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A Decade Later: Re-Examining the Presumption of Back-to-Back Cover in English Insurance Law

M. Bob Kao

A DECADE LATER: RE-EXAMINING THE PRESUMPTION OF BACK-TO-BACK COVER IN ENGLISH INSURANCE LAW

*M. Bob Kao**

I. ABSTRACT

The aim of insurance is to spread risk.[1] Reinsurance is insurance purchased by the insurer in order to pass on the risk so it can take on additional business.[2] The presumption of back-to-back cover exists between the insurance contract and reinsurance contract, where the terms are deemed to be identical so that when the insurer indemnifies the policyholder, the reinsurer would in turn compensate the insurer.[3] The presumption was put in doubt by the United Kingdom House of Lords in 2009, in a case where the court found that there was no back-to-back cover when the applicable law for the underlying insurance policy was unknown at the time of the conclusion of the reinsurance contract.[4] This case created uncertainty in the market that still exists a decade later.[5] This Article examines the possibility that the reasoning of the House of Lords, in the 2009 case, was incomplete and discusses the possibility that applying different American tort principles of liability allocation in the underlying insurance dispute could have affected the decision of the House of Lords on English insurance Law.

II. INTRODUCTION

Insurance is pervasive in the modern world.[6] Businesses insure everything from medical costs arising out of a slip and fall on their premises, to the value of cargo they ship from one part of the globe to the other.[7] Similarly, most individuals have health insurance, motor insurance, and travel insurance, among others. In the United States, insurance is regulated by states, with the federal government playing a more limited role.[8] As such, regulations and laws differ across the country.[9] On a larger level, insurance is a global

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* Ph.D. Candidate, Centre for Commercial Law Studies, Queen Mary University of London; J.D., University of California, Berkeley; LL.M. with Distinction, University College London.

1 *See Insurance 101*, INSURANCE INFORMATION INSTITUTE, https://www.iii.org/article/insurance-101 (last visited Apr. 10, 2020).

2 *See* George Blazenko, *The Economics or Reinsurance*, 53 THE J. OF RISK INS. 258 (1986).

3 *See* THIAGO MOUTINHO RAMOS, REINSURANCE CONTRACTS AND BACK TO BACK PRESUMPTION: A COMPARATIVE STUDY BETWEEN ENGLISH AND NORWEGIAN LAW 16 (Jan. 11, 2013), https://www.duo.uio.no/bitstream/handle/10852/38216/masteroppgaven-pdf.pdf?sequence=1&isAllowed=y.

4 *See* Özlem Gürses, *The Construction of Terms of Facultative Reinsurance Contracts: Is Wasa v Lexington the Exception or the Rule*, 73 THE MOD. L. REV. 119, 122-23 (2010).

5 *See id.* at 129-30.

6 *See Insurance 101*, *supra* note 1.

7 *See id.*

8 *See* Christopher C. French, *Dual Regulation of Insurance*, 64 VILL. L. REV. 25. 45 (2019).

9 *See* Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 629 (2014) (Despite the state regulatory systems and some differences between them, the National Association of Insurance Commissioners (NAIC) and its model laws have made the regulatory measures quite similar across jurisdictions.); *see also* David Schwarcz,

industry.[10] Usually, the insurance companies and policyholders are from different countries, and very often the law governing the insurance contract is English law, because London has traditionally been the center of the international insurance industry.[11] Therefore, certainty in the legal obligations of the parties involves in insurance under English law is vital to the growth and stability of the industry.[12] Consequently, insurance law has been interpreted in courts often and the codification of it in the Marine Insurance Act ("MIA") 1906, serves as the model for many other jurisdictions internationally.[13]

Modern insurance contracts developed in fourteenth century Italy and spread to London in the sixteenth century.[14] Initially, insurance developed as a way to spread maritime risks for sea journeys.[15] The marine insurance market in London began at a coffee shop called Lloyd's where merchants gathered to buy and sell insurance from other merchants.[16] Other types of insurance such as fire and life and personal accident insurance later developed due to industrialization and the dangers of modern technology.[17] Insurers also purchase insurance to reallocate the risk they assume from policyholders, also known as the insureds.[18] The insurer is the reinsured in the contractual relationship with the reinsurer. The insurance contract and reinsurance contract are presumed to have back-to-back cover, meaning that they have identical terms and if the insurance has to pay the claim, the reinsurance would also have to indemnify.[19]

Though insurance and reinsurance cases are litigated by the courts in England, most disputes today are settled through international arbitration.[20] Since international commercial arbitration is confidential and the awards do not have precedential value, the opportunity for clear judicial guidance on many issues concerning the contracting and performance of insurance

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Is the U.S. Insurance Regulation Unconstitutional?, 25 CONN. INS. L. REV. 180 (2018) (provides an overview of the role of the NAIC in insurance regulations and its possible constitutional overreach).

[10] Randall, *supra* note 9 at 664.

[11] *See* Paul Jaffe, *Modern Marine Insurance: Coverages, Current Issues, and Connection: Reform of the Insurance Law of England and Wales – Separate Laws for the Different Needs of Business and Consumers*, 87 TUL. L. REV. 1075, 1123-24 (2013).

[12] *See id.* at 1124.

[13] *See id.* at 1077; *see also* Marine Insurance Act 1906 (U.K.); *see also* Marine Insurance Act 1908 (N.Z.); *see also* Marine Insurance Act 1909 (Austl.) (All Marine Insurance Acts will *hereinafter* be referred to as "MIA" within the text of this article, but not within footnotes).

[14] *See* JOHN BIRDS, BIRDS' MODERN INSURANCE LAW 1 (2016).

[15] *See id.* at 1.

[16] *See id.* at 2.

[17] *See id.* at 3; *see also* James Oldham, *Insurance Litigation Involving the* Zong *and Other British Slave Ships, 1780-1807*, 28 J. LEGAL HIST. 299, 300 (2007) (The slave trade played a large role in the development of marine insurance and insurance law.); *see also* Jane Webster, *The* Zong *in the Context of the Eighteenth-Century Slave Trade*, 28 J. LEGAL HIST. 285 (2007); *see also* Anita Rupprecht, *'Inherent Vice': Marine Insurance, Slave Ship Rebellion and the Law*, 57 RACE & CLASS 31 (2016); *see also* Tim Armstrong, *Slavery, Insurance, and Sacrifice in the Black Atlantic*, *in* SEA CHANGES: HISTORICIZING THE OCEAN 167 (Bernhard Klein & Gesa Mackenthun eds., 2003).

[18] *See* Blazenko, *supra* note 2, at 258-59.

[19] *See* ÖZLEM GÜRSES, REINSURING CLAUSES 115 (Informa Law 2014).

[20] *See* Charles F. Corcoran, III, *Reinsurance Litigation: A Primer*, 16 W. NEW ENG. L. REV. 41, 49 (1994).

policies is limited.[21] The last reinsurance case to reach the highest court in the United Kingdom occurred before the founding of the United Kingdom Supreme Court in 2009.[22]

On its final day of operation, July 30, 2009, the House of Lords released its judgment in *Wasa International Insurance Co. Ltd. v. Lexington Insurance Co.*[23] One of the issues in question was whether the presumption of back-to-back cover is maintained when the insurance policy and reinsurance policy have different applicable laws.[24] In a surprise judgment, the House of Lords distinguished the case from two precedents that appeared to have similar fact patterns where the English law applicable to the reinsurance contract was interpreted to reach the same result as the foreign law applicable to the insurance contracts due to the presumption of back-to-back cover.[25] Here, there was no back-to-back cover because the applicable law of the insurance contract was neither identified nor capable of being identified at the time of the conclusion of the reinsurance contract.[26] As there was no back-to-back cover, it was found that the reinsurer did not have to pay the insurer even though the insurer has already made a settlement with the insured in the United States to cover damages to property due to toxic pollution.[27] This case was obviously a significant one for the insurance industry.[28] It did however, generate some negative commentary as Dr. Özlem Gürses of King's College London concluded that "their Lordships' reasons for distinguishing [the two prior cases] are contradictory and unconvincing, and throw into doubt the significance of the presumption of back-to-back cover."[29] This Article re-examines this important case from a fresh perspective. Though their Lordships based their decision on the lack of an applicable law to the insurance contract at the time of the conclusion of the reinsurance contract, their opinions hinted that they may not have ruled the same way if the result of the subsequently identified law of Pennsylvania on the insurance contract were not so contrary from English law.[30] In other words, this Article suggests that although implicit, it was the need to interpret English law in such a contrary way in order to reach the same result as the interpretation under Pennsylvania law to maintain back-to-back cover that dissuaded the House of Lords from upholding the presumption.

Part I of this Article provides a brief background of the development of insurance and insurance law in England. Part II discusses the nature of reinsurance, including the different types and the presumption of back-to-back cover. Part III examines the *Wasa* judgment by the House of Lords, the industry's response to the ruling to create more certainty in the market, and the possibility that the decision was motivated not only by the lack of an identifiable law but also the divergent result between English law and Pennsylvania law.

III. BACKGROUND ON INSURANCE

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21 *See* KYRIAKI NOUSSIA, REINSURANCE ARBITRATIONS 135 (Springer 2013).

