Trinity Term
[2013] UKSC 57
On appeal from: [2011] EWCA Civ 1570

JUDGMENT

Teal Assurance Company Limited (Appellant) *v* W R Berkley Insurance (Europe) Limited and another (Respondents)

before

Lord Neuberger, President
Lord Mance
Lord Clarke
Lord Sumption
Lord Toulson

JUDGMENT GIVEN ON

31 July 2013

Heard on 17 and 18 June 2013

Appellant	*Respondents*
Christopher Butcher QC Rebecca Sabben-Clare QC (Instructed by DAC Beachcroft LLP)	Colin Edelman QC Alison Padfield (Instructed by Clyde & Co LLP)

LORD MANCE (with whom Lord Neuberger, Lord Clarke, Lord Sumption and Lord Toulson agree)

Introduction

1. Black and Veatch Corp ("BV") is an engineering company incorporated in Delaware. This appeal concerns the top layer of its professional liability insurance programme for the year from 1 November 2007. The first or primary layer was with Lexington Insurance Co ("Lexington"). There are then three successive excess layers (described as the "PI tower") with the appellant, Teal Assurance Co Ltd ("Teal"), which is an associate or "captive" of BV based in the Cayman Islands. Teal reinsured the risks under these layers with various retrocessionaires (Swiss Re, Zurich, etc). Finally comes the top layer, a "top and drop" policy, again placed with Teal and reinsured by Teal with the respondents, WR Berkley Insurance (Europe) Ltd and Aspen Insurance UK Ltd for 50% each. Unlike the layers beneath it, which provided worldwide cover, the top and drop policy excludes any claims emanating from or brought in the USA and Canada.

2. BV has received and notified to its insurers various claims, some emanating from or brought in the USA or Canada, others not. The ultimate issue on this appeal is whether BV and Teal or either of them is entitled to choose which claims to meet from the primary and/or lower excess layers, so as to ensure that those remaining are not US or Canadian claims, and can be met by Teal out of the top layer and passed on to the respondents. The courts below (Andrew Smith J, [2011] EWHC 91 (Comm), and the Court of Appeal, [2011] EWCA Civ 1570) have held that Teal cannot do this. They have held that the claims fall to be allocated to the successive layers, starting with Lexington's primary layer, as and when BV's third party liability is ascertained by agreement, judgment or award in accordance with a general principle of liability insurance established in *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363 and *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957.

3. Teal now appeals with the Court's permission. Teal submits that a party is entitled to exercise contractual rights as best suits it, here to maximise the insurance cover available to its associate BV. The primary and lower excess layers covered US and Canadian claims and BV and Teal were entitled to take full advantage of this. Further, Teal submits that the top and drop, and each of the lower excess layers, contains a clause (clause 1 of a set of clauses LSW055) making clear that no liability can arise under them unless and until underlying insurers "shall have paid or have admitted liability or have been held liable to pay,

the full amount of their indemnity inclusive of costs and expenses". Teal's case is that liability thereunder necessarily depends upon the order in which underlying insurers, including Teal, choose (or are held liable) to settle insurance claims, rather than upon the order in which third party liability claims are ascertained by agreement, judgment or award as against BV. Teal submits that this scheme is complemented by clause IV.E of the Lexington policy, requiring BV to pay the deductible and self-insured retention prior to Lexington indemnifying BV.

4. Teal's application for permission and written case also suggested that the case raises, or may raise, what Teal calls a legal fiction, that a claim under a liability insurance is for damages for the insurer's failure to hold the insured harmless. It submits that a more appropriate analysis would be that insurers undertake to pay valid claims on the occurrence of particular events. This would have the potential effect that insurers could become liable in damages for non- or late payment, contrary to the rule presently established by cases such as *Ventouris v Mountain (The "Italia Express") (No 2)* [1992] 2 Lloyd's Rep 281 and *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111. It would also enter upon an area presently under consideration by the English and Scottish Law Commissions: see their *Issues Paper 6: Damages for Late Payment and the Insurer's Duty of Good Faith* (2010) and their subsequent formal consultation paper *Insurance Contract Law: Post Contract Duties and Other Issues* (2012). However, as the submissions developed, it became apparent that it could make no difference to the outcome of this appeal how an insurer's liability to indemnify is formulated. In particular, whether the insurer's liability is by way of damages or in debt does not answer the question whether such liability is exhausted as and when a claim, insured and notified under the policy, gives rise to ascertained third party liability or expenses on BV's part.

