – Retrocession – Nature of compromise settlements – Nature of commutation agreement – Plaintiff reinsurer entering into reinsurance contract – Plaintiffs entering into retrocession contract with defendant retrocessionaire – Plaintiffs entering into commutation agreement with reinsured – Defendants not participating in commutation negotiations – Whether commutation agreement binds defendants

Words and Phrases – 'Compromise settlements' – 'Loss settlements' – 'Commutation agreement'

Judgment

Cur Adv Vult

GROUNDS OF DECISION

Introduction

1. Overseas Union Insurance Limited ('OUI') is the Plaintiff in DC Suit No 51197 of 1999. It is an insurance company incorporated in Singapore and at all material times was engaged in business as general insurers and reinsurers.

2. Home And Overseas Insurance Company Limited ('Home') is the Defendant. It is an insurance company incorporated in the United Kingdom and is engaged also in business as general insurers and reinsurers.

3. Between 1980 and 1984, OUI entered into various insurance and/or reinsurance contracts with C.J. Warrilow ('CJW') Syndicate No 553. One of these contracts was NM 8100270 dated 18 August 1981 and was for Excess of Loss (or 'XOL') Reinsurance in respect of So-Called 'Casualty Account' ('the XOL contract'). OUI's liability under this contract was in turn reinsured with or retroceded to Home ('the Retrocession contract').

4. Although para 4 of OUI's Statement of Claim stated that part of the risk in the XOL contract was retroceded to Home, it was common ground that 100% of the risk was retroceded to Home subject to a qualification from Andrew Tang Ming Leung (PW1) at NE 41 which is not important for present purposes.

5. From 1984, OUI suffered losses and began to run-off its XOL reinsurance business.

6. In 1995, OUI commenced negotiations with CJW to commute all reinsurance claims under various contracts between them and on or about 5 December 1995, a commutation agreement was achieved in respect of ten such contracts. Under the commutation agreement, OUI was to pay CJW

US$625,650 and OUI would be released from all claims by CJW.

7. Pursuant to this commutation agreement and OUI's payment to CJW, OUI then sought payment of US$74,773 from Home under OUI's contract with Home. The US$74,773 was derived purely from a mathematical formula of apportionment used by OUI.

8. Home disclaimed liability on the basis that the sum claimed represented loss in respect of which liability had not attached yet and for which the loss had not crystallised and that it was not liable to indemnify OUI for Home's share of the aggregate commutation sum 'as such sums do not fall within the risks covered' by the Retrocession contract or the XOL contract. Home also said it did not participate in the commutation negotiations.

9. OUI's claim was dismissed by the District Court after trial. OUI then appealed to the High Court.

Basis of OUI's claim

10. Before the trial judge Mr Zainol Abeedin Bin Hussin and before me, OUI had sought to rely on Article XVIII of the XOL contract to bind Home to the commutation agreement OUI had reached with CJW. Article XVIII states:

> ' ARTICLE XVIII
>
> NOTICE OF LOSS CLAUSE
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> All loss settlements made by the Reinsured, including compromise settlements, shall be unconditionally binding upon Reinsurers provided such settlement are within the conditions of the original policies and/or contracts (other than as provided for in Article V hereof) and within the terms of this reinsurance, 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 Reinsured.
>
> In the event of a claim arising hereunder notice shall be given to the Reinsurers through Butcher, Robinson and Staples Limited, London House, 6 London Street, London EC3R 7LQ, as soon as practicable, and all papers in connection therewith shall be at the command of the Reinsurers on this reinsurance or parties designated by them for inspection.'

Trial Judge's Reasons

11. The trial judge decided that OUI was not entitled to rely on Article XVIII of the XOL contract because Article XVIII was not pleaded. In any event, Article XVIII did not apply to a commutation agreement.

Whether OUI might take the position that Article XVIII was applicable

12. OUI had a number of difficulties in seeking to establish that Article XVIII was applicable.

13. First, in para 4 of its Statement of Claim, it pleaded that the terms of the Retrocession contract were set out in the reinsurance slip executed by OUI and acknowledged by Butcher Robinson &

Staples Ltd ('BRS') for and on behalf of Home. This plea was repeated in para 2 of its Reply which stated that the Retrocession contract 'was contained and/or (sic) in a evidenced by and/or to be inferred from the slip issued by' BRS.

14. The reinsurance slip referred to by OUI is dated 24 March 1981. It does not contain or refer specifically to the XOL contract, let alone Article XVIII thereof. OUI sought to rely on the sentence, 'All other terms and conditions as Original' in the reinsurance slip to incorporate Article XVIII of the XOL contract. I will refer to this as 'the Sentence'.

15. However, it had not pleaded that Article XVIII of the XOL contract had been incorporated by the Sentence.

16. Mr Liew Teck Huat, for OUI, sought to avoid this obstacle by relying on a number of cases.

17. In The Geo W McKnight [1947] 80 Lloyd's Rep 419, Lord Normand said, at p 423 to 424:

> 'Counsel for Geo W McKnight naturally founded on this evidence and on the rule that a party is not to be allowed to contradict his preliminary act. Yet the court is not bound by the pleadings of parties and must proceed upon the evidence which it deems to be most accurate and trustworthy, and Mr Justice Pilcher has found that there is no evidence more accurate and trustworthy than the letter written by the master of the Geo W McKnight to her owners…'
> [Emphasis added.]

18. This passage was cited with approval by K S Rajah JC in Thai Kenaf Co Ltd v Keck Seng (S) Pte Ltd [1993] 1 SLR 92 at p 105.

19. Mr Liew also relied on K.E.P. Mohamed Ali v K.E.P. Mohamed Ismail [1981] 2 MLJ 10. In that case, Rajah Azlan Shah CJ said, at p 11 and 12:

> '…. Since the material facts and circumstances were not pleaded in the statement of claim, it should have been pleaded in the reply. Be that as it may, this aspect of the case has been satisfactorily presented and developed in the proceedings before the High Court and we think there are materials on the record from which a decision to that effect could be arrived at. As one of the objects of modern pleadings is to prevent surprise, we cannot for one moment think that the defendant was taken by surprise. To condemn a party on a ground of which no material facts have been pleaded may be as great a denial of justice as to condemn him on a ground on which his evidence has been improperly excluded.'

20. Mr P Jeya Putra, Counsel for Home, in turn cited The Ohm Mariana [1993] 2 SLR 698. In that case, L P Thean J, delivering the judgment of the Court of Appeal, said at p 714 to 715:

> 'There is yet another objection to the finding made by the learned judicial commissioner. On the pleadings no issue was raised whether the management agreement had been tampered with or fabricated and also no issue was raised as to malice in the arrest of the vessel based on the tampering or fabrication of the management agreement. The learned judicial commissioner, as stated above, found malice on the ground that the appellants had fabricated the first four pages of the management agreement.

