JUDGMENT : Mr. Justice Cresswell : 1st December 2005.

The appeal

1. This is an appeal by Reinsurers as claimants (following permission granted on 8 November 2005) under section 69 of the Arbitration Act 1996 from the Partial Award on Preliminary Issue made on 6 April 2005 ("the Award") by Mr Kenneth Rokison QC, Mr Richard Outhwaite and Mr T Richard Kennedy (made on the relevant issues by a majority, Mr Kenneth Rokison QC dissenting) on the following questions of law:
   (1) By reference to which substantive law is AZICL's liability to Garst to be determined?
   (2) By reference to which substantive law is the Reinsurers' liability to AZICL under the Reinsurance Contract to be determined?
   (3) In relation to the latter, what is the effect of the "follow the fortunes" provision in Article 12?

2. By agreement a challenge by Reinsurers under section 68 of the 1996 Act (alleged serious irregularity) was stayed pending judgment in relation to the appeal.

Introduction

3. The claim the subject-matter of the arbitration arises under a number of Policies of Reinsurance written by the claimants, whereby they agreed to reinsure the defendant, AstraZeneca Insurance Company Limited ("AZICL"), in respect of its liabilities under an Excess Liability Policy issued to AstraZeneca Plc on behalf of itself and its worldwide subsidiaries. The Policy issued by each of the Reinsurers was in identical terms.

4. The parties agreed that the Tribunal should hear and determine a preliminary issue concerning the law to be applied to the question whether or not there was a loss under the underlying Excess Liability Policy in respect of which AZICL was entitled to be indemnified.

The Background to the Underlying Insurance and the Reinsurance

5. AstraZeneca Plc, a UK Corporation, is one of the largest bioscience corporations in the world. It is engaged in the development, manufacture and distribution of pharmaceutical, agrochemical and other chemical specialist products. It has a large number of subsidiaries worldwide, most of which are wholly-owned, but some of which are owned on a 50/50 basis with Royal Vanden Have Group through a jointly owned company, Advanta BV. A number of AstraZeneca's subsidiaries are located in the United States, including Garst Seed Company ("Garst"), a company incorporated in Delaware with its headquarters and principal place of business in Iowa.

6. In 1997, AstraZeneca decided to restructure the worldwide property damage, business interruption and liability insurance of the group through the defendant its wholly-owned *"**captive**"* AZICL, which is also a UK corporation. To that end, the broker, Sedgwick, prepared a folder, entitled *"Zeneca 1997 Property and Liability Underwriting Presentation"*.

7. The introductory page of the underwriting presentation stated*: "Zeneca is seeking to restructure its key insurance programmes of property damage/business interruption and general liability this year (1997). The most significant change is the proposal to put these covers onto a three-year, combined aggregate basis."* Below they said: "*The additional benefits of this approach are to:*
   1. enhance the consistency of coverage, particularly in the liability programme . . .
   2. establish long-term contractual relationships with a number of important insurance markets who we believe not only provide the level of security requisite for a company of Z's stature but also will be in tune with the Group's risk management philosophy
   3. through the establishment of partnerships, promote enhanced working relationships that go beyond the normal round of annual renewal negotiations
   4. put in place an insurance programme that more effectively matches Z's risk profile."

8. Sedgwick approached RSA and CGU as potential leading underwriters. Terms were agreed, and Sedgwick produced a slip in mid-September. This was headed: "*Type of Reinsurance: First Loss Quota Share*" and under *"Interest":*
   "Section 1: Material Damage and Business Interruption, and
   Section 2: General Liability
   All as defined in the respective master and underlying Local Policies, and for 100% of that proportion of the liability imported into the Zeneca worldwide programmes as agreed between the Reinsured and the leading Reinsurer."

The territorial scope was *"Worldwide."*

9. The slip contained a "***Follow the Fortunes***" wording, but the title was crossed out by the leader who substituted "***Assistance and Co-operation***". The relevant part of the wording read: *"The Reinsurer agrees to follow in all respects the fortunes of the Reinsured. Reinsurers hereunder will, however, have the right to and shall be given the opportunity to associate with the Reinsured in the defence and control of any claim, suit or proceedings relative to any loss where the claim or suit involves or appears relatively likely to involve Reinsurers hereunder."*

This right is then limited to CGU and RSA as leading underwriters.

10. The underwriting programme presented to the Reinsurers provided for a three-year policy covering five classes, and so far as property damage, business interruption and general liability were concerned, the first £10 million each loss was to be retained, subject to a £40 million annual cross-class aggregate deductible covering all five classes. Above £10 million, cover was to be provided by the captive, subject to a first excess reinsurance layer.

The policies reinsured included an Excess Liability Policy.

The Excess Liability Policy

11. The Excess Liability Policy No. L/702939 ("the ELP") issued by AZICL and reinsured by the claimants was in substantially the same terms as the Master Policy, except for the layer covered. The named insured was Zeneca Group Plc (subsequently amended to AstraZeneca Plc), but the insured was defined to include the Named Insured, any subsidiary or owned or controlled company of the Named Insured, or any Joint Venture in which any Insured had an interest, but only if the Insured had sole responsibility for the Joint Venture, or the Insured was obligated or otherwise agreed to provide insurance such as afforded by the Policy to the Joint Venture in its entirety.

12. Condition D, under the heading "COMPOSITE POLICY", provided as follows: *"It is agreed that this Policy is composite in nature by which is meant that all entities designated as insureds hereunder are each insured severally in respect of their separate interests."*

As respects Garst, the effect of this provision was to cause the separate interests of Garst to be insured severally from those of other AstraZeneca subsidiaries.

13. Condition J, headed *"**SEVERABILITY OF INTEREST**"*, provided that the insurer would indemnify *"each party comprising the insured [including Garst] in the same manner and to the same extent as if a separate policy had been issued to each . . . ."*

14. Cover was provided in respect of liability to pay *"damages on account of (a) Personal Injuries [and] (b) Property Damage …".*

15. The Excess Liability Policy, like the Master Policy, contained a *"USA Service of Suit"* clause which provided as follows: *"**USA SERVICE OF SUIT.** As respects Insureds operating in the United States of America, its territories or possessions, the Company agrees that:*
In the event of the failure of the Company to pay any amount claimed to be due hereunder, the Company, at the request of the Insured, will submit to the jurisdiction of a Court of competent jurisdiction within the United States. Nothing in this Clause constitutes or should be understood to constitute a waiver of the Company's right to commence an action in any Court of competent Jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another Court as permitted by the laws of the United States or of any state in the United States.
Service of process in such suit may be made upon the person(s) or firm named in item 10 of the Declarations [Messrs Mendes & Mount of New York City] and that in any suit instituted against them upon this Policy, the Company will abide by the final decision of such Court or of any appellate Court in the event of an appeal."

16. Neither the Master Policy nor the Excess Liability Policy contained an express choice of law clause.

The Reinsurance Policy

17. Following the scratching of a slip on behalf of the Reinsurers in September 1997, policy wordings were prepared approximately one year later. The cover was described in the wording as *"**QUOTA SHARE EXCESS OF LOSS AND EXCESS OF AGGREGATE REINSURANCE AGREEMENT….**"*

18. It provided for a limit of £75 million each occurrence (subject to an aggregate limit of £150 million) in excess of a deductible of £10 million each occurrence. The deductible was itself subject to a £40 million annual aggregate limit to be eroded by AZICL's retention under each of the heads of the global programme.

19. The terms of the wording included the following:
"Article 1 BUSINESS COVERED
Under the terms of Article 2 the REINSURER agrees to reimburse the REINSURED on an excess of loss and excess of aggregate basis. This Agreement to reimburse the REINSURED is limited to the REINSURED's participation on the interest hereunder, being [there was then a reference to the Excess Liability Policy] all as defined in the original policies and for 100% of that proportion of the liability imported into the world-wide programme of Zeneca Group Plc . . .

Article 2 CESSION
The REINSURED shall reinsure by way of Quota Share Excess of Loss and Excess of Aggregate Reinsurance 100% of the business specified in Article 1 . . .

Article 7 LIABILITY OF THE REINSURER
The liability of the REINSURER shall commence and expire simultaneously with that of the REINSURED. The CESSIONS hereunder are subject to all the conditions of the original policies or any amendments thereto . . .".

Article 9 contained the details of the Reinsured's net retention.

