Neutral Citation Number: [2014] EWHC 2105 (Comm)

Case No: 2013 Folio 177

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

The Rolls Building
Fetter Lane
London EC4A 1NL

Date: 02/07/2014

Before :

MR JUSTICE FIELD

- -

Between :

Tokio Marine Europe Insurance Limited	**Claimant**
- and -	
Novae Corporate Underwriting Limited (on its own behalf and on behalf of the members of Syndicate 2007 at Lloyd's for the 2011 year of account)	**Defendant**

- -
- -

Stephen Midwinter (instructed by **Clausen Miller LLP**) for the **Claimant**
Simon Picken QC and Sushma Ananda (instructed by **Locke Lord LLP**) for the **Defendant**

Hearing dates: 13 June 2014

- -

Judgment

Mr Justice Field:

Introduction

1. This is an application for summary judgment made by the Claimant ("TMEI") relating to one of the defences of the Defendant ("Novae") to a claim under a facultative excess of loss reinsurance ("the retrocession") in respect of a payment made by TMEI to the original insurer, ACE European Group Ltd ("ACE") following the settlement by ACE of a claim by the original insured, Tesco plc and its subsidiaries ("Tesco").

2. The retrocession contained a follow settlements clause in these terms:

> This Contract is subject in all respects (excluding the rate and/or premium hereon and subject always to the Limits Reinsured hereon and except as otherwise provided herein) to

> the same terms, clauses and conditions as original and without prejudice to the generality of the foregoing, Reinsurers agree to follow all settlements (excluding without prejudice and ex-gratia payments) made by original Insurers arising out of and in connection with the original insurance and to bear their proportion of any expenses incurred whether legal or otherwise in the investigation and defence of any claim hereunder in addition to limits hereunder.

3. The defence to TMEI's claim that is the target of this summary judgment application is that ACE did not take all proper and business like steps in making the settlement with Tesco in accordance with Robert Goff LJ's well-known "2nd proviso" promulgated in *Insurance Company of Africa v Scor (UK) Reinsurance* [1985] 1 Lloyd's Rep 312 :

> In my judgment, the effect of a clause binding reinsurers to follow settlements of the insurers, is that the reinsurers agree to indemnify insurers in the event that they settle a claim by their assured, i.e., when they dispose, or bind themselves to dispose, of a claim, whether by reason of admission or compromise, provided that the claim so recognized by them falls within the risks covered by the policy of reinsurance as a matter of law, and provided also that in settling the claim the insurers have acted honestly and have taken all proper and businesslike steps in making the settlement... I do consider that the clause presupposes that reinsurers are entitled to rely not merely on the honesty, but also on the professionalism of insurers, and so is susceptible of an implication that the insurers must have acted both honestly and in a proper and businesslike manner. I do not, however, consider it possible to imply any stronger term, imposing a higher duty of care on insurers, on the basis proposed by Mr. Yorke [counsel for reinsurers].

4. TMEI submits that Novae's defence that ACE did not take all proper and business like steps in making the settlement with Tesco has no real prospect of success.

5. Novae also raised a number of other defences based on the true construction to be given to the retrocession. The issues thereby arising were determined as preliminary issues by Hamblen J who, in a judgment handed down on 6 November 2013, rejected Novae's construction and upheld that advanced by TMEI. Novae's appeal against Hamblen J's decision is due to be heard in October 2014. In the meantime, the parties have been progressing TMEI's claim on the assumed basis that the appeal will be dismissed. If Hamblen J's decision is upheld, the only remaining defence to TMEI's claim will be the defence challenged in the instant application. It follows that, if summary judgment is awarded, the dispute will be over, pending the outcome of Novae's appeal.

6. The relevant facts are not in dispute. Tesco's claim against ACE was in respect of damage to 212 premises in Thailand owned and operated by a Tesco subsidiary

company (5 distribution centres, 6 hypermarkets, 7 supermarkets, 152 Tesco Express stores and 41 stores in development). The damage occurred during widespread flooding of rivers and canals in Thailand in October and November 2011. Unusually heavy rains throughout the rainy season caused the Chao Phraya River and its tributaries in central Thailand to swell and burst its banks. The floodwater swept southwards from the north flooding over 20,000 km of farmland and causing an estimated US$50 billion of damage.