The issue of the authenticity of the management agreement produced by the appellants had been raised in the trial, but that was in the context of the case that had been pleaded, ie the claim for reimbursement of the expenses and the counterclaim for an account. The allegation of wrongful arrest was made on the basis that there was no sum due to the appellants. The issue of malice in the arrest was never raised, either in the pleadings or in evidence. In finding that the appellants had fabricated the management agreement in order to sustain the arrest, the learned judicial commissioner had decided an issue not raised in the pleadings. Under O 18 r 12(1) of the Rules of the Supreme Court particulars of fraud and malice relied upon by a party are required to be specifically pleaded.

In Blay v Pollard and Morris, the trial judge decided the case on issues not raised in the pleadings and on appeal the Court of Appeal held that he was not entitled to do that. Scrutton LJ said, at p 534:

> … Cases must be decided on the issues on the record; and if it is desired to raise other issues they must be placed on the record by amendment. In the present case the issue on which the judge decided was raised by himself without amending the pleadings, and in my opinion he was not entitled to take such a course.

In Kiaw Aik Hang Co Ltd v Tan Tien Choy, this court held that the trial judge had decided on issues not raised in the pleadings and ordered a new trial. Buttrose J in his judgement (with whom Wee Chong Jin CJ and Tan Ah Tah J concurred) said, at p 101:

> While one can appreciate the dilemma in which the learned trial judge found himself as the result of his findings he has, with the greatest respect, in my opinion, decided the case on issues not raised by the pleadings and against the admissions contained in them and the evidence.
>
> The case, in my view, must be decided on issues raised by the pleadings which bind the parties. If other issues are desired to be raised or come to light during the trial they must be pleaded by way of amendment.
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> For these reasons alone, in my judgment, this decision cannot be allowed to stand and in the circumstances of this case I have come to the conclusion that in order to do justice between the parties a new trial must be ordered.

More recently, Lord Edmund-Davis in Farrell v Secretary of State, at p 180 said:

> … pleadings continue to play an essential part in civil actions, and although there has been since the Civil Procedure Act 1833 a wide power to permit amendments, circumstances may arise when the grant of permission would work injustice or, at least, necessitate an adjournment which may prove particularly unfortunate in

> trials with a jury. To shrug off a criticism as 'a mere pleading point' is therefore bad law and bad practice. For the primary purpose of pleadings remains, and it can still prove of vital importance. That purpose is to define the issues and thereby to inform the parties in advance of the case they have to meet and so enable them to take steps to deal with it.'

21. Mr Jeya also relied on an unreported judgment in 2001 by Judith Prakash J in Leefon Corporation (Pte) Ltd v Stone Tec Material Supplies Pte Ltd, DCA No 600003 of 2001. She said, at para 47:

> '47. Whilst I have pointed out the deficiencies in Stone Tec's evidence, the basic problem with their counterclaim was that it was not properly pleaded. As every litigation lawyer should know, what you do not plead you cannot prove and thus cannot successfully claim.'

22. In my view, the general rule is that a party is bound by his pleadings even if evidence has been given in a trial which touches on a matter which is not pleaded. If he wishes to rely on the matter raised in the trial, then he has to amend his pleadings. Moreover, according to paragraph 8 of the Grounds of Decision of the trial judge, the Opening Statement for Home had highlighted that the relevant provision in the XOL contract had not been pleaded by OUI. Yet, OUI still did not apply to amend its Statement of Claim or Reply. Accordingly, I am of the view that it was not open to OUI to take the position that Article XVIII was applicable.

23. Secondly, para 3 of OUI's Reply stated that OUI had concluded a commutation with CJW and as such 'all outstanding losses between [OUI and CJW] became crystallised and the underlying reinsurance contract itself ceased to have any further effect' [emphasis added]. Mr Jeya submitted that this meant that OUI could not rely on Article XVIII of the XOL contract as it was the underlying reinsurance contract.

24. Mr Liew's position was that 'ceased to have any effect' did not mean that the XOL contract had been thrown out but that all liabilities of OUI under it had been extinguished.

25. While I accept that para 3 of OUI's Reply could be read to mean what Mr Liew had advocated, the question is whether that was the correct interpretation.

26. I note that para 3 of OUI's Reply was to deny para 6 of Home's Defence which asserted, inter alia, that the losses which were commuted did not fall within the risks covered by the Retrocession contract or the XOL contract.

27. Bearing that in mind and the words used in para 3 of OUI's Reply, I am of the view that para 3 was intended to assert and did assert that the XOL contract was no longer applicable. In my view, such a position is not correct in law. Just because no further claim can be made against OUI under the XOL contract does not mean that all the contractual terms under the XOL contract cease to have effect. However, that was the position that OUI had adopted and it was too late for Mr Liew to try and advocate the correct position through submission especially since the incorporation or application of Article XVIII was not specifically mentioned anywhere else in OUI's pleadings.

28. Thirdly, the Sentence (in the reinsurance slip) cannot possibly incorporate Article XVIII of the XOL contract because the latter was not in existence as at the date of the reinsurance slip. The XOL contract is dated 18 August 1981 whereas the insurance slip is dated 24 March 1981.

29. Fourthly, the reinsurance slip was not the correct document to be construed as it had been replaced by the policy of reinsurance dated 14 September 1981. In Overseas Union Insurance Ltd v Turegum Insurance Co [2001] 3 SLR 330, Judith Prakash J provided a very useful account as to how such contracts come about. She said, at p 350 to 351:

> 'THE BACKGROUND
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> 69 There are four reinsurance contracts which are now in issue between OUI and Turegum. ….
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> 70 Before I go on to discuss the issues relating to these contracts, it would be helpful to give a brief account of how such contracts usually come about. An insurance contract placed in the London market is initiated when an insurance broker presents a proposal for insurance or reinsurance to underwriters at Lloyds or to insurance companies. The procedure is described by Lord Diplock in American Airlines Inc v Hope [1974] 2 Lloyd's Rep 301 at 304-305. What happens is that the broker acting for the assured prepares the slip (a folded card) and indicates in brief terms the cover the assured requires. Thereafter, as Lord Diplock says:
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> > … He takes the slip … to an underwriter whom he has selected to deal with as leading underwriter, i.e., one who has a reputation in the market as an expert in the kind of cover required and whose lead is likely to be followed by other insurers in the market. If it is the first contract of insurance covering that risk in which a particular underwriter has acted as leading underwriter it is treated as a n original insurance. The broker and the leading underwriter go through the slip together. They agree on any amendments to the broker's draft and fix the premium. When agreement has been reached the leading underwriter initials the slip for his proportion of the cover and the broker then takes the initialled slip round the market to other insurers who initial it for such proportion of the cover as each is willing to accept. For practical purposes, all the negotiations about the terms of the insurance and the rate o f premium are carried on between the broker and the leading underwriter alone …
> >
> > …
> >
> > After the slip has been initialled by all the insurers it is retained by the broker. In due course, often after several months, he prepares the policy from the slip. In the case of an original insurance he generally agrees the wording of the policy with the leading underwriter before taking it to Lloyd's Policy Signing Office for signature.
>
> 71 When the slip is signed, it constitutes a binding contract. At that stage, the whole of the contract is found in the slip. It has been described as 'free-standing'. See Insurance Co of the State of Pennsylvania v Grand Union

Insurance Co [1990] 1 Lloyd's Rep 208 and The Zephyr [1984] 1 Lloyd's Rep 58. OUI relies on these principles in relation to the two slips (for contracts 3TD70 and 3TG71) which it has in its possession and argues that since these slips do not contain arbitration clauses or any reference to any arbitration clause in any other document, the contracts of insurance do not contain any agreement to submit disputes to arbitration.

