Neutral Citation Number: [2013] EWHC 349 (Comm)

Case No: 2011 FOLIO 1047

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28/02/2013

Before:

THE HONOURABLE MR JUSTICE FLAUX

- -

Between:

ASTRAZENECA INSURANCE COMPANY LIMITED — **Claimant**

- and -

(1) XL INSURANCE (BERMUDA) LTD
(2) ACE BERMUDA INSURANCE LTD.

Defendants

- -
- -

Mr Paul Stanley QC and Mr Geraint Webb (instructed by DAC Beachcroft LLP) for the **Claimant**
Mr David Edwards QC and Mr David Scorey (instructed by **Clyde & Co LLP**) for the **Defendants**

Hearing dates: 15th, 16th and 17th January 2013

- -

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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THE HON MR JUSTICE FLAUX

The Honourable Mr Justice Flaux:

Introduction and background

1. There are two preliminary issues for determination by the court (set out at [12] below) involving the construction of a liability insurance Policy. The claimant in these proceedings is, as its name suggests, the captive insurer of the AstraZeneca group of companies, a major worldwide pharmaceutical group (referred to for convenience hereafter as "AZ"). The defendants are insurance companies incorporated in Bermuda which specialise in the provision of high level or catastrophe excess of loss insurance and reinsurance. The claimant provided liability insurance cover to AZ, including to the US and Canadian companies in the AZ group, AstraZeneca Pharmaceuticals LP ("AZPLP") and AstraZeneca Canada Inc. ("AZC") respectively, for the period of 36 months from 1 January 2001 to 31 December 2003, including for a layer of £133,333,333 excess of £365 million. Although there is no policy wording for that liability insurance, it is common ground that the insurance was to be on essentially the same terms as the expiring policy, which was on a form based on XL004, together with amendments effected by Endorsements to that Policy.

2. Each of the defendants agreed to reinsure the claimant for a 50% share in respect of that insurance provided by the claimant under the Policy, subject to the second defendant's limit of US$100 million per occurrence. The reinsurance contracts covered the period 31 December 2000 to 31 December 2003. It is common ground that although the parties to these proceedings are the insurers and reinsurers, what the court has to consider in relation to the preliminary issues is the construction of the underlying insurance Policy between AZ and the claimant.

3. XL004 is a so-called Bermuda Form liability insurance. The Bermuda Form was introduced by insurance companies, primarily in the first instance the present defendants, XL and ACE, when the US casualty insurance market collapsed in 1985. The intention of XL and ACE and of the corporate entities responsible for their initial capitalisation was to achieve a form of policy which would meet the needs for liability insurance of such substantial corporations, specifically those which faced large product liability exposures in the United States, whilst providing "a balanced policy form, aiming to hold the ring fairly between the interests of policyholders and the interests of investors, as the same industrial corporations were in both roles"[1].

4. The resolution of disputes under an unamended Bermuda Form Policy is usually by London arbitration before three arbitrators, but on the basis that the contract of insurance or reinsurance is expressly governed by New York law. By this form of dispute resolution, major US companies and their liability insurers and reinsurers are able to have their policy disputes determined outside the United States and without the risk of jury trial, but pursuant to a system of state law for the determination of insurance disputes recognised to be more developed and neutral than that of other states in the United States[2]. A substantial number of Bermuda Form arbitrations have taken place in London over the years, but because the insurances or reinsurances in question are governed by New York law, no questions of construction of the Bermuda

[1] *Jacobs, Masters and Stanley: Liability Insurance in International Arbitration* (2nd edition) [1.19].
[2] *Jacobs et al* [1.25-1.26].

Form have come before the English Courts on appeal under section 69 of the Arbitration Act 1996 (although this court is the supervisory court under that Act).

5. The present Policy contains a critical difference from the standard Bermuda Form. By Endorsement 14 to the Policy which took effect from inception of the expiring Policy on 30 September 1997, the insurance was to be subject to English law, with various provisos considered in more detail below. The parties have also waived the arbitration clause in the reinsurance and conferred jurisdiction on the Commercial Court in respect of the current dispute. It follows from what I have said that this is the first occasion on which issues of construction of the Bermuda Form have come before the English Commercial Court. However, because of the express choice of English law as the governing law, New York law plays no part in the construction of this particular Policy. To the extent that Mr Paul Stanley QC for the claimants sought to contend that part of the "matrix" or "background" which this court should consider in construing the Policy was that the Bermuda Form is conventionally governed by New York law and that, somehow, the court should be influenced in construing the Policy by how the New York courts or New York law would approach the issues of construction, that contention is misconceived and heretical, for reasons I elaborate below.

6. The factual background for the purposes of the preliminary issues is essentially common ground and can be shortly stated. From 1997, AZ manufactured, marketed and sold in the United States and Canada through the US and Canadian companies in the Group, a second generation atypical antipsychotic drug under the name "Seroquel" which was approved by the United States Food and Drug Administration ("the FDA") on 26 September 1997. At all material times, the label for Seroquel approved by the FDA contained information about weight gain and diabetes.

7. On 28 August 2003 a putative class action (*Zehel-Miller*) was filed against AZPLP in Florida in which the plaintiffs alleged (i) that Seroquel caused personal injury; (ii) that Seroquel was defective and (iii) that there had been a failure by AZPLP to provide adequate warning. The Complaint in that action was first notified to the claimant on or about 11 September 2003. By a letter dated 1 December 2003, AZPLP issued the claimants with a Notice of Integrated Occurrence pursuant to Article V of the Policy.

8. Since that action was commenced, numerous plaintiffs in the United States and Canada have brought proceedings or joined lawsuits against AZ alleging that Seroquel has caused them personal injury. As at 31 October 2012, the claimant has settled claims presented by AZ for legal costs incurred in defending the claims and for settlements made in respect of the claims made against AZ of some £83.5 million excess of £365 million. It would appear that in only one of the cases has the matter been litigated through to a full trial and that resulted in a verdict for the defence. Other claims have been dismissed summarily.

9. The vast preponderance of what AZ has paid out represents legal costs incurred in defending the claims, US$786 million, as against US$63.7 million paid out in settlements (representing on average, including settlements agreed in principle, about US$20,000 per plaintiff). The claimant insurer has indemnified AZPLP and AZC in respect of the legal costs incurred in defending the claims (referred to as "Defense Costs" in the Policy, although, save where the context requires otherwise, I will refer to these as "defence costs"). It has also indemnified those insureds in respect of about 50% of settlement sums paid, but declined to indemnify in respect of the other 50%

on various grounds, such as that the claims relate to injuries caused by Seroquel sold after the date of the Notice of Integrated Occurrence. The claimant claims in the present proceedings that it is entitled to be indemnified by the defendants pursuant to the reinsurance contracts, in respect of all sums it has paid in respect of settlements and defence costs, within the relevant layer. The defendants deny any such entitlement to an indemnity.

10. It is a striking feature of this case that, as recorded in [17] of the Reply and [8] of the List of Issues, the claimant does not advance a positive case that AZ would, on a balance of probabilities, have been liable for the claims in question, assuming a correct application of the law governing the claims to the evidence as properly analysed, that being the test as a matter of English law for whether the insured has demonstrated, on a balance of probabilities, that it was under an actual legal liability to the third party whose claim it settled: see per Aikens J (as he then was) in *Enterprise Oil Ltd v Strand Insurance Co Ltd* [2007] Lloyd's Rep IR 186 at [72] (referred to hereafter as *Enterprise Oil*).

11. So it is that the claimant contends in this case that the Policy provides an indemnity not only where the insured establishes an actual legal liability in that sense but where the insured settles an arguable liability. The defendants however contend that the Policy (and hence the reinsurance) only responds where there is actual legal liability. There are a number of issues in dispute between the parties and defences raised by the defendant reinsurers, but it is clear that the core issues in dispute concern whether the Policy responds to actual legal liability or to settled alleged liability and, correspondingly, whether the Policy indemnity in respect of Defense Costs is only incurred where actual legal liability can be demonstrated by the insured or constitutes a free-standing entitlement to indemnity irrespective of whether there is any actual legal liability.

The preliminary issues

12. Accordingly, the parties very sensibly agreed to the trial of two preliminary issues as ordered by HHJ Mackie QC on 2 March 2012 with a view to determining those core issues. Those preliminary issues are as follows:

    i) Does the Insured's entitlement to indemnity under the Policy against sums which it pays in settlement of claims, depend on whether the Insured would, on a balance of probabilities, have been liable for the claims in question, assuming a correct application of the law governing the claims to the evidence as properly analysed, so that the Insurer would always be entitled to refuse to approve settlement (or, 'would not be bound to approve settlement', being the formulation suggested by the Reinsurers) when the Insured does not assert (or, 'assert and prove', being the formulation suggested by the Claimant) that it would, on a balance of probabilities, have been liable for the claims in question?

    ii) Other than in cases where the Insured's relevant liability is established by judgment of a court of competent jurisdiction, does the Insured's entitlement to indemnity under the Policy in respect of Defense Costs depend on whether the Insured would, on a balance of probabilities, have been liable for the

claims in question, assuming a correct application of the law governing the claims to the evidence as properly analysed?

13. Although the first preliminary issue is worded in a slightly cumbersome way by reference to the settlements approved by the claimant, it is common ground that the real issue raised is whether, as the claimant contends, it is only necessary to demonstrate that the insured settled an arguable liability or, as the defendants contend, it is necessary to establish that the insured was under an actual liability. Thus the court is only concerned at this stage with the reasonableness of the settlements approved in the "second" sense identified by Moore-Bick J in *Structural Polymer Systems Limited v Brown* [2000] Lloyd's Rep IR 64 at 72 rhc: "whether it was reasonable in terms of the amount paid compared with the true extent of the claimants' recoverable loss". It will only be if I decide the first preliminary issue in favour of the claimant that at a later hearing the court would need to go to consider whether the settlements were reasonable in his "first" sense: "whether the settlement was reasonable in the sense of fairly reflecting the overall merits of the action".

The terms of the Policy

14. The terms of the Policy which are of particular relevance to the issues are as follows:

> "**NOTICE**
>
> THE COMPANY DOES NOT HAVE ANY DUTY TO DEFEND. DEFENSE COSTS COVERED BY THIS POLICY ARE INCLUDED WITHIN AND ARE NOT IN ADDITION TO THE LIMITS OF LIABILITY OF THIS POLICY.
>
> **INSURING AGREEMENTS**
>
> **I COVERAGE**
>
> Zeneca Insurance Company (the "**Company**") shall, subject to the limitations, terms, conditions and exclusions below, indemnify the **Insured** for **Ultimate Net Loss** the **Insured** pays by reason of liability:
>
> (a) imposed by law, or
>
> (b) of a person or party who is not an **Insured** assumed by the **Insured** under contract or agreement,
>
> for **Damages** on account of:
>
> (i) **Personal Injury**
>
> (ii) **Property Damage**
>
> (iii) **Advertising Liability**
>
> encompassed by an **Occurrence,** provided:

COVERAGE A: notice of the **Occurrence** shall have been first given by the **Insured** in an **Annual Period** during the **Policy Period** in accordance with Article V of this Policy,

or

COVERAGE B: notice of the **Occurrence** shall have been first given during the **Discovery Period** in accordance with Article V of this Policy, but only if the **Discovery Period** option has been elected in accordance with the provisions of this Policy.

III DEFINITIONS

A. "**Advertising Liability**" means liability for **Damages** on account of:

(1) libel, slander or defamation,

(2) any infringement of copyright or of title or of slogan,

(3) piracy or misappropriation of ideas under an implied contract, or

(4) any invasion of right of privacy,

committed or alleged to have been committed in any advertisement, publicity article, broadcast or telecast and arising out of the **Insured's** advertising activities.

G. "**Damages**" means all forms of compensatory damages, monetary damages and statutory damages, punitive or exemplary damages and costs of compliance with equitable relief, other than governmental (civil or criminal) fines or penalties, which the **Insured** shall be obligated to pay by reason of judgment or settlement for liability on account of **Personal Injury, Property Damage** and/or **Advertising Liability** covered by this Policy, and shall include **Defense Costs**.

H. "**Defense Costs**" means reasonable legal costs and other expenses incurred by or on behalf of the **Insured** in connection with the defense of any actual or anticipated **Claim**, including attorneys' fees and disbursements, law costs, premiums on attachment or appeal bonds, pre-judgment and post-judgment interest, expenses for experts and for

investigation, adjustment, appraisal and settlement, excluding the salaries, wages and benefits of the **Insured's** employees and the **Insured's** administrative expenses.

R. **"Integrated Occurrence"** means an **Occurrence** encompassing actual or alleged **Personal Injury, Property Damage** and/or **Advertising Liability** to two or more persons or properties which commences over a period longer than thirty (30) consecutive days which is attributable directly, indirectly or allegedly to the same actual or alleged event, condition, cause, defect, hazard and/or failure to warn of such; provided, however, that such **Occurrence** must be identified in a notice pursuant to Section C of Article V as an **"Integrated Occurrence"** and is subject to all provisions of paragraphs (1) and (2) of Definition V.

V. (1) An **"Occurrence"** exists if, and only if:

(a) except with respect to actual or alleged **Personal Injury** or **Property Damage** arising from the **Insured's Products**, there is an event or continuous, intermittent or repeated exposure to conditions which event or conditions commence on or subsequent to the **Inception Date**, or the **Retroactive Coverage Date**, if applicable, and before the **Termination Date** of Coverage A, and which cause actual or alleged **Personal Injury**, **Property Damage** or **Advertising Liability**;

(b) actual or alleged **Personal Injury** to any individual person, or actual or alleged **Property Damage** to any specific property, arising from the **Insured's Products** takes place on or subsequent to the **Inception Date**, or the **Retroactive Coverage Date,** if applicable, and before the **Termination Date** of Coverage A.

(2) Except as provided in paragraph (3) below, where an **Occurrence** exists and a series of and/or several actual or alleged **Personal Injuries**, **Property Damages** and/or **Advertising Liabilities** occur which are attributable directly, indirectly or allegedly to the same actual or alleged event, condition, cause, defect, hazard and/or failure to warn of such, all such actual or alleged **Personal Injuries**, **Property Damages** and/or **Advertising Liabilities** shall be added together and treated as encompassed by one **Occurrence** irrespective of the period (but without limiting the effect of Exclusion IV.A) or area over which the actual or alleged **Personal Injuries, Property Damages** and/or **Advertising Liabilities** occur or the number of such actual or alleged **Personal Injuries, Property Damages** and/or **Advertising Liabilities**; provided, however, that any actual or alleged

Personal Injury, Property Damage or **Advertising Liability** which is **Expected or Intended** by any **Insured** shall not be included in any **Occurrence**. So far as **Personal Injuries**, **Property Damages** and/or **Advertising Liabilities** resulting or alleged to result from the design, formulation, manufacture, distribution, use, operation, maintenance and/or repair of an **Insured's Product**, and/or the failure to warn as to the use, operation, maintenance and/or repair of an **Insured's Product**, the term "the same actual or alleged event, condition, cause, defect, hazard and/or failure to warn of such" means any such design, formulation, manufacture, distribution, use, operation, maintenance, repair and/or failure to warn, as the case may be, as to which such losses, injuries or damages are directly, indirectly or allegedly attributable. As respects **Advertising Liability**, multiple or repeated broadcasts or publications of the same or similar materials shall constitute "the same actual or alleged event, condition, cause or defect."