20. Article 12 provided: *"ASSISTANCE AND CO-OPERATION*
(a) The REINSURER agrees to follow in all respects the fortunes of the REINSURER.
(b) The REINSURER will, however, have the right and shall be given the opportunity to associate with the REINSURED in the defence and control of any claim, suit or proceedings relative to any loss where a claim or suit involves or appears likely to involve the REINSURER . . .".

Article 19 provided that the Reinsurance should be interpreted and governed by the laws of England, and Article 20 provided for disputes to be resolved by Arbitration in London.

Factual Background to the Claim

21. In November 1997, Garst obtained a licence to produce and distribute a genetically-modified cornseed called "Starlink", and from August 1998 the United States Department of Agriculture permitted the use of Starlink for purposes which did not include human consumption.

22. In September 2000, there were reports that certain human feed products had tested positive for the protein which Starlink produced. Thereafter, a large number of claims were advanced against Garst by farmers, food manufacturers, food processors, consumers, exporters, grain elevator manufacturers and transport operators. The claims are summarised in the Points of Claim in the arbitration.

23. Claims totalling about $2 billion were made against Garst, and between November 2001 and January 2003 Garst settled a number of claims and sought an indemnity from AZICL in the sum of approximately $80 million, which AZICL settled in the full principal sum claimed, but with no payment in respect of interest.

24. AZICL had notified the Reinsurers during the Policy Period that an occurrence had taken place in relation to Starlink. AZICL alleged that Reinsurers were kept informed throughout about the Starlink claims, Garst's settlement of those claims, and Garst's claim for indemnity against AZICL. The Reinsurers on the hearing of the Preliminary Issue did not dispute this allegation. Nor did the Reinsurers offer any evidence indicating that they chose to exercise their right under Article 12 of the Reinsurance Policy to associate with AZICL in the defence and control of any of the underlying claims or proceedings.

25. AZICL sought to be indemnified by Reinsurers, who declined to pay the full amount claimed. AZICL therefore commenced arbitration proceedings.

The Arbitral Proceedings

26. AZICL served its notice of arbitration on 8 April 2004, appointing Mr N David Thompson as its arbitrator. That nomination was subsequently replaced by the nomination of Mr T Richard Kennedy of New York City as AZICL's party-appointed arbitrator. The Reinsurers appointed Mr Richard H M Outhwaite as their party-appointed arbitrator.

27. The parties thereafter agreed that Mr Kenneth Rokison QC should be appointed as third arbitrator and chairman.

28. Points of Claim were served on behalf of AZICL on 30 April 2004, in which it was contended that, had AZICL declined Garst's claim, Garst would have commenced proceedings against AZICL in Iowa, that the State Court in Iowa, applying Iowa's *"most significant relationship"* approach to choice of law, would have applied Iowa law to determine the scope of coverage under the Primary and Excess Policies, and that the State Court in Iowa, applying Iowa law, would have held that all the amounts claimed by Garst were recoverable as sums which Garst had been obliged to pay for *"damages on account of Personal Injuries and/or Property Damage*" within the meaning of the Primary and Excess Policies.

29. Points of Defence were served on behalf of Reinsurers on 14 May 2004, limited to a Preliminary Issue as to the law applicable to the ELP underlying the Reinsurance. Reinsurers contended that the question of loss under the ELP should be determined by English law which, upon a proper application of the English rules of conflicts of laws to be applied by an arbitral tribunal sitting in London, was subject to English substantive law.

30. Points of Reply were served on 3 June 2004, in which it was conceded on behalf of AZICL that the arbitral tribunal, sitting in London, is bound to apply English conflict of law rules as the law of the forum to determine the original proper law of the Primary and Excess Policies, and that, applying English conflict of law rules, the original proper law of the Primary and Excess Policies is English law. However, it was denied that the fact that the arbitral tribunal may conclude that English law was the original proper law of the Primary and Excess Policies is determinative of the law to be applied to determine the meaning and scope of the Primary and Excess Policies as between AZICL and Garst for the purposes of the determination of the extent to which AZICL was liable to Garst and/or whether AZICL reasonably settled Garst's claims.

The Preliminary Issue

31. It was agreed between the parties that this question of applicable law should be determined as a preliminary issue, and the hearing of that issue took place before the Tribunal in London on 15, 16 and 17 November 2004.

32. In the course of the hearing, evidence of fact was given by Mr Robert Simms, formerly general counsel of Garst, and expert evidence was given on United States and Iowa law by Professor Weintraub and Mr Thomas Newman.

AZICL's Case :

AZICL's case before the Tribunal was as follows.

33. For the purposes of considering AZICL's right to recover against Reinsurers under the Reinsurance Policy, the Tribunal must apply Iowa law to the question of whether or not there was a loss under the underlying Excess Liability Policy in the amount settled, and that AZICL should be entitled to be indemnified under the Reinsurance Policy in respect of its consequent liability to Garst.

Reinsurers' Case

34. Reinsurers' case before the Tribunal was as follows.

35. An arbitral tribunal sitting in London should apply English conflicts of laws principles, and it was common ground applying those principles, the underlying ELP was subject to English law. In these circumstances, even if an Iowa Court would have concluded, in proceedings by Garst against AZICL under the underlying policy that Iowa law governed, this was irrelevant.

36. Even if there were a loss under the ELP in the amount claimed, AZICL had to clear a second hurdle, and must establish a corresponding liability under the terms of the Reinsurance Policy, which incorporated the terms of the underlying insurance, but which was itself expressly subject to English law. Whilst this second point was strictly not within the scope of the preliminary issue originally proposed, both parties agreed that it was an issue which the Tribunal should determine at this stage.

The Tribunal's unanimous holding

37. The Tribunal held unanimously as follows.

(1) Absent settlement of its claim, Garst would have exercised its right under the US service-of-suit clause in the underlying ELP, and would have commenced proceedings in Iowa, where it had its headquarters and principal place of business.

(2) There would have been a right for AZICL to have applied to have the case transferred to a US District Court or another US State Court of competent jurisdiction, but the Tribunal doubted whether that right would have been exercised.

(3) The possibility of an Iowa Court choosing to apply English law in the circumstances of this case to a hypothetical coverage dispute between Garst and AZICL was remote in the extreme.

(4) If the Iowa Court had concluded that the issue between the parties ought, in accordance with Iowa conflicts rules, to be determined by reference to Iowa law, it was inconceivable that it would nonetheless have stayed the Iowa proceedings in favour of proceedings in England.

Common ground

The Tribunal recorded the following.

38. It was common ground that the "original" proper law of the ELP issued to AstraZeneca was English law.

39. It was common ground that the terms and conditions of the underlying ELP were incorporated into the Reinsurance Agreement.

The majority holding : The majority of the Tribunal held as follows.

(1) Their task as arbitrators was to ascertain the common intention of the parties to the ELP and to give effect to that intent. The common intention of the parties was to be ascertained by reference to the contractual documentation and the surrounding circumstances.

(2) The primary concern of both the insured, Garst, and its insurer, AZICL, was liability that might arise from Garst's activities in the US. Towards this end, it was agreed that the ELP was to be considered a "separate policy" (Condition J) which "insured severally" Garst's "separate interests" (Condition D). In the event of the insurer's failure to pay a claim made by the insured, the Policy required AZICL to submit to the jurisdiction of any US court of competent jurisdiction. Under these circumstances the parties to the ELP contemplated at the time the contract was made that the extent of the coverage afforded to Garst under the Policy would be determined according to US law.

(3) It was not the presumed intention of the parties that the ELP would be subject to the laws of Iowa from its inception.

(4) AZICL and Garst properly could, and did, provide at the time of creating the Policy that questions regarding the extent of policy coverage for a US insured would be determined by US law.

(5) They were looking not at what the parties intended to be the proper law as to the whole of the ELP (conceded to be the law of England) but at only what law the parties contemplated should apply in respect of the insurer having failed to pay a claim made by a US insured under the Policy.

(6) The policy wordings and commercial circumstances left the majority in no doubt that the parties intended US law to apply to that part of the Policy under review.

(7) The common intention of the parties to the reinsurance agreement must again be ascertained by reference to the contractual documentation between them as understood, if necessary, by the surrounding circumstances.