72 The slip is usually only the first stage in the process. Following its signing, the broker will issue a cover note to its own client confirming the cover which has been placed on the client's behalf. As stated in The Law of Reinsurance in England and Bermuda by O'Neill and Woloniecki, the cover note is not provided to the insurer and thus cannot be a contractual document. It is, however, prima facie evidence of a contract and may be used to establish the terms of that contract when the slip is lost.

73 Further, it is often clear from the slip itself that the parties intend that a policy or treaty wording be issued subsequently. The purpose of this is to expand on the terms found in the slip which are usually short and often only titles of the clauses required. According to another text, Reinsurance Practice and The Law (1993) put out by a firm called Barlow, Lyde and Gilbert, once a wording is executed by both parties, it replaces the slip as a contract document. Should any inconsistency between the slip and the wording need to be resolved, it is the wording which is paramount (see 10.5.1.3). This statement was based on the holding in Youell v Bland Welch & Co [1990] 2 Lloyd's Rep 423 (HC); [1992] 2 Lloyd's Rep 127 (CA) which discussed the ranking of the slip versus the wording and ruled that if formal wording was subsequently issued, the slip would be inadmissible as an aid to construction of the policy. The judge at first instance, Philips J, also stated (at p 429):

> An insurance slip customarily sets out a shorthand version of the contract of insurance, in terms which may neither be clear nor complete. Where, as here, the slip provides for the formal wording to be agreed by the leading underwriter, the other subscribers to the risk anticipate and agree that the leading underwriter will, on their behalf, agree the final wording that will spell out their rights and obligations. If differences between the wording of the slip and that of the formal contract which is embodied in the policy give rise to the possibility that the natural meaning of the slip differs from that of the policy, the natural assumption is and should be that the wording of the policy has been designed the better to reflect the agreement between the parties. To refer to the slip as an aid to construction of the policy runs counter to one of the objects of replacing the slip with the policy.'

30. I would add that on the facts before me, the cover note appears to have been issued before the slip but that is not material as the policy of reinsurance was issued after the slip.

31. As for the policy of reinsurance, it is true that it has, under the Other Conditions, the words 'All other terms and Conditions as Original, as far as applicable'. In another page, there is also the

sentence, 'This Reinsurance is subject to the same terms and conditions as the original contract as far as they may be applicable hereto ….'. However, the Statement of Claim and the Reply did not assert that the policy of reinsurance was the contract. Accordingly, it was not open to OUI to rely on the policy of reinsurance to incorporate Article XVIII.

32. A fifth obstacle faced by OUI is that when Home applied for a stay of proceedings in reliance on an arbitration provision in the XOL contract, i.e Article XXI, OUI took the position that Article XXI did not apply because OUI had only sighted the retrocession slip and it was only the slip which evidenced the contract between OUI and Home. Accordingly, although Home succeeded in its application at first instance, OUI's appeal to resist the stay was successful. In the light of this, I am of the view that OUI cannot approbate and reprobate. It was too late for OUI to say that the rest of the XOL contract, except Article XXI, applies.

33. A sixth obstacle faced by OUI was that it did not produce the original of the XOL contract despite repeated requests for it during discovery. I am of the view that this omission would also preclude it from raising Article XVIII of the XOL contract.

34. A seventh obstacle faced by OUI was an argument raised by Mr Jeya. He said that there was an Ultimate Net Loss clause in the policy of reinsurance and that this was different from and inconsistent with the Notice of Loss clause that is Article XVIII. Accordingly the two cannot apply together.

35. On the other hand, Mr Liew pointed out that Article XVIII was not necessarily inconsistent with an Ultimate Net Loss clause because even in the XOL contract, there was an Ultimate Net Loss clause. This was Article VII of the XOL contract. Accordingly, Article XVIII could co-exist with an Ultimate Net Loss provision. I agree with this argument of Mr Liew.

36. However, in the light of the other obstacles, I am of the view that the trial judge was correct in concluding that OUI was not entitled to take the position that Article XVIII was applicable.

Meaning of 'as Original' or 'as Original, as far as applicable' etc.

37. The Sentence (in the retrocession slip) has the words 'as Original'. The policy of insurance has the words 'as Original, as far as applicable' and 'as the original contract as far as they may be applicable hereto …'.

38. One question was whether the Sentence or the words in the policy of reinsurance would be sufficient to incorporate Article XVIII of the XOL contract, leaving aside for the time being the obstacles I have mentioned.

39. Mr Jeya submitted that such words would not have incorporated Article XVIII on the authority of Pine Top Insurance Co Ltd [1987] 1 Lloyd's Rep 476. In that case, the words were 'All terms clauses and conditions as original'. Gatehouse J said, at p 480, that such words were used to ensure that 'the risk undertaken by reinsurers was identical, as to period, geographical limits and nature of the risk, with the risk undertaken by the primary insurers. They therefore used this catch-all phrase, even though it was repetitive, and therefore strictly unnecessary'. Accordingly he concluded that such words did not incorporate an arbitration clause which was found in the second layer of documents i.e between Home and the reinsurers in that case but not found in the contract between the reinsurer defendants and the retrocessionaire plaintiffs.

40. Apparently this question is not a new one. The ambiguity which arises from the use of such words was already raised in Reinsurance Practice and The Law 1993 by the Reinsurance Division of Barlow, Lyde and Gilbert at paras 10.6.1 to 10.6.1.6.

41. However, in the light of the obstacles I have mentioned above and the rest of my judgment below, it is not necessary for me to decide whether I agree with Gatehouse J's conclusion and, if so, whether it should be confined to the facts in that case.

If Article XVIII was applicable, was the commutation agreement binding on Home?

42. Assuming that Article XVIII had been incorporated into the Retrocession contract, the question then was whether the commutation agreement was binding on Home. I set out again, for convenience, the first limb of the first paragraph of Article XVIII:

> 'All loss settlements made by the Reinsured, including compromise settlements, shall be unconditionally binding upon Reinsurers'
> [Emphasis added]

43. Mr Liew submitted that the commutation agreement was based only on Known Outstanding Losses ('KOL') which were in turn based on an actuarial report. Accordingly, it was not based on claims which had been incurred but not reported ('IBNR'). He also submitted that commutation agreements were common. Hence Article XVIII should be construed as binding Home to pay on the commutation agreement.