(3) Notwithstanding paragraphs (1) and (2) above, if an **Occurrence** is not identified in the notice thereof as an "**Integrated Occurrence**," then actual or alleged **Personal Injury** to each person, **Property Damage** to each piece of property and/or **Advertising Liability** which commences at any time shall be deemed to be encompassed within a separate **Occurrence** from which **Personal Injury** to any other person, **Property Damage** to any other piece of property and/or **Advertising Liability** which commences more than thirty (30) days prior or later thereto is encompassed.

W. **"Personal Injury"** means **Bodily Injury**, mental injury, mental anguish, shock, sickness, disease, disability, false arrest, false imprisonment, wrongful eviction, detention, malicious prosecution, discrimination, humiliation, and libel, slander or defamation of character or invasion of rights of privacy.

Z. **"Product Pollution Liability"** means liability or alleged liability for **Personal Injury** or **Property Damage** arising out of the end-use of the **Insured's Products**, if such use occurs after possession of such goods or products has been relinquished to others by the **Insured** or by others trading under its name and if such use occurs away from premises owned, rented or controlled by the **Insured;** such goods or products shall be deemed to include any container thereof other than an **Automobile, Watercraft or Aircraft**.

AA. "**Property Damage**" means:

(1) physical damage to or destruction of tangible property, including the loss of use thereof at any time resulting therefrom;

(2) loss of use of tangible property which has not been physically damaged or destroyed arising from physical damage to or destruction of other tangible property; or

(3) losses consequent upon evacuation arising from actual or threatened **Bodily Injury** or destruction of tangible property.

AD. **"Ultimate Net Loss"** means the total sum which the **Insured** shall become obligated to pay for **Damages** on account of **Personal Injury, Property Damage** and/or **Advertising Liability** which is, and/or but for the amount thereof would be, covered under this Policy less any salvages or recoveries.

IV EXCLUSIONS

This policy does not apply to actual or alleged:

A. PRIOR TO INCEPTION OR RETROACTIVE COVERAGE DATE

Personal Injury to any individual person, **Property Damage** to any specific property or **Advertising Liability** which takes place prior to the **Inception Date** or, if applicable, the **Retroactive Coverage Date**.

F. ADVERTISING

Advertising Liability arising out of:

(1) breach of contract, but this paragraph (1) shall not exclude liability for unauthorized misappropriation of advertising ideas based upon breach or alleged breach of an implied contract;

(2) infringement of registered trademarks, service marks or trade name by use thereof, but this paragraph (2) shall not apply to titles or slogans;

(3) the failure of goods, products or services to conform with advertised quality or performance;

(4) the wrong description of the price of goods, products or services; or

(5) advertising activities on behalf of a party other than an **Insured** by an **Insured** engaged in the business of advertising.

I. AIRCRAFT

Liability arising out of the design, manufacture, construction, maintenance, service, use or operation of any **Aircraft** or any component part of or equipment thereof or any other **Aircraft** navigational or related equipment or service, including, without limitation, liability arising from a crash or hijacking; provided, however, that this Exclusion I shall not apply to any liability or alleged liability in respect of:

(1) **Aircraft** fueling and related operations with respect to **Personal Injury** or **Property Damage** occurring at the time of such operations, i.e., while the **Aircraft** involved is on the ground and motionless;

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K. POLLUTION

(1) (a) liability for **Personal Injury**, **Property Damage** or **Advertising Liability** arising out of the **Discharge** of **Pollutants** into or upon land or real estate, the atmosphere, or any watercourse or body of water whether above or below ground or otherwise into the environment; or

(b) liability, loss, cost or expense of any **Insured** or others arising out of any direction or request, whether governmental or otherwise, that any **Insured** or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize **Pollutants**.

This Exclusion K applies whether or not such **Discharge** of such **Pollutants**:

(i) results from the **Insured's** activities or the activities of any other person or entity;

(ii) is sudden, gradual, accidental, unexpected or unintended; or

(iii) arises out of or relates to industrial operations or the **Waste** or by-products thereof.

(2) Paragraph (1) of this Exclusion K does not apply to:

(a) **Product Pollution Liability**; or

(b) (i) liability of the **Insured** for **Personal Injury** or **Property Damage** caused by an intentional **Discharge** of **Pollutants** solely for the purpose of mitigating or avoiding **Personal Injury** or **Property Damage** which would be covered by this Policy; or

(ii) liability of the **Insured** for **Personal Injury** or **Property Damage** caused by a **Discharge of Pollutants** which is not **Expected** or **Intended**, but only if the **Insured** becomes aware of the commencement of such **Discharge** within seven (7) days of such commencement;

provided that the **Insured** gives the **Company** written notice in accordance with Section D of Article V of this Policy of such commencement of the **Discharge** under subparagraphs (2)(b)(i) or (ii) of this Exclusion K within forty (40) days of such commencement. Such notice must be provided irrespective of whether notice as soon as practicable otherwise would be required pursuant to Section A of Article V of this Policy.

V NOTICE OF OCCURRENCE

A. NOTICE AS SOON AS PRACTICABLE

If any **Executive Officer** shall become aware of an **Occurrence** likely to involve this Policy, the **Named Insured** shall, as a condition precedent to the rights of any **Insured** under this Policy, give written notice thereof to the **Company** in the manner provided in Section D of this Article V.

Such notice shall be given as soon as practicable and, in any event, during the **Policy Period** or the **Discovery Period**, if applicable, and in accordance with Paragraph 2(b) of Exclusion K, if applicable. Failure to provide written notice as prescribed above shall result in a forfeiture of any rights to coverage hereunder in respect of such **Occurrence**.

B. PERMISSIVE NOTICE

Any **Insured** may at any time during the **Policy Period** or **Discovery Period** give notice of an **Occurrence** to the **Company** in the manner provided in Section D of this Article V.

C. PERMISSIVE NOTICE OF INTEGRATED OCCURRENCE

The **Insured** may at its option give written notice to the **Company** of any **Occurrence** as an "**Integrated Occurrence**" by designating it as such and giving such notice in the manner

provided in Section D of this Article V. Once the **Insured** gives **Notice of Integrated Occurrence**, all **Personal Injury** or **Property Damage** that falls within the **Integrated Occurrence** (as provided in the terms, conditions and exclusions of this Policy) shall be treated as such for all purposes under this Policy irrespective of whether this Policy has been terminated after the **Insured** has given **Notice of Integrated Occurrence**. The limit of liability applicable to such **Integrated Occurrence** shall be the limit described in Article II of this Policy.

VI CONDITIONS

C. CROSS LIABILITY

In the event of a **Claim** being made by reason of **Personal Injury** suffered by an employee of one **Insured** hereunder for which another **Insured** hereunder is or may be liable, this Policy shall cover such **Insured** against whom such a **Claim** is made or may be made in the same manner as if separate policies had been issued to each **Insured** hereunder.

Nothing contained herein shall operate to increase the **Company's** limits of liability as set forth in Item 2 of the Declarations.

D. ASSISTANCE AND COOPERATION

(1) The **Company** shall not be called upon to assume charge of the settlement or defense of any **Claim** made or suit brought or proceeding instituted against an **Insured**, but the **Company** shall have the right and shall be given the opportunity to associate with the **Insured** or the **Insured's** underlying insurers or both in the defense and control of any **Claim**, suit or proceeding relative to any **Occurrence** where the **Claim** or suit involves, or appears reasonably likely to involve, the **Company**, in which event the **Insured** and the **Company** shall cooperate in all things in the defense of such **Claim**.

(2) The **Insured** shall furnish promptly all information reasonably requested by the **Company** with respect to any **Occurrence**, both with respect to any **Claim** against the **Insured** and pertaining to coverage under this Policy.

(3) If liabilities, losses, costs and/or expenses are in part covered by this Policy and in part not covered by this

Policy, the **Insured** and **Company** shall use their best efforts to agree upon a fair and proper allocation thereof between covered and uncovered amounts, and the **Insured** shall cooperate with such efforts by providing all pertinent information with respect thereto.

(4) Those expenses incurred by the **Company** on its own behalf in connection with claims representation pursuant to this Condition D shall be at its own expense and shall not be part of **Ultimate Net Loss**.

E. APPEALS

In the event the **Insured** or the **Insured's** underlying insurers elect not to appeal a judgment in excess of the retention or the underlying limits, as the case may be, the **Company** may elect to make such appeal at its own cost and expense and shall be liable for the taxable costs and disbursements of such appeal and post-judgment interest on the judgment appealed from accruing during such an appeal. In no event, however, shall liability of the **Company** for **Ultimate Net Loss** exceed the applicable limit of liability plus the costs and expenses of such appeal.

F. LOSS PAYABLE

Liability under this Policy with respect to any **Occurrence** shall not attach unless and until:

(1) the **Insured's** underlying insurer(s) or the **Insured** shall have paid the greater of the amount of any applicable underlying limits or the applicable retention set forth in Item 2(a) of the Declarations; and

(2) the **Insured's** liability covered hereunder shall have been fixed and rendered certain either by final judgment against the **Insured** after actual trial or by settlement approved in writing by the **Company**, and the **Insured** shall have paid such liability.

Any consideration paid by the **Insured** or the **Insured's** underlying insurers other than in legal currency shall be valued at the lower of cost or market, and any element of the **Insured's** profit or other benefit to the **Insured** shall be deducted in determining the value of such consideration. The **Company** may examine the underlying facts giving rise to a judgment against or settlement by the **Insured** to determine if, and to what extent, the basis for the **Insured's** liability under such judgment or settlement is covered by this Policy.

The **Insured** shall make a definite demand for payment for any amount of the **Ultimate Net Loss** for which the **Company** may be liable under this Policy within twelve (12) months after the **Insured** shall have paid such amount. If any subsequent payments shall be made by the **Insured** on account of the same **Occurrence** or **Claim**, additional demands for payment shall be made similarly from time to time. Such losses shall be due and payable by the **Company** thirty (30) days after they are respectively paid by the **Insured**, demanded and proven in conformity with this Policy.

AMENDMENT OF ARTICLE VI. CONDITION O. ENDORSEMENT [14]

It is hereby agreed that Article VI. Condition O. is deleted and replaced by the following:

O. LAW OF CONSTRUCTION AND INTERPRETATION

This Policy, and any dispute, controversy or claim arising out of or relating to this Policy, shall be governed by and construed in accordance with the internal laws of England and Wales, except insofar as:

(1) such laws may prohibit payment in respect of punitive damages hereunder;

(2) the law of another jurisdiction must apply pursuant to any directive of the Council of the European Community relating to non-life insurance

(3) such laws are inconsistent with any provision of this Policy;

provided, however, that the provisions, stipulations, exclusions and conditions of this Policy are to be construed in an evenhanded fashion as between the Insured and the Company; without limitation, where the language of this Policy is deemed to be ambiguous or otherwise unclear, the issue shall be resolved in the manner most consistent with the relevant provisions, stipulations, exclusions and conditions (without regard to authorship of the language, without any presumption or arbitrary interpretation or construction in favor of either the Insured or the Company or reference to the "reasonable expectations" of either thereof or to contra proferentem and without reference to parole or other extrinsic evidence).”

Summary of parties’ submissions

15. The submissions of Mr Paul Stanley QC on behalf of the claimant in relation to the first preliminary issue can be summarised as follows:

(1) That although the Policy had been amended to provide that it was governed by English law, the court should keep in mind in construing the contract that the Bermuda Form is usually governed by New York law, under which this Policy would be construed as providing coverage for liability established by a reasonable bona fide settlement or by judgment, irrespective of whether there was an actual legal liability.

(2) So far as the English cases are concerned, none of them decides directly or conclusively that there is a general principle that liability insurance covers against actual liability, not merely alleged liability and many of them can be distinguished as reinsurance cases or cases concerned with policy exclusions. In any event, whether or not a particular policy covers against alleged as well as actual liability is ultimately a question of the construction of the particular contract.

(3) On the true construction of this contract as a whole, it provides coverage in respect of liability established by a settlement or judgment without the need for the insured to demonstrate that it was or would have been under an actual legal liability. That construction is said to emerge from various provisions of the contract, including several of the Definitions in Article III, the Exceptions in Article IV and Article VI F, the Loss Payable clause.

(4) Irrespective of whether (3) above is correct, on its true construction, the Policy provides free-standing coverage for Defense Costs, even where no actual liability of the insured to third party claimants has been established, so that the defence costs incurred in this case are covered.

16. In summary, Mr David Edwards QC submitted on behalf of the defendant reinsurers as follows:

(1) The fact that the Bermuda Form is generally governed by New York law is irrelevant to the construction of this contract, as the parties have chosen to amend the governing law provision to provide that the contract is governed by English law. In those circumstances, it would be impermissible to have regard to New York law in construing the contract. In any event, to the extent that New York law holds that an insurer is bound by a reasonable bona fide settlement by the insured, irrespective of whether there was an actual legal liability, it does so not as a matter of the construction of the contract of liability insurance but because of a substantive principle of New York law deriving from the duty to defend imposed on liability insurers.

(2) Whether construing the terms of the Policy in isolation or against the background of the English cases on liability insurance, this Policy provides coverage against actual liability not against alleged liability or in respect of any sum AZ might pay in response to claims or allegations.

(3) If AZ had wished to obtain coverage against sums paid in response to claims or allegations, whether good or bad, that is a form of contingency insurance which

could be achieved in a number of ways, as by the QC clause in professional indemnity insurance or a similar provision. There was no such provision in the present Policy and that form of coverage could not be achieved by the process of construction suggested by the claimant.

(4) The issue of approval of settlements by the claimant, which featured in Mr Stanley's written submissions, is irrelevant to the question the court has to decide. Irrespective of the reasonableness of any settlement and whether it was approved by the claimant, in the absence of any follow the settlements clause in the reinsurance, if the defendants are correct in their submissions as to the scope of coverage under the Policy, it would always be open to the defendants to say that, in truth, there was no actual liability.

(5) Whilst liability policies do frequently contain provisions affording free-standing cover for defence costs, there is no such provision in the present Policy. Defense Costs are only recoverable as an element of Damages and are thus only recoverable when Damages are recoverable, that is when the insured is under an actual liability.

