Fall Conference Course Materials

Thursday General Session Course Materials

ARIAS U.S.

Fall Conference

November 9-10, 2023

New York, NY

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The Changing Landscape of Petitions to Confirm and Vacate

Suman Chakraborty, Mintz
Larry Greengrass, Arbitrator
Erika M. Lopes-McLeman, Dentons
Kristina Matic, Foley & Lardner

Badgerow v. Walters

596 U.S. 1 (2022)

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Key Holding (8-1 Decision)

"The [Federal Arbitration] Act's authorization of a petition does not itself create jurisdiction. Rather, the federal court must have what we have called an "independent jurisdictional basis" to resolve the matter."

Key Holding (8-1 Decision)

"Section 9 and 10 applications conform to the normal—and sensible—judicial division of labor: The applications go to state, rather than federal, courts when they raise claims between non-diverse parties involving state law. . . . [T]hose claims may have originated in the arbitration of a federal-law dispute. But the underlying dis[1]pute is not now at issue. Rather, the application concerns the contractual rights provided in the arbitration agreement, generally governed by state law. . . . [A]djudication of such state-law contractual rights . . . typically belongs in state courts."

Key Holding (8-1 Decision)

"The question presented here is whether that same 'look-through' approach to jurisdiction applies to requests to confirm or vacate arbitral awards under the FAA's Sections 9 and 10. We hold it does not. …

Without that statutory instruction, a court may look only to the application actually submitted to it in assessing its jurisdiction."

Federal vs. State Court Practice

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State Courts with Business Divisions

Nearly 30 states have business or commercial divisions, including:

- Georgia
- Illinois
- Massachusetts
- New York
- New Jersey
- Texas (as of 2024)

Monetary thresholds vary:

- *e.g.*, 500K in New York County vs. $5 million in Texas

Confidentiality

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Confidentiality of Awards

"…an arbitration award attached to a petition to confirm that award is ordinarily a judicial document."

But

"in weighing disclosure, courts must consider not only the sensitivity of the information and the subject but also how the person seeking access intends to use the information."

Stafford v. IBM, 78 F.4th 62, 70 (2d Cir. 2023)

Confidentiality of Awards

"Here, however, because the parties jointly request that the Court confirm the final award, the final award itself does not directly affect the Court's adjudication of that petition. Thus, the final award is not a "judicial document" subject to a presumption of access.

Moreover, the Court is persuaded by the parties' assertion that the final award should be sealed because it is subject to a confidentially agreement and contains confidential, sensitive, and proprietary information that could potentially prejudice the outcomes of related legal disputes not before the Court as well as prejudice the parties in future competitive business negotiations."

West Coast Life Ins. Co. v. Swiss Re Life & Health America, Inc. (No. 21cv05317, SDNY)

Confirmation of Satisfied Awards

Fully Paid Awards

"The FAA's process for confirming an arbitration award still requires Article III injury, and § 9 of the FAA does not itself confer standing.

In sum, [Petitioner's] petition to confirm her arbitration award became moot when [Respondent] paid the award, and her petition should have been dismissed as moot."

Stafford v. IBM, 78 F.4th 62, 69 (2d Cir. 2023)

Protocols

Honorable Engagement

The arbitrators shall not be obliged to follow judicial formalities or the rules of evidence except to the extent required by governing law, that is, the state law of the situs of the arbitration as herein agreed; they shall make their decisions according to the practice of the reinsurance business.

The arbitrators shall have the power to determine all procedural rules for the holding of the arbitration including but not limited to inspection of documents, examination of witnesses and any other matter relating to the conduct of the arbitration. The arbitrators shall interpret this Contract as an honorable engagement and not as merely a legal obligation; they are relieved of all judicial formalities and may abstain from following the strict rules of law.