The insurance programme

5. With this introduction, I describe the insurance programme in greater detail:

a. BV accepted a deductible of US$100,000 per claim (or US$250,000 for remedial work under an endorsement) and a self-insured retention of US$10m per occurrence and US$20m in the aggregate (though it was permitted to insure part of this with Teal under a policy No 2007-006 not relevant to this appeal).

b. BV's layer of cover with Lexington was for US$5m excess of the deductible of US$100,000 (or US$250,000) per claim and the self-insured retention of US$10m per occurrence, with an aggregate limit of US$20m.

c. Above that, the "PI tower" consisted of the three excess layers:

i. Policy No 2007-009 for US$5m any one claim and in the aggregate excess of US$15m any one claim (i.e. excess of the Lexington cover);

ii. Policy No 2007-010 for US$30m any one claim and in the aggregate excess of US$20m any one claim; and

iii. Policy No 2007-011 for US$20m any one claim and in the aggregate excess of US$50m any one claim.

d. The top and drop policy (number 2007-012) applied in excess of the Lexington policy and the PI tower, and had a limit of liability of £10m or equivalent excess of the underlying retention of US$10m any one claim and US$20m in the aggregate.

6. The Lexington policy read:

"NOTICE: THIS IS A CLAIMS-MADE POLICY. SUBJECT TO THE TERMS AND CONDITIONS OF THE POLICY, THIS INSURANCE APPLIES TO ONLY THOSE CLAIMS THAT ARE FIRST MADE AGAINST THE INSURED AND REPORTED TO THE COMPANY DURING THE POLICY PERIOD, OR THE OPTIONAL EXTENDED REPORTING PERIOD. THE COSTS OF DEFENSE UNDER THIS POLICY, INCLUDING ATTORNEY'S FEES, REDUCE THE LIMITS OF COVERAGE AND THE DEDUCTIBLE AND SELF-INSURED RETENTION, STATED IN THE DECLARATIONS. THE COMPANY SHALL NOT BE OBLIGATED TO PAY ANY CLAIM OR CLAIM EXPENSES, OR UNDERTAKE TO CONTINUE DEFENSE OF ANY SUIT OR PROCEEDING AFTER THE LIMIT OF THE COMPANY'S LIABILITY HAS BEEN EXHAUSTED.

Declarations

…

Deductible and Self-Insured Retention:

a. $ 100,000 per Claim Deductible (including Claim Expenses)

b. $10,000,000 per Claim Self-Insured Retention (including Claim Expenses)

c. $20,000,000 aggregate Self-Insured Retention per Policy Period (including Claim Expenses)

The Insured shall have the obligation to pay up to:

1. the Deductible amount stated in line a.; and

2. the per Claim Self-lnsured Retention amount stated in line b.

Payments made under the per Claim Self-Insured Retention, line b. are subject to the maximum Aggregate Self-Insured Retention amount in line c.

…

THIS IS A CLAIMS-MADE AND REPORTED POLICY. CLAIMS MUST FIRST BE MADE AGAINST THE INSURED AND REPORTED TO THE COMPANY DURING THE POLICY PERIOD UNLESS AN EXTENDED REPORTING PERIOD APPLIES. THE PAYMENT OF CLAIM EXPENSES REDUCES THE LIMITS OF INSURANCE.

Various provisions in this policy restrict coverage. Read the entire policy carefully to determine rights, duties and what is and is not covered. Refer to SECTION IV - DEFINITIONS for the special meaning of other words and phrases that appear in bold face.