(8) The decision of the House of Lords in Vesta v Butcher embodies the principles exactly in point in the present case, i.e. where the terms and conditions of the underlying policy are incorporated into the reinsurance agreement, then the wording of the policy which determines the extent of the insurer's obligation to the insured, must be construed to have the same meaning in the reinsurance agreement in the absence of any express declaration in the reinsurance agreement to the contrary.

(9) It was open to the Reinsurers to have insisted on inclusion of a separate clause in the ELP requiring that the validity of a claim asserted in a US jurisdiction could be determined only under English law.

(10) The intent of the underlying coverage was also evident to the Reinsurers in the very nature of the reinsurance transaction. Reinsurers providing 100-percent reinsurance of a captive reinsured have need to be significantly more involved in the terms of the underlying coverage than is the case in traditional quota share reinsurance.

(11) Reinsurers' business experience and common sense should have made them appreciate that claims by a US insured, such as Garst, would be determined in accordance with US law.

(12) The evidence overwhelmingly points to an intent of the parties at the time the Reinsurance Agreement was made that AZICL's US liabilities under the terms of the ELP would be matched by liability of the Reinsurers. That was the cover sought by the Reinsured and the cover agreed to be provided by the Reinsurers.

(13) The Reinsurers agreed in Article 12 "to follow in all respects the fortunes" of the reinsured. Such a provision makes little sense if the Reinsurers can avoid liability under English law where the Reinsured is expressly subject to policy liability under the law of a US jurisdiction.

(14) The parties to the Reinsurance Agreement were aware and contemplated at the time of making the Agreement that where a claim was brought in the States by an insured who was entitled, and likely, to invoke the Service of Suit clause (with the result that the claim would be determined by the law of the US jurisdiction where the claim was brought) the claim so determined or otherwise properly settled would be passed down the reinsurance chain to Reinsurers.

(15) In accordance with the clear intention of the parties at the time the contract was made, Iowa law is to be applied to the question of whether or not there was a loss under the terms and conditions of the ELP. That intent was incorporated by the parties to the Reinsurance Agreement.

(16) For the above reasons the law to be applied to the issue of whether or not there was a loss under the underlying ELP, and for the purposes of establishing consequent liability on the part of the Reinsurers to indemnify AZICL under the Reinsurance Policy, is the law of the State of Iowa.

Mr Rokison QC's dissenting opinion

40. In his dissenting opinion Mr Rokison said that three issues are to be determined:

1. By *reference to which substantive law is AZICL's liability to Garst to be determined?*
2. *By reference to which substantive law is the Reinsurers' liability to AZICL under the Reinsurance Contract to be determined?*
3. *In relation to the latter, what is the effect of the "follow the fortunes" provision in Article 12?*

41. Mr Rokison QC held as follows.

(1) Even if, in accordance with Condition D and Condition J of the underlying ELP, the contract between AZICL and Garst were to be regarded as a separate policy, with Garst's interests separately insured, the option given to Garst under the USA Service of Suit clause not having been exercised, this gives no indication that it was the presumed intention of the parties to that contract that it should be subject to the laws of Iowa from its inception.

(2) It was common ground between the parties to this arbitration that in accordance with English conflicts of laws principles, which an English tribunal is prima facie required to apply, the underlying ELP should properly be regarded as governed by English law. The fact that Garst would have brought proceedings against AZICL in Iowa and that an Iowa Court would have determined AZICL's liability under the ELP by reference to Iowa law is not sufficient ground to conclude that the question of AZICL's liability to Garst should be determined by Iowa law.

(3) The majority make it clear that they do not seek to go behind the concession that the "original" proper law of the ELP was that of England. Their decision seems to be based either on the ground that in circumstances where the relevant insured was a US corporation, part of the Policy was to be governed by Iowa Law (or US Law), or that, in these circumstances, at some point in time the governing law was to change.

(4) If the former is the rationale, then that runs contrary to the concession; if the latter, the question arises – at what time does the law change in a case where the relevant insured has not even invoked the USA Service of Suit clause? Is a threat to sue in Iowa sufficient? If so, it would appear that the Insurers could be properly advised, by an English lawyer, on one day that he was not liable, but that, if the relevant insured threatened proceedings in Iowa the following day, he would or may become liable. Such a conclusion is impracticable, to say the least. It cannot reflect the presumed intention of the parties.

(5) In order to recover under a reinsurance contract, the reinsured must establish not only that he was liable to the original insured under the terms of the underlying insurance contract, but also that he is entitled to recover under the terms of the reinsurance contract.

(6) Even if it were right, in accordance with the conclusion of the majority, that, for the purposes of determining that there was a loss under the underlying policy, the Tribunal should look at the law which would have been applied by the Iowa Court had Garst's claim not been settled, but had been litigated against AZICL in Iowa, the question remains - which law should be applied in order to determine whether or not Reinsurers are liable under the Reinsurance Policy in respect of such loss?

(7) Even if one were to conclude that there was a loss under the underlying policy, because AZICL would have been held liable by an Iowa Court applying Iowa law, the English authorities make it clear that this is not enough, and that it is always open to the reinsurers to take the point that they are not liable to indemnify the reinsured because the loss is not within the terms of the reinsurance.

(8) In this case, the Tribunal is not concerned with construing or applying any purported limitation on the Reinsurers' liability. The issue concerns the scope of the risk, and in particular the meaning to be attributed to the phrase "Property Damage" which would, apparently, be wider under Iowa law than under English law.

(9) It is perhaps dangerous to seek to ascertain the intention of the parties by reference to assumptions as to their subjective beliefs or understandings at the time the contract was made. The task of a tribunal is to ascertain and apply the parties' presumed intentions from the terms of their contract properly construed albeit in the context of the commercial background.

(10) AZICL was not an "arm's length" insurer of Garst and the other AstraZeneca companies, but was the group "captive". AZICL did not have any retention, but reinsured 100% of its risk. The real commercial bargain was to be found in the Reinsurance under which Reinsurers, a number of leading companies in the London market, effectively insured AstraZeneca (an English corporation with worldwide subsidiaries) through its English captive in London for a negotiated premium under a contract expressly made subject to English law.

(11) It was not suggested that the Reinsurance contract was "severable" in the sense that Reinsurers should be regarded as having reinsured AZICL separately in relation to each and every AstraZeneca company. To conclude that Reinsurers' liability to AZICL under the Reinsurance in relation to such matters as the scope of cover and in particular what constituted "Property Damage" would vary, depending on (i) the identity of the insured AstraZeneca company making the original claim, (ii) the court in which such claim would have been pursued if not settled, (iii) the law which that court would have applied, and (iv) how the term "Property Damage" would have been construed in accordance with that law, would not be "back to back" so much as "back to front".

(12) Even if (contrary to the above) for the purposes of considering Reinsurers' liability under the Reinsurance, AZICL's liability to Garst should properly be determined by reference to Iowa law, nevertheless Reinsurers should only be held liable under the Reinsurance to the extent to which the loss in respect of which AZICL had indemnified Garst and for which it sought indemnity against Reinsurers, arose from "Property Damage" as properly construed under English law, being the express governing law of the Reinsurance contract, both under Article 19: "This agreement shall be interpreted as governed by the laws of England", and under Article 20, the Arbitration Clause: "The seat of the arbitration shall be in London and the arbitral tribunal shall apply the laws of England as the proper law of this agreement."

(13) The first and second question should be answered English law.

(14) AZICL did not contend that, if it failed on its principal argument based on the notional application of Iowa law by an Iowa court, the "follow the fortunes" clause would have been sufficient, on its own, to establish liability in this case. In particular, AZICL did not suggest that it had the same effect as a "follow the settlements" clause, the incorporation of which in the case of the reinsurance of a "captive" insurer of the original insured would (as the majority decision acknowledges) be surprising.

(15) In these circumstances, it is not necessary for the Tribunal to attempt to define the scope and effect of the "follow the fortunes" clause. In its context, in an article dealing with "Assistance and Cooperation", and with the qualification in Article 12(b): "The REINSURER will, however, have the right and shall be given the opportunity to associate with the REINSURED in the defence and control of any claim, suit or proceedings relative to any loss where a claim or suit involves or appears likely to involve the REINSURER…", its meaning and effect, if any, would go no further than to provide that the Reinsurer would be bound by any judgment obtained by the original insured against the Reinsured but would only be bound by a settlement if and to the extent to which the settlement had been the consequence of its own intervention.. But that would not avail AZICL in the present case. To go

further would, in effect, be applying the "follow the fortunes" provision as if it were a "follow the settlements" clause, which it is common ground it is not.