All arbitrators shall interpret this Contract as an honorable engagement rather than as merely a legal obligation. They are relieved of all judicial formalities and may abstain from following the strict rules of law. They shall make their award with a view to effecting the general purpose of this Contract in a reasonable manner rather than in accordance with a literal interpretation of the language

Questions/Comments

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Evolving Challenges of Reinsurance for the Property and Casualty Market

November 9, 2023 | 1:35 – 2:35 pm

Moderator

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Macro and Regional Trends

- Cat losses
- Inflationary trends
- Social inflation
- Regulatory trends / Legislation

Challenges

- Modeling innovations to keep pace with the dynamic risk landscape
- Pace at which model changes are validated and adopted

Opportunities

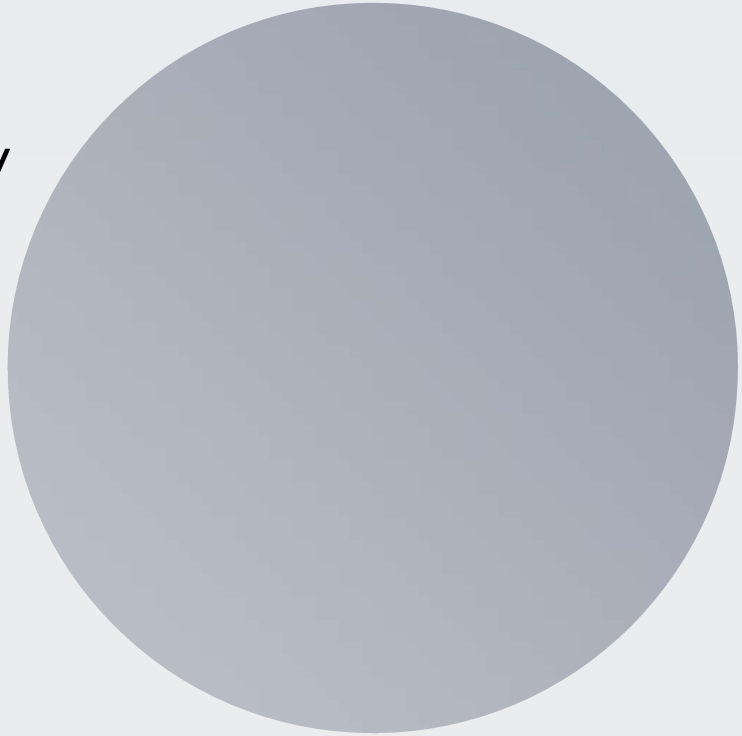
- Software as a service (SaaS) / Generative Artificial Intelligence (GenAI)
- Expanding capabilities to develop complete and correlated views of property and casualty risk or to address emerging needs (e.g., climate change)
- Expanding the suite of model analytics to close the protection and application gaps

Industry Results

- Reinsurer results consistently below cost of capital, with Combined Ratios exceeding 100% for the past six years

Worldwide Property

- Significant activity in the property insurance sector, particularly in Europe, with incidents of hail, floods, earthquakes, and other natural disasters
- Hurricane Otis ranked a Category 5 storm in less than 24 hours



U.S. Activity

- Two "I" storms (Idalia and Ian) if moved less than 75 miles, would have caused much larger impact
- Potential for secondary peril activity (severe convective storms, winter storm, fire, etc.)
- Reinsurers moved up attachment points to protect capital events
- Shift towards capital protection over earnings protection