In consideration of the premium charged, the undertaking of the **Named Insured** to pay the **Deductible and/or Self-Insured Retention** and in reliance upon the statements in the application, and subject to the Limit of Liability of this Insurance as set forth in the Declarations, and the Exclusions, Conditions and other terms of this

Policy, Lexington Insurance Company, hereafter referred to as the Company, agrees with the **Named Insured** as follows:

PART A

I. INSURING AGREEMENT – COVERAGE

The insurance afforded by this Policy applies to **Claims**…which allege any negligent act, error or omission provided …

The Company will indemnify the **Insured** all sums up to the Limits stated in the Declarations, in excess of the **Insured's Deductible and/or Self-Insured Retention**, which the Insured shall become legally obligated to pay as **Damages** if such legal liability arises out of the performance of professional services in the **Insured's** capacity as an architect or engineer and as stated in the Application provided …

IV. **DEFINITIONS**

…

E. **Deductible and/or Self-Insured Retention** means the amount stated in Item 5. of the Declarations that the **Insured** will pay, as set forth in the Declarations, for **Claim Expenses** and **Damages** with respect to every Claim made during the Policy Period. This amount must be paid prior to the Company indemnifying the **Insured** under the terms and conditions of this Policy.

…"

7. By Endorsement No 8 the Lexington policy further provided:

"In addition to the coverage granted under this Policy, but subject to the same Self-Insured Retention and limits of liability, we agree to indemnify the Named Insured for the Named Insured's Actual and Necessary Costs and Expenses incurred in rectifying a Design Defect in any part of the construction works or engineering works for any

project upon which you are providing design/build services provided:

A) the Insured reports the Claim for such Actual and Necessary Costs and Expenses as soon as practicable after discovery of such Design Defect but in no event after any certificate of substantial completion has been issued;

B) the Insured proves to us that its Claim for Actual and Necessary Costs and Expenses arises out of the Insured's rendering of professional services which resulted in a Design Defect for which a third party could otherwise make Claim against the Insured."

8. Each of the PI tower policies provided cover to BV as "the Assured" as follows:

"To indemnify the Assured for claim or claims which may be made against the Assured during the period of insurance hereon up to this Policy's amount of liability (as hereinafter specified) in the aggregate, the excess of the Underlying Policy/ies limits (as hereinafter specified) in the aggregate, the latter amount being the subject of Indemnity Policy/ies (as hereinafter specified) or any Policy/ies issued in substitution or renewal thereof for the same amount effected by the Assured and hereinafter referred to as 'the Underlying Policy/ies'."

Each PI tower policy then went on to specify its limit, and the underlying policy number(s) and limit(s). Each then set out the following set of clauses, with the reference LSW055 indicating that they were in fact a standard excess wording (dating, as appears elsewhere, from August 1998):

"1. Liability to pay under this Policy shall not attach unless and until the Underwriters of the Underlying Policy/ies shall have paid or have admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses.

2. It is a condition of this Policy that the Underlying Policy/ies shall be maintained in full effect during the currency of this Policy except for any reduction of the aggregate limits contained therein solely by payment of claims or of legal costs and expenses incurred in defence or settlement of such claims.

3. If by reason of the payment of any claim or claims or legal costs and expenses by the Underwriters of the Underlying Policy(ies) during the period of this Insurance, the amount of indemnity provided by such Underlying Policy/ies is:-

(a) Partially reduced, then this Policy shall apply in excess of the reduced amount of the Underlying Policy/ies for the remainder of the period of insurance;

(b) Totally exhausted, then this Policy shall continue in force as Underlying Policy until expiry hereof.

4. In the event of a claim arising to which the Underwriters hereon may be liable to contribute, no costs shall be incurred on their behalf without their consent being first obtained (such consent not to be unreasonably withheld). No settlement of a claim shall be effected by the Assured for such a sum as will involve this Policy without the consent of Underwriters hereon.