44. Mr Jeya submitted that the actuarial report was prepared for CJW and not for Home. While he accepted that the claims which were settled under the commutation agreement did not include IBNR claims, he submitted that KOL claims were fluctuating. He relied on the evidence of Andrew Tang (PW1) at NE 36 where Mr Tang said that such claims have already been notified but have not been settled or quantified due to pending litigation or settlement. The KOL figure could increase or decrease.

45. Mr Jeya also referred to two textbooks. The first was Reinsurance Practice and The Law 1993 by The Reinsurance Division of Barlow, Lyde and Gilbert. At p 22-6, it states:

> ' 22.5 COMMUTATIONS
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> We have mentioned already that one of the business objectives of reinsurance companies which are in run-offs is to try and reduce administrative costs to the minimum by cutting their claims handling costs. This objective can be achieved b y commuting as many inwards contracts as possible with reinsureds. A commutation is an arrangement between a reinsurer and a reinsured under which in consideration of the payment of an amount by the reinsurerer to the reinsured the latter releases the former from future ongoing liabilities under the reinsurance policy.'
> [Emphasis added.]

46. At p 22-9 and 22-10, it states:

> ' 22.6 RETROCESSIONS

It has already been mentioned that an important consideration before a reinsurer enters into a commutation agreement is to evaluate the effect of the proposed agreement upon its retrocessional collections. Most retrocession agreements will contain either a "follow the settlements" or a "follow the fortunes" clause. Under English law, a retrocessionaire will usually be bound to indemnify a reinsurer in respect of a commutation agreed by the reinsurer under a contract containing one of the above clauses provided:

> (a) the losses fall within the risks covered by the retrocession agreement; and
>
> (b) the reinsurer commuted or settled the reinsurance contract honestly and in a businesslike fashion taking reasonable steps to ascertain the amount of the reinsured's loss.

22.6.1 The first condition raises a different legal question in connection with commutations which include a compromise settlement in respect of outstanding and IBNR claims. The retrocessionaire may argue that the settlement of such claims is not recoverable under the retrocession contract because it is not a loss settlement because such claims have been artificially quantified by virtue of the commutation. Although there has, at present, been no court decision which has given authoritative guidance about this question, some assistance can be gleaned from the recent case of In Re a Company No. 0013734 of 1991 [1992] 2 Lloyd's Rep 415. The case arose from an application by an unidentified insurance/reinsurance company ("the Company") to strike out a winding-up petition which was presented by Cambridge Re (which is now in liquidation, having been ordered to be wound up in Bermuda in May 1985). One of the principal difficulties faced by liquidators of insurance or reinsurance companies is that the winding-up of such companies can take many years because of the need to run off the portfolio of business written by the insolvent company. In a novel and imaginative response to this problem, the liquidators of Cambridge Re applied to the Bermudan court to obtain its approval to actuarial valuations of contingent claims and claims of uncertain value. These actuarial valuations were approved by the court. The Company submitted that the order of the Bermudan court was not binding on it as it valuations were not "loss settlements" under the reinsurance agreements concerned.

The judge commented on this issue in the following terms: "... I have considerable sympathy with the liquidators. Their argument has the undoubted merit of good common sense and is in keeping with the view of Stirling and Hirst JJ" (i.e., the case of Eddystone Marine and Mentor v. Home and Overseas - see discussion in chapter 23, Insolvency). However, the judge declined to express any final opinion about this issue as he felt it was not appropriate in the circumstances (i.e., in the context of an application to strike out a winding-up petition) to decide an important and serious matter which might affect the insurance and reinsurance market.
[Emphasis added.]

47. The second textbook referred to by Mr Jeya was The Law of Reinsurance in England and Bermuda by P T O'Neill and J.W. Woloniecki, 1998. It states at p 163 to 164:

‘Commutations

Under commutation agreements an insurer/reinsurer will typically obtain a release from the insured/reinsured in respect of all present and future liability, whether known or unknown at the date of the commutation in consideration for a single payment. The recovery from reinsurers/retrocessionaires in respect of such a commutation payment may be problematic. To the extent that the commutation represents a bona fide compromise of known claims for which there is arguably coverage under the insurance/reinsurance contracts which are the subject of the commutation, in principle reinsurers/retrocessionaires will be bound. However, commutations typically do not apportion the amount payable between particular claims made or between claims made and claims outstanding, or between claims outstanding and claims which are incurred but not reported (IBNR). There may also be a practical difficulty in apportioning the amount in a commutation over several underwriting years. But where there has in fact been such an apportionment by agreement between the reinsured and the original insured, the reinsurers arguably may be bound, by virtue of a "follow the settlements" clause to accept the claims and outstanding claims as settled, although we suggest the better view is that reinsurers are entitled to dispute such an apportionment.

In Hiscox v. Outhwaite (No. 3) Evans J. said:

> "So far as future claims are concerned … I cannot see any objection in law to the original insurer discharging future as well as existing liabilities towards a group of claimants, provided there is sufficient identification of a group to which they belong or will belong … Even so, any insurer proposing to enter into such arrangements would be well advised to obtain his reinsurers’ consent before doing so, and thereby obtain a variation of the reinsurance contract." (Emphasis added.)

In particular, where a commutation is agreed in respect of IBNR (however commercially sensible it may be to obtain, for the payment of a relatively small sum, a release from unknown but potentially substantial future liabilities) reinsurers/retrocessionaires may be entitled to stand upon their strict contractual rights and deny liability in respect of any part of it because it does not represent claims. IBNR is no more than an estimate of liability in respect of claims which may arise in the future (which ex hypothesi have not been made upon the reinsured), generally discounted to present day value. It may not represent a "claim" in any sense. The whole commutation may have been driven by the reinsured rather than the original insured. If reinsurance is on an aggregate excess of loss basis, and the consequence of the commutation is that the reinsured parts with a sum of money in one period (because effectively estimated future "claims" are brought back into the commutation), the aggregate excess of loss reinsurer is entitled to object to his coverage being impacted by such a commutation. Since reinsurance is against risk of loss, not a certainty as a result of a deliberate act by the (re)insured, the reinsurer would be most unlikely to be found liable in such circumstances in respect, at least, of any element in the commutation representing claims outside of the period of coverage even if a court were to be persuaded by an argument that IBNR could

be described as "claims".

> Where an insurer/reinsurer is in liquidation and the liquidator makes an estimate of the insurer's/reinsurer's liabilities to a particular creditor (in effect imposing a compulsory commutation under applicable insolvency law), recovery from reinsurers/retrocessionaires of the insolvent company may also be problematic.' [Emphasis added.]