Casualty Insurance

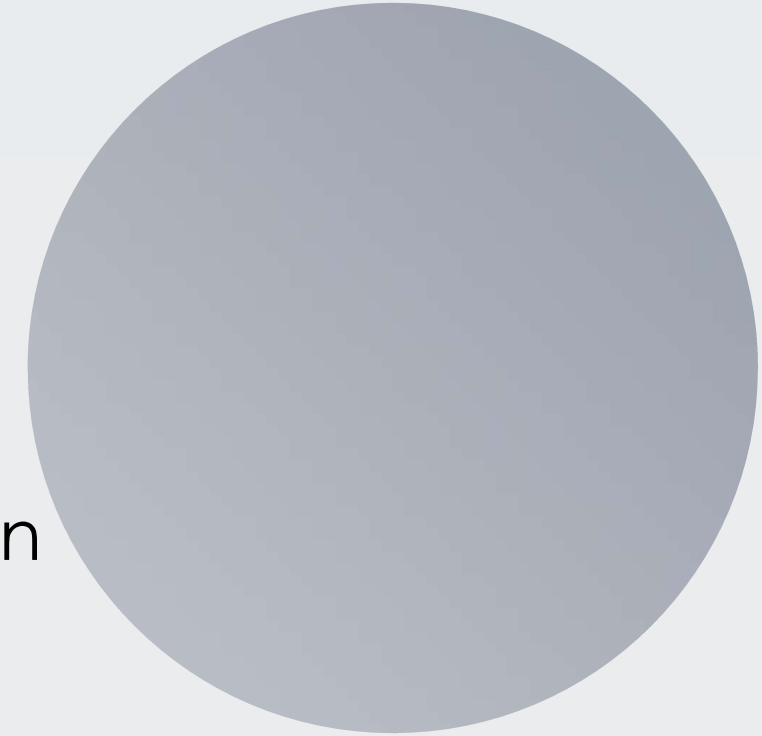
- Significant activity, particularly in auto, general liability (GL), and umbrella insurance
- Pressure on results from a soft market period
- Delays in court openings and social inflation contributing to challenges

Casualty Insurance

- Directors & Officers primary ABC market not rational with rate decreases
- Litigation funding expected to increase defense and loss costs
- International Casualty covers and writers need to be mindful of their U.S. exposures in this environment (e.g., Surfside)

Global Specialty Insurance

- Increased demand for certain energy portfolios, especially QS
- Higher loss activity in the last decade
- Aviation/Space insurance is at an interesting crossroads



Ceding Company

- Volatility highlights the challenges of the regulatory framework
- Speed to adapt to changes limited by operating in the admitted market
- Business moving into the excess & surplus space as reflected in the dramatic increase in market share
- All companies, especially admitted, must have sophisticated rating/underwriting, capital modeling and strong enterprise risk management

Questions & Answers

Thank You.

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Breakout Sessions Course Materials

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Does London Market Reinsurance Cover U.S. “all sums” Losses?

November 9-10, 2023

Seema Misra, Arch
Christopher Foster, HFW
Drew Poplinger, Chaffetz Lindsey
Bob Hall, Hall Arbitration

ROAD MAP

1. Introduction to the Issue – do London-Market reinsurers cover U.S. cedents' "all aums" losses?
2. *ICSOP v. Equitas*: The Second Circuit answers "yes"
3. Did the Second Circuit misinterpreted English law?
4. How might an Arbitrator view the Issue?
5. Discussion/Questions

Introduction

The “All Sums” Rule

Under the “all sums” method, which is also sometimes referred to as the joint-and-several method, an insured is entitled “to collect its total liability ... under any policy in effect during the periods that the damage occurred,” and is limited in its ability to recover from any single insurer only by that insurer’s specific policy limits.

- *Danaher Corporation v. Travelers Ind. Co.*, 414 F.Supp.3d 436, 449 (S.D.N.Y., 2019)

- Based on the interpretation of the common CGL insuring clause:

Insurer will “***pay all sums*** which the Insured shall be obligated to pay by reason of liability imposed upon the Insured by law on account of personal injuries and property damage, caused by or arising out of each occurrence happening during the policy period.”