5. All recoveries or payments recovered or received subsequent to a loss settlement under this Policy shall be applied as if recovered or received prior to such settlement and all necessary adjustments shall then be made between the Assured and the Underwriters provided always that nothing in this Policy shall be construed to mean that loss settlements under this Policy are not payable until the Assured's ultimate net loss has been finally ascertained.

6. Except as otherwise provided herein this Policy is subject to the same terms, exclusions, conditions and definitions as the Policy of the Primary Insurers. No amendment to the Policy of the Primary Insurers during the period of this Policy in respect of which the Primary Insurers require an additional premium or a deductible shall be effective in extending the scope of this Policy until agreed in writing by the Insurers. …

8. If the Assured shall prefer any claim knowing the same to be false or fraudulent, as regards amount or otherwise, this Policy shall become void and all claims hereunder shall be forfeited."

9. The top and drop policy followed similar wording. It was:

> "To indemnify the Insured for claim or claims first made against the Insured during the Period of Insurance hereon up to this Policy's amount of liability (as hereinafter specified) in the aggregate, the excess of the Underlying Policy(ies) limits (as hereinafter specified) in the aggregate, the latter amount being the subject of Indemnity Policy(ies) (as hereinafter specified) or any Policy(ies) issued in substitution or renewal thereof for the same amount effected by the Insured and hereinafter referred to as 'the Underlying Policy(ies)'."

After stating its policy limits, and the underlying policy numbers and limits, it too set out the LSW055 clauses, but with the addition of the following clause (clauses 5 and 6 above being renumbered accordingly as clauses 6 and 7):

> "5. Any claim(s) made against the Insured or the discovery by the Insured of any loss(es) or any circumstances of which the Insured becomes aware during the subsistence hereof which are likely to give rise to such a claim or loss, shall, if it appears likely that such claim(s) plus costs and expenses incurred in the defence or settlement of such claim(s) or loss(es) may exceed the indemnity available under the Policy(ies) of the Primary and Underlying Excess Insurers, be notified immediately by the Insured in writing to the Insurers hereon."

10. The reinsurance taken out by Teal in respect of the top and drop layer identified the reinsured interest as "Architects and Engineers Professional Liability as more fully defined in the primary policy wording, in connection with the Original Insured's business activities as Architects and Engineers". It also identified the underlying layers and provided "Excess Policy in any event no broader than any underlying form", and by Endorsement Seven it defined the basis and scope of indemnity as follows:

> "A. REINSURING CLAUSE
>
> Except as otherwise agreed, the Reinsurer's liability under this Agreement shall follow that of the Reinsured for losses under all terms, conditions, and limits to the Reinsured Original Policy or Policies specified therein ('the Policy'). Subject to treaty reinsurance only, the Reinsured warrants to retain for its own account the amount indicated as its Net Retention for the Agreement period. The Reinsured shall provide to the Reinsurer promptly after closing a copy of the Policy and any endorsements thereto affecting this Agreement, and shall make available for inspection and place at the

> disposal of the Reinsurer at the office of the Reinsured any of its records relating to this Agreement or to claims in connection therewith at all reasonable times during and after the Agreement period.
>
> B. SCOPE OF INDEMNITY
>
> The Reinsurer shall indemnify the Reinsured to the extent of the Reinsurer's written share for any loss, interest or Allocated Expenses (as defined below) paid by the Reinsured and covered by this Agreement. …"

The claims made

11. During the relevant insurance year, BV notified 27 claims, four of which have a value in excess of US$1m. Two of these four are US or Canadian claims, made against BV by American Electric Power ("AEP") and known as (a) FRP Pipe and (b) Jet Bubble Reactors – JBR Internals. BV puts the amount of the FRP Pipe claim at US$10,491,368, in respect of which BV has paid out its self-insured retention of US$10m and bears an applicable deductible of US$250,000. BV puts the cost of repairs in respect of the JBR Internals at over US$200m, of which its own incurred costs and liability are said to represent the major part. The two non-US/Canadian claims are known as (c) Ajman Sewage and (d) PPGPL – Trinidad – Design Issues. BV puts its incurred costs and liability in respect of the Ajman Sewage claim at over US$33.9m. The PPGPL Trinidad Design Issues represent in fact three separate design issues. After deductibles totalling US$750,000, BV puts the claim at US$8,169,487.

