DLA PIPER

INSURANCE AND REINSURANCE UPDATE

UK Supreme Court upholds general rule on prioritisation of claims in liability insurance

In *Teal Assurance Company Ltd v WR Berkley Insurance (Europe) Ltd*[1] the Supreme Court considered whether an insured and its captive insurer were entitled to choose the order in which claims were paid under a tower of insurance contracts, in order to maximise the insured's recovery under its professional indemnity insurance programme.

BACKGROUND

Black and Veatch Corp (**"BV"**), an engineering company incorporated in Delaware, purchased a professional indemnity insurance programme which included a tower of insurance contracts. Its primary insurance layer was with Lexington Insurance Co. Above that and forming the "PI tower" were three successive excess layers with BV's captive insurer, Teal Assurance Co Ltd (**"Teal"**). Teal also underwrote "top and drop" insurance, which it reinsured 50% each with WR Berkley Insurance (Europe) Ltd and Aspen Insurance UK Ltd[2]. The top and drop cover sat above the excess layers. It excluded claims brought in the US and Canada, while the layers underneath provided worldwide cover.

BV received and notified various claims to its insurers. Some of the claims were brought in the US and Canada - but not all. The total value of the claims was expected to exhaust the cover available under the PI tower for the relevant policy period.

Teal sought to maximise BV's recovery by exhausting the PI tower with the US/Canadian claims in an attempt to avoid the application of the territorial exclusion and effect a recovery of the non-US/Canadian claims from reinsurers under the top and drop policy. Teal argued that a clause in the excess and top and drop policies providing that liability did not arise until the underlying insurers (ie Teal) "*shall have paid or have admitted liability or have been held liable to pay*" meant that Teal and BV could choose the order in which claims were presented and paid under the PI tower to adjust the prioritisation of claims to their advantage. Reinsurers disagreed with Teal's approach, arguing that the claims must be met according to the order in which they were established against BV, which meant that losses relating to the non-US/Canadian claims fell to be covered under the excess layers and not under the top and drop insurance.

The parties went before the English courts to resolve the issue. The Court of Appeal[3] upheld the Commercial Court's earlier decision that cover is burned through the layers of the tower sequentially according to when the insured's liability to the third party is established and ascertained (whether by agreement, award or judgment) and not, as Teal had contended, when the insurer indemnifies the insured.

The excess and top and drop policy wording was insufficiently clear to justify a departure from this general rule. Teal appealed to the Supreme Court.

DECISION

The key question for the Supreme Court was whether BV and/or Teal were entitled to choose which claims to meet from the primary and/or excess layers, with a view to ensuring that the remaining claims were not US or Canadian, and could therefore be met by Teal out of the top and drop layer and passed on to the respondent reinsurers.

Teal contended that it was entitled to exercise its contractual rights as best suited it, in this case to maximise the cover available to its "associate", BV. In addition to arguing that the wording of the excess and top and drop policies operated to vary the general rule on prioritisation of claims, Teal also submitted that it was only when a claim was actually paid by an insurer that policy cover was exhausted to the extent of that claim, so that BV was free to choose which of a number of claims made against it was to be presented and paid first, regardless of when liability was ascertained in respect of those claims.

The Court robustly rejected Teal's arguments and unanimously dismissed the appeal. Case law dictates that an insurer's liability under a third party liability policy arises on the ascertainment of the insured's liability - by agreement, judgment or award. The ascertainment of liability gives rise to the claim under the insurance. The claim exhausts the insurance either entirely (ie because the limits are blown) or to the extent of the claim. In other words, the policy serves the purpose of meeting each ascertained loss when and in the order in which it occurs. The Court also commented that, had Teal been an independent, rather than captive, insurer and determined to avoid as much liability to BV as possible, BV would no doubt vigorously have objected to the legitimacy of Teal, as its excess layer insurer under the PI tower, adjusting the order of payment of claims ascertained as against BV, with the aim of ensuring that it was only US and Canadian claims that reached the top and drop policy. The concept of an insurer seeking to maximise its own liabilities in the interests of the insured could not readily be reconciled with the basic philosophy that insurance covers risks lying outside an insured's own deliberate control.

CONCLUSION

The Supreme Court's decision conclusively reinforces the need for very clear and unambiguous wording if the liability of insurers is to be determined other than in chronological order by reference to the date on which liability was established against the insured.

For further information please contact:

Andrew Symons
Partner
T +44 (0)20 7796 6580
andrew.symons@dlapiper.com

Amanda Howe
Senior Associate
T +44 (0)20 7153 7872
amanda.howe@dlapiper.com

ABOUT US

DLA Piper's specialist Insurance and Reinsurance team provides legal expertise and practical advice to insurers, reinsurers, intermediaries, service providers and insureds. We handle complex, large-scale insurance and reinsurance disputes, including court-based litigation at all levels, international arbitration and mediations. We also provide advice on product development and policy wordings, regulatory issues, restructuring and assistance with M&A transactions.

Our unrivalled geographical reach enables us to offer a truly international and cross-jurisdictional service to the insurance and reinsurance industry.

Find out more about DLA Piper's Insurance: (Re) insurance and Risks practice.

[1] [2013] UKSC 57

[2] The programme was intended to operate so that, once the primary layer was exhausted, the first excess layer "dropped down" and became the primary policy. The same applied to each excess layer upon the exhaustion of the previous layer and, once all layers of the PI tower were exhausted, the top and drop policy would drop down and become the primary policy.

[3] [2011] EWCA Civ 1570