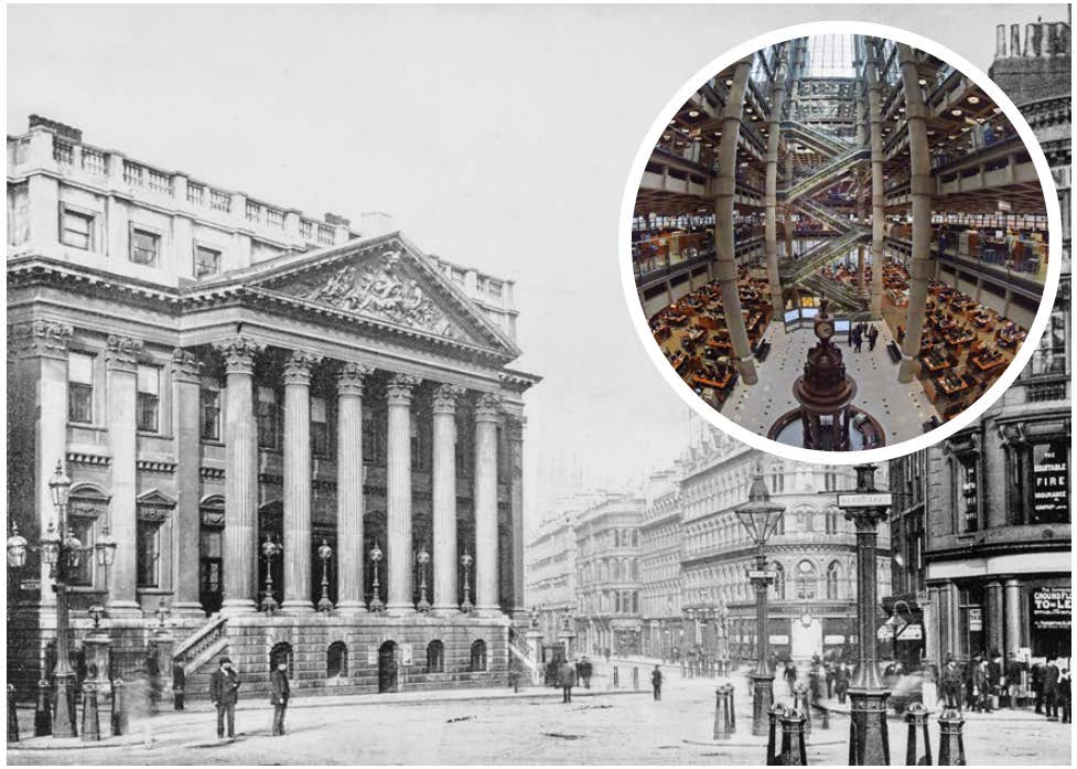
The Issue

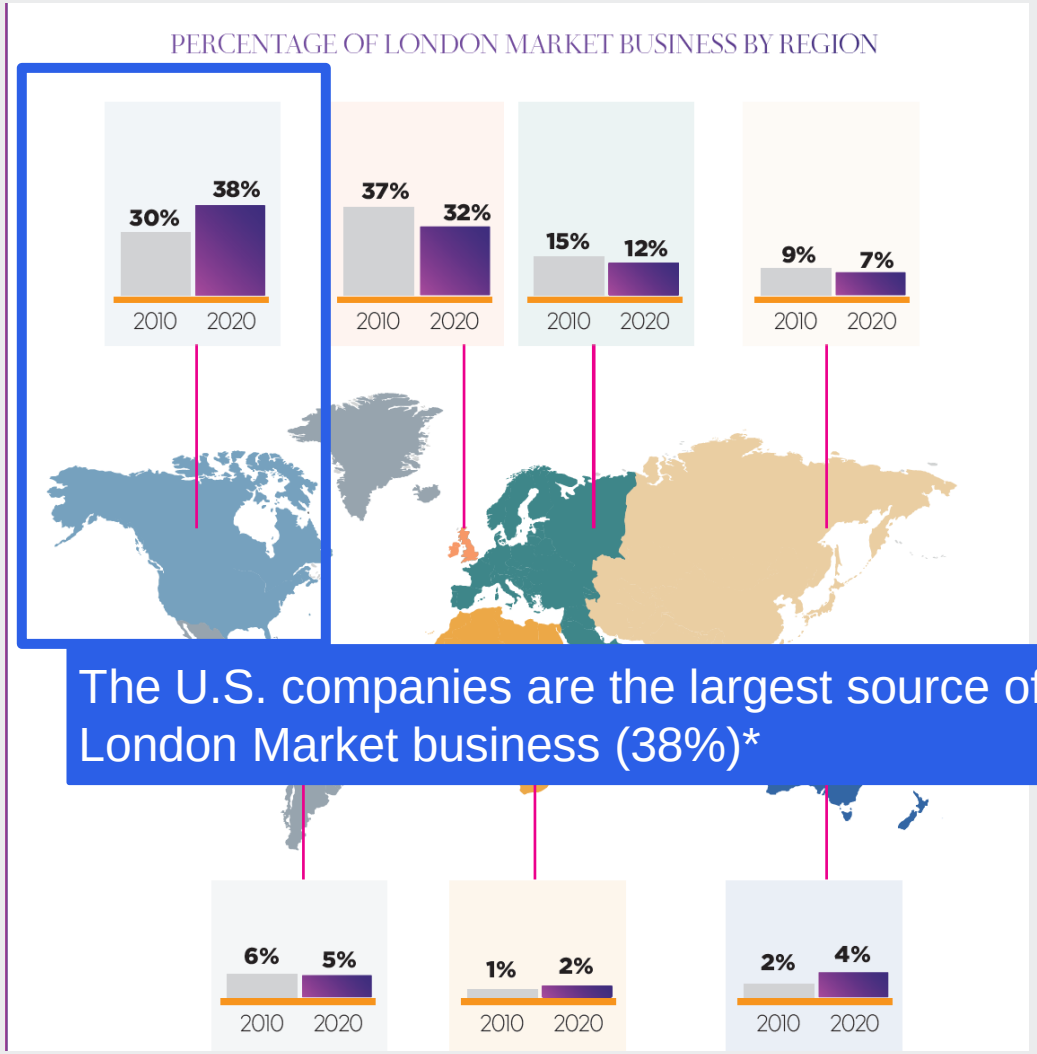
Does an English law facultative certificate reinsuring a U.S. policy cover losses the cedent pays on an "all sums" basis under the law governing the ceded policy?