Permissible background or matrix

17. Mr Stanley QC submitted in his Skeleton Argument (although it is fair to say the point was not pursued with much vigour in his oral submissions at the trial) that part of the background or factual and legal matrix to which the court should have regard was the origins of the Bermuda Form, including that whilst the objective was to achieve a form of policy which would meet the needs of companies, particularly those with large US product liability exposures, the Form was "thoroughly rooted in the traditions and practices of the US [insurance] market". Mr Stanley went on to submit that, which is no doubt correct in the case of the unamended Bermuda Form governed by New York law, New York law was selected as being more neutral as between insured and insurer than some other state laws of the United States. He described the Bermuda Form policies as intended to be balanced policies carefully avoiding over-correction in favour of the insurer.

18. I agree with Mr Edwards QC that, to the extent that Mr Stanley was seeking to contend that the approach the English court should adopt to a contract of insurance expressly governed by English law should be influenced by how New York law would construe the contract because, if the parties had not amended Article VI. O by Endorsement no. 14, it would have been governed by New York law, that contention is wholly misconceived and, as I said earlier, heretical as an approach to construction. The fact is that the parties have deliberately chosen to amend Article VI. O to provide that the contract is governed by English law rather than New York law so that what New York law might decide in terms of construction is irrelevant. If coincidentally the two systems of law have the same effect, the court will follow that effect because that is the English law of construction of the contract, not because coincidentally New York law would decide the same.

19. By their agreement to Endorsement 14 the parties (that is AZ and the claimant, its insurers) are to be taken objectively to have intended that their contract should be governed by English law and to have decided that system of law should govern in replacement for New York law which would otherwise govern the contract. In those

circumstances, it seems to me it would be quite wrong to construe the contract in any respect by reference to New York law. Equally, the parties are to be taken to know English law (including the principles applicable to liability insurance to which I refer in more detail later in the judgment) and, to the extent that it differs from New York law, to have appreciated the differences and yet deliberately chosen English law.

20. In those circumstances (and contrary to Mr Stanley's written submissions) the principle emanating from the judgment of Scrutton LJ in *Hooley Hill Rubber v Royal Insurance* [1920] 1 KB 257 at 272 applies, that in construing a contract of insurance governed by English law, the English courts will have regard to English authorities, not American authorities where they have formed a different view from that taken by the English authorities:

> "I feel bound to read the words of the condition in the light of existing English decisions. It would take a very strong case to induce me to give to the words a meaning different from that given to them by an English decision unquestioned for fifty years. I am not impressed by the fact that a different view has been taken by American Courts on American policies. Those Courts frequently differ from ours on the construction of mercantile documents. English Courts construe documents by the light of English decisions. "

21. In any event, to the extent that the claimant seeks to rely upon the fact that the Bermuda Form is usually governed by New York law in support of a submission that, as a matter of New York law, the policy indemnifies in respect of alleged liability and the insured is not required to prove actual liability, provided that the alleged liability has been settled or determined at trial, that submission is misconceived. I agree with Mr Edwards that, in the New York cases where the insurer has been held bound to indemnify the insured in respect of such alleged liability without the need to prove actual liability, that is not because as a matter of New York law, a reference to "liability" in the Policy is construed as being to alleged as opposed to actual liability, but because of a substantive principle of New York law that, where the insurer is under a duty to defend, if the insurer is notified of a claim but declines to defend it and the insured then settles that claim, the insurer will be bound by a good faith settlement, without the need for the insured to establish actual liability.

22. This substantive principle of New York law can be traced back to the decision of the Appellate Division of the Supreme Court of New York in *Feuer v Menkes Feuer* 8 A.D. 2d 294 (1959). That was not an insurance case, but a case of a contract of indemnity between a company and its former employee, although the principle laid down has been subsequently applied in insurance cases. At 298-300, Breitel J, giving the judgment of the court, drew a distinction between two situations, (i) where the indemnitor is notified of a claim and declines to defend it and (ii) where the indemnitee fails to notify the indemnitor of a claim or, upon notice, the indemnitor assumes the obligation to defend the claim. In the second situation, it is evident from the judgment that the position under New York law is much as it would be under English law. If the indemnitor does defend the claim, he will be bound by the result, as would be the case in English law where an insurer takes over the defence of a claim under a liability policy, subject to any express reservation of rights. If the indemnitee fails to give the indemnitor notice of the claim, the indemnitee "proceeds at his own

risk with regard to any judgment or settlement…[and] must establish that he would have been liable and that there was no good defense to the liability", as would be the case under English law.

23. However, where the indemnitee notifies the indemnitor of a claim but the latter declines to defend it: "then the indemnitor is conclusively bound by any reasonable good faith settlement the indemnitee may make or any litigated judgment that may be rendered against him". As Mr Edwards, pointed out there is no suggestion in the judgment that the result in the first situation is arrived at by a process of interpretation of the contract, but rather it is arrived at by a substantive principle of New York law.

24. That principle has been applied subsequently in insurance cases. Mr Stanley relied in particular upon the decision of the Court of Appeals of the Second Circuit in *Luria Brothers v Alliance Assurance* 780 F.2d 1082 (1986). That was a case where, having been notified by the shipowner insured of a third party claim, the defendant liability insurers declined coverage. The insured then went on to settle the claim. The Court of Appeals held at [7][8] (p.1091):

> "When an insurer declines coverage, as here, an insured may settle rather than proceed to trial to determine its legal liability…In order to recover the amount of the settlement from the insurer, the insured need not establish actual liability to the party with whom it has settled 'so long as a potential liability on the facts known to the [insured is] shown to exist, culminating in a settlement in an amount reasonable in view of the size of possible recovery and degree of probability of claimant's success against the [insured].' *Damanti v. A/S Inger*, 314 F.2d 395, 397 (1963) [an earlier decision of the Court of Appeals of the Second Circuit]."

25. The principle is clearly being formulated as one of substantive New York law and not of interpretation of the particular contract and is predicated on the liability insurer having declined coverage. A similar approach was adopted in the other case relied upon by Mr Stanley, the decision of the United States District Court for the Eastern District of New York in *Uniroyal Inc v The Home Insurance Co* 707 F. Supp. 1368 (1988). That case arose in the context of the "Agent Orange" product liability litigation in the United States which involved Vietnam War veterans and their families suing the United States and manufacturers for exposure to herbicide defoliants used in the war which were alleged to have caused them a variety of devastating physical injuries. The particular claims by Uniroyal, one of the manufacturers of the herbicides, were made under a series of Comprehensive General Liability ("CGL") policies issued by Home during the years 1965 to 1975. The wording of the insuring clause under those policies, which were occurrence policies, bore considerable resemblance to the insuring clause in the present Policy (which is perhaps not surprising since the Bermuda Form developed out of the CGL policies issued by insurers before the crisis in the United States liability insurance market in the mid 1980s). There was no suggestion in the insuring clause that it covered alleged as opposed to actual liability.

26. The court in that case was determining what was, in effect, a series of issues of law arising on agreed facts, which included that the insured had notified the insurer of the

litigation and the settlement discussions with the claimants and had invited the insurers to participate, but the insurers had declined to do so. The insured went on to settle the class action and it was common ground that settlement was reasonable. One issue which arose was whether, as the insurer contended, the insured's claim for indemnity in relation to claims it had settled failed because it could not establish that "actual injury" had taken place. The first reason the court gave for rejecting the insurer's argument was that a settlement of an underlying personal injury claim was a "contract or agreement" under which liability had been assumed by the insured and thus within the indemnity provided under the insuring clause. That conclusion is definitely not one which would be reached as a matter of English law, since on the same contract wording, Aikens J rejected exactly that argument in *Enterprise Oil*. In any event, paragraph (b) of the insuring clause in the present Policy is in much narrower terms and covers only contracts entered by the insured to indemnify a third party in respect of its liability.

27. The second reason for rejecting the insurer's argument is not relevant for present purposes, but the third reason involves the application of the principle derived from *Feuer*. Having recorded that the insured had settled the litigation following notification to the insurer which had declined to defend the action or participate in the settlement discussions, at p. 1379, Weinstein DJ cited *Feuer* and the passage from the judgment of the Court of Appeals in *Luria* which I have quoted above and reached the conclusion that, in those circumstances, the insurer is bound by the reasonable good faith settlement made by the insured, without the insured having to prove actual liability. Once again that conclusion is reached by the application of a principle of New York law, without reference to specific policy wording.

28. That principle of New York law has no application in the present case and hence Mr Stanley can derive no assistance from it for two simple reasons. First, the Policy is governed by English law and that principle has no application in the absence of express policy language, there being no duty on a liability insurer to defend under English law as there is in New York law, absent an express contractual obligation. Second, this Policy states in terms in the Notice at the beginning of the wording and also makes clear in the first sentence of Article VI D(1) that there is no duty on the insurer to defend, thereby demonstrating an intention in any event to exclude whatever might be the position under New York law.

29. A similar objection can be raised to the much repeated assertion in Mr Stanley's submissions that there is some settled understanding in the market that the Bermuda Form does not require the establishment of actual liability. In my judgment there are two essential flaws in that argument. First, as Mr Edwards pointed out, there is simply no evidence before the court of this alleged settled understanding or which "market" is being referred to. Second, to the extent that the argument depends upon the fact that the Bermuda Form is usually governed by New York law, not only is this contract different because it is governed by English law, but as I have set out above, the relevant principle of New York law is a substantive principle of law not dependent on the construction of the contract.

30. One of the other matters by way of alleged factual matrix or background on which the claimant placed considerable reliance is the commercial background to the product liability problems faced by pharmaceutical manufacturers in the United States with mass tort litigation and particularly the uncertainties of jury trial and the spectre of

awards of punitive damages. The claimant served expert evidence from Professor Byron Stier, who specialises in such mass tort litigation. The defendants served a short report in response from another eminent U.S. tort lawyer, Mr Victor Schwartz, without prejudice to their primary position that such expert evidence is inadmissible.

31. In my judgment, the defendants are correct that such expert evidence is precisely the sort of extrinsic evidence which the proviso to amended Article VI O renders inadmissible. Professor Stier's opinion is obviously intended by the claimant to convey a message as to what the parties or reasonable people in their position are to be taken to have intended. However, that is precisely the sort of extrinsic evidence as to the "reasonable expectations" of the parties which is prohibited by the proviso.

32. I did consider that expert evidence *de bene esse* but found it of little, if any, assistance in construing the Policy. Quite apart from the fact that, with no disrespect to the two experts, it did not really tell the court more than is already well known to judges of this court, as Mr Edwards pointed out the selection by the claimant of US mass tort litigation as constituting part of the factual background to the construction of the policy is partial. The Policy protected AZ against liability in respect of its worldwide operations, so focusing solely on the United States inevitably distorts the position. In any event, even if it were permissible to consider the US tort system as part of the background, in one sense that does not assist the claimant, because the fact that the parties chose English law rather than New York law to govern the Policy might be thought to point away from an approach which sought to give priority to protection in respect of the vagaries of the US tort system. However, the better view, in my judgment, is that those matters, even if they were not inadmissible, are irrelevant to the proper construction of the Policy.

33. A similar objection applies to the suggestion made several times in the claimant's submissions that there is something commercially unfair or unreasonable about a liability policy only responding to actual liability and therefore precluding the insured from recovering for commercially reasonable settlements (particularly in view of litigation risks in the United States) unless it could establish actual liability, which it is said would be a disincentive to the insured entering such settlements and thereby avoiding the costs of defending the underlying claims. This is not a legitimate or permissible consideration in construing the Policy wording: it would in effect take into account the "reasonable expectations" of the insured in a manner which amended Article VI O prohibits. Similar arguments were rejected by the Court of Appeal in *Yorkshire Water v Sun Alliance* [1997] 2 Lloyd's Rep 21 and *Commercial Union v NRG Victory* [1998] 2 Lloyd's Rep 600. The short answer is that, if cover is required against those eventualities, it can be obtained: in a professional indemnity context, the QC clause is a good example. The issue I have to decide is whether the Policy wording as a whole does cover the insured for arguable or alleged liability or not, uninfluenced by what is said by the insured to be the commercial desirability of such a conclusion from its own standpoint.

34. Looking at the proviso to amended Article VI O as a whole, whatever effect it may have in the context of the unamended Article governed by New York law, so far as English law is concerned, the proviso, and particularly the even-handed approach which it advocates, is adding little if anything to the usual approach of English courts to the interpretation of contracts, as applied to insurance contracts.

35. That approach was summarised by Aikens J in *Enterprise Oil* at [60] as follows:

> "The principles of construction or interpretation of commercial documents that are governed by English law have been recently restated, particularly by Lord Hoffmann in *Investors Compensation Scheme Limited v West Bromwich Building Society*, and *The Bank of Credit and Commerce International SA v Ali* and also by Lord Steyn in *Sirius General Insurance Co v FAI General Insurance Ltd*. In *G Absalom v TCRU Ltd* I attempted to summarise the key principles. This summary was endorsed by Longmore LJ on appeal. The summary is as follows: (i) the aim of the exercise is to ascertain the meaning of the relevant contractual language in the context of the document and against the background to the document. The object of the enquiry is not necessarily to probe the "real" intention of the parties, but to ascertain what the language they used in the document would signify to a properly informed observer; (ii) the interpretive exercise must not be done in a vacuum, but in the milieu of the admissible background material. That comprises anything that a reasonable man would have regarded as relevant in order to comprehend how the document should be understood, provided that the material was reasonably available to both parties at the time (ie up to the time of the creation of the document); (iii) however, evidence of negotiations and subjective intent are not admissible for the purposes of this exercise; (iv) a commercial document must be interpreted so as to make business common sense in its context. But if a 'detailed semantic and syntactical analysis of a word in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense'".

36. Mr Stanley drew attention to the fact that "exception" (3) in amended Article VI O made it clear that, as he put it, the Bermuda Form subordinates the choice of law to the terms of the Policy. To the extent that he sought to rely upon that as somehow displacing the general principle of English law (to which I refer in greater detail in the next section of this judgment) that liability insurance provides an indemnity against actual legal liability and not merely alleged liability, unless the language of the insurance contract provides the contrary, it seems to me the argument is entirely circular and assumes what it has to prove. The real question raised by the first preliminary issue is whether the language of this Policy provides for an indemnity, not only where the insured can demonstrate an actual liability to the third party claimant, but an alleged liability, in the sense of a liability established by settlement or judgment, even if, on a proper analysis of the applicable facts and law, the insured was not in fact under any actual liability.

The authorities on liability insurance

37. Mr Stanley sought to minimise the impact of the English authorities on the interpretation of liability insurance policies, categorising many of them as reinsurance cases or cases dealing with policy exclusions, all with a view to supporting the thesis

that there has been relatively little judicial consideration of the issue whether, as a general rule, a liability policy requires proof of actual liability. I was unimpressed by this analysis and agree with Mr Edwards that the authorities consistently support the general proposition stated in *MacGillivray on Insurance Law* (12th edition) at [29-006]:

> "The general principle is that liability insurance provides an indemnity against actual established liability, as opposed to mere allegations …"

38. Furthermore, whilst there remains an unresolved debate as to whether in some cases a contract of reinsurance may more properly be regarded as liability insurance than a reinsurance of the original subject matter[3], for the purposes of the issue I have to determine as to what the insured or reinsured has to prove in order to be entitled to an indemnity, the applicable principles are the same: see per Aikens J in *Enterprise Oil* at [80].