22 *See* Wasa International Insurance Co. Ltd. v. Lexington Insurance Co. [2009] UKHL 40; *see also* Constitutional Reform Act 2005, c. 4 §3, sch 23 (Pursuant to the Constitutional Reform Act 2005, the United Kingdom Supreme Court was established on October 1, 2009. The duties of the Law Lords in the House of Lords were transferred to the Supreme Court, and the Law Lords themselves became Justices of the Supreme Court).

23 Wasa International Insurance Co. Ltd. v. Lexington Insurance Co. [2009] UKHL 40.

24 *See id.*

25 *See id.*

26 *See id.*

27 *See id.*

28 *See id.*

29 Gürses, *supra* note 4, at 129.

30 *See* Wasa International Insurance [2009] UKHL 40.

A. Lloyd's of London

Starting as a coffee shop in the mid-1600s in which merchants gathered and engaged in commercial transactions, Lloyd's of London has become "a Corporation formed with statutory authority."[31] As Lloyd's was frequented by seafarers who bought and sold insurance for ships, it became better known amongst the community which led to a booming business.[32] By 1691, the coffee shop was relocated, which generated even more interest.[33] After the move, owner Edward Lloyd:

> [E]mbarked on two innovative ventures, both of which would ultimately have the effect of cementing his institution as a maritime commercial powerhouse. Lloyd first began by creating a network of correspondents located in surrounding ports and abroad who could report on the movement of specific vessels and other maritime-related information. This further strengthened his establishment as a strategic nexus for admiralty-related industry. Lloyd thereafter synthesized the shipping intelligence gleaned from these correspondents into a weekly trade paper, which could then be distributed throughout the London maritime market. Accordingly, merchant businessmen reading the Lloyd News could keep abreast of nearby port information, ship schedules, and even receive periodic updates concerning maritime affairs in foreign lands.[34]

By the early eighteenth century, Lloyd's was "considered the 'chief commercial Saleroom of London.'"[35] Lloyd's began to attract even more seafarers, leading to an increase of "underwriters, brokers, and insurance companies who attempted to gain a piece of the action."[36] The modern practice of obtaining insurance coverage at Lloyd's today has changed little since this time.[37] Potential insureds would approach brokers to explain the proposed coverage.[38] The broker would then write down the proposal and circulate the insurance document, called a slip, for insurers to sign.[39] At this time, however, no regulations existed and business was disorganized.[40] Today, though it is much more highly regulated, the practice of

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[31] BIRDS, *supra* note 14, at 2.

[32] Jeremy A. Herschaft, *Not Your Average Coffee Shop: Lloyd's of London—A Twenty-First-Century Primer on the History, Structure, and Future of the Backbone of Marine Insurance*, 29 TUL. MAR. L.J. 169, 170 (2005).

[33] *See id.* at 170-71.

[34] *Id.* at 171.

[35] *Id.* (quoting RAYMOND FLOWER & MICHAEL WYNN JONES, LLOYD'S OF LONDON: AN ILLUSTRATED HISTORY 29 (1974)).

[36] *Id.* at 172.

[37] *See id.*

[38] *See id.*

[39] *See* BIRDS, *supra* note 14; *see also* Herschaft, *supra* note 32, at 172.

[40] *See id.*

obtaining insurance coverage remains practically the same.[41] One major difference is that Lloyd's is now located in its own fourteen-floor building in the City of London.[42]

B. English Law on Insurance

The laws of marine insurance, first developed as merchant law or *lex mercatoria,* were the business practices of merchants engaged in the business, much of which occurred in the early days of Lloyd's, that ultimately became the law governing the industry.[43] Lord Mansfield, Lord Chief Justice during the mid-eighteenth century, was an immensely influential jurist who "applied principles derived from the law of merchant as well as more traditional common law concepts to the solution of disputes over insurance, and by the time of his retirement in 1788, the jurisdiction of the courts over insurance matters had been established."[44] The standard policy forms at Lloyd's along with the case law developed by Lord Mansfield were later codified in the MIA of 1906.[45] Consisting of 94 sections, the MIA was the basis of the marine insurance laws in other commonwealth countries.[46] Despite the title, the principles in the MIA are applicable to other forms of insurance unless specifically exempted by case law.[47] The MIA defines a marine insurance contract as "a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure."[48] The law also includes the peculiar principles of insurance law, including insurable interest,[49] utmost good faith,[50] and warranties.[51] Despite being seen as essential tenets of marine insurance law, the onerous requirements governing utmost good faith and warranties were abrogated by the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015.[52] Although insurable interest is still required in English insurance law, some jurisdictions like Australia have removed it as a prerequisite.[53] Reinsurance is part of the MIA. Section 9 states: (1) The insurer under a contract

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[41] For a detailed overview of the players involved at Lloyd's and the process of placing risks, *see* Herschaft, *supra* note 32, at 174-81; *see also* ANDREW DUGUID, ON THE BRINK: HOW A CRISIS TRANSFORMED LLOYD'S OF LONDON (2014).

[42] *See* Herschaft, *supra* note 32, at 173; *see also Lloyd's building*, INSTITUTION OF CIVIL ENGINEERS (last visited Apr. 10, 2020), https://www.ice.org.uk/what-is-civil-engineering/what-do-civil-engineers-do/lloyds-building.

[43] *See generally* Philip Rawlings, *Bubbles, Taxes, and Interests: Another History of Insurance Law, 1720-1825*, 36 OXF. J. LEG. STUD. 799 (2016).

[44] BIRDS, *supra* note 14, at 1-2; *see also* Arthur C. Schreiber, *Lord Mansfield—The Father of Insurance Law*, 1960 INS. L.J. 766 (1960).

[45] See BIRDS, *supra* note 14; *see also* Marine Insurance Act 1906 (U.K.).

[46] *See* Marine Insurance Act 1906 (U.K.).

[47] *See* Sacha Patel, *The Insurance Act 2015*, STEAMSHIP MUTUAL (May 2016), https://www.steamshipmutual.com/publications/Articles/insuranceact2015.htm.

[48] Marine Insurance Act 1906 (U.K.), at § 1.

[49] *Id.* at §§ 4-15.

[50] *Id.* at § 27.

[51] *Id.* at §§ 33-41.

[52] *See* Rob Merkin & Özlem Gürses, *The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured*, 78 MOD. L. REV. 1004 (2015); *see also* MALCOLM CLARKE & BARIŞ SOYER (EDS.), THE INSURANCE ACT 2015: A NEW REGIME FOR COMMERCIAL AND MARINE INSURANCE LAW (2016).

[53] *See* Sharo Michael Atmeh, *Regulation Not Prohibition: The Comparative Case against the Insurable Interest Doctrine*, 32 NW. J. INT'L L. & BUS. 93, 136-39 (2011). Some scholars have questioned whether the insurable interest requirement should be eliminated in English law also. *See, e.g.,* Gary Meggitt, *Insurable Interest – The*

of marine insurance has an insurable interest in his risk, and may re-insure in respect of it, and (2) Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.[54]

IV. REINSURANCE

A. What and Why?

In general, concepts in insurance law apply to reinsurance law.[55] The parties in an insurance contract are the insurer and the insured, while the parties in a reinsurance contract are the reinsurer and the reinsured.[56] The reinsured is the insurer in the underlying insurance contract.[57] The commonly accepted view today is that reinsurance is not liability insurance for the insurer, but further insurance on the subject matter of the underlying policy.[58] Therefore, the reinsurer is not automatically obliged to indemnify simply because the insurer is liable for the losses.[59] In other words, reinsurance is not liability insurance purchased by the insurer where it automatically indemnifies the insured upon being found liable.[60] This view was not universally accepted even as recently as the beginning of the 21st century, as the Court of Appeal opinion in *Wasa* found otherwise and characterized reinsurance as liability insurance.[61]

There are two major reasons for insurance companies to purchase reinsurance. First, it allows for the insurance of "major and often international risks which would otherwise be uninsurable."[62] National markets may not be able to handle the risks that international markets could.[63] This internationalization of insurance is also done through fronting "where the reinsurer is not permitted to conduct direct insurance business in a certain country (or state) and therefore has to find a local insurer notionally to insure the risk."[64] Second, reinsurance "enables insurers to protect their own solvency" and expands their capacity to underwrite due to the

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Doctrine that Would not Die, 35 LEGAL STUD. 280 (2015); *see also* Kyriaki Noussia, *Insurable Interest in Marine Insurance Contracts: Modern Commercial Needs Versus Tradition*, 39 J. MAR. L. & COM. 81 (2008).

54 Marine Insurance Act 1906 (U.K.), at § 9.

55 *See* Project Group on Principles of Reinsurance Contract Law (PRICL Project Group) & International Institute for the Unification of Private Law (UNIDROIT), *PRINCIPLES OF REINSURANCE CONTRACT LAW (PRICL)*, at 3 (2019), https://www.ius.uzh.ch/dam/jcr:c5e36159-2cbc-4686-83ce-1067bc4704a3/PRICL_1.0_2019.pdf.