48. It seems to me that both textbooks suggest that if the commutation agreement does not include IBNR claims, then it should bind the retrocessionaire if there is a 'follow the settlement' clause, leaving aside for the time being questions as to whether the claim is within the reinsurance policy and whether the reinsurer acted honestly and in a businesslike fashion. However if IBNR claims are included, then the commutation agreement is not binding.

49. However, no case-law authority was cited in The Reinsurance Practice and The Law 1993 for these propositions. Also, in The Law of Reinsurance in England and Bermuda, the cases which were cited in the footnotes were not on point.

50. According to Mr Jeya, there is no English or local decision so far on the point.

51. In my view, the compromise settlements referred to in Article XVIII must be in the nature of loss settlements even though the first limb of the first paragraph of Article XVIII may be interpreted in one of two ways.

52. The first interpretation is that 'compromise settlements' refers to a settlement of a loss by way of compromise whereas 'loss settlements' refers to a settlement of a loss which is not by way of a compromise.

53. The second interpretation is that 'loss settlements' refers to a settlement of a loss whether by way of compromise or not and it is unnecessary to state that it includes 'compromise settlements', although the inclusion is to avoid any doubt that 'loss settlements' includes compromises.

54. In either interpretation, 'compromise settlements' must also be in the nature of loss settlements. The question then is whether 'loss settlements' would include commutation agreements.

55. No expert evidence was given for OUI. The expert witness for Home was Mr Kenneth Vivian Louw (PW3). He was the Managing Director of Reinsurance Evaluations Ltd, a reinsurance consultancy specialising, among other things, in giving expert advice to the London reinsurance market. His evidence was that a commutation agreement is a separate agreement from the reinsurance agreement (NE 131). It is not a loss settlement but an agreement to terminate a contract (NE 133).

56. I am of the view that a loss settlement is one where a loss is being settled whether by a court order or an arbitration award or via a compromise. The nature of a commutation agreement is different. While, in a sense, it does include the settlement of losses, the reasons for settlement are quite different because the reinsurer has another priority besides merely settling the losses. The reinsurer wishes to run-off its business or, as Mr Louw put it, to terminate its contract. It is a separate agreement over and above a reinsurance contract whereas a loss settlement on which the reinsurer seeks payment by a retrocessionaire comes under the reinsurance contract.

57. The nature of a commutation agreement is to release the reinsurer from future ongoing liabilities under the reinsurance contract (see again p 22-6 of Reinsurance Practice and The Law 1993 cited

above). I am of the view that whether it includes IBNR or not, the nature of a commutation agreement remains the same. Accordingly a reinsurer like OUI may well be prepared to pay a premium over and above what it would otherwise have agreed to in the usual settlement of a loss.

58. If the reinsurer takes the position that it did not take into account any consideration other than the settlement of a loss, then it should make its claim against the retrocessionaire not on the basis of a commutation agreement but on the basis that it had settled a loss. However, this will be easier said than done because, as in the present case before me, the 'losses' which were settled included claims for which the amounts to be paid by CJW were still uncertain as at the date of the commutation agreement.

59. While I sympathise with a reinsurer who wishes to enter into a commutation agreement, I am of the view that if it had wished to bind the retrocessionaire by such an agreement, it should have provided for such an eventuality in the retrocessionaire contract in the first place. After all, commutation agreements are supposed to be not that uncommon. If it cannot obtain the retrocessionaire's agreement at the time the retrocession contract is entered into, then it should involve the retrocessionaire in its negotiations with the insurer for a commutation agreement and try and obtain the retrocessionaire's agreement. Thus, The Law of Reinsurance in England and Bermuda states, at p 685:

> 'A commutation between a reinsurer and his reinsured may well involve the reinsurer's retrocessionaire. We have discussed above commutations in the context of "follow the settlements" clauses and the problem of allocation. The only practical solution to the legal difficulties which a reinsurer who commutes inwards reinsurance will face in collecting under outwards reinsurance is to involve his outwards reinsurers in the commutation discussions and persuade his outwards reinsurers to pay an appropriate amount to be released from liability to reflect the release which he has negotiated under the inwards contracts.

60. It is common ground that OUI did not involve Home in its negotiations for the commutation agreement. I am mindful that where there are several retrocessionaires, it may be very difficult to include all of them in the negotiations. However that is a difficulty a reinsurer must face and not ignore.

61. As the commutation agreement is at the behest of the reinsurer or at least to serve its own purpose, the reinsurer cannot impose such an agreement on the retrocessionaire unilaterally. It may well be that the industry should come up with a dispute resolution mechanism if retrocessionaires refuse to be bound by commutation agreements. However, that is another matter.

62. There is another assertion. In paragraph 5 of its Reply, OUI also alleged that it was market practice that a commutation agreement entered into by a reinsurer with a reinsured would be binding on the retrocessionaire. However OUI produced no evidence of such a market practice whereas Home's witness Mr Louw denied such a practice.

63. As regards Mr Liew's argument that the commutation agreement is binding on Home because the policy of reinsurance is a contract of indemnity, even though it does not say so explicitly, I am of the view that the question is not so much whether it is a contract of indemnity but what it purports to indemnify OUI for. For the reasons I have given, it does not indemnify OUI against OUI's liability under the commutation agreement.

64. In the circumstances, I am of the view that even if Article XVIII applied, Home was not bound

by the commutation agreement.

If Article XVIII was applicable, must OUI establish that the claims which were settled with CJW were within the terms of the XOL contract and the Retrocession contract?

65. Mr Jeya submitted that even if Article XVIII is applicable, OUI must still establish that the claims which it settled with CJW fall under the XOL contract and the Retrocession contract in view of the provisos to the first paragraph of Article XVIII which state, '… provided such settlement are within the conditions of the original policies and/or contracts … and within the terms of this reinsurance ….'

66. On the other hand, Mr Liew submitted that so long as there was a settlement of the claims, the burden was on Home to establish that the claims did not fall under these two contracts. Mr Liew relied on three cases which I shall now come to.

67. In The Insurance Co of Africa v Scor (U.K.) Reinsurance Co Ltd [1985] 1 Lloyd's Rep 312 ('Scor'), the plaintiffs issued a fire insurance policy. The policy was issued in respect of a building called the Old Customs Building in Monrovia, Liberia. On 7 February 1982, the building was totally destroyed by fire, together with its contents. African Trading Co (Liberia) Ltd ('ATC') was in possession of the building as lessees. ATC made a claim on the policy against the insurers who failed to pay. ATC then sued the insurers and obtained judgment against the insurers in Liberia. The insurers appealed but abandoned their appeal. They then paid ATC and claimed against the defendants who were the lead reinsurers. In the policy of reinsurance, there was a 'follow settlements' clause which provided:

> 'Being a Reinsurance of and warranted same … terms and conditions as and to follow the settlements of the Insurance Company of Africa.'

68. The reinsurers refused to pay because they alleged that the fire was deliberately caused by a Mr Ali. He was described as 'in effect the sole proprietor of ATC'.