39. In my judgment, what the English cases establish, consistently, is that the insured under a liability insurance policy will need to establish actual legal liability to a third party claimant before it can recover from the insurer, unless the particular language used in the policy clearly provides to the contrary. Thus, the determination of the first preliminary issue turns on whether on the true construction of the policy wording as a whole, that general principle of English law is displaced. As I have already said earlier in the judgment, the construction of the policy is to be determined on the basis of English law principles and not influenced in any way by the fact that, had the parties not amended their contract, it would have been governed by New York law.

40. In any event, it is striking that, for the reasons I have given in the previous section of the judgment, in the cases where the New York courts have decided that insurers are bound by a reasonable good faith settlement of liability by the insured, even if there was no actual liability, they have done so not as a matter of construction of the relevant policy language but by applying a principle of substantive New York insurance law that where a liability insurer is in breach of the duty to defend, it will be bound by such a reasonable good faith settlement. As I have said, that principle forms no part of English law in the absence of express contractual provisions to that effect.

41. The principle that insuring clauses in liability insurances (or reinsurances) governed by English law are to be construed as providing cover against actual liability as distinct from against alleged liability unless there is clear wording in the contract showing that this principle is intended to be excluded, is established by numerous authorities.

42. *West Wake Price & Co v Ching* [1957] 1 WLR 45 concerned professional indemnity insurance provided to a firm of accountants. Under the insuring clause, the underwriters agreed to indemnify the insured against "Loss for any claim or claims which may be made against them … in respect of any act of neglect, default or error on the part of the assured … or their partners or their servants, in the conduct of their

[3] Although the latter analysis is the preferred view in relation to most reinsurances: see the discussion of this issue in the judgment of Potter LJ in *Commercial Union v NRG Victory Reinsurance* [1998] 2 Lloyd's Rep 600 at 608-9

business as accountants …" The policy also contained a so-called QC (or at the relevant time KC) clause whereby it was agreed that the underwriters would pay "any such claim or claims which may arise without requiring the assured to dispute any claim, unless a King's Counsel (to be mutually agreed upon by the underwriters and assured) advise that the same could be successfully contested by the assured, and the assured consents to such claim being contested, but such consent not to be unreasonably withheld."

43. A claim was made against the accountants by clients in respect of sums of money received by the accountants from the clients which could not be accounted for. The claim was pleaded in three ways: as damages for negligence or breach of duty, for money had and received and as moneys converted by the insured to their own use. A request for indemnity was refused by the underwriters on the ground that the claims did not, in fact, fall within the scope of the policy. The accountants commenced proceedings seeking a declaration that the claims against them were claims based in negligence and thus brought into operation the QC clause. The accountants asserted before Devlin J that the nature of the claims was sufficiently and conclusively set out in the statement of claim. The underwriters contended that the nature of the claims could not be ascertained without an investigation into the facts on which they were based and when that investigation was undertaken it would reveal that the money was dishonestly converted by an employee of the accountants. The problem in the case, as the judge identified at p. 47, was how to deal with a "mixed" claim where both negligence and dishonesty were raised.

44. The judge found that he was entitled to look at the substance of the matter and not just the form of the statement of claim and that, although three causes of action were pleaded, the truth was that the employee was alleged to have stolen the clients' money. Accordingly, he held that the claim was one based primarily on the fraud of the employee (see p. 48). He then went on to consider the construction of the policy. In relation to the main indemnity clause he held as follows (at p. 49):

> "The essence of the main indemnity clause — as indeed of any indemnity clause — is that the assured must prove a loss. The assured cannot recover anything under the main indemnity clause or make any claim against the underwriters until they have been found liable and so sustained a loss. If judgment were given against them for the sum claimed, they would undoubtedly have sustained a loss and the question would then arise what was the cause of the loss. If the proximate cause (this seems to be the test; *Goddard and Smith v Frew* [1939] 4 All ER 358) of the loss was the dishonesty of their servant, they could not recover under the policy; if on the other hand it was their own neglect, they could recover. If the action between the claimants and the assured did not settle the question of causation, it would in all probability settle the facts in the light of which the question could be answered. But all this would involve publicity which, where charges of professional negligence are made, might do considerable harm to an assured over and above the amount of any judgment obtained against him. For this reason professional men may prefer paying a bad

> claim to fighting it. Obviously one of the main objects of a QC clause is to give the assured additional cover, not only against the costs of litigation but also as a protection against unwelcome publicity."

45. Devlin J went on to consider the effect of the QC clause, which, as the passage just cited demonstrates, by definition arises before the liability of the insured has been ascertained by judgment or settlement. At p. 50, he said this:

> "I turn now to an analysis of the Q.C. clause. It comprises three promises by the underwriters, and while this combination of promises produces a clause which is sui generis in contracts of insurance, each of the promises looked at individually is, I think, based on a conception which is not a novelty in insurance law. The three promises, each contingent upon the happening of certain events, are: (1) that the underwriters will pay the costs of legal proceedings; (2) that they will pay a claim against the assured without proof of actual loss, if it is more likely than not that there will be a loss, the question of likelihood being determined by Queen's Counsel; (3) that they will pay a claim without proof of loss, and even if it is unlikely that it would cause a loss, if the assured reasonably objects to fighting it."

46. He went on to describe the first promise as "supplementary to the contract of insurance", the description of a "sue and labour" clause in section 78 of the Marine Insurance Act 1906 and thus a promise which did not involve the insurers in any liability to indemnify the insured against the loss. As he said:

> "If the action against the assured succeeds, a loss will be proved; but it would still be open to underwriters to assert that the loss is not within the policy. For example, a claim which appeared on presentation to be in respect of negligence might turn out in reality, when all the facts were known[4], to be in respect of fraud. It would then be open to the underwriters, irrespective of whether they could properly be made liable for the costs of the action, to refuse to pay the claim."

47. As Clarke LJ noted in *MDIS v Swinbank* [1999] Lloyd's Rep IR 516 at 524, Devlin J was there essentially reiterating the same point as he had made earlier about the main indemnity clause, that once the loss had been ascertained (or as he put it sustained) it remained for the insured to prove that the loss was proximately caused by neglect.

48. Devlin J's analysis of the second promise is of no relevance for present purposes, but his analysis of the third promise at p. 51 is of some relevance in view of Mr Stanley's submission that the present Policy is to be construed as providing cover akin to that of a QC clause:

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[4] In *MDIS v Swinbrook* [1999] Lloyd's Rep IR 516 at 524, Clarke LJ rejected an argument by the assured that by "when all the facts are known" Devlin J meant "when all the facts are known from the judgment", holding that Devlin J "simply meant that if on the true facts the proximate cause of the loss was fraud which was not covered under the policy, underwriters would not be liable".

> "The third promise involves underwriters in the obligation of paying the claim, whether or not it can be successfully contested, if the assured has reasonable grounds for refusing to contest it. This is not, I think, an indemnity insurance at all. The underwriters undertake to pay on the happening of an event, namely, the making of a claim within the categories defined in the policy, even though it may be beyond question a bad claim and therefore one which cannot legally involve the assured in any loss; the assured need prove neither that the loss has occurred nor that there is any likelihood of a loss occurring. It is, in short, what is called contingency insurance."

49. The judge went on to hold that to fall within the scope of the policy, the character of the claim must not be a mixed one for fraud and negligence but for negligence alone and that since the claim was primarily in respect of fraud, it fell outside the scope of the policy, including the QC clause, which did not confer cover where there would not have been cover under the main indemnity clause.

50. The approach of Devlin J in that case has been endorsed in many subsequent cases. Although slightly out of order chronologically, it seems appropriate to consider first *McDonnell Information Systems [MDIS] v Swinbank* [1998] 1 Lloyd's Rep 98 (Mance J) and [1999] Lloyd's Rep IR 516 (Court of Appeal). In that case, the claimant computer consultants MDIS were insured by the defendant insurers under a standard form professional indemnity insurance certificate. MDIS concluded a contract with paint manufacturers Silkolene for the development and supply of software and hardware, intended to interface with a financial processing system, Griffin, produced by another company. Silkolene treated MDIS as in repudiatory breach of contract and commenced proceedings claiming damages. In the statement of claim, Silkolene claimed that MDIS had misrepresented the compatibility of Griffin with its software and that MDIS was in breach of contract by failing to complete delivery of the software and by delivering defective software. Other breaches of contract were alleged, but there were no allegations of fraud in the statement of claim. MDIS settled Silkolene's claim before disclosure and claimed an indemnity under the insurance.

51. The insuring provision in the certificate in that case provided as follows:

> "2. Operative Clause
>
> The underwriters will indemnify the Assured to the extent and in the manner detailed herein against any claim for which the Assured may become legally liable, first made against the Assured and notified to the Underwriters during the period of this Certificate arising out of the professional conduct of the Assured's business as stated in the Schedule alleging:
>
> (a) Neglect Error or Omission
>
> any neglect or omission including breach of contract occasioned by same.

> (b) Dishonesty of Employees
>
> any dishonest, fraudulent, criminal, malicious act(s) or omission(s) of any person employed at any time by the Assured.
>
> The Assured will not be indemnified against any claim or loss, resulting from the dishonest, fraudulent, criminal or malicious act(s) or omission(s) perpetrated after the assured could reasonably have discovered or suspected the improper conduct of the employee(s).
>
> No indemnity shall be provided to any person committing any dishonest, fraudulent, criminal or malicious act(s) or omission(s)."

52. As Clarke LJ recorded in [11] of his judgment, it was common ground that in order to recover under the insurance, (i) the insured had to establish a loss, either by judgment, arbitration award or settlement agreement and (ii) that loss must be in respect of a legal liability because of the words "for which the Assured may become legally liable" in clause 2. As he said, the issue in that case was a narrow one. The insurers contended that in order to recover under that clause the insured had to show that it was legally liable to Silkolene in respect of "neglect error or omission including breach of contract occasioned by the same". The insurers contended that when the underlying facts were examined, the claim was for fraudulent misrepresentation and fraud by MDIS employees. MDIS contended that the word "alleging", immediately before clause 2(a), distinguished that case from *West Wake Price v Ching* and meant that clause 2 was focusing on the allegations made against MDIS in the statement of claim which were not of fraud and that, so long as there was a judgment or settlement agreement, it was irrelevant to consider whether the real or proximate cause of the liability was "neglect, error or omission" rather than "dishonesty of employees".

53. Both Mance J and the Court of Appeal rejected the insured's argument, holding that it placed more weight on the single word "alleging" than it could properly bear in its context. The judge and the majority of the Court of Appeal held that, as in *West Wake Price v Ching*, the insurers could go behind the form of the claim in the pleading and look at the true nature of the claim to see the real underlying basis for the insured's liability.

54. Mr Stanley accepted that the case is helpful as far as it goes but submitted that it was not really on point for what I have to decide. However, whilst I accept that the case may not be directly relevant to the first preliminary issue, I agree with Mr Edwards that there are passages, particularly in the judgments of the majority of the Court of Appeal, which are of significance in relation to the issue in the present case. First, the two preconditions to an indemnity identified in [11] of the judgment of Clarke LJ draw a distinction between the requirement that the loss be ascertained or established by judgment or settlement (that being the well-established principle derived from *Post Office v Norwich Union* [1967] 2 QB 363, approved by the House of Lords in *Bradley v Eagle Star* [1989] AC 957) and the requirement that loss is in respect of a legal liability to the third party claimant.

55. Second, Clarke LJ makes the point at [14], in discussing *West Wake Price v Ching* that although the court was construing the particular contract and not the contract in *Ching*: "both the decision and the dicta in that case can in my judgment properly be treated as relevant to the construction of this clause since they have been well known amongst insurance lawyers and indeed brokers for many years and would be likely to have been in the back of the minds of those negotiating this contract." In other words, that passage confirms the point I have already made above, that part of the admissible matrix or background in construing the contract of insurance in the present case is the established principles of English law as applied to liability insurance. That is a point also made in subsequent cases.

56. Third, that case recognises the distinction between provisions which relate to the temporal scope of the policy, the making of a claim or allegation within the period of the policy which may trigger coverage if the other preconditions for coverage are satisfied, and provisions which set out the scope of the coverage provided, in that case against legal liability of a certain kind. Thus, at [18] Clarke LJ cites a passage from the judgment at first instance at p. 102 where Mance J drew that distinction:

> "The certificate wording is no model of precise draughtsmanship. Clause 2 deals in a rolled up way with different times and concepts. Its reference to 'any claim for which the Assured may become legally liable, first made …' refers first to the need for a third party claim to be made and notified during the period of the certificate and secondly to the idea of legal liability (which either exists or does not from the time of the original act, error or omission, etc.) or possibly, the establishment of legal liability for a third party claim by judgment, award or agreement. The use of the word 'alleging' in relation to sub-clause (a) and (b) is understandable in so far as clause 2 is concerned with a third party claim, and, in location and grammar, 'alleging' appears to qualify 'first made' or possibly 'any claim'"

57. Apart from cavilling at the suggestion that "alleging" was qualifying "first made" rather than "any claim", Clarke LJ agreed with that analysis, in which Mance J was essentially concluding that the word "alleging" was concerned with the temporal scope of the insurance, that a third party claim or allegation had to be made and notified during the period of the insurance. However, as Mance J noted, the insured still has to demonstrate that there was a legal liability. At [23] Clarke LJ stated that it did not follow that it might not be possible to draft a clause which had the effect for which MDIS contended in that case, but he agreed with Mance J that clause 2 did not achieve that result and that that conclusion was consistent with the judgment of Devlin J in *Ching*.

58. Having considered Devlin J's judgment in some detail, Clarke LJ said at p.524 lhc:

> "It is important…to note that, in the context of the main indemnity clause which Devlin J was considering, he said that once the loss had been ascertained (or as he put it sustained) it remained for the insured to prove that that loss was proximately caused by neglect."

Clarke LJ went on to apply that principle, concluding at [25] that, while by the settlement agreement, MDIS had proved a loss, it still had to establish that the loss was proximately caused by neglect and that it was open to the insurers to challenge that conclusion by alleging that the loss had resulted from the dishonest acts of the insured's employees.

59. The same distinction between provisions concerned with triggering coverage in the sense of claims or allegations being made in the policy period and provisions which define the scope of actual coverage provided and the need, in the latter context, for not only ascertainment or establishment of loss, but also that the loss arises from liability of a type falling within the coverage provision is made in the other majority judgment[5], that of Judge LJ. At p. 526 lhc he said:

> "In my judgment the operative clause is concerned with the reality and not the epithet chosen by the third party to apply to the claim against the assured. The claim, or the allegation, triggers the process which may ultimately demonstrate the assured's right to indemnity and the underwriter's corresponding obligation to indemnify. If the result of this process demonstrates that the "loss" against which the assured is seeking indemnity in fact arises from improper conduct by employees within clause 2(b), in my judgment the underwriters are entitled to avoid liability where such conduct could reasonably have been discovered or suspected by the assured."