56 *See* National Association of Insurance Commissioners, *Reinsurance* (last updated Feb. 26, 2020), https://content.naic.org/cipr_topics/topic_reinsurance.htm.

57 *See id.*

58 *See Wasa International Insurance* [2009] UKHL, at 33, 114.

59 *See* Larry Schiffer, *If It Looks Like a Claim, and Sounds Like a Claim, Is It a Claim for Reinsurance Purposes?*, INT'L RISK MGMT. INST., INC. (Jan. 2002), https://www.irmi.com/articles/expert-commentary/is-it-a-claim-for-reinsurance-purposes.

60 *See id.*

61 *See* Robert Merkin, *Commercial Certainty in the Reinsurance Market*, 126 L. Q. REV. 1, 24-30 (Mar. 2010).

62 JOHN LOWRY, PHILIP RAWLINGS & ROBERT MERKIN, INSURANCE LAW: DOCTRINES AND PRINCIPLES (3rd ed. Hart Publishing 2011) 501.

63 *See generally* Gerry Dickinson, *The Economic Role of the Insurance Sector in the Risk Transfer - Capital Market Nexus*, 23 THE GENEVA PAPERS ON RISK AND INSURANCE. ISSUES AND PRACTICE 89, 519-29 (Oct. 1998).

64 COLIN EDELMAN QC, ANDREW BURNS, DAVID CRAIG AND AKASH NAWBATT, THE LAW OF REINSURANCE § 1.15 (Oxford Press 2d ed. 2013) (eBook).

increased capital.[65] This allows for the insurer to "insure a volume, type or size of risk that it would not be able to cover in the absence of reinsurance."[66]

B. Types of Reinsurance

There are various types of reinsurance.[67] Typically, reinsurance can be differentiated in two ways: (1) by the way the contracts are concluded between the reinsurer and insurer; and (2) by the substance of the reinsurance contract and the coverage that the reinsurer provides to the insurer.[68] The focus of this Article is on proportional facultative reinsurance, as only this type of reinsurance is presumed to have back-to-back cover with the underlying insurance contract. It is important to discuss the different categories of reinsurance before examining the incorporation of incorporation of the insurance contract terms into the reinsurance contract and the presumption of back-to-back cover.

i. Facultative and Treaty Reinsurance

Reinsurance can further be categorized into two types: facultative reinsurance or treaty reinsurance.[69] For facultative reinsurance, each risk is individually bargained for and both parties, the reinsurer and insurer, can decide whether to enter into the reinsurance contract.[70] There is no obligation for either party to enter into the contract.[71] Facultative reinsurance involves high administrative costs and time since each individual risk needs to be considered and analyzed.[72] However, once the contract is concluded, there is usually no "administrative oversight by the reinsurer" as it is delegated to the insurer.[73] Thus, the insurer is often required to maintain a certain percentage of the risk so that the reinsurer can be confident that the insurer has the financial incentive to competently administer the claims.[74] Facultative reinsurance may involve a high degree of uncertainty for the insurer because "in its most traditional form (i.e. where insurance is effected first and reinsurance is then sought) [...] an insurer can take on a risk and then discover that he cannot obtain any reinsurance."[75] Nevertheless, this concern can be addressed as "[i]n many cases reinsurance is arranged, at least in principle, before insurance is affected."[76]

By contrast, in the case of treaty reinsurance, there is an ongoing agreement between the two parties whereby the reinsurer is required to accept the risk if it falls within the category

[65] LOWRY ET AL., *supra* note 62, at 501.

[66] *Id.*

[67] *See* The Independent Financial Portal: Financial Web, *7 Types of Reinsurance*, https://www.finweb.com/insurance/7-types-of-reinsurance.html (last visited April 9, 2020).

[68] *Id.* (referencing different types of reinsurance).

[69] *See* Sean Ross, *Facultative vs. Treaty Reinsurance: What's the Difference?*, INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/articles/markets/081716/facultative-vs-treaty-reinsurance-differences-and-examples.asp.

[70] *See* EDELMAN ET AL., *supra* note 64, at para. 1.41.

[71] *See id.*

[72] *See id.*

[73] JOHN S. DIACONIS & DOUGLAS W. HAMMOND, REINSURANCE LAW, at § 1:4.1 (Kelliann Kavanagh ed. 2011).

[74] *See* GRAYDON S. STARING, LAW OF REINSURANCE §2.2 (Clark Boardman Callaghan 1993) (2020).

[75] EDELMAN ET AL., *supra* note 64, at para. 1.42.

[76] *Id.* at para. 1.44.

already agreed to in the contract.[77] Individual risks are not further bargained for or assessed by the reinsurer.[78] The premiums are also contracted for in advance.[79] This method of reinsurance ensures "certainty of reinsurance cover simultaneously with the direct insurance being placed,"[80] addressing a potential shortcoming of facultative reinsurance.[81] A less common form of treaty reinsurance is non-obligatory reinsurance, where "the reinsured has the right to decide whether to proffer a risk for acceptance, and the reinsurers have the right to refuse any particular risk."[82] The treaty here is less a binding obligation and more of an agreed machinery for the presentation of proposals by the reinsured."[83]

There is a third, hybrid form of reinsurance called facultative/obligatory or open cover reinsurance where "the reinsured retains a choice as to what risks he will cede and the reinsurer binds himself to take whatever is ceded."[84] Any risk ceded must still fall within the treaty.[85] This type of reinsurance "is unfavorable to reinsurers as they are more or less at the mercy of the reinsured who may decide to offload poor business on the reinsurers."[86] This type of reinsurance allows the reassured "to put onto his reinsurer the least attractive pieces of qualifying business in his book, while keeping what he considers to be the best business for himself."[87] This type of reinsurance is considered a hybrid because "the arrangements are facultative so far as the reinsured is concerned because he retains the choice as to whether or not to cede. So far as the reinsurer is concerned, the arrangement is obligatory, like a treaty."[88]

ii. Proportional and Non-Proportional Reinsurance

Reinsurance can also be divided into proportional and non-proportional reinsurance, both of which could be facultative or treaty.[89] These two categories describe the structure of the coverage as opposed to the facultative-treaty distinction, which is how the reinsurance contracts are concluded. In proportional reinsurance, "the reinsurer has an interest in all the insurer's losses as it will pay the proportion of such losses that he has agreed to reinsure."[90] In the most simplistic terms, the reinsured pays the reinsurer a percentage of the premium it receives from the underlying policyholder, and the reinsurer then becomes liable for the same percentage of the loss.[91] Under a treaty arrangement, proportional reinsurance can be divided

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[77] *See id.*

[78] *See id.*

[79] *Id.* at para 1.50; *see also* Diaconis & Hammond, *supra* note 73, at §1:4.2.

[80] EDELMAN ET AL., *supra* note 64, at para. 1.50.

[81] *See* Ross, *supra* note 69.

[82] LOWRY ET AL., *supra* note 62, at 504.

[83] *Id.*

[84] JOHN BIRDS, ANDREW LONGMORE, EVAN JAMES MACGILLIVRAY, DAVID OWEN, MACGILLIVRAY ON INSURANCE LAW 1040 (11th ed. 2008).

[85] *See* EDELMAN ET AL., *supra* note 64, at para 1.50.

[86] LOWRY ET AL., *supra* note 62, at 504 (citing Aneco Reinsurance Underwriting Ltd. V. Johnson & Higgins (1998) 1 Lloyd's Rep 565).

[87] Aneco Reinsurance Underwriting Ltd. v. Johnson & Higgins Ltd. [2001] UKHL 51, [26].

[88] EDELMAN ET AL., *supra* note 64, at para. 1.71.

[89] *See id.* at para 1.42, 1.51.

[90] *Id.* at para 1.34.

[91] *See* DIACONIS & HAMMOND, *supra* note 73, at § 1:5.1.

into quota share and surplus business.[92] Quota share reinsurance "involves the cession by the reinsured of a fixed proportion of business within the scope of the reinsurance contract to the reinsurer."[93] Under this arrangement, the "insurer and reinsurer are obliged to cede and accept a fixed share of each and every risk within the scope of the treaty."[94] Surplus business reinsurance, on the other hand, "involves cession by the reinsured to the reinsurer of a surplus of business over that for which he is prepared to accept liability."[95] The insurer's retention, called a line and quantified as a monetary sum, is decided by the insurer depending on the specifics of each risk.[96] If the loss is not greater than the line, the insurer retains the whole risk.[97] If the loss is greater than the line, however, "that part over the retention is ceded to the surplus share treaty reinsurer(s) as a multiple of the sum retained by the insurer," and the reinsurer must indemnify.[98]

Non-proportional reinsurance is where the "liability of the insurer is capped at a certain level (the deductible). Within that retained layer the insurer will remain liable for all losses. The reinsurer will be liable for sums that exceed the deductible."[99] Non-proportional treaty reinsurance, more commonly used than the non-proportional facultative reinsurance, can be divided into excess of loss reinsurance and stop loss business. The former "requires that the ceding insurer pay all loss, but [requires] that the reinsurer indemnifies loss above a predetermined retention, up to predetermined limit of liability."[100] Therefore, if the loss does not reach the predetermined baseline, the reinsurer is not obligated to indemnify since the "reinsurer only becomes involved in a loss when it exceeds the insured's deductible."[101] In stop loss reinsurance, "the reinsurer becomes liable when the reinsured's aggregated losses exceed an agreed level."[102]