69. There were several issues, one of which concerned the interpretation of the 'follow settlements' clause. Three interpretations were suggested by counsel for the insurers. I cite from p 554 of the law report:

> 'Upon Mr. Hunter's [the insurers' Counsel] helpful analysis of this clause it may be interpreted or applied in one of three possible ways. (1) In the absence of lack of good faith or collusion by the ceding company the reinsurers are bound to follow the settlement of the ceding company; (2) the reinsurers are bound to follow any settlement of the ceding company unless the reinsurers can show lack of good faith or collusion or failure on the part of the ceding company to take all proper and business-like steps to have the amount of the loss fairly and carefully ascertained; or (3) the reinsurers are bound to follow any settlement of the ceding company unless they can show lack of good faith or collusion or failure by the ceding company carefully and fairly to ascertain the loss.'

70. Apparently, the dispute was whether the insurers' duty was as set out in the third interpretation or the second interpretation and Counsel for the disputing parties appeared to have proceeded on the basis that the onus was on the reinsurers to establish that the insurers had failed to carry out their duty.

71. Furthermore, while Leggatt J and Stephenson LJ did express the view that the onus was on the reinsurers, Robert Goff LJ did not say so explicitly. The oft cited passages from Goff LJ's judgment bear this out, see p 330:

> '… 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 recognized 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 to be consistent with the approach of Mr. Justice Branson in Excess Insurance Co. v. Mathews. 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 Mr. Justice Bigham, I do consider that the clause presupposes that 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. …. Furthermore, 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. In my judgment, they must follow the settlement, as they have contracted to do so; and they must have recourse to their rights of subrogation, arising upon payment of the claim under the policy of reinsurance, in order to seek to rescind the settlement with the assured and to recover the money paid by the insurers under that settlement.'

72. The above points about Scor are neatly summarised by Hunter JA of the Hong Kong Court of Appeal in Insurance Company of the State of Pennsylvania v Grand Union Insurance Co and Lowndes Lambert Construction Ltd [1990] 1 Lloyd's Rep 208 ('ICSP v Grand Union'). At p 223 to 224, Hunter JA said:

> 'The principal authority is again the case of Scor. At first instance, [1983] 1 Lloyd's Rep 541, it is plain that Mr. Hunter, Counsel for the equivalent of the insurer, was then arguing that the onus lay upon the reinsurer. It is not clear what stance on this Mr. Yorke for the reinsurer then took. But Mr. Justice Leggatt's finding is quite clear at p.555. It was that the onus was upon the reinsurer.
>
> In the Court of Appeal, both Counsel put the onus upon the reinsurer. Mr. Hunter repeated his same submissions and Mr. Yorke adopted that view and did not challenge Mr. Justice Leggatt's conclusion in that respect. This can be seen from the nature of the argument reported at p.319, col. 1 and p.327, col. 2. Lord Justice Stephenson quite explicitly agreed with Mr. Justice Leggatt p.319, col. 2 and p.322, col.1. So that there is clear authority from those two Judges that the

onus lies upon the reinsurer.

Lord Justice Robert Goff did not expressly cover the point, perhaps because it was not in issue. But the whole of his judgment suggests to my mind that he agreed with the views of Mr. Justice Leggatt and of Lord Justice Stephenson. First he cites Mr. Justice Leggatt's conclusion in full, without a word of criticism. Secondly he formulates his principle as subject to two provisos. I am minded to think that coming from Lord Justice Robert Goff that may well be significant. Provisos are examples of exceptions and it may be an echo of what Lord Goddard had said many years before in Bond Air Services v. Hill [1955] 2 Q.B. 417 at p.427 that "it is axiomatic in insurance law" that the onus of proof of an exception is upon the insurer who seeks to rely upon it.

Thirdly the language he uses in his judgment immediately after his formulation of principle, seems to me consistent only with this view. He cannot for example have been intending to reverse the universal rule in professional or any negligence, that he who alleges must prove. A simple example of this principle in operation is to be seen in Street v. Royal Exchange Assurance, (1914) 19 Com. Cas. 339 which shows that all the insurer has to do is to prove his settlement, and then if the reinsurer wishes to challenge it the onus is upon him.

Reason to my mind equally points to the same conclusion. The reinsurer's obligation is to follow the settlement. If he wants the right to be consulted, he can try to (sic) included a claims cooperation clause in his cover, which is what happened in slip D. But if Mr. Collins is right, even without that, the reinsurer is entitled to put the insurer to proof in respect of every claim that (a) it is within the policy and (b) that the settlement is proper. If that is right, the clause is valueless and meaningless. It seems to me in this field both sensible and economical for the lead reinsurer to be trusted to do all the necessary investigation. Repetition down the line is absurd, and where, as here, the reinsurance cover spans the globe it is ruinous in cost.'

73. However, I accept that in ICSP v Grand Union, one of the issues under the quantum issue was whether ICSP, the reinsurer, had to prove that certain claims settled by them fell within the risks covered by the retrocessionaire. The Hong Kong court of first instance and the Hong Kong Court of Appeal decided that the onus was on Grand Union, the retrocessionaire, to prove that the claims settled did not fall within the risks covered.

74. In that case, the 'follow settlements' clause provided that the reinsurance is subject in all respects to the same terms and conditions excluding rate and retention as and to follow, the settlements of the Insurance Company of the State of Pennsylvania and to bear its proportion of any expenses incurred whether legal or otherwise in the investigation and defence of any claim thereunder.

75. I have already cited a part of the judgment of Hunter JA of the Hong Kong Court of Appeal. I now cite from the judgment of Justice Martimer in the court of first instance where, after referring to the 'follow settlements' clause, as well as a simultaneous payment clause, he said (at p 210):

'The aims of such conditions are these. (1) To avoid the expense of multiple claims enquiries by different insurers and reinsurers in the chain. (2) To simplify and hasten the claims procedures. (3) To reduce or avoid the possibility of

disputes arising between reinsurers in the chain, and (4) to have an immediate flow of funds through the chain when a claim is agreed to be settled. If a reinsureer wishes to be involved in the claim procedure, he will require a claims co-operation clause to be inserted. Neither slip in this case has one. Whether a prudent underwriter asks for such a clause depends upon many factors and at one stage those factors were relevant to my consideration of this case. They are no longer relevant and I do not refer to the matter again.'

76. At p 216, Justice Mortimes concludes:

'As it effects this case the law is as follows: a reinsurer bound by the follow the settlement clause agrees to indemnify the insurer in circumstances in which the insurer agrees to compromise a claim by its insured whether on liability or quantum provided that [a] the claim falls within the risks covered by the policy of reinsurance and [b] in making the compromise to settle the claim the insurers have acted honestly and have taken all proper and businesslike steps.