60. Before turning to the later cases, I should deal with the slightly earlier decision of the Court of Appeal in *P & O v Youell* [1997] 2 Lloyd's Rep 136, to which Mr Stanley referred. In that case, luxury cruises on three of the claimants' vessels had to be aborted for one reason or another. The claimants agreed an overall compensation package with their passengers and then sought to claim on their liability insurance with the defendants. That provided cover against "any sum or sums which the Assured shall become legally liable whether contractually or otherwise howsoever to pay as damages to third parties…". The insurers contended that the claimants had been under no legal liability to the passengers because, *inter alia*, of exclusions in their conditions. The Court of Appeal upheld the decision of Langley J that the claimants were under a legal liability in damages in respect of the passengers' claims.

61. Mr Stanley referred to the passage in the judgment of Potter LJ at p. 141 rhc where, having concluded that the claimants had been under a legal liability to the passengers, he recorded that in those circumstances, counsel for the insurers did not seek to argue that, in seeking an indemnity in respect of the overall compensation package paid, the claimants were obliged to prove a liability to the full extent paid out in respect of every individual passenger, but accepted that the intention of the parties to the insurance justified a bulk approach to the settlement of the claims. To be fair to Mr Stanley, he did not place much reliance on this point other than to submit that it demonstrated that, even where the policy provided expressly that the indemnity was in respect of sums that the insured was legally liable to pay, the commercial circumstances would justify a bulk settlement and one could look at the settlement as

[5] Peter Gibson LJ decided the appeal in favour of the insurers but on entirely different grounds from those of the majority, not relevant for present purposes.

a whole as opposed to on a claim by claim basis. Mr Edwards accepted that this was a perfectly sensible construction of the insurance, but, as he rightly pointed out, it did not impinge upon the requirement for proof of actual liability in an amount at least equal to the overall amount paid under the settlement. In other words, it is not a construction which affects the principle that, generally in liability insurance, the insured has to prove that it was under an actual legal liability, which of course the Court of Appeal found the insured had proved in that case.

62. *Commercial Union Assurance v NRG Victory Reinsurance* [1998] 2 Lloyd's Rep 600 is a well-known reinsurance case arising out of the grounding of and consequent spillage of oil from the *Exxon Valdez*. The claimants were certain of the direct insurers under a Global Corporate Excess policy of Exxon, the owners of the vessel and the defendants were the reinsurers of the claimants pursuant to a series of excess of loss contracts. Exxon commenced proceedings against the insurers in a Texas court claiming an indemnity in respect of clean-up costs under various sections of that policy. The claim under one of those sections (section 1) was compromised shortly before Exxon's summary judgment application was due to be heard by a settlement agreement between Exxon and the insurers. The claim under the other section (section 3) proceeded to trial and the jury decided that the insurers were liable to Exxon.

63. The claimant insurers claimed an indemnity from the defendant reinsurers under the reinsurance contracts. At first instance, Clarke J held in favour of the insurers, but that decision was reversed on appeal. One point on which the Court of Appeal agreed with the judge was that where there is a judgment of a foreign court against the reinsured, that should be decisive and binding as to the reinsured's original liability, save within narrow limits (i) that the English court would regard the foreign court as a court of competent jurisdiction; (ii) that the judgment should not have been obtained in breach of an exclusive jurisdiction clause; (iii) that the reinsured took all proper defences and (iv) that the judgment was not manifestly perverse (see per Potter LJ at pp. 610-611).

64. As Mr Edwards correctly pointed out, that dictum has not found favour in subsequent cases: see per Aikens J in *Enterprise Oil* at [167] and per Christopher Clarke J in *Omega Proteins v Aspen Insurance* [2010] EWHC 2280 (Comm); [2011] Lloyd's Rep IR 183 at [76]. In *Wasa International Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40; [2010] 1 AC 180 at [37], Lord Mance did not find it necessary to decide the point but emphasised the strength of the contrary view at [37]:

> "It is unnecessary to decide upon the correctness or otherwise of the Court of Appeal's obiter observations on the effect under reinsurance of a judgment against the insurer. I note only that there was no suggestion in the *Scor* case [1985] 1 Lloyd's Rep 312, where there was such a judgment, that this judgment could be binding in the absence of a follow the settlements clause; and that the basis for such a contractual implication has been questioned by a powerfully constituted Bermudian arbitration panel in an interim award dated 12 December 2000 in *Gold Medal Insurance Co v Hopewell International Insurance Ltd*, as well as by specialist writers: O'Neill & Woloniecki, The Law of Reinsurance in England and Bermuda, 2nd ed (2004), pp 191—193."

65. I consider that the better view is that, absent some agreement to be bound, it will be open to a liability insurer or a reinsurer to challenge findings of liability in an underlying judgment in proceedings to which it was not a party in order to question whether in fact the insured is under a liability. In other words, whilst the judgment may ascertain or establish the loss, it will not necessarily establish the legal liability of the insured or reinsured, although it may be compelling evidence of such liability, depending on the circumstances in which it was obtained. I agree with Mr Edwards that the position must be an *a fortiori* one where there is no judgment ascertaining the loss, but only a settlement or settlements, as in the present case. Of course, it is always open to the parties to agree ways in which an insured or reinsured can satisfy the requirement of proof that a loss falls within the cover provided, the second principle identified by Lord Mustill in *Hill v Mercantile & General Reinsurance* [1996] 1 WLR 1239 at 1251F. Mr Stanley sought to place much emphasis on that passage in his submissions, but, ultimately, it does not seem to me that it advances the argument in the present case, where the critical question is whether upon the true construction of this policy, the parties have agreed that the insured is entitled to an indemnity wherever liability is "ascertained" by judgment or settlement, even if on an objective analysis, there was no legal liability.

66. The ratio of the decision of the Court of Appeal in *Commercial Union v NRG Victory* is clearly to the effect that, absent some provision to the contrary, a settlement will not do more than ascertain loss; it will not prove a legal liability. In that case the claimant insurers relied upon the fact that they had settled Exxon's claim on the basis of the advice of their Texas attorney that the jury would be likely to find against the insurers, since they would be directed by a non-specialist judge in an area where they lacked expertise and that juries were often biased against insurers. The attorney filed an affidavit setting out the advice.

67. The Court of Appeal concluded that, in the absence of a judgment (in relation to which I have already indicated what their conclusion was and how the contrary view is to be preferred), the reinsured had to demonstrate legal liability. The point was articulated by Potter LJ at p. 612 rhc in these terms:

> "Without it [i.e. a judgment that the insurers were liable], if the plaintiffs wished to claim from NRG as reinsurers, there was an independent necessity to demonstrate legal liability which the affidavit of Mr Reasoner did not attempt to achieve other than by a prediction directed to other considerations than those of legal merit."

Later cases expand upon what the insured has to demonstrate in terms of legal liability to the underlying third party claimant, where the insured has entered into a settlement agreement with that third party.

68. *Structural Polymer Systems Ltd v Brown* [2000] Lloyd's Rep IR 64 was another case of professional indemnity insurance, there of designers involved in the design and construction of a super-yacht. The insurance was a common type of claims made insurance, under which the insurers agreed to indemnify the two insured companies against all sums which they "may become legally liable to pay and shall pay as damages in respect of claims made against [them] during the [policy] period". The insured were sued in proceedings in New Zealand and entered into a settlement

agreement. They then proceeded against the insurers in the Commercial Court. On a summary judgment application, Moore-Bick J held that there was no defence and the insured were entitled to be indemnified for the amounts they had paid out under the settlement agreement.

69. Although, as appears from p. 67 rhc of the judgment, the insured accepted the principle that, as the policy was to indemnify the insured against sums it became legally liable to pay, the insured had to show that it was under a legal liability to the third party which was covered by the policy and that the settlement of that liability was reasonable, Moore-Bick J clearly considered that principle was established by authority, including the decision of the Court of Appeal in the *NRG Victory* case. He summarised the effect of that decision on the case before him in these terms at p. 68 lhc:

> "…if the claim were settled rather than being fought to judgment it was necessary to show that the insured was in fact liable on a correct view of the law. It follows that in the present case the plaintiffs must show that one or other of them, or for that matter the two of them together, were actually liable in an amount not less than that paid under the Settlement Agreement."

70. At p. 72, in a passage to which I have already referred at [13] above, Moore-Bick J dealt with an argument by the insurers that there was an issue to be tried as to the reasonableness of the settlement, because commercial considerations had played a part in the settlement:

> "In my judgment this argument proceeds on a false basis. Since the plaintiffs must show that they were liable to the claimants in order to bring themselves within the policy at all, no question arises as to whether the settlement was reasonable in the sense of fairly reflecting the overall merits of the action, only whether it was reasonable in terms of the amount paid compared with the true extent of the claimants' recoverable loss."

71. In other words, where the insured has to demonstrate that it was under an actual legal liability, as Moore-Bick J went on to hold: "provided [the insured] can show that they were liable to [the third party] in an amount at least equal to the total sum paid under the Settlement Agreement, the amount of the settlement cannot be regarded as unreasonable". If the insured has to show that it was under an actual legal liability but cannot do so, it will not be entitled to an indemnity however commercially reasonable a settlement may have been, for example in terms of assessment of litigation risk. That emerges clearly from the decision of the Court of Appeal in the *NRG Victory* case.

72. *Thornton Springer v NEM Insurance Co Ltd* [2000] Lloyd's Rep IR 590 was another case of professional indemnity insurance, where a firm of accountants sought a declaration that their insurers were liable to indemnify them in defending a claim by a client who alleged that a partner in the firm had given advice to him in relation to the sale of shares to a company in which the partner had an interest. Costs were incurred by the firm in defending that claim which culminated in the client's claim being

dismissed by the court on the basis that the partner had not given advice as an accountant or as a partner in the firm but in his private capacity. The fundamental issue in the claim brought by the firm against the insurers was whether their costs of defending the client's claim were recoverable from the insurers. One of the bases upon which the firm sought an indemnity in respect of those costs was under the insuring clause.

73. The insuring clause in that case provided as follows:

> "Now we the Underwriters to the extent and in the manner hereinafter provided hereby agree:
>
> To indemnify the Assured against any claim or claims first made against the Assured during the period of insurance as shown in the Schedule in respect of any Civil Liability whatsoever or whensoever arising (including liability for claimants' costs) incurred in connection with the conduct of any Professional Business carried on by or on behalf of the Assured."

The insured firm sought to contend that it was entitled to an indemnity if it established that during the period of insurance a claim had been made against the firm alleging civil liability in connection with its professional business and that the putting forward of such a claim had caused loss to the insured, there in the form of defence costs. As Colman J said at p. 597 lhc: "Fundamental to this construction is that it is not relevant to investigate whether the claim was well-founded. What matters is whether the claim falls within the scope of the description to be found in [the insuring clause]."

74. Colman J rejected that argument. He held first [at 33] that, without reference to authority, the wording of the insuring clause favoured the insurers' construction on the basis that: "it is important to bear in mind that in liability policies such as this an insurance clause has to define the eventuality insured against by reference both to its intrinsic character and to the period of cover provided by the policy. That against which the insured is to be indemnified is loss caused by the eventuality as defined." He went on to hold at [34] as follows:

> "In the present case Insuring Clause 1 defines the intrinsic character of the eventuality insured against by reference to 'any civil liability whatsoever and whensoever arising (including liability for claimants' costs) *incurred* in connection with the conduct of any Professional Business carried on by or on behalf of the Assured' (emphasis added). These words make it very clear that the eventuality is the *actual* liability of the insured, as distinct from the alleged liability, of the Assured. If the latter meaning had been intended the clause would hardly have referred to 'Liability … incurred'. Nor would it have expressly provided for liability for the claimants' costs. When this wording refers to 'liability' it is thus referring to actual liability. When the underwriters are expressed to 'indemnify the Assured against any claim or claims first made … during the period of insurance' the wording is directed to defining the eventuality

> by reference to the period of cover. The scope of cover is thus defined as being against loss caused to the assured by their actual liability incurred in connection with the conduct of any professional business, including their actual liability for claimants' costs in respect of which liability a claim or claims are first made during the period of insurance."

75. I agree with Mr Edwards that this passage clearly draws the distinction between provisions addressing the nature of the eventuality insured, in that case actual liability and provisions concerned with the temporal scope of the policy. As with the judgment of Clarke LJ in *MDIS v Swinbank* that distinction becomes of significance in considering some of the provisions in the present Policy.

76. Colman J then held at [35] that the conclusion that this wording was to be construed as defining the relevant eventuality as actual, as opposed to alleged liability was supported by numerous authorities. He then cited *Ching*, *Post Office v Norwich Union* and *Bradley v Eagle Star* and concluded at [38]:

> "It is true that in none of these cases was it argued that the relevant insuring clause engaged the insurers' liability upon the making of a claim as distinct from the ascertainment of the assured's liability. However, the approval of Devlin J's analysis in these two subsequent cases, in my judgment, leaves no room for such an argument unless the insuring clause is drafted to show in clear terms that this basic principle of liability insurance is intended to be excluded. This could not be said of the wording in the present case: as I have already indicated, it points very strongly towards the application of the usual principle."

He then went on to find at [39] that "the strong presumption that a liability policy is to be construed consistently with this principle" was well illustrated by the recent decisions of Mance J and the Court of Appeal in *MDIS v Swinbank.*

77. The decision of Aikens J in *Enterprise Oil v Strand Insurance* [2006] EWHC 58 (Comm); [2007] Lloyd's Rep IR 186, although the terms of the policy were by no means identical to those in the present case, is one of the authorities which, in my judgment, poses serious obstacles to the arguments advanced on behalf of the claimant by Mr Stanley. Strand was in fact the captive insurer of Enterprise Oil and was reinsured on a back to back basis by Lloyd's and London market reinsurers, who invoked a claims control clause in the reinsurance contract in order to defend Enterprise's claim against Strand. The underlying dispute was complex, but for present purposes, it is only necessary to record that Enterprise sought an indemnity in respect of what it contended was its liability to pay its proportion of a settlement agreement with certain claimants in proceedings in Texas.

78. The relevant section of the insurance policy was entitled "Occurrence Liabilities" and provided an indemnity:

> "For all sums which the Insured [i.e. Enterprise] may be obligated to pay by reason of liability imposed on the Insured

> by law or assumed under Contract or Agreement (written or oral) or otherwise, on account of personal injury and/or bodily injury and/or loss of life and/or loss of and/or damage to tangible property, (including loss of use following physical loss of or damage to property or persons) arising out of an occurrence occurring during the period of this Policy, all in connection with the Offshore/Marine and/or waterborne and/or airborne operations of the Insured wheresoever occurring.
>
> The term "personal injury" or "personal injuries", wherever used herein, shall include, but not by way of limitation, bodily injury (including death at any time resulting therefrom), mental injury, mental anguish, shock, sickness, disease, disability, false arrest, false imprisonment, wrongful eviction, detention, malicious prosecution, discrimination whether on the grounds of sex or sexual orientation, race, ethnic origin, nationality or skin colour, creed, religious or political convictions, disability or appearance or otherwise, humiliation, invasion of rights of privacy, libel, slander, defamation of character, piracy and/or infringement of copyright or of property or contract rights committed or alleged to have been committed in the conduct of the Insured's operations."