C. Focus on Proportional Facultative Reinsurance

Proportional facultative reinsurance is the focus of this Article, as the presumption of back-to-back cover is only applicable to this type of reinsurance.[103] It logically follows that the cover for reinsurance and insurance contracts would be presumed to be back-to-back as "[t]he purpose of facultative proportional reinsurance is to share the risk and premium between the reinsured and the reinsurers."[104] Other types of reinsurance, however, cannot support the back-to-back cover presumption because, for example, in excess of loss reinsurance, the nature of the risk is different.[105] When the nature of the risk is different, and when the risk of individual policies cannot be negotiated to conform between the original insurance contract and the

[92] *See* EDELMAN ET AL., *supra* note 64, at para 1.53.
[93] BIRDS ET AL., *supra* note 84, at 1039.
[94] EDELMAN ET AL., *supra* note 64, at para 1.54.
[95] BIRDS ET AL., *supra* note 84, at 1039.
[96] *See* EDELMAN ET AL., *supra* note 64, at para. 1.56.
[97] *See id.*
[98] *Id.*
[99] *Id.* at para. 1.61.
[100] DIACONIS & HAMMOND, *supra* note 73, at § 1:5.2.
[101] EDELMAN ET AL., *supra* note 64, at para. 1.62.
[102] BIRDS ET AL., *supra* note 84, at 1039.
[103] *See* EDELMAN ET AL., *supra* note 64, at para. 1.43-1.48.
[104] GÜRSES, *supra* note 19, at 47.
[105] *See* Rob Merkin, *The Rome I Regulation and Reinsurance*, 5 J. PRIVATE INT'L L. 69, 78 (2009).

reinsurance contract, "it is not apt to apply the presumption."[106] Professor Merkin said it well, stating:

The presumption has no part to play in respect of non-proportional reinsurance, where the reinsurers assess the risk for themselves, charge a premium that does not have an automatic relationship to the insurance premium and accept a risk based not on percentages but rather in absolute terms over and above the reinsured's financial retention.[107] For these reasons, the discussion to follow in the remainder of this Article will be exclusively devoted to a deeper examination of proportional facultative reinsurance.

i. Incorporation of Terms

The terms in a proportional facultative reinsurance contract typically incorporate the terms of the original insurance contract.[108] Incorporation is the practice of transposing all of the material terms and conditions from the underlying insurance contract into the reinsurance contract, often identically.[109] Although incorporation is not mandatory for the presumption of back-to-back cover, it is the easiest and most practical way to ensure the existence of the basic condition of the presumption.[110] Generally, incorporation is accomplished through the use of a blanket clause or "by appending to the direct policy a cover page which states that reinsurance is as same terms 'as original.'"[111] The majority view holds that such a general incorporation clause effectively "incorporates the terms of the insurance contract into the reinsurance."[112] Although incorporation is generally undertaken "to achieve an identical standard of liability on the two contracts,"[113] there are nonetheless limitations of and exceptions to this general principle.

Indeed, the main problem is rooted in the "fundamental tension...between the undoubted principle that insurance and reinsurance are separate contracts and the further principle that the reinsurance is designed to provide matching cover."[114] Incorporation of the underlying insurance into the reinsurance contract can be achieved by (1) an explicit provision or (2) "a warranty by the reinsured that the terms and conditions of the insurance and the reinsurance are the same."[115] Although incorporation is not mandatory for the presumption back-to-back cover, it leaves less room for contract drafting and interpretation ambiguity when the two contracts to have identical terms.[116] Nevertheless:

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[106] EDELMAN ET AL., *supra* note 64 at para. 3.28.

[107] Merkin, *supra* note 105, at 78 (internal references omitted).

[108] *See id.* at 73, 79.

[109] *See* Larry Schiffer, *Reinsurance Contract Wording Revisited*, INT'L RISK MGMT. INST., INC. (Dec. 2018), https://www.irmi.com/articles/expert-commentary/reinsurance-contract-wording-revisited.

[110] *See* Merkin, *supra* note 105, at 79; *see also* Gürses, *supra* note 4, at 119.

[111] GÜRSES, *supra* note 19, at 51.

[112] *Id.*

[113] BIRDS ET AL., *supra* note 84 at 1061; *see also* Lower Rhine & Wurtemberg Insurance Association v Sedgwick, [1899] 1 Q.B. 179.

[114] Gürses, *supra* note 4, at 120.

[115] BIRDS ET AL., *supra* note 84, at 1055-56 (*citing* Forsikringsaktieselskapet Vesta v. Butcher, [1989] 1 Lloyd's Rep. 331).

[116] *See* Merkin, *supra* note 105, at 79.

> . . . [t]here are many provisions in an underlying contract which may well be wholly inappropriate for incorporation into any contract of reinsurance. The question of whether terms have actually been incorporated, notwithstanding an apparent statement that they have, and what meaning and effect they have if incorporated, is essentially therefore a question of construction.[117]

In *HIH Casualty & General Insurance Ltd. v. New Hampshire Insurance Co.*, the court outlines the conditions the terms must meet to be successfully incorporated into reinsurance contract through the use of a general incorporation clause.[118] Namely, (1) the term has to make sense with permissible manipulation; (2) the term has to relate to the subject matter; (3) the term has to be appropriate for inclusion; and (4) the term has to be consistent with express terms.[119] In addition, unusual terms are usually not incorporated "unless the party relying on it proves that he drew the other party's attention to it."[120] Whether a term is unusual can be ascertained by using a reasonable person standard in the specific market.[121] Given the criteria, courts have found that arbitration clauses,[122] exclusive jurisdiction clauses,[123] and choice of law clauses cannot be incorporated by general incorporation clauses.[124] These clauses were found to be ancillary in nature and cannot be given any meaning in the reinsurance contract without the express consent of both parties to incorporate the terms.[125]

The failure to incorporate choice of law clauses by general incorporation language is further bolstered by European law, as seen in Rome I Regulation:

> A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.[126]

A clear and unequivocal choice of law and not merely a passive general incorporation clause would be necessary to give effect to a choice of law provision in the reinsurance contract.[127] Though, as Professor Merkin pointed out, this may be moot because, "[r]einsurance agreements are generally governed by express choice-of-law clauses."[128]

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[117] EDELMAN ET AL., *supra* note 64, at para. 3.39.

[118] HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co [2001] Lloyd's Rep IR 596 (C.A.).

[119] *See* EDELMAN ET AL., *supra* note 64, at 3.40 (*citing* HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co [2001] Lloyd's Rep IR 596); *see also* LOWRY ET AL., *supra* note 62, at 508.

[120] *See* GÜRSES, *supra* note 19, at 56-7 (*citing* Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd. [1989] QB 433 (Eng.)).

[121] *See id.* at 57.

[122] *See id.* at 64 ("An arbitration clause governs dispute resolution and is not relevant to the performance of the contract.").

[123] *See id.* at 67 ("Such clauses...have nothing to do with defining the risk; thus, they are wholly inappropriate to disputes arising between the parties to the reinsurance contract.").

[124] *See* EDELMAN ET AL., *supra* note 64, at 3.53-3.56.

[125] *See* LOWRY ET AL., *supra* note 62, at 509.

[126] Council Regulation 593/2008 of June 17, 2008, Rome I, art. 3.1, 2008 (O.J.) (L 177) 6, 10.

[127] *See* Merkin, *supra* note 105, at 73-4.

[128] *Id.* at 84.

In *Gan Insurance Co. Ltd. v. Tai Ping Insurance Co. Ltd.*, a significant incorporation of choice of law case, the court declined to incorporate the choice of Taiwanese law, the applicable law in the underlying insurance, into the reinsurance company because "[a] departure from the usual course of business on the London market could only be justified if the terms of the reinsurance agreement unequivocally pointed to an intention that the proper law of the contract should be Taiwanese law."[129] The court noted that the use of standard form clauses "found in reinsurance contracts placed on the London market pointed to an implied choice of English law."[130] Absent a contrary express provision or intention, the practice of placing reinsurance in the London market would point to the choice of English law to settle any disputes regardless of the general incorporation clause. [131] A general incorporation clause stating "as original" is not enough to conclude that the parties intended for the choice of law clause in the insurance contract to be incorporated into the reinsurance contract.[132] The court also noted that England was the appropriate jurisdiction and English law the appropriate law because, among other reasons, the claims cooperation clauses were "standard London reinsurance market clauses designed to protect London market reinsurers,"[133] and they were in English.[134] In essence, "reinsurers who have had business placed with them on the London reinsurance market will have good grounds for asserting that the appropriate forum for the dispute is England."[135]

Furthermore, in *AIG Europe (UK) Ltd v. Anonymous Greek Insurance Co. of General Insurances (The Ethniki)*, the underlying insurance contract had a jurisdiction clause indicating Athens as the jurisdiction, and the reinsurance contract incorporated the terms with the words "wording as original."[136] The court held that incorporation of the jurisdiction clause failed because "the jurisdiction clause in the underlying contract did nothing to define the risk and that, if regard were had to its terms, it was wholly inappropriate to disputes arising between insurers and reinsurers under a contract that was probably governed by English law."[137] Courts in other cases, including, *Arig Insurance Co. Ltd. v. Sasa Assicuazione Riassicurazione SPA* and *AIG Europe SA v. QBE International Insurance Ltd* have similarly held that the jurisdiction clause was not incorporated because a consensus between the parties on the clause was not indicated.[138] General incorporation favors the likelihood of reinsurance and insurance contracts being found to have back-to-back cover, but as demonstrated above, it is clearly not without exceptions.[139]

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[129] EDELMAN ET AL., *supra* note 64, at para. 3.54.