7. Tesco was insured under: (i) a global property damage (all risks) and business interruption Master Policy issued by ACE; and (ii) local policies issued by local ACE entities pursuant to the Master Policy in every jurisdiction in which Tesco had operations (other than the UK, China and India). The limit of cover under both the Master and local policies for property damage and business interruption combined was £100m "any one occurrence". The local policy relevant to these proceedings ("the Local Policy") was issued by ACE INA Overseas Insurance Company Limited ("ACE INA") and the relevant deductibles under this policy were £10,000 for Tesco Express stores any one occurrence, otherwise £100,000 any one occurrence.

8. "Occurrence" was not defined in the local policies but it was defined in the Master Policy as follows: "Occurrence shall mean any one Occurrence or any series of Occurrences consequent or attributable to one source or original cause".

9. The Master Policy also contained a 72 hour clause as follows:

> All loss, destruction or damage … caused by inundation from the sea or the rising, overflowing or breaking of boundaries of any lake, pond, reservoir, river, stream or other body of water … and occurring during a period of seventy two consecutive hours … shall be deemed to have been caused by a single Occurrence.

10. The Master Policy further provided for a range of deductibles and self-insured retentions[1] up to a maximum of £16.65 million in the annual aggregate in respect of all claims arising out of any one occurrence.

11. The Master Policy operated on a DIC/DIL basis to the Local Policy (Difference in Conditions/Difference in Limits). This meant that it was only to the extent that losses fell outside the Local Policy by reason of the scope of the Local Policy or because they were not within the limits of the Local Policy that they were covered by the Master Policy.

12. The Master Policy was governed by English law, the Local Policy by Thai law.

13. ACE was in turn reinsured as to 55% of its exposure under the Master Policy and the local policies by way of a reinsurance placed in the London market ("the Reinsurance"). TMEI took a 12.5% line on the Reinsurance and in respect thereof placed excess of loss reinsurance with Novae in respect of losses of £25m xs £53m (the retrocession).

[1] Tesco's captive insurance company, ELH, reinsured ACE Europe up to £2.5 million "each and every occurrence" in respect of both the Master Policy and the local policies.

14. Tesco claimed in the first instance £125,300,000. ACE and ACE INA appointed loss adjusters, VRS Vericlaim UK Ltd ("VRS") and, to assist in the adjustment of Tesco's business interruption claim, forensic accountants, RGL Forensics ("RGL"). ACE also appointed solicitors, Kennedys LLP, to advise on legal issues, including the interpretation of policy provisions.

15. VRS produced 4 reports dated 2 November 2011, 22 November 2011, 9 January 2012 and 18 May 2012. To begin with, ACE and its advisers took the view that there would be eleven policy deductibles in light of the 72 hour clause in the Master Policy. Tesco, on the other hand, supported by an opinion letter from Freshfields addressed to ACE, strongly contended that its losses arose from one "Occurrence" within the meaning of the Master Policy and thus attracted only one deductible of £100,000 under the Master Policy and only one self-insured retention of £2.5 million under ELH's reinsurance of ACE Europe.