79. Under the General Insuring Conditions, the policy included clause 2 which provided:

> "In the event of any conflict of interpretation between the various clauses and conditions contained in this Policy, the broadest and least restrictive wording to the benefit of the Insured shall always prevail".

That provision required an interpretation which was pro-insured (in contrast to Article VI O in the present case which requires an even-handed construction as between insured and insurer) and yet Aikens J found that the insuring clause still required that the insured demonstrate actual legal liability.

80. The first principal question which Aikens J had to decide was what Enterprise had to establish in order to obtain indemnity under the policy. He stated the general principle in liability insurance in these terms (citing Clarke LJ in *MDIS* and Moore-Bick J in *Structural Polymer*) at [27]:

> "Generally speaking when an insured makes a claim under a liability policy it has to demonstrate that it has suffered a loss by virtue of a legal liability which has been ascertained, whether by a judgment being entered against it by a third party, or an arbitration award or a settlement of the third party's claims. Moreover, if the loss is to be recovered under the policy, the insured must prove that its loss was caused by an insured peril under the policy. Again, generally speaking, in order to claim under a liability policy where the insured has settled the claim of the third party, the insured still has to demonstrate that it was or would have been liable to the third

> party. It cannot simply rely on the fact of the settlement to demonstrate either liability or that the amount of the settlement was reasonable. In order to show the settlement was reasonable, the insured must show that the amount of damage for which it would have been liable is at least as much as the amount paid under the settlement."

81. In that case, Enterprise submitted however, as the judge recorded also at [27]:

> "that the combination of the words 'liability assumed under contract or agreement' and 'committed or alleged to have been committed' mean that to recover an indemnity under the policy, it only has to prove that: (a) the sum paid under the Settlement Agreement was a reasonable sum; (b) it was paid under an honest and business-like settlement of an arguable liability for a peril that is insured under the policy; (c) in this case, the arguable liability was in respect of the tortious interference with the Service Agreement—loss resulting from liability for tortious interference with contract being an insured peril under the policy."

82. Aikens J rejected that argument for three reasons set out at [64] to [72] of his judgment. The first reason was:

> "64….First, in my view the arguments of Mr Beazley [counsel for Enterprise] do not recognise sufficiently the importance of the words 'on account of personal injury' in clause 1(a) of Section iv (a). By clause 1 the insurer agrees to indemnify the insured for all sums that the insured may be obligated to pay 'on account of personal injury', as that is subsequently defined. So the insured's obligation to pay must be referable to 'personal injury', not alleged personal injury."

It is to be noted, in relation to that reasoning, that the insuring clause in the present case refers in the same way to "on account of personal injury". Furthermore, unlike in that case, in the present case the definitions of Personal Injury and Property Damage are not qualified in any way by the word "alleged".

83. The second reason for rejecting Enterprise's argument was:

> "65 Secondly, it must be noted that the right to indemnity arises in two circumstances that are defined in the clause. The first of these is if the insured is obligated to pay sums by law "on account of personal injury". As Mr Beazley accepts, an insured can only be obligated to pay sums by law if there is an actual liability to do so. One cannot be obligated by law to pay sums if there is only an alleged liability.
>
> 66. The second circumstance in which a right to indemnity arises is when the insured is obligated to pay sums by reason of "*liability….assumed under contract or agreement….on account*

> *of personal injury…*". In my view, when a party enters into a settlement agreement, it does not thereby "assume liability" on account of personal injury. I agree with Mr Schaff's analysis, which is that a settlement agreement is a compromise of the question of whether or not there is in fact any liability on account of personal injury. I also agree that the phrase "*assumed under contract or agreement*" is intended to refer to liability that is undertaken by contract "*on account of personal injury*", such as when one party agrees to indemnify another for the personal injuries of a third party. But the phrase was not intended by the parties to convert an arguable liability, which cannot be imposed by law, into an actual liability simply by virtue of a compromise embodied in a settlement agreement."

84. The third reason for rejecting Enterprise's argument was that the learned judge considered that his conclusion was supported by the reasoning of Mance J and the Court of Appeal in *MDIS*. He referred in detail to that reasoning and then concluded at [72]:

> "72 The importance of the decision of Mance J and the Court of Appeal in the *MDIS* case lies in the approach they took to the nature of the liability policy. All, including Peter Gibson LJ, started from the proposition that, in the absence of express wording to the contrary, an insured under a liability policy can only recover against his insurer if it was actually under a liability to a third party, upon a proper analysis of the law and the facts. In this case it is clear from the wording of the opening of clause 1(a) of Section iv (a) of the Policy, that the same rule applies. In my view, the words 'alleged to have been committed' at the end of the wording that defines 'personal injury' refer to the time the acts which come within 'personal injury' were committed 'or alleged to have been committed'."

85. In my judgment that last part of Aikens J's reasoning is of considerable importance in considering the correct construction of the present Policy. Mr Stanley relies to a considerable extent upon the fact that, in a number of places in the Policy wording, reference is made to "actual or alleged" Personal Injury or Property Damage (for example in the Occurrence definition, in contrast to the definition of "occurrence" in *Enterprise Oil*) or to "actual or alleged" Liability (for example at the outset of Article IV Exclusions). For reasons that I will elaborate when I consider the correct construction of the Policy in more detail, I also consider that the word "alleged" in those parts of the Policy wording in the present case are referring similarly to the time when underlying claims are made against the insured.

86. The second issue with which Aikens J was concerned, which is of particular relevance to the present case, was the issue as to what was the proper basis upon which the English court should consider the question whether Enterprise was or would have been liable in the Texas proceedings. Aikens J followed the approach of the Court of Appeal in the *NRG Victory* case. He held [at 80] that although that was a case of reinsurance rather than liability insurance, the applicable principles were the same, namely:

> "(i) when an English court has to consider whether one party is liable to another under a contract and that matter has been decided by a foreign court, then the English court should accept the decision of a foreign court as to relevant liability (which in this case would be that of Enterprise to Rowan), subject to exceptions which are not relevant to this case; (ii) in cases where the foreign court has not actually determined the matter, then the English court has to decide what the foreign court's decision would have been, following the applicable law and any relevant rules of construction; (iii) it is for the English court to determine, by evidence, the applicable law; (iv) the presumption of the English court should be that a foreign court would arrive at a decision according to law, whether the decision is by a judge's ruling or a jury's verdict; (v) extraneous reasons for saying that a jury would arrive at a particular verdict are irrelevant, at least when such a verdict would be contrary to the applicable law."

87. That last principle is of some significance, since it is a further reason (apart from the inadmissibility of extraneous evidence) why the expert evidence of Professor Stier as to the risk of adverse findings by a jury even when on the proper application of the law and the facts the insured should not be liable, is irrelevant and inadmissible.

88. Mr Edwards also drew my attention to Aikens J's treatment of Issue 9 before him, the issue as to whether Enterprise was entitled as a matter of English law to recover any part of the settlement amount it had paid. Given the learned judge's conclusion that Enterprise had to show it had been under an actual liability and could not do so, this point did not arise for decision, but the learned judge dealt with it on an obiter basis, in order to express his disagreement with that part of the analysis of Colman J in the controversial case of *Lumberman's Mutual Casualty Co v Bovis Lend Lease Ltd* [2005] 1 Lloyd's Rep 494, where that learned judge held that where a settlement agreement did not specify the cost to the (re)insured of discharging insured (as opposed to uninsured) liability, extrinsic evidence was not admissible to supply an ascertainment of that cost and thus of the relevant loss for the purposes of the (re)insurance.

89. Part of the reasoning of Aikens J in declining to follow the approach of Colman J in *Lumberman's* was that it should be open to the insured to assert and prove by extrinsic evidence that it is liable to a third party for a particular sum under the settlement agreement and that that sum represents a loss covered by an insured peril, in exactly the same way as the insurer has the right to go behind a settlement (or for that matter a judgment[6]) and adduce extrinsic evidence that the insured was not in fact or in law legally liable to the third party. Aikens J expressed that latter right at [167] in these terms:

> "The most important, if obvious, point is that an insurer always has the right to challenge whether the insured's right to indemnity under the policy has been established. Therefore it

[6] The point I have already addressed briefly above in relation to the controversial aspect of Potter LJ's judgment in the *NRG Victory* case.

> has the right to challenge whether the insured was, in fact and law, liable to the third party. It has the right to challenge the quantum of the liability. And it must also have the right to challenge whether, on the facts of the case, the insured's liability to the third party is a loss within the scope of the liability policy, whatever is stated in a judgment, award or settlement. Apart from anything else, the insurer will not be a party to the judgment, award or settlement, unless specifically involved. I accept that in the case of judgments and awards, the conclusion of a competent tribunal on the merits as to liability and quantum is unlikely to be upset in an action on the liability policy. But I cannot see why, in principle, it should not be challenged. In the case of settlements, Colman J himself specifically accepted that an insurer is not bound by a settlement agreement between the insured and the third party as to liability, or quantum."

90. Finally in this line of authorities on the principles applicable to liability insurance, is the decision of Christopher Clarke J in *Omega Proteins v Aspen Insurance UK Ltd* [2010] EWHC 2280 (Comm); [2011] Lloyd's Rep IR 183. That was a claim under the Third Party (Rights Against Insurers) Act 1930 against the liability insurers of Northern Counties Meat Ltd, a meat processing company which had supplied contaminated meat to the claimant Omega, which intermingled the contaminated material with sound material which it supplied to a customer Pears, which then sold it to pet food manufacturers and to Webster Thompson for use as tallow. Webster Thompson commenced proceedings against Pears for damages and Pears joined Omega as a third party, claiming damages for breach of contract. Omega in turn sued Northern Counties as fourth party on the same basis. Following a summary judgment application, HHJ Mackie QC held that Omega was liable to pay damages to Pears for breach of contract and that Northern Counties was liable to indemnify Omega, on the basis that it was in breach of an express obligation in the contract only to supply material of a particular category. He also held Northern Counties in breach of implied terms as to satisfactory quality and fitness for purpose. No allegation was made in those proceedings that Northern Counties had been negligent or was liable to Omega for breach of any non-contractual duty.

91. The liability insurance provided by the defendant insurers to Northern Counties contained an exclusion against liability under a contract unless such liability would have attached in the absence of the contract. Northern Counties having gone into liquidation, Omega claimed against the insurers under the 1930 Act. The insurers' case was that it was not permissible to go behind Judge Mackie's judgment which had conclusively determined that the liability of Northern Counties to Omega was in contract. Christopher Clarke J rejected that argument and held that Omega was entitled to recover from the insurers.

92. Having cited with approval the decisions in *Ching* and *MDIS v Swinbank*, Christopher Clarke J at [49] summarised the principles applicable to liability insurance in eight propositions:

> "As it seems to me in liability insurance such as this the position, generally speaking, lies thus:

> 1. The insured must establish that it has suffered a loss which is covered by one of the perils insured against: *West Wake*; *Post Office v Norwich Union* [1967] 2 QB 363; *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957; *Horbury Building Systems Ltd v Hampden Insurance NV* [2004] 2 CLC 453 , 464;
>
> 2. That may be done by showing a judgment or an arbitration award against the insured or an agreement to pay;
>
> 3. The loss must be within the scope of the cover provided by the policy;
>
> 4. As a matter of practicality, the judgment, award, or agreement may settle the question as to whether the loss is covered by the policy because the insurers will accept it as showing a basis of liability which is within the scope of the cover;
>
> 5. But neither the judgment nor the agreement are determinative of whether or not the loss is covered by the policy (assuming that the insurer is not a party to either and that there is no agreement by the insurer to be bound).
>
> 6. It is, therefore, open to the insurers to dispute that the insured was in fact liable, or that it was liable on the basis specified in the judgment; or to show that the true basis of his liability fell within an exception;
>
> 7. Thus, an insured against whom a claim is made in negligence, which is the subject of a judgment, may find that his insurer seeks to show that in reality the claim was for fraud or for something else which was not covered, or excluded by, the policy: *MDIS Ltd v Swinbank*;
>
> 8. Similarly, an insured who is held liable in fraud (which the policy does not cover) may be able to establish, in a dispute with his insurers, that, whatever the judge found, he was not in fact fraudulent, but only negligent and that he was entitled to cover under the policy on that account."

93. Christopher Clarke J then declined to follow an earlier decision of Tomlinson J in *Redbridge LBC v Municipal Mutual Insurance* [2001] Lloyd's Rep 545 to the effect that it was normally neither permissible nor possible to look behind a judgment. His reasoning for rejecting the approach of Tomlinson J was, so far as relevant to the present debate, set out in two passages. First at [58] he said:

> "If A successfully sues B to judgment the basis upon which he succeeds will be apparent from the judgment. It will not be open to C to say that A succeeded on another basis. To do so would be to rewrite history. But if A succeeds in suing B and B then claims against C, it is open to C to claim that in truth B

> was not liable to A (either at all or to the same extent), or that, if liable, it was not on the basis decided by the judge or not only on that basis. Unless B and C have by contract agreed something different, a judgment given in proceedings between A and B is neither binding on, nor enforceable by, C in subsequent proceedings between B and C. The authorities to this effect were recently reviewed and applied by the Court of Appeal in *Sun Life Assurance Co of Canada v Lincoln National Life Insurance* [2005] 1 Lloyd's Rep 606."

94. Then at [62] he said:

> "This [the reasoning in *Redbridge*] …assumes that what the insurer has agreed to cover is only such liability as is found by another court in proceedings against the insured, whether those findings were correct or not, and whether or not the insured could also have been found liable on another basis as well. That is not, however, the nature of the cover which, in the present case is against 'all sums which the Insured becomes legally liable to pay'. Whether in truth there is such a liability begs the question as to who shall determine that question. As to that, in circumstances where no cause of action or issue estoppel arises the insured (and the insurer) are both, absent some special agreement, entitled, in my judgment, to have the matter determined by the judge who hears the suit to which they are both party."

95. He then cited with approval the decision of Aikens J in *Enterprise Oil* which he identified as having expressed a view contrary to that of Tomlinson J. He agreed with the reasoning of Aikens J in that case, including his disagreement with the decision of Colman J in *Lumberman's*. He expressed the view that the *NRG Victory* case did not require a different conclusion in the case before him than the one he had reached. He concluded that, just as the insurer could look behind a judgment to claim that the insured was not in truth liable, so the insured must be able to claim as between himself and the insurer, that a finding in the judgment is not correct or that he was also liable on other grounds (see [69]).