[130] *Id.* at para 7.08.

[131] *See id.* at para. 7.10, 7.13 (*citing* King & Ors v. Brandywine Reinsurance Co. (UK) Ltd. [2004] EWHC (Comm) 1033).

[132] *See* Gan Insurance Co. Ltd. v. Tai Ping Insurance Co Ltd. [1999] Lloyd's Rep IR 472 (Eng.).

[133] EDELMAN ET AL., *supra* note 64, at para. 7.56.

[134] *See id.*

[135] *Id.* at para 7.59.

[136] *See* AIG Europe (UK) Ltd v. Anonymous Greek Insurance Co. of General Insurances (The Ethniki) [1999] Lloyd's Rep IR 221 (Eng.).

[137] EDELMAN ET AL., *supra* note 64, at para. 7.46.

[138] AIG Europe SA v. QBE International Insurance Ltd., [2002] Lloyd's Rep I.R. 22 (*citing* Arig Insurance Co. Ltd. v. Sasa Assicurazione Riassicurazione S.P.A., (unreported, Feb. 10, 1998)).

[139] *See* Larry Schiffer, *Why Reinsurance Matters, and Other Must-Know Reinsurance Concepts*, INT'L RISK MGMT. INST., INC. 8 (May 2019), https://www.squirepattonboggs.com/~/media/files/insights/publications/2019/04/why-reinsurance-matters-and-other-must-know-reinsurance-concepts/whyreinsurancemattersandothermustknowreinsuranceconcepts.pdf.

ii. Back-to-Back Cover

1. Presumption

Because reinsurance is insurance purchased by the insurer to cover the same subject matter as the underlying insurance policy, it follows logically that the reinsurance and insurance contracts should be matching. This is a concept known as back-to-back cover, it acts to minimize circumstances in which the insurer is liable to indemnify while the reinsurer is not.[140] Fundamentally, insurance is about creating certainty. As Professor Malcolm Clark noted:

> Policyholders want peace of mind and security: the certainty of cover against the slings and arrows of outrageous life...Insurers too want certainty—certainty about the particular risk to be insured so that they can rate it and insure it, effectively and profitably. Uncertainty, whether it concerns changes in the law or changes in the weather, is the bane of insurers.[141]

Regardless of whether there is incorporation, the principle of back-to-back cover in reinsurance, also known as concurrency in the United States, exists.[142] The theory is that the reinsurance contract is identical to the insurance contract, therefore coverage of the risk is the same.[143] If the insurer is found to be liable to indemnify the risk, then the reinsurer would be liable too.[144] Indeed, as previously stated:

> [t]he courts have held that as a matter of general principle a policy of *proportional* reinsurance should be construed so that the cover provided under the reinsurance is co-extensive with the cover contained in the primary policies issues by the reinsured; contracts of reinsurance should, in cases of doubt, accordingly be construed so as to provide back to back cover.[145]

Nevertheless, as with contracts generally, reinsurance contracts are subject to contractual construction.[146] Indeed, "[t]he presumption of back-to-back cover is simply a rule of construction."[147] It is rebuttable when the language does not match or in situations "where the risk is exceptionally large and the reinsurance terms have been the subject of individual negotiation."[148] Besides, "the notion of back-to-back cover cannot operate to strike out or

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[140] *See* MOUTINHO RAMOS, *supra* note 3, at 32.

[141] MALCOLM CLARKE, POLICIES AND PERCEPTIONS OF INSURANCE LAW IN THE TWENTY-FIRST CENTURY 335 (Oxford, 2005).

[142] *See* GÜRSES, *supra* note 19, at 40.

[143] *See* MOUTINHO RAMOS, *supra* note 3.

[144] Gürses, *supra* note 4, at 122.

[145] EDELMAN ET AL., *supra* note 64, at para. 3.12.

[146] *See id.* at para 3.01; *see also* William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance Contracts*, 33 TORT & INS. L.J. 1, 28 (1997) (*citing* Colin Edelman, *Current "Soft Targets" in Reinsurance Contract Wording*, 11 INT'L INS. L. REV. 327 (1996)).

[147] *See* GÜRSES, *supra* note 19, at 84.

[148] JOHN S. BUTLER & ROBERT MERKIN, REINSURANCE LAW B-0183 (Sweet and Maxwell, 2010) (*citing* Youell v. Bland Welch & Co. (No. 1) [1992] 2 Lloyd's Rep. 127).

override those express terms of the reinsurance agreement which are inconsistent with the underlying terms."[149]

The presumption of back-to-back cover is sensible as a business presumption and legal concept because it creates certainty and predictability.[150] The insurer, if found liable to indemnify the policyholder, can be confident that while it has to pay on an insurance claim, it would be able to collect compensation from the reinsurer in most situations.[151]

2. Back-to-Back Cover with Different Laws

When the laws governing the insurance and reinsurance contracts are different, it may be reasonable to question whether back-to-back still exists. This section discusses two cases, *Forsikringsaktieselskapet Vesta v. Butcher*[152] and *Groupama Navigation et Transports v. Catatumbo Seguros*,[153] that examine this issue. These two cases stand "for the proposition that where insurance and reinsurance are back-to-back, and each is governed by a different applicable law, the construction of the common term provided for by the law governing the direct policy is to be applied to the reinsurance, so that the same wording gives rise to the same coverage."[154]

Vesta is a House of Lords case concerning damages to a fish farm in Norway caused by a storm.[155] The insurance contract was concluded between the Norwegian policyholder and Norwegian insurer, which subsequently purchased reinsurance on the London market.[156] The reinsurance contract had a general incorporation clause referencing the underlying insurance contract, and the contracts were "substantially back-to-back."[157] The warranty that there would be a 24-hour guard at the fish farm in the insurance contract was thus incorporated into the reinsurance contract.[158] The warranty was breached in the case, which meant the reinsurer was not liable under English law regardless of the lack of a causal link between the breach of the warranty and the loss due to the storm.[159] However, the insurer was still liable because under Norwegian law, the breach would have had to have a causal relationship to the loss in order for the insurer to disclaim liability.[160] The court "held that the intention of the parties to the reinsurance must have been to provide an indemnity against the liability of the reinsured, and that accordingly the warranty in the reinsurance was to receive the same meaning as it had in Norwegian law."[161] Lord Templeman stated, "In my opinion, in the absence of any express

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149 LOWRY ET AL., *supra* note 62, at 511 (*citing* GE Reinsurance Corporation v. New Hampshire Insurance Co (2004) Lloyd's Rep IR 404; *and* Municipal Mutual Insurance Ltd v. Sea Insurance Co Ltd. (1996) LRLR 265; *and* Youell v. Bland Welch (No 1) (1992) 2 Lloyd's Rep 127).

150 *See* MOUTINHO RAMOS, *supra* note 3, at 16.

151 *See id.*

152 Forsikringsaktieselskapet Vesta v. Butcher [1989] EWHC (Comm) 331 (Eng.).

153 Groupama Navigation et Transports v. Catatumbo Ca Seguros [1999] EWHC (Comm) 845 (Eng.).

154 Gürses, *supra* note 4, at 125.

155 *See generally Vesta*, [1989] EWHC (Comm).

156 *See id.*

157 *See id.*

158 *See id.*

159 *See* Marine Insurance Act 1906 (U.K.), at § 33(3).

160 *See Vesta*, [1989] EWHC (Comm), at 331.