12. In what order these claims may have been ascertained in the sense used in *Post Office v Norwich Union* and *Bradley v Eagle Star*, and what relevance this may have is in issue. Teal's objective is to ensure that the Ajman Sewage and PPGPL Trinidad Design Issues claims are met from the top and drop policy, irrespective of the dates of their ascertainment against BV. But, if and so far as ascertainment as against BV is relevant, BV and Teal also intend to argue that all or some of BV's liability in respect of the Ajman Sewage claim was ascertained after the PI tower was exhausted by the ascertainment of the other claims, and so falls within the top and drop policy.

The nature of third party liability insurance

13. The nature of liability under a third party liability insurance cover was considered in the context of the Lloyd's litigation of the 1990s in *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437. The problem there was that some agents had policies against which there were likely to be various calls, either because several claims were being pursued against the same agents by different Lloyd's Names, or because the policies were group policies covering several agents against each of which claims were being pursued, by different Lloyd's Names. The essential issue was whether each claim ascertained as against an agent exhausted the agent's insurance cover pro tanto, or whether all claims falling individually within a policy's scope ranked or could be treated as ranking pari passu against the policy in whatever order they were ascertained against the insured agent or agents. Both Phillips J and the Court of Appeal held that the former was the correct answer. Phillips J said at p 442 (right) that

> "No obligation on the part of the insurer arises until the liability of the assured to a third party is established and quantified by judgment, arbitration award or settlement."

A little later, he added:

> "Thereafter if further third party claims are established it does not seem to me that these can result in further liability on the part of the insurer."

In between these two passages, he analysed insurers' liability in the traditional terms which Teal criticises, that is as a liability for damages for breach of duty in failing to hold harmless or to provide the indemnity. But, whether that analysis is adopted has no bearing on the conclusion that an insurer's liability under the policy arises on the ascertainment of the insured's third party liability, and that once it arises the policy indemnity is pro tanto used up.

14. In *Cox v Bankside* itself, Phillips J held that the policy was called upon to respond in this way to a court order for interim payment; if this were not so, an insured "adequately protected by E & O insurance, would nonetheless be liable to be rendered insolvent by his inability to call upon his E & O underwriters to indemnify him against his liability to comply with an interim payment order" (p 453, left). In such circumstances, where the quantum of an insured's third party liability or insured expenses is ascertained in stages, its cause of action on its insurer is progressively enlarged, and the insurance limit is progressively used up.

15. In the Court of Appeal Saville LJ expressed a similar conclusion to Phillips J's. He was speaking of the position after the statutory assignment to a claimant under the Third Parties (Rights against Insurers) Act 1930 of the potential right to recover under the insurance policy claims as yet unascertained against the insolvent insured. He said at p 467 (right) that in such a case:

> "That right [the right to immediate payment under a liability policy] only arises when, in each case, the claim is established, just as that right, while owned by the insured, would also arise only when the particular claim in question was established. It is only when that right arises that the insurers come under the correlative obligation to make payment. To my mind it follows that as each claim is established (whether this occurs before or after the statutory assignment), the right to payment arises and thus the amount of the available insurance is in effect diminished, so that when it is exhausted later established claims have no right to an indemnity. I can find nothing in the Act which begins to suggest that somehow a claimant third party whose claim is established cannot recover that claim under the Act, or has to share that recovery with others who have no rights against the insurers because the limit of cover has been reached."