96. From this analysis of the case law, in my judgment there is a consistent and well-established line of authority that, in the absence of clear contrary wording in the contract of liability insurance, under English law (i) the insured has to establish that it was under an actual legal liability, not just an alleged liability, to the third party before it is entitled to an indemnity under the contract and (ii) the ascertainment of loss by a judgment or settlement does not automatically establish such actual legal liability (although a judgment against the insured may be strong evidence of such liability). It is still open to the insurer to challenge that there was an actual legal liability, in which case it is for the insured to prove that there was.

Analysis in relation to the first preliminary issue

97. Mr Stanley submitted that the Policy terms could and should be read together to provide a unified and comprehensible scheme under which the source of the insured's

obligation was the settlement or judgment and thus, when the Policy (and in particular Article I Coverage, the insuring clause) speaks of "liability", that means "established" liability, in the sense of a liability established by the settlement or judgment and not just actual legal liability, as the defendants contend. Those submissions were certainly beguiling and ingenious, but I am unable to accept them for a number of reasons.

98. First and foremost, Article I makes it clear that the indemnity provided is in respect of what the insured "pays by reason of liability… imposed by law". The words "by reason of" indicate that there has to be a clear causal link between what is paid and the liability and the words "imposed by law" make it clear in my judgment that there has to be an actual legal liability. Mr Stanley submitted that those words were referring to the kind or source of liability, in other words they meant no more than that the kind of liability, whether actual or alleged, was one that arose in tort rather than in contract, that the source of the liability was tort. He sought to support that argument by reference to the other kind of liability covered in (b) "of a person or party who is not an Insured assumed by the Insured under contract or agreement" which is describing the situation where, prior to any claim, the insured has agreed to indemnify someone else in the event that they face a claim.

99. This distinction between liability in contract and liability in tort is obvious from the wording of the provision, but it seems to me that it does not assist the claimant in its argument that the liability may be alleged as well as actual. There is nothing in (b) to suggest that there would be coverage where the insured settles a claim by a third party for indemnity when, as a matter of legal analysis and on the particular facts, the relevant contract did not oblige him to indemnify the third party at all. There either is an actual liability to indemnify under the contract or there is not and it is only where there is an actual liability that there is coverage.

100. Equally, in my judgment, there cannot be a liability in tort "imposed by law" unless there is an actual legal liability as opposed to just an alleged liability. Mr Stanley's argument really cannot answer this point. Although the wording of the insuring clause in *Enterprise Oil* was slightly different, it seems to me that the analysis of Aikens J in that case at [65] is correct:

> "As Mr Beazley accepts, an insured can only be obligated to pay sums by law if there is an actual liability to do so. One cannot be obligated by law to pay sums if there is only an alleged liability."

101. Mr Stanley submitted that this was an example of the court reaching a conclusion as to the need for actual legal liability to be established without the point having been fully argued. In a sense that is true, but it is evident that the point was not argued because neither counsel nor the judge thought that it was arguable. Furthermore, the other reasons Aikens J gave in that case for rejecting the argument that the insuring clause insured not just against actual liability, but against alleged liability, are equally valid here. As in that case, the argument for the insured fails to recognise the significance of the words "liability …on account of personal injury". If it really had been intended that the Policy should respond to allegations of personal injury (or for that matter property damage) it would have been very easy for the wording to say so. The draftsman is not shy in using the word "alleged" elsewhere in the Policy wording when he wants to.

102. It seems to me that, in a very real sense, all Mr Stanley's arguments founder on the rock of the insuring clause, which clearly insures against actual liability, rather than alleged liability or some ingenious but artificial halfway house of "established" liability. For all the points Mr Stanley makes to the effect that "Damages" or "Ultimate Net Loss" are defined by reference to what he calls established liability or that other terms of the Policy refer to "alleged liability", I do not see how, even if he were right, any of those points could broaden the scope of coverage under Article I of the Policy which is expressly limited to an indemnity "for Ultimate Net Loss the Insured pays by reason of liability...imposed by law...for Damages on account of Personal Injury" and thus limited to actual legal liability.

103. Second, despite Mr Stanley's argument to the contrary I do not consider that the definitions of "Damages" and "Ultimate Net Loss" broaden the scope of coverage or purport to provide coverage for alleged or "established" liability. Since the definition of Ultimate Net Loss is "the total sum which the Insured shall become obligated to pay for Damages on account of Personal Injury", it is appropriate to focus on the definition of "Damages".

104. The critical words are "[damages] which the Insured shall be obligated to pay by reason of judgment or settlement for liability on account of Personal Injury". It is certainly correct that, as Mr Stanley submitted, this makes clear that the immediate source of the Insured's obligation is a judgment or settlement, but that point only takes the claimant so far, because it is not damages payable under <u>any</u> judgment or settlement that qualify under this provision: the judgment or settlement must be "for liability", in other words there must be a liability. I do not see how the word "liability" in this context can be interpreted as anything other than actual legal liability. "For liability" must be qualifying both judgments and settlements in the same sense. Since you cannot have a judgment for alleged liability, it seems to me you cannot have a settlement for alleged liability under this clause. In both cases, the liability must be actual. Furthermore, when the contract is intending to encompass alleged liability as well as actual liability (as in the definition of "Product Pollution Liability") it says so.

105. Given that, to qualify under the Damages definition, the damages must be payable pursuant to a judgment or settlement where there is an actual legal liability, it is only those "Damages" which can be included in the "total sum" within the definition of "Ultimate Net Loss". Furthermore, the closing words of the definition of Ultimate Net Loss make it clear that the definition only encompasses the total sum "which is, and/or but for the amount thereof would be [i.e. because the total sum exceeds the limit of indemnity]) covered under this Policy". In other words nothing in that definition is intended to extend the scope of coverage provided under the Policy, which, for the reasons I have given, is circumscribed by Article I Coverage and limited to actual not alleged liability.

106. Third, I do not consider the claimant's argument is supported by the Loss Payable clause in Article VI F. Mr Stanley emphasised the opening words and then sub-paragraph (2): "Liability under this Policy…shall not attach unless and until…the **Insured's** liability covered hereunder shall have been fixed and rendered certain either by final judgment against the **Insured** after actual trial or by settlement approved in writing by the **Company**." He submitted that the liability is then rendered

certain, is an established liability and it is no longer necessary to ask whether the liability is actual or alleged, it is established and is "liability" under the Policy.

107. Ingenious though this argument is, it seems to me it gives insufficient weight to the last sentence of the second paragraph which provides:

> "The **Company** may examine the underlying facts giving rise to a judgment against or settlement by the **Insured** to determine if, and to what extent, the basis for the **Insured's** liability under such judgment or settlement is covered by this Policy."

108. Mr Stanley accepted that that sentence was recognising the right of the insurer, as in cases such as *MDIS v Swinbank*, *Enterprise Oil* and *Omega Proteins*, to challenge by reference to the underlying facts whether the basis for liability under the judgment or settlement is covered. However, he went on to submit that it does not enable the insurer to examine whether there was a liability at all because the liability is fixed or rendered certain by the judgment or settlement. With respect to Mr Stanley, that argument seems to me entirely circular.

109. It is quite clear from the sentence that the ascertainment of liability by judgment or settlement is not conclusive. This sentence expressly confirms the right of the insurer to challenge, by reference to the underlying facts and evidence, that the "ascertained" liability is an insured liability under the Policy. Thus the sentence negatives any suggestion that the judgment or settlement is conclusive as to liability under the Policy. One of the ways that the insurer can challenge a settlement is to contend that it is only for alleged liability not for actual liability, in which case there will be no cover under the Policy unless the insured establishes that there would have been an actual liability.

110. In other words, ascertainment of liability by judgment or settlement is a necessary condition to the insurer being liable to provide an indemnity, but not a sufficient condition, in the sense that the insured still has to demonstrate that it was under an actual legal liability which was covered by the Policy. The Loss Payable clause is drawing the distinction, which Mr Edwards emphasised in his submissions, between ascertainment of loss on the one hand and actual coverage under the policy on the other. In my judgment, the clause is entirely consistent with the insuring clause only providing coverage in respect of actual liability and does not widen the scope of coverage.

111. Fourth, I do not consider that the definitions of "Occurrence" or "Integrated Occurrence" widen the scope of coverage provided by the insuring clause. These definitions are complex and hardly a model of clarity of draughtsmanship (to echo what Mance J said about the wording in *MDIS*) but I agree with Mr Edwards that these provisions are a gateway to coverage, in the sense that they circumscribe the types of personal injury (focusing on that rather than property damage or advertising liability for these purposes) that potentially qualify for an indemnity. Hence the phrase "encompassed by an Occurrence" in the insuring clause which, as a matter of ordinary language, conveys something that is within the scope of an Occurrence.

112. On the basis that the Occurrence definition is defining a gateway to coverage rather than defining the coverage itself, it seems to me that the references to "actual or

alleged" personal injury make perfect sense. The insured who becomes aware from complaints or claims that a particular product is being alleged to cause injury to people needs to be in a position, if there are a multitude of claims to that effect to give a Notice of Occurrence, usually, in the context of this sort of high layer excess of loss insurance, a Notice of Integrated Occurrence within Article V. The insured will want to ensure, so far as possible, that claims attributable for example to the same defect or failure to warn can be aggregated under Article III V (2) of the wording, otherwise it may not be entitled to contend that there is an Integrated Occurrence. However, at the time that the decision has to be taken whether to serve such a Notice, inevitably the third party claims may only be at the stage of allegations.

113. In circumstances where the Policy covers against Occurrences reported, it follows inevitably that, at the time any notice is given, the insured may only be faced with a series of allegations of personal injury or property damage or advertising liability, without any claim(s) having crystallised into a finding of actual liability. The fact that the Occurrence and Integrated Occurrence definitions refer to actual or alleged personal injury etc. is thus readily understandable as designed to ensure there can be no argument that, at the time Notice is given, claims are inchoate and consist only of allegations.

114. Mr Stanley submitted that, in effect, if the defendants were right that coverage was only being provided against actual liabilities, the references in these Occurrence definitions to alleged personal injury would be otiose. It seems to me that argument is a circular one, in the sense that it depends upon establishing that the definition of Occurrence in some way defines the extent of coverage, whereas, as I have already indicated, in my judgment the question of whether there is an Occurrence or an Integrated Occurrence does not determine the scope of actual coverage. The Occurrence definitions simply define the third party claims which are capable of giving rise to an indemnity if all the other conditions for indemnity, specifically the terms of Article I Coverage, are satisfied. Once those Occurrence provisions are understood as a necessary but not a sufficient condition to eventual coverage, in other words a gateway to eventual coverage, which has to be gone through to establish potential coverage, but actual coverage thereafter is determined by Article I, the wording referring to actual or alleged personal injury is readily understood: at the time that consideration is being given as to whether the gateway has been passed, the third party claims may well be only at the stage of allegations.

115. Mr Stanley sought to challenge that conclusion by contending that, because the Occurrence definition referred to both "actual" Personal Injury and "alleged" Personal Injury, that was making it clear that when Article I Coverage referred to "Personal Injury" it meant both actual and alleged Personal Injury. There are a number of fallacies in that argument, the two most obvious of which are (i) it ignores the fact that (for reasons I have already set out) an alleged Personal Injury cannot give rise to a liability imposed by law. The most obvious way in which an insured can establish it is not liable to a third party claimant is by demonstrating that the claimant has suffered no Personal Injury at all so, by definition, it is only actual Personal Injury which triggers the insuring clause; (ii) it ignores the definition of Personal Injury and for that matter of Property Damage which contain no hint that they are intended to encompass alleged as well as actual Personal Injury or Property Damage.

116. Next, Mr Stanley submitted that it was not necessary to construe the Occurrence and Integrated Occurrence definitions as a gateway to potential coverage, because it was not a pre-condition to the giving of Notice under the Policy that there be an Occurrence at all. Quite apart from the fact that this argument runs counter to the Notice provisions in Article V, which are all predicated upon there being an Occurrence of which the insured becomes aware, it ignores the fact that, if the Occurrence and Integrated Occurrence definitions did not include references to alleged as well as actual Personal Injury, upon the insured purporting to give Notice, the insurer could simply turn round and reject the Notice on the basis that in the absence of actual Personal Injury, there was no Occurrence of which notice could be given.

117. In other words, in the present case, if the claimant gave notice of a series of allegations that Seroquel caused diabetes, the insurer could come back and say has anyone actually been found to have suffered diabetes through use of Seroquel and, on receiving a negative answer, simply reject the Notice and tell the insured to go away until there was actual Personal Injury. In my judgment, it is precisely to avoid those sorts of difficulties which could make unworkable what is supposed to be an "occurrence reported" insurance, where the giving of Notice crystallises in which policy year the occurrence is reported.

118. In any event, whatever one makes of the Occurrence and Integrated Occurrence definitions (which are on any view expressed in a complex and confusing manner) it seems to me that, to the extent that the claimant is seeking to contend that the Occurrence definition in some way can expand the coverage provided by Article I, that contention suffers from the same fallacy as identified by the Court of Appeal in *Yorkshire Water v Sun Alliance* [1997] 2 Lloyd's Rep 21. It is not necessary to describe the detail of the dispute in that case, but sufficient to record that the two separate policies there provided cover against "legal liability for damages in respect of accidental injury" (Sun Alliance) and "all sums which the insured shall become legally liable to pay as damages...in respect of death or bodily injury" (Prudential). The Sun Alliance policy contained an aggregation provision in respect of any one Event defined as one occurrence or all occurrences of a series consequent on or attributable to one source or original cause. The Prudential policy contained an occurrence definition which made it clear that one occurrence included a series of occurrences arising out of the original cause.

119. The essence of the argument advanced by the claimant in that case, as recorded by Stuart-Smith LJ at p. 27 lhc, was that the insurance was against an "event" (under the Sun Alliance policy) or an "occurrence" (under the Prudential policy) which "could or did give rise to legal liability to pay damages to third parties". In rejecting that argument, Stuart-Smith LJ held at p. 28 rhc:

> "In my judgment the fallacy of Mr. Griffiths' argument is that it seeks to elevate the 'event' or 'occurrence' into the peril insured against, whereas the peril insured against is in fact:
>
> 'legal liability for damages in respect of accidental loss or damage to material property' (Sun Alliance).

> 'all sums which insured shall become legally liable to pay as damages and compensation in respect of … loss or damage to property' (Prudential).
>
> It involves reading in between the words 'against' and 'legal liability' (Sun Alliance) some such words as 'against all such costs and expenses incurred in respect of an event which may give rise to legal liability'. Such a major re-writing of the bargain is not in my view justified."

In my judgment, the claimant's argument in the present case, seeking as it does to elevate the Occurrence definition to a provision which affects and extends the insuring clause, suffers from precisely the same fallacy.