Why it Matters?

- All sums losses often represent some of U.S. ceding companies' largest exposures
  - Includes long-tail environmental and asbestos losses
  - May be applied to new types of progressive losses, such as PFAS
  - Can greatly expand exposure of individual policies
- U.S. companies purchase substantial reinsurance in the London Market

Why it Matters?

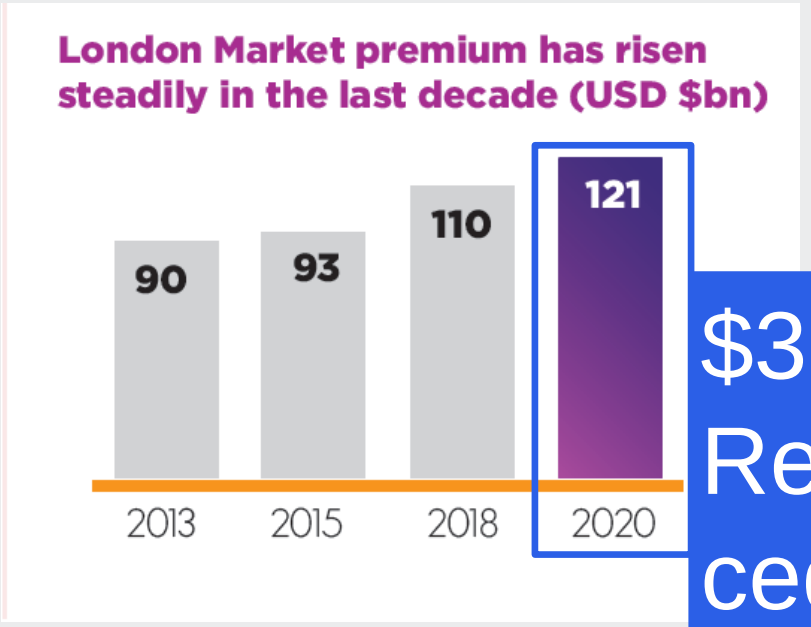


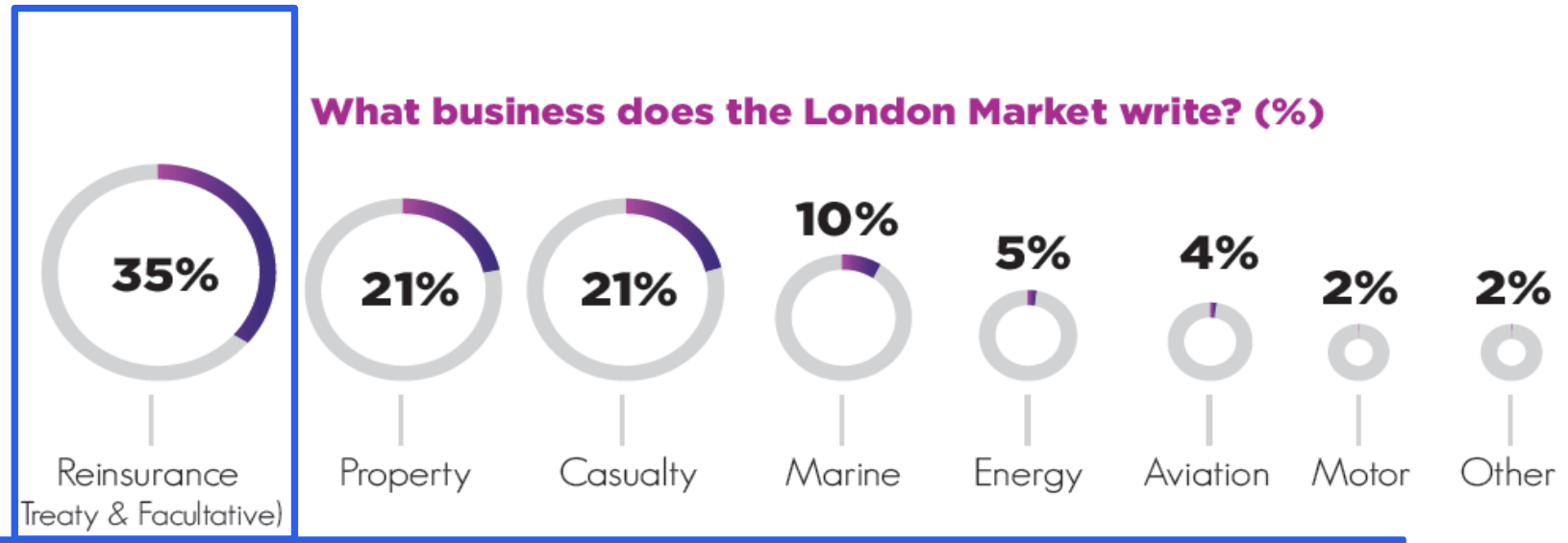


The U.S. companies are the largest source of London Market business (38%)*

* London Market Group (https://lmg.london/wp-content/uploads/2022/09/Why-London-Matters-2022.pdf)

Why it Matters?





$35% of London Market Business is Reinsurance – Nearly $43 billion in ceded premium*

* London Market Group (https://lmg.london/wp-content/uploads/2022/09/Why-London-Matters-2022.pdf)

Why *ICSOP v. Equitas* Matters?

- In *ICSOP v. Equitas, 68 F.4th 777 (2023)*, the Second Circuit, applying English law, held that Lloyd's facultative certificates covered ICSOP's all sums settlement in accordance with Hawaii law
- The standard service-of-suit clause in most London-market reinsurance contracts makes it more likely that U.S. courts, rather than English courts, will be called on to decide this issue
  - **"Underwriters submit to the jurisdiction of any Court of competent jurisdiction within the United States . . . and all matters arising hereunder shall be determined in accordance with the law and practice of such Court."**

ICSOP v. Equitas (2d Cir. 2023)

Underlying Loss

- A Dole subsidiary built a housing tract in the 1960s on land formerly occupied by an oil tank farm
- Contaminants released into the soil from oil tanks spread across the housing tract over ensuing decades
- In 2009, over 1500 homeowners sued Dole (and others) for property damage caused by soil and ground water contamination

ICSOP Policy and Settlement

- ICSOP agreed to pay its full $20 million limit based on Hawaii all sums rule
- Umbrella policy for years 1968 to 1971
  - $20 million per occurrence limit – no aggregate.
  - No pollution exclusion
  - Insuring clause contained standard “all sums” language
  - Included Express Hawaii Choice of Law provision
- All other policies issued to Dole from 1968-2009 included a pollution exclusion