General analysis

16. Mr Christopher Butcher QC for Teal challenges the proposition that the ascertainment of a claim against the insured exhausts the insured's insurance policy cover pro tanto. He accepts that, under a claims made liability policy like the present, an insurer's liability arises typically as and when loss within the scope of the policy is ascertained as against the insured. But he submits that it is only when the claim is met by the insurer that the policy cover is pro tanto exhausted; until then it is possible, if a second notified claim is made and ascertained against BV as insured, to speak of a second cause of action or claim existing under the policy; BV is free to claim and the insurer is liable to make payment of the later, rather than the earlier, ascertained claim. As regards expenses incurred by BV and covered under Endorsement No 8 to the Lexington policy, he submits that BV as insured can again choose which expenses are paid first and against which claim or claims it sets the self-insured retention or deductible, and, after the retention and deductible are used up, in respect of which claim it claims payment of such expenses from its insurer; in the last situation, it is again only when insurers pay those, rather than any earlier ascertained, expenses, that the cover can be said to be exhausted.

17. I cannot accept Mr Butcher's case on these points. Where an insurance has a limit, it makes no sense to speak of the insured having causes of action or recoverable claims which together would exceed that limit. If the limit is US$10m and the insured incurs ascertained third party liability of US$10m in respect of each of two successive third party claims, it makes no sense to speak of the insured having two causes of action or two recoverable claims against its insurer totalling US$20m. Likewise, if its liability is ascertained at US$7.5m each claim, the insured will have two causes of action or claims against its insurer, but the second will only be for US$2.5m. The ascertainment, by agreement, judgment or award, of the insured's liability gives rise to the claim under the insurance, which exhausts the insurance either entirely or pro tanto. The claim against the insured must of course fall within the scope of the policy and the insured may have to fulfil procedural requirements regarding notification to the insurer as a condition of recovery (see e.g. Clarke, *The Law of Insurance Contracts*, paras 17-4D4 and 26-2G), but this appeal raises no issue regarding either of such points.

18. Similar considerations govern the incurring of ascertained expenses where, as here under Endorsement No 8 to the Lexington policy, these fall potentially within the policy indemnity. As and when BV incurs quantified expenses, they fall to be set against the policy retention and deductible; over and above the retention and deductible, any further expenses incurred fall not within the retention and deductible, but within the insurance provided by Lexington (and thereafter, potentially within the successive excess layers).

19. The policy thus serves the purpose of meeting each ascertained loss when and in the order in which it occurs. An insured can forbear from notifying, or can withdraw or abandon, a claim under an insurance in respect of expenses or third party liability. The insurance will not then be exhausted by that claim, and the next claim will be recoverable in the ordinary course under the insurance. But what is here proposed is not the withholding or withdrawal of a claim; it is its continued pursuit, coupled with adjustment of its priority as against the insurance or programme of insurances.

Policy terms

(a) Lexington

20. On this basis, it is necessary to consider the terms of the insurances involved in the programme to see whether they are consistent with this analysis or lead to a different result. Starting with the Lexington policy, the Definition in Part A.IV.E, read together with the Declarations section and the insuring provisions, requires BV to have "paid" the amount of the deductible and self-insured retention

"prior to the Company indemnifying the Insured under the terms and conditions of this Policy". Three points arise. First, this provision relates to the deductible and retention; it underlines that, before Lexington can be called upon, the deductible and retention must be used up in meeting expenses or liability to which the policy indemnity otherwise applies. It is not a clause which would be expected to affect, or give a choice as to, the nature or subject-matter of the indemnity.

21. Second, it is not certain that the word "paid" here means disbursed. As was held in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, under a differently worded excess of loss reinsurance referring to the "sum actually paid", so here the word "paid" should in my opinion probably be understood as being used only as a measure of liability incurred, rather than with the intention of insisting on monetary disbursement. Otherwise, the present liability insurance would not meet the aim of providing the insured with an indemnity to avoid the insolvency which third party claims might otherwise threaten – a consideration emphasised in the context of reinsurance in *Charter Re* and in the context of liability insurance by Phillips J in *Cox v Bankside*.