There are two further matters. First, the burden of showing that the claim is not within the risks covered by the reinsurance or that the reinsured had not acted honestly or in a proper and businesslike manner in making a settlement rests upon the reinsurer who seeks to avoid liability. This accords with the passage from the judgment of Mr. Justice Leggatt to which I have referred, it accords with the aims and genesis of the provision to follow the settlements. It gives proper commercial effect to that provision and in modern international reinsurance business it is a necessary commercial interpretation to avoid the unnecessary bringing of witnesses from all over the world to give evidence if the reassured in these circumstances is simply put to proof.

Secondly, if the reinsurer challenges the settlement that has been made by the reinsured he can only do so on the one or other or both of the two grounds that the settlement was not made honestly or in a proper and businesslike manner or that it was not within the reinsurance contract for he cannot seek to rip up the settlement and show that claims were paid for which the insured was not liable save as part of the proof that the settlement was not made in a proper and businesslike manner. It follows from what was said in the Scor case that he cannot seek to avoid liability simply by seeking to rip up the settlement by showing that in fact and only in fact that the insurer could have defeated the claim. It follows that when Lord Justice Robert Goff speaks of claims which fall within the policy of reinsurance he is referring to the terms of the policy of reinsurance and not the detailed terms of the original insurance incorporated therein. Were it otherwise he would be nullifying the conclusion to which he had already reached.'

77. The third case relied upon by Mr Liew was John Robert Charman v Guardian Royal Exchange Assurance Plc & another [1992] 2 Lloyd's Rep 607 ('Charman'). In that case, the 'follow settlements' clause read:

'Subject to the same terms, conditions, definitions, warranties as … the original policy and to follow … insofar as applicable, including loss settlements, liable or not liable.'

78. In dealing with the issue of onus of proof as the third issue in that case, Webster J said, at p 612 to 614:

> 'The third point of law is whether, as Mr. Sumption submits, the burden of proof lies upon a reinsurer to displace his reassured's right to rely as against him upon the follow settlements clause.
>
> The point has not been decided in any of the authorities to which I have been referred; and the dicta in those cases are not entirely consistent, which is not surprising since the point was not before the Courts to whose decisions I have been referred.
>
> Were reliance to be placed upon those dicta (which in my view is not the best way to approach the point: I prefer to approach it as a matter of first principle), it seems to me that most of the dicta favour the proposition that the burden lies upon a reinsurer to prove that his reassured has not settled the claim in a business-like fashion.
>
> The dictum which expressly has a contrary effect is that of Mr. Justice Bigham in Poole's case at p.386:
>
> > The re-insurer, when called upon to perform his promise, is entitled to require the re-assured first to show that a loss of the kind reinsured has in fact happened; and secondly that the re-assured has taken all proper and business-like steps to have the amount of it fairly and carefully ascertained.
>
> That dictum was expressly approved by Lord Justice Stephenson in Scor at p.322, col. 1 ("I adhere to the exact words unmodified of Mr. Justice Bigham's formulation …"); and by Lord Justice Robert Goff at p.330, col. 1 who did not, however, expressly approve Mr. Justice Bigham's wording.
>
> But there are a number of other passages in Scor which are inconsistent with the proposition that the burden lies upon the reassured.
>
> Lord Justice Stephenson at p.319, col. 2 approved Counsel's formulation in col. 1 (as I have already said), which included the words:
>
> > … unless the re-insurers can show lack of good faith … or failure … to take all proper and business-like steps.
>
> And Lord Justice Robert Goff is to be taken as having preferred the requirement that the burden of proof should lie upon the reinsurer. At p.327, col. 2 he cited with approval part of the judgment of Mr. Justice Leggatt first instance, quoting the words:
>
> > Where the reinsurers' obligation is to "follow the settlements" of the original underwriters, a compromise, whether of liability or amount, will bind the reinsurers unless they can prove either that the compromise was dishonestly

> arrived at, or that the reassured has failed to take all the proper and businesslike steps to have the amount of the loss fairly and carefully ascertained. (My emphasis).

Finally Lord Justice Robert Goff, at p.330, col. 1, in the middle of the first full paragraph in that column, uses the words -

> … provided … that in settling the claim the insurers … have taken all proper and business-like steps in making the settlement.

This phrase is, perhaps, neutral; but it seems to me that the inference clearly to be drawn from the immediately following passage is that the burden lies upon the reinsurers. In a paragraph which I have already quoted he said:

> 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 …

As I have said, in my view the point can best be resolved by resort to first principles and the historical analysis of the legal effect of clauses of this kind, although I do not exclude the possibility that, in relation also to this point, evidence of market practice might be relevant.

As I have said, the essential element of the follow settlements clause is that the reinsurer puts his trust in the reassured; but a requirement that the reassured should have to prove that the trust is justified is quite inconsistent with the existence of any such trust at all. Secondly, as I have already said, the effect of the follow settlement clause as construed by the Court of Appeal in Scor is that the reinsurer must follow the reassured whether or not in fact there has been liability; but to impose upon the reassured the burden of proving that he had taken business-like steps in settling the claim might to some extent have the effect of requiring of him to prove that liability existed in fact. In my view, the relevant (i.e. evidentiary) effect of the construction of the clause in Scor is that, prima facie, the reassured is entitled to require the reinsurer to pay his claim upon him, upon proof that the (sic) reinsurer has paid his original insured and upon proof that his claim against his reinsurer falls within the reinsurance policy.

In other words, in my view, there is a presumption that the reassured is entitled to call upon the (sic) reinsured to follow his settlement, so that if an issue arises either as to good faith or as to the fact that the settlement was made in a business-like fashion, the burden must lie upon the reinsurer. I therefore agree, with respect, with the judgment of Justice of Appeal Hunter in the Hong Kong Court of Appeal in Insurance Co. of the State of Pennsylvania v. Grand Union Insurance Co. and Lowndes Lambert Construction Ltd., [1990] 1 Lloyd's Rep. 208 at pp. 223-224.

The elementary distinction between the loss of an original assured and the loss of a reassured will not have been overlooked: the loss of the original assured is,

> for instance, property damage which he must prove in order to establish his right to an indemnity; the loss of a reassured is not the property damage but the payment by him in good faith of his assured's claim. In the absence of special circumstances, therefore, there must, it seems to me, be a presumption against his being required to prove the original loss - all he has to prove is the claim upon him and his reasonable settlement of it, albeit that, in order to settle reasonably, he will have required the assured to prove the loss. When he makes his claim, against his reinsurer, it does not follow at all that he should have to prove the loss of the original assured.'
> [Emphasis added]

79. In my view, Charman does not help OUI. While Webster J did say that the burden was on the reinsurer to prove lack of good faith or that the reinsured did not act in a business-like fashion, he also said that it was for the reinsured to prove that his claim against the reinsurer falls within the reinsurance policy.

80. I would also add that Home is not suggesting that OUI has to prove the loss of the original assured but rather that the claim of the original assured comes within the XOL contract and the Retrocession contract.