ICSOP's Reinsurance

- Lloyd's market Facultative certificates - 35% quota share
  - "The perils and interests reinsured hereunder" will be "As original"
  - "Being a Reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the Company"

Equitas Denies Coverage

- Acknowledged that ICSOP's settlement was reasonable
- Argued that ICSOP's settlement nevertheless recognized a loss that fell outside the reinsurance as a matter of law
  - The reinsurance was governed by English law
  - English law does not recognize the "all sums" rule

The “Back-to-Back” Presumption

Reinsurance presumed to be coextensive with interpretation of ceded coverage under its governing foreign law:

“The parties to [the reinsurance] are deemed to have used the same dictionary, in this case a Norwegian legal dictionary, to ascertain the meaning of the terms and conditions [incorporated from the underlying policy.]”

Lord Lowry, *Vesta v. Butcher at 911*

The “Back-to-Back” Presumption

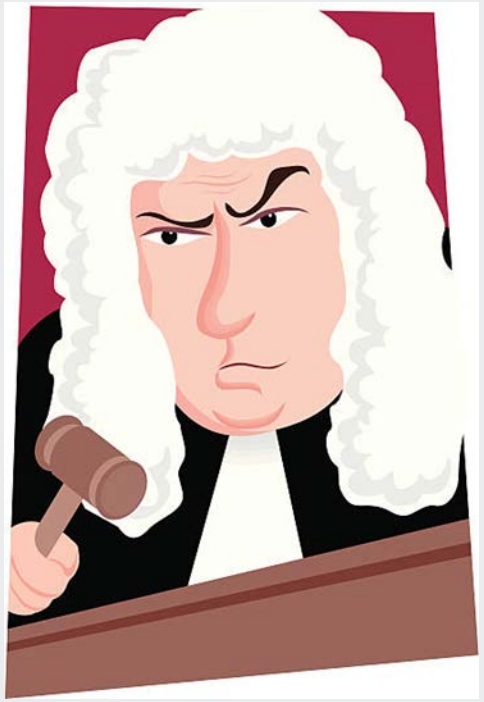
Reinsurance presumed to be coextensive with interpretation of ceded coverage under its governing foreign law:

“[I]n a proportionate [facultative] reinsurance … there is a presumption that, in the absence of clear words to the contrary, the scope and nature of the cover afforded is the same as the cover afforded by the insurance. That at least I think is the effect of Vesta and it makes obvious commercial sense.”

Court of Appeal
Groupama v. Catatumbo at ¶17

Wasa v. Lexington: House of Lords (2009)

Affirmed presumption that terms incorporated from ceded policy are interpreted in accordance with that policy's foreign law:

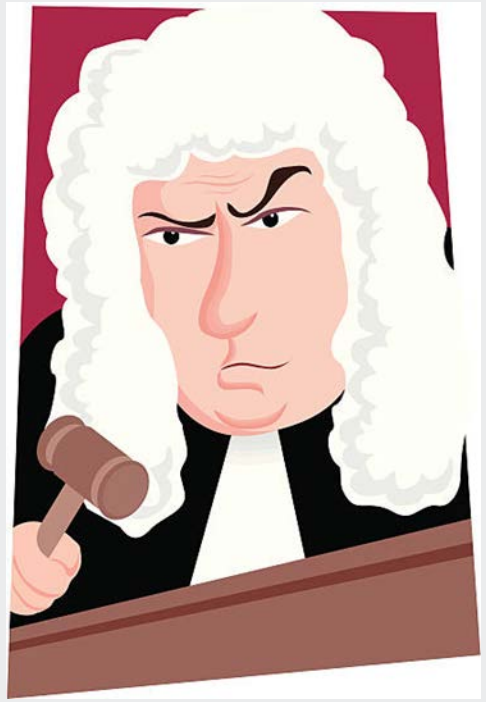


"In the case of proportional facultative reinsurance the obvious commercial intention is for the original insurer to reinsure part of its own risk and for the reinsurer to accept that part of the risk, and it is therefore equally obvious that the relevant terms in the reinsurance contract should be construed so as to be consistent with the contract of insurance. This is simply commercial common sense. Consequently, the starting point for the construction the reinsurance policy is that the scope and nature of the cover in the reinsurance is co-extensive with the cover in the insurance."