22. Third, even if the word "paid" here means disbursed, a requirement of disbursement as a pre-condition to recovery from insurers says nothing about *what* has to be paid for a right to indemnity to arise under the insurance. It means only that, as and when expenses and third party liability are incurred and ascertained, they become recoverable under the insurance, provided that the insured first disburses an amount equivalent to the deductible and self-insured retention. It does not mean that the insured, by delaying such disbursement and choosing to make a disbursement in respect of different, later ascertained expenses or liability, can alter the order in which or policy in the insurance programme to which the first ascertained expenses or liability attach. Nor does it give its insurer a right to say that it will only provide indemnity in respect of later ascertained expenses or liability, so promoting the claim in respect of such expenses or liability ahead of the claim in respect of the earlier ascertained expenses or liability.

(b) The PI tower and the top and drop policy

23. It follows that, as and when expenses or third party liability are incurred and ascertained, they are to be taken into account against the Lexington policy. First, the self-insured retention and deductible must be used up, and then the policy will respond up to its limit. Once that limit is used up, the next layer is engaged, and so on up the PI tower of excess layer policies until the top and drop policy itself is engaged. Taking the set of clauses LSW055, this is what would be expected from in particular clause 6 of the PI tower policies (clause 7 of the top and drop policy), which provides that each excess layer policy, including the top and drop policy, is subject to the same terms, exclusions, conditions and definitions as the primary

Lexington policy. It is also the more natural effect of clause 4 of the PI tower policies (clauses 4 and 5 of the top and drop policy), which postulate a degree of certainty from the outset about what claims are likely to impact, and what settlements in particular will impact, different layers of an excess insurance programme.

24. However, Teal relies upon clauses 1, 2 and 3 as leading to a different conclusion. Under clause 1, liability only attaches to each excess layer once the underlying insurers, starting with Lexington and moving upwards, "shall have paid or have admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses". So, Teal submits, its liability to BV under the top and drop policy is conditioned by the order in which the underlying insurers pay, or admit or are held to have liability, meaning that Teal in its different capacity as underlying excess layer insurers can shape its own liability as top and drop insurer, in order best to suit the interests of itself or its associate BV.

25. The basic difficulty with this submission is, once again, that it treats a clause intended to define *when* liability arises as affecting the claims *in respect of which* liability arises. "Liability under an excess policy attaches only after all primary coverage has been exhausted": *North River Ins Co v American Home Assurance Co* (1989) 210 Cal App 3d 108, 112, quoted in Clarke, *The Law of Insurance Contracts*, para 28-9B. Clause 1 of LSW055 goes further in performing what Andrew Smith J (paras 36-37) and Tomlinson LJ in the Court of Appeal (para 22) described as the "readily understandable" function of making clear that the obligation to pay under each excess layer is deferred until the resolution of any uncertainty or dispute as to the liability of underlying insurers. But it cannot sensibly be read as intended to alter the identity of the claims which fall to be met under any underlying insurance or will in due course fall to be met under the excess layer insurances. The basic aim of a layered insurance programme like the present is indicated by clause 6 of the PI tower policies (clause 7 of the top and drop policy). Subject to their differences in threshold, limits, aggregates and premium and to specific exceptions like that in respect of US and Canadian claims in the top and drop policy, each layer operates on the same terms and conditions and attaches to the same risks, albeit under clause 1 at different times depending upon the settlement of claims under the underlying layers.

26. Teal's case also looks at the picture from the top down, instead of looking at claims as they in fact impact the programme, from the bottom up. At the bottom, as I have already indicated, Lexington becomes liable, up to its policy limit, for claims in the order in which BV incurs ascertained expenses or third party liability. There are no other claims which Lexington can pay or in respect of which it can admit or be held to have liability under its policy. These are the only claims which Lexington *can* pay under its policy. To the extent that Lexington has paid or admitted or been held liable to pay claims, there is no basis upon which Teal as an

excess layer insurer can pay them either again or instead of Lexington. All that Teal can pay is any balance remaining of such claims or any later ascertained expenses or liability which BV may have incurred. Clause 1 of LSW055 cannot alter this. It merely provides that liability under the first excess layer only attaches as and when Lexington pays or admits or is held to have liability in respect of BV's ascertained expenses or third party liability.