The appeal

Reinsurers' submissions

Mr Christopher Butcher QC for the claimants submitted as follows.

42. The ELP covers liabilities for (among others) "damages on account of … Property Damage".

43. AZICL has settled with one of its insureds, Garst, on the basis that there was full cover for Garst's liabilities under the rubric of "damages on account of … Property Damage", if the ELP were to be construed in accordance with Iowa law. The working assumption underpinning the preliminary issue is that there is no such cover, or significantly more limited cover, for Garst's liabilities under that insuring language, when the ELP is construed in accordance with English law.

44. AZICL was never sued by Garst, and there has been no judgment in this case establishing any liability of AZICL to Garst (under any system of law).

45. Applying English conflicts rules, the ELP is conceded to be governed, in its entirety, by English law. English law regards it as implausible that parties could have intended a global liability policy to be "scissored up" so that different proper laws should apply to different sections, to different insureds or in different circumstances (**American Motorists Insurance v Cellstar** [2003] EWCA Civ 206 at [20]-[21], [2003] Lloyd's Rep IR 295 at 305; **Travelers v Sun Life** [2004] EWHC 1704 (Comm) at [46]-[47]; [2004] Lloyd's Rep IR 846 at 857); and AZICL does not contend otherwise

46. The Reinsurance contains an express choice of English governing law, and of London arbitration.

47. The arbitrators appointed under that arbitration clause were therefore bound to apply the conflicts rules of their forum (i.e. English conflicts rules) when determining the scope of the cover provided by the ELP (and the Reinsurance).

48. There is no "follow the settlements" provision in the Reinsurance.

49. AZICL nevertheless contends that because it would have been found fully liable to Garst in Iowa, if it had been sued there (which it was not), the Reinsurance must respond fully to the amount of its settlement with Garst arrived at on the basis of how the ELP would have been interpreted by an Iowa court: i.e. it and the ELP must be construed as providing cover in accordance with how their insuring clauses would have been understood by an Iowa court, applying its own conflicts rules.

50. This is unorthodox. The orthodox approach is to identify the applicable proper law of a policy/ reinsurance, in accordance with the conflicts rules of the tribunal/forum considering the matter (here England), and then to interpret the contracts' insuring and coverage clauses in accordance with that proper law: see **King v Brandywine** [2004] EWHC 1033 (Comm) paras [32]-[34] ([2004] Lloyd's Rep IR 554 at pp. 564 to 565); [2005] EWCA Civ 235 at [35]-[36] ([2005] 1 Lloyd's Rep 655 at pp. 664).

51. AZICL's suggestion, that this approach was only followed in King because there was no evidence that conflicts rules in Texas (where Exxon had sued) differed from English conflicts rules, is unconvincing:
    (1) There was no suggestion in King that the Texas conflicts rules were considered relevant at all (with or without evidence of how they differed from English rules).
    (2) It is implausible that the Texas conflicts rules did not differ from the English rules: see the Second Restatement rules, set out in paragraph 11.5 of the Reasons of the majority arbitrators.
    (3) By the time of the settlement which led to the dispute in King, there had been a judgment of the Texas court on coverage under Part IIIA of the policy in issue in that case, which must have determined what Texas conflicts rules identified as the applicable proper law (English/ New York/ Texas or other). It is inconceivable that one party or other in King would not have relied on that Texas decision in support of their respective cases on applicable law (English law or New York law), had either of them considered the Texas conflicts rules to be conceivably relevant.

52. AZICL's case also overlooks the nature of a reinsurance as a matter of English law. Reinsurance is not liability insurance. The fact that AZICL might have been found liable to Garst in Iowa does not answer the question of whether there is cover under the Reinsurance.

(1) A reinsurance is an insurance on the same subject-matter as the original insurance (e.g. ship, factory, potential liabilities of AstraZeneca group), issued to an insurer, whose insurable interest in that original subject-matter derives from his potential obligation to indemnify the original insured against the risks covered by the direct insurance.

(2) It is not an insurance of the insurers'/ reinsured's potential liabilities under the direct insurance.

(3) A reinsurance is, nevertheless, a contract of indemnity: so, in order to make good a claim on the reinsurance, the insurer/ reinsured must show a loss or damage to his insured interest in the original subject-matter, suffered by him by reason of his undertaking to indemnify the original insured against the insured risks. The reinsured's loss will be *measured* by his actual and ascertained obligation to indemnify the original insured, because this shows the extent of the damnification of his insurable interest. But his liability to the original insured is not what is insured: it is the original subject-matter which is (re)insured on the terms of the direct insurance.

See **Delver v Barnes** (1807) 1 Taunt 48, **British Dominions v Duder** [1915] 2 KB 394 at 400 (Buckley LJ), **Forsikringsaktieselskabet of Copenhagen v. Attorney General** (1924) 19 Ll. L.R 32 at 34 (Scrutton LJ), 35 (Atkin LJ); [1925] AC 639 at 642 (Lord Cave); **Toomey v Eagle Star Insurance Company Limited** [1994] 1 Lloyd's Rep. 516 at 522rhc-524lhc (Hobhouse LJ); **Charter Re v Fagan** [1997] AC 313 at p. 392E (Lord Hoffmann).

53. A reinsurance is, in effect, a separate insurance on the same subject-matter and against the same risks as insured by the underlying direct insurance. (There may, of course, be additional terms in the reinsurance.) The scope of cover afforded by that separate insurance must be understood by reference to some system of law: a contract cannot exist in a vacuum: **Armar Shipping v Caisse Algerienne** [1981] 1 WLR 207 at 214-215 (Megaw LJ); **Amin Rasheed v Kuwait Insurance** [1984] AC 50 at 60, 65 (Lord Diplock). The scope of the cover afforded by the separate insurance (including any incorporated terms) must be capable of being understood and defined at the outset.

54. Where the reinsurance actually incorporates the terms of the underlying, the above position is all the clearer. In a case such as the present the coverage terms of the underlying insurance are treated as incorporated in a contract which is expressly governed by English law. That incorporation took place at the outset, and the coverage terms bore, from the outset, the meaning attached to them by English law.

55. In the event of a claim on a reinsurance the reinsured must prove (i) that "*the loss falls within the cover of the policy reinsured and within the cover created by the reinsurance*" (**Hill v Mercantile** [1996] 1 WLR 1239 at 1251) and (ii) that he himself has sustained an ascertained loss to his insured interest. In relation to the first of these matters, the ambit of each cover is to be determined in accordance with the proper law of the relevant contract.

56. **Re London County Commercial Reinsurance Office** [1922] 2 Ch. 67 does not say anything different. In that case, no consideration was being given to a case in which different laws might govern the insurance and reinsurance. (See the explanation of the dictum of P. O. Lawrence J, at p. 80, given by Hobhouse LJ in Toomey at 523lhc).

57. Here there is no provision in the ELP or in the Reinsurance which could displace these basic principles, or explain how reinsurers could be liable to indemnify AZICL in circumstances where:

(1) There was (it is to be assumed) no or limited cover for Garst under the terms of the ELP; and

(2) Any such loss as has been suffered by AZICL is not within the scope of the cover given by the Reinsurance, given that Garst's liability was not within the cover given by the ELP, nor within the terms of the Reinsurance (which incorporated the terms of the ELP)

when those contracts are interpreted in accordance with their respective proper laws (both English law).

58. Because there was no judgment of any foreign court, **CU v NRG** [1998] 2 Lloyd's Rep 600 is irrelevant. Neither that case, nor **Vesta v Butcher** [1989] AC 852, decides that cover (whether under an underlying insurance or any reinsurance) must extend so far as a foreign court might say that it extends.

59. **Vesta v Butcher** was a case in which what was decided was that a particular clause, incorporated from an underlying insurance which was governed (according to English conflicts principles) by Norwegian law, was to be construed, as incorporated in an English law reinsurance, by reference to its Norwegian law

meaning. This is the meaning it had from the outset and throughout. That is a very different position from the present, in that (1) the ELP is and always has been governed by English law – the present case involves the incorporation of an English law contract into an English law contract; (2) it cannot be said that any term of the Reinsurance is to be read as having, say, an Iowa law meaning, given that Iowa law was of no relevance until, well after the issue of the insurance, there was a claim made in Iowa. If (say) Iowa law was relevant, then so would Argentinian, Australian, Austrian and all the other laws which might conceivably have been relevant depending on where an AstraZeneca subsidiary was sued, and which law was then applied.