16. Paragraphs 4.1 – 4.4 of Freshfields' letter read:

> The 72 hour clause essentially provides that all flood damage occurring within any 72 hour period shall be deemed to have been caused by one Occurrence. The damage to Tesco's Thai stores was incurred over a total of 32 days, encompassing eleven separate 72 hour periods. Application of the 72 hour clause therefore results in a series of eleven Occurrences.
>
> It is also necessary, however, to consider the effect of the aggregation wording, which is that any *"series of Occurrences"* falls to be aggregated into one Occurrence if that series is consequent upon or attributable to *"one source or original cause"*. As explained above, this language is generally regarded as providing aggregation in the widest possible range of circumstances. It is, in effect, a kind of "but for" formulation, which seeks to identify the factor underlying all of the flooding that took place.
>
> In our view, based on the facts as Tesco has explained them to us, there is a compelling argument that the "original cause" of all of the flooding that has affected the stores was the exceptionally heavy monsoon rain season in the north of Thailand. It is these waters that drained down the central region of the country and damaged Tesco's stores. This was an abnormal weather event and appears to be the original cause of all the flooding that has happened. Put another way, the abnormal monsoon rains can reasonably be characterised as the consistent and necessary factor which allowed all of the flooding to occur, and could be described as the cause of the entire problem.
>
> In the circumstances, and in particular given the breadth of interpretation afforded to Original Cause Clauses, we believe that it is likely that an English court or arbitral panel would decide that the relevant "source or original cause" of the

> flooding was the exceptional monsoon rain, such that the series of Occurrences determined by the 72 hour clause was consequent upon or attributable to that one particular source or original cause. This would result in the series of eleven Occurrences being aggregated into one Occurrence. Our view is that this would be the most appropriate application of the Policy wording in light of the facts as Tesco have explained them to us.

17. At a meeting on 14 February 2012 at Kennedys' offices attended by representatives of ACE, TMEI and other reinsurers, VRS and RGL, an offer from Tesco to settle its claim for £82.5 million with a single deductible of £2.5 million subject to a deadline of 16 February 2012 was discussed. Tesco's starting point in recent negotiations had been £90 million. Tesco wanted the claim paid by 23 February 2012 so that it could be included within its 2011/2012 financial year. Tesco had indicated that if the claim were not settled within its 2011/2012 financial year it would need to carry out a full stock audit and VRS considered that if this occurred the stock claim would be far higher than that submitted. VRS also considered that a realistic value of Tesco's claim was £113 million, but on a worst case the figures would exceed this significantly. Freshfields' letter was referred to on the question of the number of occurrences and ACE advised that Tesco were fully behind Freshfields' advice and would have no hesitation in litigating the issue. ACE wanted to accept Tesco's offer; it considered it was a once in a lifetime opportunity.

18. Following this meeting, ACE sent an undated letter to the reinsurers which canvassed the opposing arguments as to whether there were eleven occurrences and noted that the issue of the number of occurrences was worth £14.4 million. The letter continued:

> The discussion has focused upon the provisions of the Master Policy. If the matter were to become the subject of a protracted dispute it would be relevant to note that the Master Policy is only designed to respond on a DIC/DIL basis with the first port of call being a review of the local policy issued by ACE in Thailand. That shorter form wording contains neither a 72 hour clause nor an occurrence definition and whilst the focus has to date been upon terms of the Master Policy (see by way of example the Freshfields letter) it can be anticipated that if the matter becomes contentious then all avenues of enquiry will be pursued. Any dispute as to the interpretation of the local policy will call for determination in Thailand with Thai law applying.

19. ACE went on to refer to an attached document prepared by VRS in conjunction with RGL from which it could be seen that Tesco's claim could "very easily exceed £120 million" and there were very real reasons to believe that when finally adjusted the claim could significantly exceed £100 million. In ACE's view a settlement at the figure of £82.5 million with one deductible of £2.5 million was considered to be an excellent outcome.

20. The reinsurers informed ACE that they did not object to the proposed settlement. Attempts were made to obtain Novae's approval but on 15 February 2012, Novae's broker informed TMEI that in the absence from Novae's office of the individual who

had been handling the claim, any decision would have to await this individual's return to the office next week.

21. On 20 February 2012 a written settlement was entered into by, inter alios, Tesco and ACE and ACE INA by which ACE agreed to settle the loss claimed by Tesco for £82,400,00 (being the principal amount less one £100,000 deductible) with the captive's (EHL's) liability being £2,400,000. Approximately £58 million of the settlement amount was allocated to the Local Policy and £24.4 million allocated to the Master Policy. All the reinsurers have paid up in accordance with the terms of the Reinsurance.