27. The position is confirmed by clause 3(b), providing that, upon payment by Lexington of the relevant ascertained expenses or claim exhausting the Lexington policy, the first excess layer policy "drops down" to continue in force as the underlying policy. The Lexington policy itself has no equivalent of clause 1. It pays, as explained above, by reference to BV's ascertained expenses or third party liability. In both clauses 2 and 3, the word "payment" may again be no more than shorthand (in the *Charter Re* sense of "established" or "ascertained") for the comprehensively expressed test "shall have paid or have admitted liability or have been held liable to pay", used in clause 1. But, if this is wrong, it makes no difference. Upon payment by Lexington, whatever that means, the first excess layer policy will have to "drop down" under clause 3 to become the underlying policy, i.e. on the same terms as the Lexington policy. Liability under the first excess layer, in its new role as underlying policy, will then necessarily be determined by the timing of the ascertainment of BV's third party liability and expenses. The same position will apply successively under each excess layer, including the top and drop, as each is exhausted in turn.

28. It is true, that, if "payment" in clauses 2 and 3 means disbursement, there may, at least in some cases, be a difference between the time when liability "attaches" to the first excess layer under clause 1 (e.g. as a result of an admission or finding of liability) and a later moment in time when Lexington disburses payment. But that cannot allow Teal as first excess insurer in that gap period, if it can and does exist, to make payments other than or in a different order than those for which it will in due course become underlying insurer when its excess insurance drops down to become the underlying policy under clause 3(b).

Commerciality

29. What I have said corresponds, very substantially, with the reasoning of Longmore and Tomlinson LJJ, with both of whose judgments Sir Robin Jacob agreed, in the Court of Appeal. In reaching his conclusion, Longmore LJ also placed some weight on what he regarded (in his paras 13 and 16) as the commercial common sense of the top and drop policy, citing *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900, paras 21 to 30. Mr Butcher took issue with this, and maintained that, on the respondents' case, there was scope both for haphazard results and for some degree of control by an insured or primary

insurer in the timing of the ascertainment of BV's third party liabilities or expenses; the scheduling or difficulty of settlement discussions could mean that a later arising third party claim led to ascertained liability on BV's part sooner than an earlier claim; BV or its insurers, in so far as they took over the conduct of a third party claim, might take steps to ensure that either a third party claim or expenses were ascertained sooner than another. This is true.

30. On the other hand, the degree of adjustment of the order of claims which Teal maintains it can achieve, for the benefit of its associate BV, is more remarkable, and only arises as a possibility because Teal is BV's insurance captive and is party to BV's programme of layered insurance coverage. It suits Teal in the present case to claim that BV or it itself can adjust the order in which claims impact the different programme layers, in order to assist Teal's associate BV. This produces the unfamiliar phenomenon of an insurer seeking to maximise its own insurance liabilities. Teal can afford to try to do this on the back of its reinsurance in respect of the top and drop layer by the respondents. Had Teal been an independent rather than captive insurer and determined to avoid as much liability to BV as possible, BV would no doubt vigorously have objected to the legitimacy of Teal as its excess layer insurer under the PI tower policies adjusting the order of payment of claims ascertained as against BV, with the aim of ensuring that it was only US and Canadian claims that reached the top and drop policy. Its objection would in my view have been well-founded. The freedom of choice which Mr Butcher advocates on behalf of Teal and in the interests of BV cannot in the present context readily be reconciled with the basic philosophy that insurance covers risks lying outside an insured's own deliberate control.

31. I would myself therefore have no doubt about agreeing with Longmore LJ's view of commerciality, as confirming and reinforcing the conclusion which he reached and I also reach. However, in my view it is also unnecessary to do so. This is a case where analysis of the terms and scheme of the relevant insurance policies provides the answer without more.

Conclusion

32. For these reasons, I would dismiss this appeal.