AZICL's submissions

Mr Alistair Schaff QC for AZICL submitted as follows.

60. The arbitration (and this appeal) concern a dispute as to the extent to which AZICL is entitled to recover from Reinsurers subscribing to the Reinsurance amounts which AZICL has paid by way of its settlement with Garst.

61. The arbitrators have found (unanimously) that:
    i) if the claim for indemnity by Garst against AZICL had not been settled, Garst would have (imminently) invoked the US Service of Suit clause and sued AZICL in Iowa;
    ii) the Iowa Court, properly applying its own conflict of laws rules in accordance with the Restatement, would have determined that the governing law of the ELP as between Garst and AZICL was Iowa law and would have accordingly applied Iowa law to determine the scope of coverage afforded to Garst under the ELP.

62. The assumption that underpins the determination of the preliminary issue is that there is likely to be a very significant difference between substantive Iowa law (or US law) and English law as to the scope of coverage under the ELP, English law taking a narrower view of what constitutes "***damages on account of Property Damage***" than Iowa law for these purposes. The assumption is that if AZICL is right as to the legal relevance of Iowa law, it will be entitled to recover the US$80 million (which it has paid to Garst) from Reinsurers, or at least a substantially greater proportion thereof than that which has been acknowledged by Reinsurers as due on a proper application of English law to the same question.

63. Accordingly, what lies at the heart of the preliminary issue is the legal relevance of substantive Iowa law to AZICL's claim to be indemnified under the Reinsurance in respect of its alleged liabilities to Garst which were the subject of the settlement.

64. The submissions of the parties before the arbitrators as to the relevance of Iowa law to AZICL's claim for indemnity under the Reinsurance came to be sub-divided into two sub-limbs of the same-overarching question. AZICL accepts that the two limbs formulated by Mr. Rokison QC adequately cover the matter, namely:

    "(1) By reference to which substantive law is AZICL's liability to Garst to be determined?
    (2) By reference to which substantive law is the Reinsurers' liability to AZICL under the Reinsurance contract to be determined?"

    provided that it is understood that (i) both questions were directed towards identifying whether Iowa law had any substantive legal relevance, not merely an English conflict of law relevance, to AZICL's claim for indemnity; and (ii) the first question was concerned with the substantive law applicable to determining AZICL's liability to Garst under the ELP, not in the abstract, but in the context of assessing the validity of AZICL's claim under the Reinsurance.

65. Both questions are questions of substantive reinsurance law. They both raise questions as to the proper construction of this English law reinsurance.
    i) Question 1 is concerned with the first limb of Lord Mustill's first rule in Hill v Mercantile ("loss falling within the cover of the policy reinsured [the ELP]") – what does it mean in the present context and what does AZICL, as reassured, have to prove in order to establish that it has suffered an insured loss for the purposes of its claim under the Reinsurance?
    ii) Question 2 is concerned with the second limb of Lord Mustill's first rule in Hill v Mercantile ("losses falling within the cover created by the reinsurance [the Reinsurance]") – what does it mean in the present context and what is the meaning and effect of Articles 1,2,7 and 12 of the Reinsurance?

66. The questions of construction have to be resolved in the context of the factual matrix in which the ELP and Reinsurance were concluded. The majority arbitrators acknowledged that and they made important findings of fact. These are binding for the purposes of the determination of an appeal under section 69. Crucially:
    i) AZICL was insuring under the ELP the liabilities of AstraZeneca plc and its various associated companies world-wide.
    ii) Specifically in relation to associated companies operating in the USA (representing in the order of 45% of the group turnover), AZICL was doing so on terms which permitted those companies to sue AZICL in the US and which required AZICL to abide by the decision of a competent US court.

67. Reinsurers saw and approved the terms of the ELP and were aware of these facts. "They appreciated a very high likelihood that a US insured would sue AZICL in the US. And their business experience and common sense would have made them appreciate that claims by a US insured, such as Garst, would be determined in accordance with US law."

68. The common intention was that the ELP and the Reinsurance should be back-to-back in the sense that "AZICL's US liabilities under the terms of the ELP would be matched by liability of the Reinsurers" and thus that AZICL, as a captive insurer, should not bear any part of the risk.

The first question

69. So far as the first issue is concerned, the starting point is to understand what is meant by Lord Mustill's requirement that the loss falls within the cover of the ELP.

70. Even if, analytically, there can be said to be a difference between:
    i) whether the loss falls within the subject-matter insured under the ELP; and
    ii) whether AZICL has suffered a (necessarily ascertained) loss arising out of the damnification of its insurable interest under the ELP,
    it is difficult to see how there can be damnification of its insurable interest under the ELP, without there being a loss falling within the subject-matter insured under the ELP. Moreover, how can the two questions be determined by a different applicable law?

71. AZICL does not confuse reinsurance with liability insurance. AZICL accepts that a contract of reinsurance is an independent contract, the subject matter of which is the same as the subject matter of the underlying insurance, and the reassured having an insurable interest therein by virtue of his liability under and by reason of his original policy. However, it is conceptually difficult, if not impossible to see how an insurer/reassured who is liable to its insured under the insurance and who therefore suffers damnification to its insurable interest, has not proved that the loss falls within the scope of what is, after all, a policy of liability insurance. The loss suffered must be to his insurable interest: no other loss suffered by the reassured is relevant. How can a liability to the insured under the policy (i) arise from a loss which is outside the scope of the insurance cover but (ii) give rise to a loss to the insurer/reassured's insurable interest under the insurance cover? No case establishes that such a distinction is possible.

    It is for precisely that reason that the language of 'liability' is frequently found in statements of principle of the highest authority.

    The reason why the distinction between *'original subject matter'* and liability insurance is drawn is for a completely different reason, namely to ensure that an honest and conscientious (but mistaken) belief by the insurer that a claim falls within the policy does not transfer into the reinsurance, risks beyond those which the insurer and thus the reinsurer have accepted: **Hill v Mercantile** at 1253. Mere payment in respect of a potential (but not actual) liability is not enough: Charter Re at 385, 387, 392. The decision in Toomey is consistent with that explanation.

72. The proper approach to proof of these matters is set out in the judgment of P O Lawrence in **Re London County Commercial** (1922) 2 Ch 67 at 80. *"It is well settled that (subject to any provision to the contrary in the reinsurance policy) the reassured, in order to recover from their underwriters, must prove the loss in the same manner as the original assured must have proved it against them, and the reinsurers can raise all defences which were open to the reassured against the original assured."*

73. That analysis is derived from an earlier decision in **China Traders Insurance Company Ltd v Royal Exchange Assurance Corporation** [1898] 2 QB 187 at 190-191 (A.L.Smith LJ) and 192 (Chitty LJ) where it was made plain that *"the reinsurer when sued by the underwriter had precisely the same defences as the underwriter had in an action against him by the original assured"* and *"all defences that the [insurer] could have raised in an action by the assured are open to the [reinsurer]."*

74. The historic nature of the enquiry is obvious from those authorities. The question must be determined by reference to the law of the place where action was brought or would have been brought.

75. In the context of the present case, what is required is to consider how Garst "***must have***" proved its loss against AZICL and what defences "***were open***" to AZICL against Garst. Both of these questions point to the relevance of Iowa law. Garst did not have to prove its claim against AZICL by reference to an English law definition of ***'property damage'***; nor could AZICL have successfully defended the claim by reference to an English law definition of 'property damage' in the place where the action would have been brought.

76. It is right that there is no case, one way or the other, which applies this principle in the context of a claim to be determined in one jurisdiction by one applicable law, in circumstances where the policy would be construed by a different applicable law by English conflict rules. However,
i) The P.O. Lawrence J analysis would suggest the correct answer is as AZICL contends.
ii) AZICL's analysis gives effect to, rather than undermines, the commercial expectations of the parties that there should be back to back coverage.
iii) Reinsurers' analysis gives rise to the real difficulty of what effect a foreign judgment has. The logic of Reinsurers' position is that a foreign judgment applying Iowa law would not only not be determinative of the outcome in England, between AZICL and Reinsurers, but it would be utterly irrelevant. If an exclusively Iowa law liability of AZICL under the ELP is to be treated as falling outside the scope of the ELP, an Iowa judgment cannot make it fall within the scope of the ELP.
iv) Any such distinction between the effect of a foreign judgment and the effect of a settlement of a foreign claim gives rise to major difficulties of mitigation of loss (See the Reasons of the majority arbitrators at paragraph 12.44). It would be unlikely that an insurer could ever safely settle a foreign claim.