22. VRS's final report is dated 18 May 2012. This is a highly detailed document. It recorded: (a) in paragraph 11.4.149 that: (i) at the outset the claim was £125,300,000 which after negotiation was reduced to £113,600,000; (ii) VRS had projected a gross settlement in the order of £90/100 million; and (b) in mid-February an opportunity to conclude a settlement before the end of Tesco's financial year at the end of February was explored resulting in the gross settlement figure of £82.5 million which represented "a very good and fair settlement for all Parties."

Novae's case that ACE did not take all proper and business like steps in making the settlement

23. Novae's primary submission is that ACE had no business adjusting and then settling Tesco's claims under the Master Policy and the Local Policy without considering the coverage position not only under the Master Policy but also under the Local Policy. In support of this submission, Novae's counsel, Mr Picken QC, cited paragraph C-0052 of Merkin and Butler's *Reinsurance Law* and paragraph 17-019 of *Colinvaux's Law of Insurance* (9th Edition) which are to the effect that the reinsured must consider the wording of the direct policy under which liability arises and determine on a reasonable interpretation of the policy the scope of cover for the assured's claim - and this may require the taking of legal advice from local lawyers if the policy involves a foreign risk. The reinsured must also determine the facts in order to apply the wording of the relevant policies to them, and to assess the quantum of the loss, and must assess the defences available to it and take any defences which are likely to succeed.

24. Mr Picken also relied on the evidence of Mr Damian Cleary, an insurance solicitor of 18 years' experience, who deposes in his first witness statement that it is his view and that of a number of claims personnel and loss adjusters he has consulted that: (a) it is fundamental that an insurer needs to satisfy himself not only as to the factual basis of a claim but also as to the existence and extent of the cover under the relevant policy; (b) depending on whether there is any disagreement between the parties as to the meaning and application of the particular terms of the relevant policy, and depending also on the complexity of the issue, the insurer may have to engage an expert in the law applicable to the policy which is what ACE should have done in the instant case in respect of the Local Policy; (c) it was improper and unbusinesslike for ACE to allocate and pay out losses under the Local Policy in circumstances where those losses had been adjusted under the terms of the Master Policy; (d) ACE should have satisfied itself that the losses allocated to and paid out under the Master Policy were covered under the terms of that policy, and that the losses allocated to and paid out under the Local Policy were covered under the terms of that policy.

25. Mr Picken boldly submitted that, given it is effectively admitted that ACE did not investigate whether the losses were covered by the Local Policy, and if so, to what extent, it is inconceivable that the court could conclude that Novae's defence was not fit for trial.

26. Novae also submitted that it was unbusinesslike for ACE to have failed to have properly analysed and investigated: (i) the definition of "*Occurrence*" in the Master Policy, including by obtaining English law advice; (ii) the different causes of the flooding and heavy rainfall in Thailand in 2011 and (iii) whether the Tesco losses could be attributed to different sources or original causes such as different tropical storms or other causes such as mismanagement of dams or failure of flood defences. Thus, ACE ought to have: (i) procured meteorological and/or hydrological and/or other reports relating to the weather patterns responsible for the flooding in Thailand in Autumn 2011; (ii) investigated, including by commissioning appropriate reports, whether any part of the Tesco losses could have been attributable to or consequent upon a different cause than heavy rainfall such as mismanagement of dams or other causes such as inadequate flood defences and/or drainage systems; and (iii) raised as a defence to Freshfields' letter the fact that the heavy rainfall could not legitimately be relied upon as a cause of the flooding in Thailand when that rainfall was itself caused by a number of different factors.

27. Mr Picken argued that it was no answer to Novae's case that Novae had not shown that the Tesco settlement would have been better for reinsurers if the steps it submits ought to have been taken had been taken. The focus had to be on the conduct of ACE in entering into the settlement with Tesco, not the reasonableness of the settlement. In establishing a failure to act in a business like manner, there was no causation requirement. The reinsurer is to be regarded as having placed his trust in or relied on the reinsured and if it turns out that that trust was abused or the reliance was misplaced, that was enough to disentitle the reinsured to rely on the follow settlements clause rather than having to prove a claim under the reinsurance contract. To impose a causation requirement would place too great a burden on the reinsurer and would significantly reduce the protection afforded by the "second proviso".