81. I turn now to the two cases relied on by Mr Jeya to counter Mr Liew's authorities.

82. The first is Hill v The Mercantile & General Reinsurance Co Plc [1996] Lloyd's Reinsurance LR 341 ('Hill').

83. In that case, the 'follow settlements' clause stated:

> '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.'

84. Lord Mustill divided the clause as follows at p 347:

> '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.'

85. After referring quite extensively to the judgment of Justice Rix (at first instance) and Lord Justice Hirst (from the Court of Appeal), Lord Mustill said, at p 350 to 351:

> '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 Lord Justice Robert Goff 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 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, ….. 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.
>
> Situation 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 (sic) known 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 [1995] 1 Lloyd's Rep., 312 to the present dispute.

This is well shown by the Scor decision itself. Mr. Veeder, Q.C. for M. & G. rightly (in my opinion) made no attempt to argue that the formulation of Lord Justice Robert Goff 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: pars. [b] and [c] of the follow settlement 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 visualized 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 recognize 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 claim 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. ….
[Emphasis added.]

86. It seems to me that the provisos in Article XVIII are similar to the first and second provisos in Hill. These provisos were absent from the 'follow settlement' provisions in the three cases which Mr Liew relied on. On the other hand, I note that the judgment of Lord Mustill in Hill was in the context of an application for summary judgment and the House of Lords decided only that there was an issue or question in dispute which ought to be tried (see p 352 of the report).

87. The second case relied on by Mr Jeya was Commercial Union Assurance Co Plc v NGR Victory Reinsurance Ltd [1998] 2 Lloyd's Rep 600 ('NGR'). There the 'follow settlements' clause stated:

> 'All loss settlements by the Re-assured including compromise settlements and the establishment of funds for the settlement of losses shall be binding upon the Re-insurers, providing such settlements are within the terms and conditions of the original policies and/or contracts … and within the terms and conditions of this Re-assurance'

88. In NGR, Potter LJ said in the first column at p 612:

> 'As to the decision of the insurers to settle in the light of Mr. Reasoner's prediction, as Mr. Sumption in my view rightly submitted, it was not enough for the plaintiffs to establish that the settlement was business-like and sensible. They were required to demonstrate liability to Exxon, and could only be entitled t o recover on some wider basis if they could show some kind of "follow

> settlements" clause binding the reinsurers to the plaintiffs' settlement. However, as already noted, of the 16 contracts making up the GCE policy, five contained no follow settlements clause at all and 11 contained clauses in substantially the same form as in Hill v. Mercantile. None bound the reinsurers to reasonable or business-like settlements regardless of the scope of the direct insurance. All provided that settlements should be binding upon the reinsurers only "providing such settlements are within the terms and conditions of the original policies and/or contracts".'

89. In the second column at p 612, he also said:

> '… The matter did not proceed to judgment and payment was made pursuant to a settlement in which the insurers (no doubt for good and business-like reasons) decided that they would not submit the points available to them to the decision of the Court, but would rather reach a compromise. It is in just such a position, that the reinsurer, in response to the reinsured's claim for indemnity has the right to require the reinsured to show that he was legally liable to the original assured, unless there is in the reinsurance contract an effective "follow the settlements" provision which precludes such right: see Insurance Co. of Africa v. Scor (U.K.) Reinsurance Co. Ltd., [1985] 1 Lloyd's Rep. 312.'

90. However, in that case, it was common ground that the insurer must establish that it was liable under its cover before succeeding in its claim against the reinsurer (see page 605). The question there was whether the insurer had discharged its burden. Furthermore NGR was also a case involving an application for summary judgment and the Court of Appeal decided only that the insurer was not entitled to such judgment.

91. I would adopt the observations of Lord Mustill in Hill. It was and is open to parties in the industry to provide who should have the burden of proving any aspect of a claim. In my view, the provisos in the first paragraph of Article XVIII, if applicable to the Retrocession contract mutatis mutandis, require OUI to establish that the claim of the original insured was within the original insurance policy and within the terms of the XOL contract and the Retrocession contract. OUI did not attempt to establish this as its position was that the burden was on Home to prove otherwise. Accordingly, this is another reason why OUI's claim must fail.

If Article XVIII applied, who had the burden of proof with regard to the requirement to act bona fide and in a proper and businesslike manner?

92. The three cases relied on by Mr Liew, which I have referred to above, are authorities for the proposition that a reinsured who seeks to rely on a 'follow settlements' clause must nevertheless act in good faith and in a businesslike manner. Furthermore, the burden of proof is on the reinsurer to prove that the reinsured did not act in the manner required.

93. I am of the view that even though the 'follow settlements' clause in Article XVIII is differently worded from those in the three cases relied upon by Mr Liew, there is nothing in Article XVIII or Hill or NGR which would require or persuade me to reach a different conclusion. For the reasons mentioned by Justice Mortimer and Hunter JA in ICPS v Grand Union, I am of the view that the burden of proof would be on Home to establish that OUI had failed to act in the manner required.

94. However, the conduct of OUI would have to be examined in the light of its attempting to reach

a commutation agreement and not the usual settlement of a claim. Accordingly, it is not meaningful for me to investigate whether Home has discharged this burden especially in view of my other conclusions.

Notice provision in Article XVIII

95. Mr Jeya submitted that even if Article XVIII applied, Home must still be notified first before the commutation agreement was concluded. He did not elaborate whether this argument was based on general principles or the Notice of Loss Clause that is Article XVIII.

96. In Home's Case, i.e written submission, reliance seemed to be placed on general principles. Halsbury's Laws of England, Fourth Edition, Vol 20 at para 313 was cited for the proposition that Home is entitled to impugn the commutation agreement if it was not notified of the negotiations leading to such an agreement.

97. I am of the view that while Home is not bound by the commutation agreement, it does not follow that the omission by OUI to give notice to Home of claims would necessarily mean that OUI is precluded from claiming payment from Home, leaving aside any contractual provision requiring such notice to be given.

98. As regards a contractual provision, the second paragraph of Article XVIII states:

> 'In the event of a claim arising hereunder notice shall be given to the Reinsurers through Butcher, Robinson and Staples Limited, London House, 6 London Street, London EC3R 7LQ, as soon as practicable, and all papers in connection therewith shall be at the command of the Reinsurers on this reinsurance or parties designated by them for inspection.'

99. However, Mr Jeya did not draw my attention to any provision in Article XVIII itself which spells out the consequence of a failure by OUI to give notice of the claim to Home. Nor did he identify any such provision in the XOL contract or in the policy of insurance. In the absence of any contractual provision spelling out the consequence of a failure to give notice, I am disinclined to conclude that such an omission would be fatal to OUI making a claim.

Summary

100. In summary, I dismiss the appeal with costs to be paid by OUI to Home.

Sgd:

WOO BIH LI
JUDICIAL COMMISSIONER