77. In summary, the scope of cover under the terms of the ELP, on day 1, was not liability for damages on account of property damage as determined by English law. It was rather liability for damages on account of property damage, as determined by the law of the contractually agreed forum where the claim would have been brought and determined.

78. That this might vary according to the location of the US insured and (theoretically) according to the location of non-US insureds (although there was no comparable Service of Suit clause providing for submission to [say] Argentine jurisdiction and for [say] Argentine judgments to be binding) was a necessary corollary of the reinsurance of a worldwide programme, where claims were liable to arise in different jurisdictions under different laws.

79. It should be stressed again that the argument based on P.O Lawrence J's judgment is a substantive English law reinsurance argument, not a conflict of laws argument. It entails reference to Iowa and Iowa law because it is in that forum and by reference to that law that Garst would have had to prove the loss against AZICL and that likely eventuality would have been appreciated from day 1.

80. This approach is strongly supported by the decision of, and the philosophy which underlines the decision of, the Court of Appeal in **Commercial Union v NRG** [1998] 2 Lloyd's Rep 600 in its analysis of the effect of a foreign judgment and/or of a settlement made short of judgment but on the basis of an actual foreign law liability.

81. The point did not arise in King v Brandywine, in the light of the common ground and the evidence adduced in that case.

The second question

82. So far as the second issue is concerned, this too involves a question of interpretation of the Reinsurance. The Reinsurance has to be interpreted according to English law, which is admittedly (and expressly) its governing law. It must also be interpreted by reference to the factual matrix summarised above and set out more extensively in the Reasons of the majority arbitrators.

83. The Reinsurance does not contain any express terms qualifying the cover, but incorporates and provides cover on the same terms as the ELP. The parties' mutual intention, as found by the arbitrators, that the ELP and the Reinsurance should be back-to-back, dictates that those terms should be given the same effect in the Reinsurance as they had in the ELP, and for the reasons set out above, and as a matter of construction, this requires reference to Iowa law.

84. The 'follow the fortunes' clause is relevant in this context, as the arbitrators found.
   i) The majority, applying their commercial experience to a clause which, as Saville J said in **Hayter v Nelson** [1990] 2 Lloyd's Rep. 265, was a matter for market rather than judicial construction, considered that the clause made little sense if Reinsurers could avoid liability under English law.
   ii) Even the dissent acknowledged that this clause might bind Reinsurers to follow an Iowa judgment. If it binds them to follow an Iowa judgment, why is Iowa law irrelevant if the case is (reasonably) settled prior to judgment?

85. It is no answer to say that there should have been a *'follow the settlements'* clause. Firstly, as the arbitrators held, it was for Reinsurers to stipulate for their (commercially unrealistic) interpretation of the bargain, not for AZICL to stipulate for what the parties intended to achieve in any event. Secondly, neither a **Hill v Mercantile** type clause, nor a Scor type clause would have avoided Reinsurers' analysis, if it be otherwise right. In the first example, Reinsurers could still argue that the claim fell outside the terms and conditions of the (English law) ELP; in the second example, Reinsurers could still argue that the claim fell outside the terms and conditions of the (English law) Reinsurance.

86. Once again, the reference to Iowa law is not the result of some English conflict of law principles but arises as a matter of substantive English reinsurance law. This principle of reinsurance law is, nonetheless, recognised in Dicey & Morris, volume 2, paragraph 33-201, citing **Vesta v Butcher**.

87. Reference to Iowa law (or whatever US law would have been applied to determine the question of AZICL's liability to other US insureds) is permissible because, as a matter of construction of an English law Reinsurance, the parties intended the Reinsurance to be back to back with AZICL's position under the ELP. The scope of the ELP and thus of the Reinsurance was to respond to such liabilities of US assureds as would be determined by the law as would be applied in the relevant courts of the US, to whose jurisdiction AZICL had submitted.

88. Vesta v Butcher is House of Lords authority for the proposition that such an approach is permissible to give effect to the parties' intentions.

89. This interpretation is entirely consistent with what the arbitrators viewed as commercial common-sense; indeed they found (paragraph 12.49 of the Reasons of the majority arbitrators) that were the position to be as Reinsurers contended, the reinsurance programme would have been unmerchantable ("there would have been no reinsurance contract").

ANALYSIS AND CONCLUSIONS

The reasons why the parties agreed that the question of applicable law should be determined by the Tribunal as a preliminary issue

90. According to Mr Schaff QC's skeleton argument: - *"At an early stage, it became apparent that there was a potentially very significant issue which divided AZICL and Reinsurers as to whether any liability of Garst to the various third party claimants was a liability for "damages on account of … Property Damage" within the meaning of the ELP.*

In that context, it became apparent that there was likely to be a very significant difference between substantive Iowa law (or US law) and English law, English law taking a narrower view of what constitutes "damages on account of … Property Damage" than Iowa law for these purposes.

Accordingly, the assumption which underpinned the determination of a preliminary issue in this case was that there is such a difference, and that if AZICL is right as to the legal relevance of Iowa law, it will be entitled to recover the US$80 million which it has paid to Garst from Reinsurers, or at least a substantially greater proportion thereof than that which has been acknowledged by Reinsurers as due on a proper application of English law to the same question."

91. Mr Rokison QC summarised the issue as follows: - *"The issue … concerns the scope of the risk, and in particular the meaning to be attributed to the phrase "Property Damage" which would, apparently, be wider under Iowa law than under English law."*

Some General Principles : It is convenient at this point in the judgment to set out the following general principles of law.

92. Reinsurance is prima facie a contract of indemnity, under which the reinsurer indemnifies the reinsured against the whole or against a specified amount or proportion of the risk which the reinsured has insured. (**Vesta v Butcher** [1989] AC 852, 908F, Lord Lowry).

93. It is not correct to equate reinsurance with liability insurance. Liability insurance is a species of original insurance whereby an assured insures the risk of it becoming liable to others. A reinsurance contract is, properly defined, something different. By a contract of reinsurance the reinsurer insures the reinsured against the original loss, the insurable interest of the reinsured being constituted by its policy given to the original assured. (**Toomey v Eagle Star Reinsurance Co Ltd** [1994] 1 Lloyd's Rep 516, Hobhouse LJ at 522 where he cited **Forsikringsakteieselskabet National of Copenhagen v Attorney General** [1925] A.C. 639 at p. 642, Viscount Cave, L.C).

    Reinsurance is the insurance of an insurable interest in the subject matter of an original insurance and the principles of subrogation apply. (Toomey supra at 523).

94. A contract of reinsurance is not an insurance of the primary insurer's potential liability. It is an independent contract between reinsured and reinsurer in which the subject matter of the insurance is the same as that of the primary insurance, being the risk insured. The difference lies in the nature of the insurable interest, which in the case of the reinsured, arises from his liability under the original policy. (Lord Hoffmann in **Charter Reinsurance Co Ltd v Fagan** [1997] AC 313, 392E).

95. A reinsurer is not liable to pay the reinsured until the amount of the reinsured's liability has been ascertained by judgment, award or settlement. (**Versicherungs und Transport A/G. Daugava v Henderson** (1934) 49 LI L Rep 252 at 254 Scrutton LJ).

96. The fact that the reinsured has paid under the policy reinsured does not enable the reinsured to substantiate its claims against the reinsurer. Subject to any provision to the contrary in the reinsurance policy the reinsured, in order to recover from the reinsurer, must prove the loss in the same manner as the original insured must have proved it against the reinsured, and the reinsurer can raise all defences which were open to the reinsured against the original assured. (Mr Justice P. O. Lawrence in **Re London County Commercial Re-Insurance Office Ltd**. (1992) 10 LI.L.Rep. 370 at p. 371).