28. In argument, Mr Midwinter suggested that even if advice on Thai law had been completely in favour of ACE, the deductibles for each occurrence (each of the 212 premises) would have been £7.53 million (152 x £10,000 = £1.53 million + 60 x £100,000 = £6 million) which would still render a settlement at £82.5 million of a claim of £113 million an excellent settlement. Mr Picken's reply to this argument was that for each occurrence under the Local Policy, the reinsurance provided by ELH would kick in to the tune of £2.5 million per occurrence. He also argued that the claim ought not to be taken as being for £113 million, but as being for between £90-100 million, this being VRS's value of the claim at the time the settlement was concluded.

29. Mr Midwinter for TMEI submitted that: (i) an allegation that a reinsured did not act in a proper and business like manner in settling a claim is tantamount to an allegation of professional negligence, as to which the reinsurer has the burden of proof; (ii) the purpose of the 2nd proviso is to protect reinsurers against prejudicial settlements; (iii) if the bottom line is that the final settlement figure was a good one, it cannot be said that there was anything improper or unbusinesslike in not taking points that would not have affected that bottom line; alternatively (iv) where there was no further

investigation into a point because it would not have an effect on the bottom line, it cannot be said that that would be improper or unbusinesslike.

30. Mr Midwinter further submitted that it was manifestly not improper or unbusinesslike for ACE, in the knowledge that the deductibles point under the Master Policy was worth about £14 million, to take advantage of Tesco's wish to achieve a settlement that would impact its results for 2011/2012 and to agree to settle at the net figure of £80 million against the background of VRS's projected final adjusted figure of £90 million to £100 million, without: (a) contesting in court Freshfields' opinion on the definition of "Occurrence"; and (b) taking up time to investigate possible deductibles under the Local Policy with the assistance of advice from Thai lawyers.

31. In Mr Midwinter's submission, even if the opinion of Thai lawyers had been sought on the meaning and effect of the Local Policy, it would have been very unlikely indeed that the ensuing advice would have been that there was a high probability of it being held there were 212 occurrences producing a total deductible of £7.53 million. Further, by dividing the loss under the Local Policy into numerous occurrences, the limit of cover available under that policy would be increased which could be to ACE's disadvantage. In addition, even if ACE had had a strong argument for deductibles totalling £7.53 million under the Local Policy leading to a self-insured retention of about £14 million, it would still have been proper and businesslike to settle a claim that was projected to be finally adjusted at between £90 million to £100 million for £80 million net.

32. I accept Mr Midwinter's submissions. In my view, notwithstanding that ACE did not further investigate the coverage afforded by the Local Policy, including the scope for deductibles, and did not delve more deeply into the question whether the high rain fall was the sole source or original cause of Tesco's loss before concluding the settlement, Novae's defence that ACE, in failing to take these steps, failed to act properly or in a businesslike manner has no prospect of success. Given: (i) Tesco's offer to settle for £80 million net on 14 February 2012; and (ii) VRS's projected final figure for the adjusted loss of between £90 million and £100 million, ACE were clearly, in my opinion, entitled to conclude (as the evidence shows they did) that there was nothing additional to be gained by further investigation into coverage under the Local Policy or by disputing Freshfields' opinion on the meaning and effect of the definition of "Occurrence".

33. Nor is there in my judgment some other compelling reason why the issue raised by the defence should be disposed of at trial rather than summarily. The facts and the documents are relatively few. The steps taken by ACE and VRS in dealing with Tesco's claims and the reasons why the settlement with Tesco was concluded are all clearly evidenced by VRS's reports, the note of the meeting on 14 February 2012 and ACE's undated letter. It is unlikely that further evidence is going to emerge about how ACE settled the claim or, if it does, that it will take the dispute further forward to any material extent.

34. The settlement at £80 million net was undoubtedly a good settlement. Assuming that Novae's appeal to the Court of Appeal fails, there is no good reason why the ordinary presumption that Novae as the reinsurer will follow the settlement of ACE as the reinsured should not apply.