CARTER PERRY BAILEY'S GUIDE TO

"Back to Back"

The unanimous decision of the House of Lords in *Lexington v AGF and WASA*, in which Carter Perry Bailey LLP acted for AGF, the successful appellant, has changed the ground-rules of "back to back" reinsurance. It is therefore timely to review the law as it now stands.

Many reinsurance contracts contain "Follow the Settlements" or similar wording. However, this generally only applies if the losses are covered by the reinsurance in the first place. *Lexington v AGF* looked at what losses were covered by the reinsurance, hence whether the underlying settlement had to be followed. In these circumstances, the extent to which "as original" provisions incorporate the terms and effect of the underlying, may also be key.

1. "Back to Back" contracts

1.1. Where by express terms the risk presented to reinsurers is materially different from that assumed by the reinsured, there is no presumption of back to back cover (*Gan Insurance & another v Tai Ping*).

1.2. In *Vesta v Butcher & others*; *Groupama v Catatumbo* there was held to be a presumption that facultative reinsurance cover is back to back with the original insurance. However, this is not an inviolable rule of law and must be considered subject to the decision in *Lexington v AGF* (see below).

1.3. Even where a reinsurance contact provides that its terms and conditions are to be the same as those of an insurance contract, and its clear commercial purpose is to provide corresponding cover to that provided by the insurance contract, a contract of insurance will inevitably contain terms wholly inappropriate to a contact of reinsurance. The two contracts deal with different subject matter. Insurance deals with the definition of the risk the insurer is prepared to accept, and reinsurance with the degree of that risk as defined in the policy that the reinsurer is prepared to accept. (*Vesta v Butcher & Others; Groupama v Catatumbo*).

1.4. Under English law, the governing law of a contract must be ascertainable when it is entered into. If at the time the reinsurance is agreed there is no express or implied system of law governing the

underlying, it follows that there is no law with which the reinsurance can be "back to back", so the proper law of the reinsurance will prevail (*Lexington v AGF*).

1.5. Further, the "back to back" presumption should not operate to displace the effects of the reinsurance contract being subject to a different governing law from that of the underlying, especially in fundamental terms such as the period of cover (*Lexington v AGF*).

1.6. Reinsurance is an independent contract, so if the reinsurance is, for example, for a shorter period than the underlying, any loss must be properly allocated to the period in question and not arbitrarily pro-rated. (*Municipal Mutual Insurance v Sea Insurance; Lexington v AGF*).

2. "As original"

2.1. The words "as original" serve only to define the risk and not to incorporate every condition of the insurance into the reinsurance. The purpose of the words is to ensure that the risk undertaken by reinsurers is identical (as to period, geographical limits and nature of the risk) with the risk undertaken by the insurer (*Pine Top v Unione Italiana Anglo Saxon*).

2.2. General words of incorporation are not normally sufficient to incorporate any provision from the insurance unless that provision is part of the subject matter of the insurance and not merely ancillary to it. There is a presumption against incorporation into reinsurance contracts of collateral clauses (such as jurisdiction and choice of law) from the underlying insurance – see overleaf.

3. Specific examples

3.1. Choice of law – Absent express agreement, the choice of law in the insurance will not automatically apply to the reinsurance simply by use of general words of incorporation such as "as original" (*Gan Insurance & another v Tai Ping*). One must apply established principles to determine the proper law of the contract.

3.2. Jurisdiction – There has to be a clear and concise demonstration in the reinsurance contract that the jurisdiction clause relied on in the insurance is in fact intended to be incorporated into that contract. The words "as original" are not enough (*AIG Europe (UK) & others v The Ethniki*).

3.3. Arbitration – An arbitration clause is a self-contained contact collateral or ancillary to the substantive contact (*Aughton Limited v M F Kent Services Limited*). It will only be incorporated if the words clearly express that as the intention.

3.4. "All" – The word "all" is not sufficient to demonstrate a consensus between the parties for the purpose of incorporation of all terms and conditions etc. Some terms of the original insurance are clearly not intended to apply to the reinsurance (*AIG Europe SA v QBE International Insurance*).

3.5. Warranties etc – It usually follows from the words "as original" that the reinsurance follows the insurance. Differences in the governing laws of the contracts may lead to results that are not back to back, but consistency may be achieved by construing warranties as having the same significance in the reinsurance as they have in the insurance (*Groupama v Catatumbo*).

3.6. Change of law – Reinsurers take the risk of discovering that the law of the underlying is not what they (and maybe the underlying insurers) thought it to be, and of changes or clarified by the relevant Court to their detriment (Lexington v AGF).

3.7. Period (and other fundamentals) – The Vesta principle is likely to lead to a "smoothing" of period clauses, for example, to adjust London time in a reinsurance so that it is back to back with Pacific time in the underlying. However, the fundamental nature of a period clause in an English law contact is such that its effect will be construed under English law, not by incorporating the effect of an underlying clause which gives it a fundamentally different meaning (Lexington v AGF), unless the contract clearly provides to the contrary.

The facts of each case will need to be considered but these guidelines can provide an aid to interpretation.

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