97. Where a reinsured seeks to recover under a policy of reinsurance, the reinsurer cannot be held liable unless the loss falls within the cover of the policy reinsured and within the cover created by the reinsurance. (Lord Mustill in **Hill v Mercantile and General Reinsurance Co plc** [1996] 1 WLR 1239, 1251).

98. The effect of a clause binding reinsurers to follow settlements of the reinsured is that the reinsurer agrees to indemnify the reinsured in the event that the reinsured settles any claim by their assured, i.e., when the reinsured disposes, or binds itself to dispose, of a claim, whether by reason of admission or compromise, provided (i) that the claim as so recognised falls within the risks covered by the policy of reinsurance as a matter of law and (ii) that in settling the claim the reinsured has acted honestly and has taken all proper and businesslike steps in reaching the settlement. (Robert Goff LJ in **Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd** [1985] 1 Lloyd's Rep. at p. 330).

Some particular features of this case

99. It is important to note the following particular features of this case: -
    (1) The concessions made by AZICL before the Tribunal (see below);
    (2) No proceedings were commenced by Garst in Iowa (or anywhere else);
    (3) The ELP did not contain a follow settlements clause;
    (4) This is not a case where the ELP and the Reinsurance Contract had different governing laws;
    (5) This is not a case where the Service of Suit clause in the ELP made any express provision as to the law to be applied in the event of a suit taking place in the United States.

The number of entities insured under the ELP and the number of countries in which they operate

100. Additional insureds and subsidiary and associated undertakings insured under the ELP amount to about 222. They operate in about 55 countries (treating the United States as one country).

Concessions made by AZICL before the Tribunal

101. AZICL conceded before the Tribunal: -

i) applying English conflict rules (which the Tribunal had to apply) the proper/governing law of the ELP "was, is and always will be" English law. (Transcript Day 3, page 11).

ii) the Service of Suit clause did not affect the proper law of the contract (applying English conflict rules). (Transcript Day 3, page 11).

iii) "… each insured has a separate insurance policy. Under English conflict of law rules … it does not matter that it is a separate insurance policy … the whole bundle of policies is governed by English law because English law would not … strip them out". (Transcript Day 3, page 188).

[In footnote 36 to his skeleton argument Mr Schaff said "English law, binding short of the House of Lords, regards as anathema the idea that [a] group policy such as that obtained by AstraZeneca plc could be "scissored up" so as to be impliedly governed by different applicable laws with regard to different co-assureds: see, for example, **American Motorists v Cellstar**. US law is much more susceptible to the idea that in a composite group policy, the notionally separate policies issued to each co-assured may be governed by a different applicable law: Reasons paragraphs 11.3 and 11.4"].

102. In **American Motorists Insurance Co v Cellstar Corporation** [2003] EWCA Civ. 206 at [21], [2003] Lloyd's IR 295 at 305 Mance LJ said: - *"I have no doubt that the present composite policy would fall to be regarded as a single, probably multi-partite, contract. Neither the parties nor the Rome Convention could sensibly be taken to have intended to scissor up the policy negotiated and issued in Houston and to subject different aspects of it to different governing laws. The potential problems arising on such an approach do not need emphasis. I will only instance the problems that would arise if different countries had different principles or remedies governing non-disclosure or breach of warranty".*

103. In **Travelers Casualty and Surety Co of Europe Ltd v Sun Life Assurance Co of Canada (UK) Ltd** [2004] EWHC 1704 (Comm) at [46]-[47], [2004] Lloyd's IR 846 at 857 Jonathan Hirst QC sitting as a Deputy High Court Judge said: - *"In **American Motorists Insurance Co v. Cellstar Corporation** … paras. 14-43 Mance L.J. reviewed the applicability of these schemes in considerable detail. He decided (para. 21) that the policy in that case was a single, probably multi-partite, contract and that neither the parties nor the Rome Convention could sensibly be taken to have intended to "scissor up" the policy and to subject different aspects of it to different governing laws. For the purpose of applying Schedule 3A, the policy holder in that case was the parent company which took out the policy, with the subsidiary companies being insureds.*

In this case the position is the same. The Policy was taken out by Sun Life Canada for itself and its subsidiaries. It is a composite multi-partite policy with a single undivided premium payable. It is inconceivable that the parties intended that the Policy should be "scissored up" so as to provide for a different governing law for different insureds or risks. The risk is a large risk for the purposes of Schedule 3A."

The scope of the Applicable Law

104. It is important to recognise the effect of the concessions made to the Tribunal.

105. Dicey & Morris The Conflict of Laws 13th edn states: -

"Rule 178(1) The law applicable to a contract by virtue of Rules 173 and 174 governs in particular

(a) interpretation;

(b) performance;

(c) within the limits of the powers conferred on the court by its procedural law, the consequences of breach, including the assessment of damages in so far as it is governed by rules of law;

(d) the various ways of extinguishing obligations, and prescription and limitation of actions.

(2) In relation to the manner of performance and the steps to be taken in the event of defective performance regard is to be had to the law of the country in which performance takes place."

106. The commentary states: -

"32-188 Interpretation. That a contract must be construed in accordance with its governing law is almost self-evident. The aim of the court, when called upon to interpret a contract, is to discover the intention of the parties. Accordingly, the governing law determines what terms or trade usages are to be implied into the contract and what meaning is to be attributed to technical, legal or commercial terms.

32-189 Where an expression is ambiguous, which of the possible meanings was intended by the parties is ascertained in accordance with the canons of construction which form part of the governing law. If the governing law ascribes a particular meaning to particular words, the parties are bound by that meaning. … The governing law will have to decide how far trade usages must be deemed to be incorporated in the contract for the purposes of its construction, how far words used in a contract must be interpreted in the light of negotiations which preceded or accompanied or followed the conclusion of the contract, how far the correspondence between the parties may be used in order to ascertain the meaning they attached to the words used in the instrument, etc."

107. A problem may arise where the underlying insurance and the reinsurance have different governing laws. Dicey & Morris para 33-201 states: - *"A problem of considerable practical significance may arise in a situation where the original insurance contract and the reinsurance contract have, or are held to have, different governing laws. The reinsurance contract may provide that cover is to be provided on the same terms and conditions as those of the original contract of insurance so that clear commercial purpose is to provide cover corresponding to that contained in the original contract. Difficulty arises, however, if such a result is not provided for under the relevant governing laws, as, for example, where the law governing the original insurance would not regard a breach of warranty as rendering the contract null and void but the law applicable to the reinsurance would regard the breach of warranty as having this effect. In* ***Forsikringsaktieselskapet Vesta v Butcher*** *[1989] AC 852 the original insurance policy was governed by Norwegian law according to which the breach of warranty which had occurred did not render the policy null and void because the breach did not contribute to the loss suffered by the insured. According to English law, which governed the reinsurance policy, the breach of warranty, whether relevant to the loss or not, rendered the reinsurance policy null and void. Accordingly, though it was admitted that the original insurers were liable to the insured under the original policy, it was argued that because the reinsurance policy was void the reinsurers were not liable to indemnify the reinsured against the liability it had incurred. The trial judge, Hobhouse J, held that although the reinsurance contract was governed, as a whole, by English law, the relevant clauses giving rise to the alleged breach of warranty were intended by the parties to be governed by Norwegian law. Thus the effects of common clauses in each policy were harmonised. The Court of Appeal and the House of Lords took rather a narrower view, treating the question as involving the construction or interpretation of a reinsurance contract governed by English law. As a matter of the English law of construction, it was necessary to resort to the Norwegian law governing the original insurance so that the same meaning could be given to terms common to the policies. The narrower view supports the proposition that the construction of a reinsurance policy is governed by the law applicable to that policy and that, accordingly, the extent to which harmony can be achieved in the coverage of each policy will be a matter for the rules of construction which prevail in that law."*

In the present case the ELP and the Reinsurance Contract have the same governing law. In my opinion the approach adopted in **Vesta v Butcher** has no application in the present case.

Mr Schaff QC's central submission

I draw attention to the width of Mr Schaff"s central submission which was as follows.

108. The scope of cover under the terms of the ELP, on day 1, was not liability for damages on account of property damage as determined by English law. It was rather liability for damages on account of property damage, as determined by the law of the contractually agreed forum where the claim would have been brought and determined.