161 BIRDS ET AL., *supra* note 84, at 1062.

declaration to the contrary in the reinsurance policy, a warranty must produce the same effect in each policy,"[162] and therefore the reinsurer was held to be liable to indemnify even though there was a breach of the warranty. Though English law governed the reinsurance contract, the case found that the warranty was to be construed and interpreted the same way as it was under Norwegian law, the law of the insurance contract.[163]

Eleven years later, *Groupama Navigation et Transports v. Catatumbo Seguros* was decided by the Court of Appeal. Similar to *Vesta*, this case concerned an insurance contract governed by Venezuelan law and a reinsurance contract governed by English law.[164] A warranty to maintain the class of the insured ships was stated in the insurance contract and independently stated in the reinsurance contract, in addition to a general incorporation clause incorporating the original warranty.[165] The warranty was breached by the insured and there was subsequently a loss caused by a storm unrelated to the breach.[166] Like Norwegian law, Venezuelan law requires the breach to be causative of the loss for the insurer to refuse payment.[167] What is exceptional about *Catatumbo* is that while:

> . . . the reinsurance contract not only incorporated the terms of the direct policy but contained its own class warranty . . . [the court] nevertheless thought that *Vesta* remained applicable: the contracts provided identical cover, the interpretation of the warranties should be identical and accordingly the express reinsurance warranty was either to be regarded as a provision displaced by the incorporated warranty, or to be construed in accordance with the direct warranty.[168]

The court ruled again that the warranty in the reinsurance contract must be construed the exact same way as the identical term in the insurance contract, regardless of the fact that the reinsurance contract was governed by English law.[169] In the end, the court found that the reinsurer was liable and was required to indemnify the losses.[170]

The opinions of the court in both *Vesta* and *Catatumbo* strove to give the same meaning to the same or equivalent wording in the respective contracts.[171] It was a matter of "the construction of the reinsurance contract and not one of imputed choice of law."[172] Even though the choice of law may have been different, due to the fact that reinsurance contracts are almost always governed by English law while insurance contracts are commonly governed by the law of the location of the underlying policy:

> . . . [t]here is powerful authority for the proposition that where insurance and reinsurance are back-to-back, and each is governed by a different applicable

[162] *Vesta*, EWHC (Comm), at 331.
[163] *See id.* at 874.
[164] *See Catatumbo*, EWHC (Comm) 845.
[165] *See id.*
[166] *See id.*
[167] *See id.*
[168] Gürses, *supra* note 4, at 125.
[169] *See id.*
[170] *See id.* at 129.
[171] *See* BIRDS ET AL., *supra* note 84, at 1061.
[172] *Id.* at 1063.

> law, the construction of the common term provided for by the law governing the direct policy is to be applied to the reinsurance, so that the same wording gives rise to the same coverage.[173]

The reasoning and rulings in the two cases were substantially the same, as the Court of Appeal in *Catatumbo* followed the precedence set by the House of Lords in *Vesta* in setting the rule regarding choice of law involving reinsurance and insurance contracts.

V. UK SUPREME COURT IN *WASA V. LEXINGTON*

A. Facts and Judgment

Despite the aforementioned cases, the presumption of back-to-back cover was called into question by *Wasa v. Lexington*, which was decided by the United Kingdom House of Lords on July 30, 2009.[174] In this case, the American insurer, Lexington, provided insurance coverage to an American company called Alcoa for a period of three years lasting from July 1, 1977 to July 1, 1980.[175] During the same time period, Lexington purchased reinsurance on the London reinsurance market from Wasa International which incorporated the terms.[176] The governing law of the insurance contract was not explicitly clear at the time of its conclusion, but the contract contained a Service of Suit clause that required the insurer to submit to the jurisdiction of any state in which the insured decided to commence litigation.[177] Therefore, with respect to the Service of Suit clause, the reinsurance contract was governed by English law.[178]

The original insured was found liable for toxic damages, and Lexington settled with the insured after realizing it was also liable for damages outside of the three-year period under the controlling law of Pennsylvania, as determined by the Washington State Supreme Court.[179] The insurer was found to have joint and several liability with all other insurers throughout the 44-year period of toxic damages to the insured properties, even though it only contracted to take on the risk for ten years, and only three of those were ceded to the reinsurers.[180] Nevertheless:

> Wasa and AGF declined to reimburse Lexington on the basis that, as a matter of English law, they could only be held liable for the costs of remedying the specific portion of damage that occurred during the policy period and that the 'settlement' entered into by Lexington and [the insured]

[173] Gürses, *supra* note 4, at 125.
[174] *See* Lexington Ins. Company v. Wasa Int'l Ins. Company Limited [2009] UKHL 40 [2008] 1 AC (HL) 33 (appeal taken from Eng.).
[175] *See id.* at para. 12.
[176] *See id.* at para. 20-1.
[177] *See id.* at para 19.
[178] *See id.* at para. 13.
[179] *See id.* at para. 102.
[180] *See id.* at para. 57. This is the same approach to compensation as followed by § 3 of the English Compensation Act of 2006. *See, e.g.* Compensation Act 2006, c. 3 (Eng.), http://www.legislation.gov.uk/ukpga/2006/29/contents?view=plain.

encompassed a settlement for damage that took place outside this three year period.[181]

The House of Lords affirmed the independence of reinsurance contracts from insurance contracts and cast great doubts onto the ideas set forth in *Vesta* and *Catatumbo* in which the reinsurance cover would follow the insurance cover.[182] While Lord Mance conceded that the terms of the original insurance were fully incorporated into the reinsurance contract,[183] and "it is hard to see in the reinsurance contract in *Wasa* any contrary intention showing that the reinsurance and insurance contracts should not be interpreted in the same way,"[184] the resulting decision interpreted the contracts differently by using two different laws.[185] The key difference between this case and *Vesta* and *Catatumbo,* as noted by the opinions of the House of Lords, was that when the reinsurance contract was concluded in 1977, it was impossible to determine that Pennsylvania law would be the one governing the insurance contract, therefore the reinsurer should not be expected to follow the interpretation of PA law and indemnify under such uncertainty.[186] The choice of Pennsylvanian law meant that the insurer was jointly and severally liable for all the losses prior to and during the insurance coverage period, which is antithetical to English law where:

> . . . the insurer (or reinsurer) is liable to indemnify the insured (or reinsured) in respect of loss and damage which occurs within the period of cover but will not be liable to indemnify the insured (or reinsured) in respect of loss and damage which occurs either before inception or after expiry of the risk.[187]

The House of Lords distinguished *Wasa* from *Vesta* and *Catatumbo*, both which were cited significantly and explicitly not overruled, by focusing on ambiguity around choice of law at the time of contracting.[188] This distinction allowed it to find that the reinsurer was not liable because of "the principle that reinsurers could not be expected to follow the reinsured's liability in circumstances where it was not clear which law would govern that liability,"[189] whereas "[i]n both *Vesta* and *Catatumbo*, it was possible at the time when the insurance and reinsurance were placed to identify the foreign law which would govern the insurance."[190] The court held that "the reinsurers were entitled to rely upon the terms of their own policy despite the cover being back-to-back and the reinsurers being obliged to follow settlements."[191] In making this distinction, the House of Lords reaffirmed the theory that reinsurance is not liability insurance and rather:

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181 John T. Harding, *The English Revolution: "Follow the Fortunes" After Lexington v. AGF & Wasa*, 77 DEF. COUNS. J. 328, 343 (2010).
182 *See id.* at 334.
183 *See* Gürses, *supra* note 4, at 129.
184 Adrian Mecz & Anthony Bailey, *Wasa v Lexington: Buyer Beware*, 1 J. BUS. L. 1, 3 (2010).
185 *See* Gürses, *supra* note 4, at 130.
186 Gürses, *supra* note 4, at 126.
187 *Wasa International Insurance* [2009] UKHL at para. 74.
188 *See id.* at para. 7.
189 Gürses, *supra* note 4, at 126; *see also* LOWRY ET AL., *supra* note 62, at 512-13.
190 *Wasa International Insurance* [2009] UKHL, at para. 44.
191 Gürses, *supra* note 4, at 129; *see also* LOWRY ET AL., *supra* note 62, at 512-13.

> [R]einsurance is a contract whereby the subject matter of the original insurance is insured by the reinsurer and it is not a contract under which the reinsurer agrees to indemnify the insurer for its liability arising under the primary insurance. The point is significant, because classifying reinsurance as a liability cover creates a direct link between the sums paid by the reinsured and the reinsurer's obligation to provide an indemnity, with the back-to-back terms of the reinsurance simply confirming that the reinsurers will pay when the reinsured has to pay.[192]

Therefore, the liability for payment by the insurer does not automatically translate to liability for payment by the reinsurer. In this case, "[t]heir Lordships implicitly recognized that their ruling was uncommercial...for contracts written before the ruling in *Wasa* the market will continue to be faced with great uncertainty as to exactly what the reinsurance covers."[193] A major reason that the ruling is uncommercial is because the distinction between *Wasa* and the two prior cases are unclear and unconvincing.[194] In the two previous cases, the law was applied in ways that would allow coverage under foreign laws even though coverage under English law would have been denied. In this case, English law was applied and therefore the reinsurer was free from indemnity even though the insurer's liability for the losses to the policyholder was clear.[195]

Dr. Gürses noted that "in this case the contracts had identical wordings and the insurer paid by reference to the interpretation by a court of competent jurisdiction of the original policy term which was reproduced in the reinsurance policy," the distinction made by the House of Lords was not convincing to all.[196] Another commentator, however, believes *Wasa* to be correct while recognizing the contradiction, stating, "[i]f the reinsurance contract is governed by a law other than the law of the insurance contract, it should be construed in accordance with that law as a separate contract, as the House of Lords firmly state that it is."[197]

It has been pointed out that, "[b]oth *Vesta* and *Catatumbo* were cases involving warranties.[198] A key question is whether those cases are confined to warranties or whether they lay down a general presumption of back to back cover even in coverage cases."[199] Even though there is some clue, *Wasa* does not directly answer this question, as the key distinction noted by their Lordships was the uncertainty of the applicable law at the time of the contract, not warranty clauses versus other clauses.[200]

B. Industry Response

[192] Gürses, *supra* note 4, at 122-23.
[193] *Id.* at 130.
[194] *See id.*
[195] *See Wasa International Insurance* [2009] UKHL, at 20.
[196] Gürses, *supra* note 4, at 130.
[197] PT O'NEILL & JW WOLONIECKI, THE LAW OF REINSURANCE IN ENGLAND AND BERMUDA 151 (3rd ed. 2010).
[198] BUTLER & MERKIN, *supra* note 148, at 20211.
[199] *Id.*
[200] *See Wasa International Insurance* [2009] UKHL, at para. 7.