120. In his reply submissions Mr Stanley relied upon Article VI Q, the Policy Extension provision and the words: "such cancellation or non-extension …shall not limit whatever rights the Insured otherwise would have under this Policy as respects actual or alleged Personal Injury…included in such Occurrence or Integrated Occurrence taking place subsequent to such cancellation or non-extension". In my judgment, that provision is entirely consistent with the defendants' analysis of the Occurrence definition as a gateway to potential coverage. It is simply making clear what in fact is clear from other provisions in the Policy, that, once Notice has been given of an Occurrence or Integrated Occurrence within the Policy Period, all actual or alleged Personal Injuries will be added together and treated as one Occurrence, even if they occur after the Policy Period (subject always to the "expected or intended" exclusion). That provision, like the Occurrence and Integrated Occurrence definitions, is not in any sense affecting or extending coverage.

121. Fifth, I agree with the analysis put forward by Mr Edwards in relation to the other provisions of the Policy relied upon by Mr Stanley as supporting his primary argument as to the scope and effect of the insuring clause, that is (i) the definition of Advertising Liability, (ii) the reference to "actual or alleged" in the preamble to Article IV Exclusions and then in various of the exclusions themselves; (iii) the Cross Liability provision in Article VI C and (iv) the Appeals provision in Article VI E.

122. In relation to the definition of Advertising Liability, as Mr Stanley effectively accepted, no assistance is to be gained from the use of the word "Liability". That is used because, unlike in the case of personal injury or property damage, nothing physical occurs. Mr Stanley relied upon the words: "committed or alleged to have been committed" as indicating that the Policy intended to provide cover for alleged advertising liability. It seems to me that there are three answers to that point.

123. First, it is wrong as a matter of construction. The words "committed or alleged to have been committed" are not referring back to "libel, slander or defamation" etc. earlier in the clause as Mr Stanley contends, but rather, as Mr Edwards submitted, are looking forward to the words which follow; "in any advertisement, publicity article, broadcast or telecast" in other words the medium by which the defamation is alleged to have been committed. Were it otherwise, it would be difficult to make sense of those following words. The significance of this is that libel, slander and defamation are covered elsewhere in the wording, because of the definition of personal injury. However, advertising liability is only covered if there is a type (a) occurrence within

the Occurrence definition, that is occurrences which are catastrophes such as an explosion, not a type (b) occurrence, that is, arising from the insured's products. As Mr Edwards submitted, it is not difficult to see why a liability insurer providing product liability coverage might be disinclined to pick up advertising liabilities given that the insured's products may be extensively advertised in the media.

124. The second answer to the point is that, even if it were right, it would not assist the claimant in the present case, which is concerned with product liability for Personal Injury, where, on any view, the definition is not qualified by the words "actual or alleged" as it surely would have been if there had been any intention to cover against allegations of personal injury. The claimant's construction (even if right) never satisfactorily explains why the definition of Advertising Liability refers to "alleged" whereas the definitions of Personal Injury and Property Damage do not.

125. The third answer is that, even if the present case were concerned with advertising liability, which it is not, the wording of the definition might be an anomaly, but, on any view, it could not overcome the clear wording of the insuring clause which, for the reasons I have given, insures only against actual legal liability.

126. Mr Stanley sought to place particular reliance in his reply submissions on the definition of "Product Pollution Liability" which refers to "liability or alleged liability", which he submitted Mr Edwards had not addressed. However, under this Policy, the only circumstances in which coverage is provided for Product Pollution Liability is by way of a write back or exception to the Pollution Exclusion in Article IV K. For the reasons given at [130] below, in the context of such write backs, the use of the words "actual or alleged" is readily understandable.

127. In any event, even if some of the points which Mr Stanley makes about the definitions in the Policy have force to them, it seems to me that Policy definitions are an unpromising source for an extension of coverage under the insuring clause. If it were intended to cover alleged or, to use Mr Stanley's half-way house, "established" liability as opposed to actual liability, I would expect to see an insuring clause in Article I which expressly so provided and which made clear by its wording that the parties intended to depart from the general principle of English law applicable to liability insurance, which forms part of the background against which this contract falls to be construed.

128. Turning to the Exclusions, the preamble to Article IV states: "This Policy does not apply to actual or alleged". There are then some (but by no means all of the Exclusions) which refer to allegations: Exclusion F in respect of Advertising excludes Advertising Liability arising out of breach of contract but there is then an exception to the exclusion (or a "write back"[7]) for liability for unauthorised misappropriation of advertising ideas based upon breach or alleged breach of an implied contract; Exclusion I, the Aircraft Exclusion in respect of liability arising out of the design, manufacture etc. of any aircraft again has a write back that the exclusion does not apply to certain kinds of "liability or alleged liability" (the detail of which does not matter for present purposes); and Exclusion K the Pollution Exclusion has a write back that the exclusion does not apply to Product Pollution Liability or liability of the insured for personal injury or property damage (i) caused by an intentional discharge

[7] This term is strictly more accurate than the expression "carve back" which Mr Stanley used.

of pollutants solely to mitigate or avoid personal injury or property damage which would be covered by the Policy or (ii) caused by a discharge of pollutants which was not expected or intended, provided the insured becomes aware of it within seven days.

129. Mr Edwards points out that the preamble to the Article does not state "this Policy does not provide coverage" but "this Policy does not apply", the word "apply" indicating a broader exclusion than just in respect of indemnity. I agree with Mr Edwards that these words are making the point that the matters which are excluded do not count for any policy purpose, not just for indemnity. Given that the Occurrence and Integrated Occurrence definitions refer not just to actual but to alleged personal injury or property damage, it is not surprising that the preamble to the Exclusions refers to "actual or alleged". They are clarifying not only that there cannot be an indemnity in respect of excluded matters, but also that such matters (save where a write back applies) cannot form part of a Notice of Occurrence or a Notice of Integrated Occurrence under Article V.

130. In other words, under these provisions, you can only aggregate matters which, if they eventuate in actual liability, are capable of being indemnified under the Policy. This analysis also makes sense of the fact that some of the Exclusions where there is a write back refer to "alleged" breach or liability. This is a way of confirming that, where the write back operates, the relevant matter is capable of being aggregated for the purposes of an Occurrence or an Integrated Occurrence, the definitions of which for reasons already discussed include alleged as well as actual personal injury and property damage.

131. However, even if this analysis is not correct, in my judgment the references to "alleged" in the Exclusions, which are by no means consistent, even in the case of the write backs (for example in the write back under Exclusion K, the Pollution Exclusion, paragraph (2)(b), there is no reference to "alleged" liability) whatever else they may be doing, just do not amount to clear contrary wording which would displace the normal principle of English law in liability insurance or which could in any sense extend the scope of coverage under Article I of the Policy.

132. The Cross Liability provision in Article VI C was another provision on which Mr Stanley placed some reliance because of its reference to "is or may be liable". However, I agree with Mr Edwards that that provision is of no assistance in relation to the issue I have to decide. It is dealing with a very specific situation where one insured is potentially bringing a claim against another in respect of personal injury to its employee and making it clear that in that situation, each insured is treated as having its own separate policy. The provision has no impact upon the scope of coverage generally.

133. In relation to Article VI E, the Appeals provision and Article VI F the Loss Payable clause (the principal argument in relation to which I have dealt with above), Mr Stanley submitted that these provisions assisted his argument because, if Mr Edwards were right that there had to be actual legal liability before an indemnity was provided, the insurers would have no incentive or interest in approving a settlement or in pursuing an appeal where the insured would not. However, I agree with Mr Edwards that, irrespective of the fact that coverage is only in respect of actual legal liability, the insurer has a real commercial interest in ensuring that the underlying claim is properly defended and, if appropriate the subject of appeal, rather than engaging in a

battle with the insured. These provisions are designed to protect that commercial interest, but they do not extend the scope of coverage.

134. The sixth reason why I am unable to accept Mr Stanley's submissions that the Policy is covering against "established" liability (in the sense of a liability established by a judgment or settlement) as opposed to actual legal liability is that, to the extent that those submissions entail the establishment of liability for the purposes of the insuring clause by a settlement, they involve two essential fallacies: (i) they seek to revive the argument which failed in *Enterprise Oil*, in circumstances where the relevant contractual liability covered in the present insurance is narrower than in that case, encompassing only certain obligations to indemnify and (ii) they ignore the fact, that under the second paragraph of the Loss Payable clause, the insurer has the right to challenge whether the settlement is covered by the Policy, demonstrating, as I have already held in what I have said above about the Loss Payable clause, that under this insurance, establishing liability by judgment or settlement is not definitive of coverage, it is a necessary but not a sufficient pre-condition to an entitlement to indemnity.

135. In conclusion on the first preliminary issue, in my judgment, despite the ingenious construction which Mr Stanley sought to place upon the provisions of the Policy, there is nothing in this wording which displaces or extends the coverage provided by Article I of the Policy. In particular, there is nothing akin to a QC clause or other form of contingency insurance, under which the insurers agree to pay wherever a claim has been established by a judgment or settlement, irrespective of whether there was in truth, on a proper analysis of the relevant facts and law, a liability at all.

136. The answer to the first preliminary issue is that the insured is only entitled to an indemnity under the Policy if, on a balance of probabilities and assuming a correct application of the law governing the claim in question to the evidence properly analysed, the insured would have been under an actual liability for the claim.

Analysis on the second preliminary issue

137. In considering the recoverability of Defense Costs, an important starting point is that, as a matter of English law, in non-marine liability insurance, there is no concept of "sue and labour", so that, if the insured acts to defend a claim and thereby avoids the insurer being under any liability, there is no entitlement to an indemnity against the costs and expenses incurred in defending successfully the liability which would otherwise have arisen under the insurance, in the absence of some express provision to that effect: see *Yorkshire Water v Sun Alliance* [1997] 2 Lloyd's Rep 21 at 30-32 per Stuart-Smith LJ and 32-33 per Otton LJ. Furthermore, as the Notice provision at the beginning of the Policy and the first sentence of Article D (1), Assistance and Cooperation make clear, in the present insurance there is no duty on the insurers to defend or take over the defence of a claim which might give rise to an implied right for the insured to recover legal costs of defending a claim, if the insurers failed to do so. It follows that any entitlement to recover defence costs must depend upon some free-standing entitlement as a matter of the true construction of the contract of insurance.

138. In this Policy wording, the reference to defence costs is as an adjunct to damages within the Damages definition; "and shall include Defense Costs", so that, as Mr

Stanley accepted, the reference to "Damages" in Article I Coverage has to be read as including Defense Costs. However, there is then an immediate problem: Damages are defined as [sums] the insured "shall be obligated to pay by reason of judgment or settlement for liability on account of Personal Injury…" Your own costs of defending a claim can never be something you are obligated to pay by reason of judgment or settlement, so that, as Mr Stanley accepted, viewing "Defense Costs" simply as an adjunct to "Damages" does not work, despite the terms of the Damages definition.

139. Mr Stanley submitted that, in the light of the Damages definition, it was difficult to see how defence costs could ever in fact be recoverable. He also submitted that Mr Edwards' contention that defence costs were only recoverable when traditional damages were recoverable (that is when an actual legal liability is demonstrated) did not work either, because once one tried to make sense of Defense Costs as Damages within Article I Coverage, there could in truth never be a "liability imposed by law" on the insured in respect of its own defence costs.

140. Mr Stanley submitted that, whoever was right as to the circumstances in which defence costs were recoverable, to give effect to an indemnity for Defense Costs it was necessary to construe the reference in the Damages definition as an untidy bolt-on provision in fact intended to provide free-standing coverage for defence costs. Mr Stanley submitted that the Damages definition should essentially be divided in two, the first half dealing with Damages properly so called and the second half consisting of the words "and shall include Defense Costs".

141. I agree with Mr Edwards that that way of putting the case does not establish free-standing coverage for defence costs at all. There is no basis for dividing up the definition of Damages as the words "and shall include Defense Costs" very clearly link those words with the first part of the clause. However even if the clause could be divided up in the manner suggested, so that the definition of Damages had two distinct limbs, both limbs would only be recoverable under the insuring clause in Article I Coverage in so far as they constituted Ultimate Net Loss and then "by reason of liability …imposed by law…on account of Personal Injury".

142. As I see it, there is a further fundamental difficulty with Mr Stanley's submission, which is that even when the words "and shall include Defense Costs" have been released from the remainder of the definition of Damages to become free-standing as he contends, they do not actually provide an indemnity without in effect transferring the words either (i) to the coverage provision in Article I so that "shall… indemnify the insured…for Damages on account of Personal Injury" has tacked onto it the words "and for Defense Costs" or (ii) to the definition of "Ultimate Net Loss" so that that provides "the total sum which the Insured shall become obligated to pay for Damages on account of Personal Injury… and [that total sum] shall include Defense Costs". Although Mr Stanley eschewed any claim to rectify the contract and submitted that the court should strive for a commercial construction which avoids absurdity, the difficulty is that this construction involves rewriting the contract, which is not permissible.

143. Mr Stanley sought to support the argument that there was free-standing coverage for defence costs by reference to the definition of "Defense Costs", which includes the costs of defending "anticipated" claims, indicating, so he submits, an intention to provide coverage for the defence of claims even where there is no actual liability. In

my judgment, the flaw in that argument is that the definition simply does not assist as to the basis and scope of coverage, which is to be found in Article I, not in Article III Definitions. The reference to anticipated claims is simply making it clear that where Defense Costs are recoverable (which Mr Edwards submits is only where the insured establishes an actual legal liability to a third party) there is no temporal restriction on the defence costs which can be recovered and they can include costs incurred before a claim is actually made, thereby avoiding any argument as to whether costs and expenses falling within the definition are properly described as defence costs.

144. In my judgment Mr Edwards is right that by tacking the words "and shall include Defense Costs" on to the definition of Damages, the parties have expressed the intention that defence costs should only be recoverable in circumstances where what might be described as "traditional" damages are recoverable, not that there should be free-standing coverage for such defence costs. In relation to the first preliminary issue, I have decided that traditional damages are only recoverable where there is an actual legal liability. In those circumstances, it is difficult to see how Defense Costs, which are expressly made recoverable as part of Damages ("and shall include Defense Costs") can be recoverable even where no actual legal liability is established. That conclusion involves a subversion of language.

145. It is true that, because the draughtsmanship of the contract is somewhat lacking in clarity, even the defendants' construction involves treating Defence Costs as a "liability…imposed by law" for the purposes of the insuring clause, but, unlike the claimant's construction, that does little violence to the language of the provisions of the contract. In any event, whatever the conundrum over how precisely Defense Costs become recoverable under this contract wording, in my judgment, the claimant cannot begin to demonstrate a free-standing provision for Defense Costs, let alone one which entitles the insured to recover defence costs even where no actual legal liability has been demonstrated.

Conclusion

146. It follows that the answers to the preliminary issues are:

(1) The insured is only entitled to an indemnity under the Policy where it demonstrates that it was under an actual legal liability. Where the insured has entered a settlement, this means that the insured has to show, on a balance of probabilities, that it would have been liable for the claim in question, on the basis of the correct application of the system of law governing the claim to the evidence properly analysed.

(2) The insured is only entitled to an indemnity for Defense Costs where it establishes that it was or would have been liable for the claim in question in the same sense as in relation to the answer to the first preliminary issue.