That this might vary according to the location of the US insured and (theoretically) according to the location of non-US insureds (although there was no comparable Service of Suit clause providing for submission to [say] Argentine jurisdiction and for [say] Argentine judgments to be binding) was a necessary corollary of the reinsurance of a worldwide programme, where claims were liable to arise in different jurisdictions under different laws.

109. Mr Schaff's central submission (as amplified in argument) was as follows.
(A) Whenever a claim was made against AZICL by an insured

i) in any foreign court of competent jurisdiction;
ii) whose conflict of law rules led to the application of the substantive law of that country or state; and
iii) AZICL was held liable in an action brought in that country or state,

OR

(B) Whenever AZICL reasonably settled a claim which would have been brought against AZICL by an insured
i) in any foreign court of competent jurisdiction;
ii) whose conflict of law rules would have led to the application of the substantive law of that country or state,
in both cases ((A) and (B) above) "insofar as the local law had [been] applied to determine AZICL's liability [or would have been applied but for a reasonable settlement], … then Reinsurers would not be entitled to rely on an English law consequence which had a different effect." "… Any issue that arose as between the insured and AZICL in the foreign court [or would have arisen between the insured and AZICL in the foreign court but for a reasonable settlement] is to be governed by the law of that court."

110. I emphasise that the present case is concerned with a settlement and that no proceedings were commenced by Garst in Iowa (or anywhere else).

I turn to consider the 3 questions of law.

By reference to which substantive law is AZICL's liability to Garst to be determined?

111. In context the question concerns the scope of the risk/cover, and in particular the meaning to be attributed to the phrase "*Property Damage"* which would, apparently, be wider under Iowa law than under English law.

112. "*The rights and obligations of contracting parties crystallise when a contract is made by reference to an existing proper law. Contracts cannot exist in a legal vacuum*". Bingham LJ in **E.I. Du Pont de Nemours & Co and Endo Laboratories Inc v I.C Agnew** [1987] 2 Lloyd's Rep 585.

113. AZICL conceded before the Tribunal that applying English conflict rules the proper/governing law of the ELP "was, is and always will be*" English law and that "the whole bundle of policies is governed by English law because English law would not … strip them out".*

114. Given these concessions (which appear to me to have been correctly made) the words "damages on account of … Property Damage" must (see Dicey & Morris Rule 178 above) be construed in accordance with the governing law of the ELP – English law.

115. The majority's conclusion that "the parties to the [ELP] contemplated at the time the contract was made that the extent of coverage afforded to Garst under the Policy would be determined according to US law" (Award paragraph 12.17), was a departure from the concessions.

116. It is for the Tribunal to determine what the words "*damages on account of … Property Damage*" mean in the context of the ELP applying English rules of construction of commercial contracts. These rules are set out at Chitty on Contracts vol 1 29th edn paragraphs 12 – 041 and following. Mr Butcher accepted "As a matter of principle obviously the document has to be construed in accordance with the relevant matrix, as a matter of English law". It is for the Tribunal (not me) to construe the words "*damages on account of … Property Damage"* applying English rules of construction having regard to the whole of the ELP and the relevant commercial background.

117. If (as I hold) Mr Rokison QC's answer to issue 1 is correct, an answer to the question what do the words *"damages on account of Property Damage*" mean, will be arrived at by the Tribunal applying English rules of construction having regard to the whole of the ELP and the relevant commercial background. Such an approach will provide commercial certainty in accordance with English conflict rules, which the Tribunal was bound to apply.

118. If AZICL's answer to issue 1 were correct there would be commercial uncertainty.

119. I agree with Mr Rokison that the majority decision seems to be founded either on the basis that in circumstances where the relevant insured was a US corporation, part of the Policy was to be governed by Iowa Law (or US Law), or that, in the circumstances, at some point in time the governing law was to change. If the former is the rationale, then that runs contrary to the concession; if the latter, the question

arises – at what time does the law change in a case where the relevant insured has not even invoked the USA Service of Suit clause?

120. For completeness I add that I consider that the above analysis is consistent with the statement by Potter LJ in **Commercial Union v NRG Victory Reinsurance** at 611 LHC: - *"it was for the judge to form his own view of whether or not an arguable defence had been shown by the reinsurers that the plaintiffs were not liable to Exxon under section 1 of the GCE policy according to the applicable law and rules of construction."*

121. Again for completeness I add that I consider the above analysis is consistent with the approach adopted by Colman J and the Court of Appeal in King v Brandywine supra. Colman J and the Court of Appeal considered what was the proper law of the contract of insurance, applying English conflict rules.

122. Two passages from the judgment of Waller LJ in King v Brandywine should in addition be noted. *"If the judge is right the case demonstrates the perils of settling under primary insurance when the reinsurance is not subject to a full follow the settlements clause.*" (Paragraph 1)

and *"… can it really be true that the terms of an insurance contract placed in the London market could have a different meaning depending on whether it is being construed by a court in England under English law or a court in New York under New York law? We would not have expected the approach to construction to be so different in the two places and we would have expected that authorities persuasive in one court would also be persuasive in the other. We would expect both to reach the same conclusion about the intentions of the parties to be ascertained from the written document."* (Paragraph 34).

(2) By reference to which substantive law is the Reinsurers' liability to AZICL under the Reinsurance Contract to be determined?

123. The Reinsurance Contract contains an express choice of English governing law, and provision for London arbitration.

124. The arbitrators appointed under the arbitration clause were therefore bound to apply the conflicts rules of their forum (i.e. English conflicts rules) when determining the scope of the cover provided by the ELP and the Reinsurance.

125. I emphasise that there is no "*follow the settlements*" provision in the Reinsurance. (As to the effect of such a clause see para [98] above).

126. The following general principles apply. A reinsurer is not liable to pay the reinsured until the amount of the reinsured's liability has been ascertained by judgment, award or settlement. The fact that the reinsured has paid under the policy reinsured does not enable the reinsured to substantiate its claims against the reinsurer. Subject to any provision to the contrary in the reinsurance policy the reinsured, in order to recover from the reinsurer, must prove the loss in the same manner as the original insured must have proved it against the reinsured, and the reinsurer can raise all defences which were open to the reinsured against the original assured. Where a reinsured seeks to recover under a policy of reinsurance, the reinsurer cannot be held liable unless the loss falls within the cover of the policy reinsured and within the cover created by the reinsurance. Where the reinsurance incorporates the terms of the underlying, the coverage terms of the underlying insurance are treated as incorporated in a contract which is expressly governed by English law. That incorporation took place at the outset, and the coverage terms bore, from the outset, the meaning attached to them applying English rules of construction.

127. In my opinion the answer to question (2) is the same as and consistent with the answer to question (1) – English law.

128. I agree with Mr Rokison that to conclude that in the present case (which, I again emphasise, is concerned with a settlement where no proceedings were commenced) Reinsurers' liability to AZICL under the Reinsurance in relation to the scope of cover and in particular what constituted "Property Damage" would vary, depending on (i) the identity of the insured AstraZeneca company making the original claim, (ii) the court in which such claim would have been pursued if not settled, (iii) the law which that court would have applied, and (iv) how the term "Property Damage" would have been construed in accordance with that law, would not be "back to back" so much as "back to front." Such a conclusion would be contrary to English conflicts rules and would involve a commercially uncertain and unworkable answer.

(3) In relation to question (2) above, what is the effect of the "follow the fortunes" provision in Article 12?

129. Before the Tribunal AZICL did not contend that, if it failed on its principal argument based on the notional application of Iowa law by an Iowa court, the "follow the fortunes" clause would have been sufficient, on its own, to establish liability in this case. In particular, AZICL did not suggest that the "follow the fortunes" clause had the same effect as a "follow the settlements" clause.

130. A similar position was adopted on the hearing of the appeal. The "follow the fortunes" clause in Article 12 of the Reinsurance Policy does not in the circumstances of this case cause me to alter the answers to questions (1) and (2).

131. There was no judgment in Iowa or anywhere else. This appeal is not concerned with the effect of the "follow the fortunes" clause. It is concerned with a claim by AZICL to recover following a settlement, where no proceedings were commenced, in the absence of a "follow the settlements" clause.

Conclusion

132. I allow the appeal and answer questions (1) and (2) English law.

Christopher Butcher QC and Stephen Kenny (instructed by Lovells) for the Claimants
Alistair Schaff QC and David Edwards (instructed by Mayer, Brown, Rowe and Maw LLP) for the Defendant