The judgment led to uncertainty and unpredictability in the industry.[201] Since *Vesta* is still good law alongside *Wasa*, it is unclear in what circumstances is the presumption of back-to-back cover still valid.[202] Is it when the applicable law of the underlying insurance contract is identified or identifiable, or is it when the result of the English law interpretation is drastically different from the interpretation using most other laws in the world, such as in the case of warranties?[203] Undoubtedly in the absence of further guidance, the industry had to devise measures to make the relationship between the insurer and reinsurer more certain and the reinsurance contract's coverage more predictable.

The most direct way for insurers and reinsurers to ensure that there is back-to-back cover is to be more contemplative in drafting their reinsurance contracts and to include clauses that would minimize uncertainty. In the *Wasa* Court of Appeal decision, the court "noted that more careful drafting of the reinsurance contract could avoid or minimize disputes between ceding companies and their reinsurers."[204] First, drafters can explicitly indicate that the reinsurance contract is to be governed by the law of the direct policy, though this provision "could not consist of a Service of Suit clause...because English law does not recogni[z]e the validity of a floating choice of law clause."[205] The practice is reflected in Lloyd's best practice recommendations. According to its guidelines, for American surplus lines and assumed reinsurance businesses, "underwriters must submit to jurisdiction in any US competent court, therefore no state's jurisdiction should be specified."[206] However, a choice of law must be clearly made in the policy.[207] This is clearly a marked change from prior to *Wasa*, where Lloyd's recommendation was that the reinsurer should specify a law, but the "choice of law may be in the form of a clause which specifies clearly a rule by which governing law is determined, in the case of multi-state or multi-territory risks" with a warning that "underwriters should be aware that there may be limited cases where a choice of law provision may be overridden by a court."[208] This clause would have likely led to the lack of back-to-back cover because the law would have still been undeterminable at the time of the conclusion of the insurance contract and consequently most likely at the time of the conclusion reinsurance contract also. It is uncertain when Lloyd's stopped making the suggestion to include this clause, but it was likely a response to the ruling in *Wasa*.

A second way is that parties could include a claims cooperation clause or a claims control clause in the reinsurance contract. These clauses can be used by the reinsurer to "circumscribe the power of the reinsured to make settlements or other decisions which are binding on it."[209] A cooperation clause gives the reinsurer the right to be involved from the time

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[201] *See id.* at para. 20.

[202] *See id.* at para. 43.

[203] *See* INSURANCE ACT 2015 §3, 9 Warranties and Representations. (The example of warranties is no longer applicable since the passage of Insurance Act 2015, but there may be other examples of English law being the global outlier.).

[204] Harding, *supra* note 181, at 351.

[205] Merkin, *supra* note 62, at 29.

[206] *Choice of Law and Jurisdiction – Best Practice*, LLOYD'S (Apr. 25, 2016), https://www.lloyds.com/market-resources/market-communications/regulatory-communications/regulatory-communications/regulatory-news-articles/2016/04/choice-of-law-and-juris.

[207] *See id.*

[208] Iain Saville: Lloyd's Head of Business Process Reform, *Market Bulletin: LMP Slip*, LLOYD'S, https://www.lloyds.com/~/media/lloyds/archive/marketbulletin/market-bulletins/2004/y3406.pdf.

[209] EDELMAN ET AL., *supra* note 64, at 5.07.

of the claim in order to give its opinion during the investigative and settlement stages.[210] A control clause, on the other hand gives reinsurers full control of all aspects of claims handling.[211] With the reinsurer involved from the beginning, it is most likely the case that the settlement or verdict would be approved by the reinsurer, forcing it to indemnify if the insurer is found liable. The reinsurer, therefore, once involved and subjected to the jurisdiction of the court in the insurer's jurisdiction, could not later claim to not be bound by the results.

A third approach when drafting the reinsurance agreement is:

> . . . to agree English law for the reinsurance and to specify that all the clauses in it shall be interpreted so they are back to back with whatever the underlying insurance may be held to mean under whatever system of law a Court of competent jurisdiction may choose to apply to it."[212]

This solution is also proposed by Professor Merkin when he suggested that "the choice of law clause could provide that the reinsurance is governed by English law but that questions of construction are governed by the law chosen to govern the direct policy."[213] This solution is essentially the rationale in *Vesta* and *Catatumbo* and would consequently lead to the finding of the preservation of back-to-back cover.

The difficulty in negotiating these contractual terms lies in the power imbalance between insurers and reinsurers because of the size and power of the London reinsurance industry. Indeed, the *Wasa* Court of Appeal opinion "did not suggest any practical way in the market to actually negotiate such terms."[214] Reinsurers in London prefer to enter into contracts governed by English law because it is the law that it knows best and the law that has been universally applied to reinsurance contracts given the strong presumption noted in *Gan Insurance*.[215] It is unlikely the reinsurance industry would easily consent to changing the terms of the reinsurance contract given the traditional forms and slips it has customarily used as these amendments may lead to different results and, ironically, a period of further uncertainty that may not be beneficial to reinsurers. Nevertheless, it is submitted that reinsurers should be more cognizant of the needs of its contractual partners and be more flexible in drafting insurance contracts to ensure that the needs of both parties are met.

C. Calculating Tort Liabilities

Wasa created uncertainty, and now, a decade later, the case is settled law but the resulting uncertainty remains. This section explores the possibility that *Wasa* was distinguished from prior case law because applying Pennsylvania law resulted in an interpretation that was too divergent from the interpretation of English law. Therefore, it is asserted that the case was

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[210] *See* GÜRSES, *supra* note 19, at 231.

[211] *See* Larry Schiffer, *Underwriting and Claims Clauses in Reinsurance Agreements*, INT'L RISK MGMT. INST., INC. (Sept. 2012), https://www.irmi.com/articles/expert-commentary/underwriting-and-claims-clauses-in-reinsurance-agreements.

[212] Bill Perry, *The Limitations Of "Back To Back" As a Concept In Reinsurance In English Law Following Lexington v. AGF (and Lexington v. Wasa)*, 77 DEF. COUNSEL J. 310, 326 (2010).

[213] Merkin, *supra* note 61, at 29.

[214] Harding, *supra* note 181, at 351.

[215] *See Gan Insurance Co. Ltd.*, Lloyd's Rep IR 472.

distinguished, not simply because Pennsylvania law was not identified at the time of the conclusion of the reinsurance contract, but its unidentified status combined with the particular outcome that led to the decision. It is submitted that had the applicable law resulted in an interpretation that only slightly varied from that of English law, the House of Lords may have found that back-to-back cover was still maintained. This assertion is supported by the fact that if it were just because there was no chosen applicable law, their Lordships would not have needed to discuss the resulting joint and several liability imposed on the insured and therefore the insurer at length.[216] It appeared that they were emphasizing that such a disparate result was so different from English law that back-to-back cover could not possibility be maintained.[217] Implicitly, they were conveying the possibility that had the results of the law of the insurance contract been more similar to the English law interpretation, they may have upheld the presumption.[218] The rest of this section discusses some other methods of calculating and allocating of liabilities among tortfeasors in American law to explore whether any of them could have resulted in the House of Lords upholding back-to-back cover in *Wasa*.[219]

In a toxic tort situation like in this case, the various jurisdictions in the United States have devised at least four ways to allocate liability: (1) joint and several liability, (2) pro-ration by years, (3) pro-ration by years and limits, and (4) pro-ration by exposure.[220] Joint and several liability was applied by the law of Pennsylvania and the interpretation with which the House of Lords were faced.[221] Joint and several liability means that the plaintiff can seek the entire compensation from any of the tortfeasors who have been found to be responsible.[222] The tortfeasor in turn has the right to pursue contribution from other parties found to be jointly and severally liable.[223] Inexplicably, this latter point was never raised by their Lordships, which may have given the casual reader the impression that the difference in the quantum of liability between the two interpretations was much greater than it ultimately could wind up being. This method raises the question of how the court would allocate the liability between the insurers since the rationale for using joint and several liability is that it would be difficult to divide liability amongst the various insurers to compensate the insured.[224] The allocation problem is merely postponed.[225] This method may prove unfair for those of whom were self-insured when the damages were occurring as all the losses would be allocated between the various insurers.[226]

The other three ways to allocate liability are based on a pro-ration basis.[227] The first type, pro-ration by years, is based on the proportion each policy was in effect in terms of the

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[216] *See generally Wasa International Insurance* [2009] UKHL 40 (discussing the joint and several liability imposed on insured and insurers.

[217] *See id.* at 43.

[218] *See id.*

[219] *See id.* at 46.

[220] *See* generally Thomas M. Jones & Jon D. Hurwitz, *An Introduction to Insurance Allocation Issues in Multiple-Trigger Cases*, 10 VILL. ENVTL. L.J. 25, 37-49 (1999) (discussing the different allocation of liability in U.S. law).

[221] *See Wasa International Insurance* [2009] UKHL, at 4.

[222] *See* Michael G. Doherty, *Allocating Progressive Injury Liability among Successive Insurance Policies*, 64 U. CHI. L. REV. 257, 269 (1997). For a spirited defense of joint and several liability, *see generally* Richard W. Wright, *Allocating Liability Among Multiple Responsible Causes: A Principled Defense of Joint and Several Liability for Actual Harm and Risk Exposure*, 21 U.C. DAVIS L. REV. 1141 (1988).

[223] *See* Doherty, *supra* note 222, at 269.

[224] *See id.* at 270.

[225] *See id.*

[226] *See id.* at 272.

[227] *See id.* at 278.

number of years it was on risk.[228] The rationale for this method of calculation is "Due to the difficulty of establishing the actual amount of loss sustained during an individual policy period...a simple calculation based on time on the risk is the most equitable and efficient means of allocating indemnification obligations."[229]

The drawback of this method is that policy limits are not taken into account, resulting in a situation where, "[A] policy with very low limits of liability may be liable for the same amount as a policy with much greater limits, despite the likely disparity in the premium that the respective carriers collected from the policyholder."[230] In this situation, where the number of total years found by the Washington Supreme Court was 44 years between 1942 and 1986, Lexington would have been liable from 1974 to 1984.[231] Wasa would have only been responsible for three of the years as it was only the reinsurer for that time period.

Under this formulation, Wasa would have been liable for 6.8% of the damages.[232] This would be a different figure from the exact three years of liability between July 1, 1977 and July 1, 1980 the reinsurer contracted for, if it is ascertainable at all, but it would be a significantly lower amount than a joint and several liability scheme.[233] Another calculation method is pro-ration by years and limits:

> The basis of an individual insurer's liability is the aggregate coverage it underwrote during the period in which the loss occurred. Basically, a given insurer's liability is determined by comparing its particular exposure to the total amount of exposure assumed by all carriers of the triggered policies. This comparison yields a percentage that is then applied to the amount of loss the policyholder sustained.[234]

This is also called the coverage provided method.[235] For example, Company X purchases insurance from Insurer A for two years with a policy limit of $1 million. The next three years, Company X purchases insurance from Insurer B with a limit of $2 million. The court found that the damage is $4 million during the five years.[236] The exposure for Insurer A would be $1 million multiplied by 2, which is $2 million, and the exposure for Insurer B would be $2 million multiplied by 3, which is $6 million. The total indemnity is potentially $8 million. Under the pro-ration by years and limit formulation, Insurer A would be liable for 2/8, or 1/4 of the total damages, and Insurer B would be liable for 6/8, or 3/4 of the total damages. With damages totaling $4 million, Insurer A would be liable for $1 million and Insurer B would be liable for $3 million. It would not be possible to apply this method to calculate exactly what the insurer and reinsurer would be liable for in this case without more information. However, the total

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228 *See* Jones & Hurwitz, *supra* note 220, at 42.

229 *Id.* at 42-3.

230 *Id.* at 44.

231 *See* Gürses, *supra* note 4, at 120-22.

232 *See id.*

233 *See id.*

234 Jones & Hurwitz, *supra* note 220, at 44.

235 *See* Doherty, *supra* note 222, at 274.

236 *See id.*

damages would not equal the amount they would be liable in the exact time three-year time period.[237]

Lastly, there is a pro-ration by exposure method, which is the same as under English law.[238] With that method, the court would apportion the liability based on the specific time period in which the insurer insured the risk.[239] As previously noted, calculating the damages for each policy period may be difficult. If Pennsylvania law used this approach there would have been back-to-back coverage between the insurance policy and the reinsurance policy, resulting in no litigation on this issue.[240]

Conversely, what if Pennsylvania law applied the pro-ration by year's method or the pro-ration by years and limits method? The former may be result in a quantum that is close to the result calculated by the pro-ration by exposure method. If the damages were fairly uniform throughout the overall time period, then a proportion of the damages would be close to the damages in the precise time period of the policy. If the amount of damages varied drastically, the figure undoubtedly could differ by a large amount. Nonetheless, the result would be closer than the quantum calculated by pro-ration by years and limits, as this method requires knowing the limits of each insurance policy and insurers with higher limits may be liable for more than their fair share while those with lower limits would pay less than their fair proportion under the pro-ration by years or pro-ration by exposure methods.[241]

The question remains, how would the House of Lords have ruled in either situation? On the one hand, the Lords' stated reasoning was that the choice of law was not identified at the time of contracting, so if the same rationale were applied, they would have similarly found there was no back-to-back cover, and the reinsurer would only be liable for compensation for losses suffered during the specific time period stated in the policy.[242] On the other hand, the difference in the quantum would have been much lower than that between the quantum using English law and the quantum using joint and several liability as applied by the Washington State Supreme Court.[243] Even if the law were not identified, if the resulting quantum were not drastically disparate, would that be enough to rebut the presumption of back-to-back cover? Professor Merkin suggests that "it is possible to read the judgments as indicating that the ousting of the back-to-back principle on the basis of unpredictable outcome extended only to the most fundamental terms of the reinsurance, in particular the duration of coverage."[244] Although the pro-ration by years and pro-ration by years and limits approaches are both temporally bound, they also take into account the years that are not specifically covered by the policy.[245] This certainly makes the determination of whether this would satisfy the House of Lords much more difficult.

If the House of Lords were to maintain the principle that underlies the case, then they would have no choice but to find that there was no back-to-back cover in any of the above scenarios. Yet, this does not seem to be a commercial decision if the quantum difference is low.

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[237] *See id.*

[238] *See* Jones & Hurwitz, *supra* note 220, at 47.

[239] *See id.* at 47-9.

[240] *See* Gürses, *supra* note 4, at 121.

[241] *See id.*

[242] *See id.*

[243] *See Wasa International Insurance Co. Ltd.* [2009] UKHL 40.

[244] Rob Merkin, *Insurance and Reinsurance in the* Fairchild *Enclave*, 36 LEGAL STUD. 302, 310 (2016).

[245] *See* Jones & Hurwitz, *supra* note 220, at 43-7.

The decision may be harder in such a case, which may hint at the possibility that although they did not state so explicitly, the drastic difference in the quantum may have been at least one consideration when they wrote their opinions. All in all, it appears that the choice of the method to allocate liabilities under American tort law may have determined, or at least some affect, on the interpretation of English reinsurance law.

VI. CONCLUSION

Insurance, including reinsurance, is an important global industry that seeks to offer a sense of security. Back-to-back cover in reinsurance is an important presumption that creates certainty and predictability in the market to protect the original policyholder and the insurer in the face of a multitude of potentially conflicting laws.[246] The presumption had been strong and relatively straightforward under English law until the unexpected opinions in *Wasa* by the House of Lords. Though the opinions do provide some discussion as to when the presumption of back-to-back cover ceases to exist, the guidance is not clear and has been criticized for leading to confusion.[247]

This article suggests that the stated reasoning of the House of Lords may not appear to be as principled as it appeared at first glance. The bright-line rule they announced regarding the applicable law of the underlying insurance contract being unidentified may not be so clear if the difference in the quantum had not been as large between the English law interpretation and the interpretation of the law of Pennsylvania. In fact, this Article has shown that had the decision of the Washington State Supreme Court been different, the House of Lords decision may have also been different. At the very least, it may have led to a clearer judgment.

Though *Wasa* may have been a *sui generis* case, it certainly injected some uncertainty into the presumption of back-to-back cover.[248] The industry has likely responded in its practice to ensure that back-to-back cover is maintained or clarify that coverage is not identical through more contemplative negotiations and wording in their reinsurance contracts. Disputes are undoubtedly being resolved through international arbitration, and the likelihood of another reinsurance case, let alone one whose issue turns on the presumption of back-to-back cover, reaching the Supreme Court is infinitesimally low. Nonetheless, the state of the presumption of back-to-back cover is still murky, and solidifying the presumption, however reached, should continue to be the aim of the judiciary and industry because this would only benefit the global insurance and reinsurance industry as a whole.

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[246] *See* EDELMAN ET AL., *supra* note 64, at para 2.29, 3.19.

[247] *Contrast, generally,* Wasa International Insurance Co. Ltd. [2009] UKHL 40 *with* Jie Zhang, *Comment on the Decision of the House of Lords in Wasa International Insurance Co Ltd v Lexington Insurance Co [2009] UKHL 40*, 5 SOUTHAMPTON STUDENT L. REV. 15, 15-8 (2015).

[248] *See* Wasa International Insurance Co Ltd v Lexington Insurance Co. [2009] UKHL 40.