Lord Collins, *Wasa* at ¶60

Wasa v. Lexington: House of Lords (2009)

But said whether back-to-back presumption applied was a question of "construction of the reinsurance":

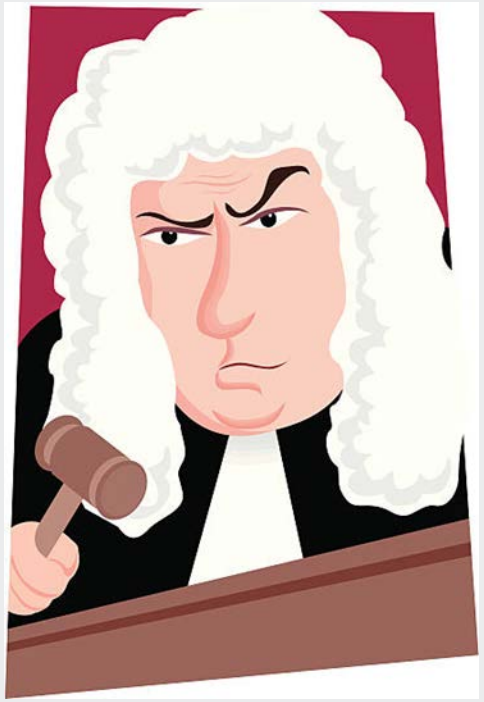


"In order to apply the underlying principle that the effect of terms in a reinsurance contract governed by English law should where possible be interpreted to be in accordance wit the effect of the terms of the insurance contract governed by foreign law, the relevant foreign law is … the law which the parties would have had in reasonable contemplation when the contracts were entered into."

Lord Collins, *Wasa* at ¶55

Wasa v. Lexington: House of Lords (2009)

Under facts in *Wasa*, question was whether application of Pennsylvania law was predictable:



"[I]n this case the effect of the service of suit clause was that litigation could take place anywhere in the United States. On a narrower view of the case (similar to that in the Vesta case) the relevant question would have been: what law would the parties have expected would be applied by a court in the United States had Alcoa taken advantage of the service of suit clause, and in particular would the parties to the reinsurance contract have reasonably had in mind that what losses were recoverable under the insurance contract would be determined ultimately by Pennsylvania law?"

Lord Collins, *Wasa* at ¶55

The *Wasa* Case: House of Lords (2009)

Presumption rebutted where Service-of-Suit clause and circumstances of coverage litigation resulted in unpredictable application of Pennsylvania law:

"I find it impossible to [apply the back-to-back presumption] in circumstances where Lexington's liability has been held to arise under a system of law which was applied to the insurance not by reason of the terms of the insurance or their operation, but in the context of a choice of law on a blanket basis to cover also a large number of other independent insurances and claims."

Lord Mance, *Wasa* at ¶54

The *Wasa* Case: House of Lords (2009)

Absence of "identifiable system of law" defeated back-to-back presumption:

"[I]n complete contrast to Vesta v. Butcher and Groupama v. Catatumbo, in the present case there was in 1977, when the insurance contract and the reinsurance contract were concluded, no identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract or reinsurance in a manner different from its ordinary meaning in the London insurance market."

Lord Collins, *Wasa* at ¶108

2d Circuit Finds ICSOP's Reinsurance Back-to-Back

ICSOP Policy's Hawaii choice-of-law clause distinguished *Wasa*:

"Wasa differs from this case in one important aspect.... [T]he underlying ICSOP-Dole policy contains an express choice-of-law clause directing the application of Hawaii law, which, Equitas concedes ... follows the all sums rule in environmental suits involving continuous and indivisible injuries."

ICSOP v. Equitas, 68 F.4th at 787

Did the Second Circuit Misinterpret English Law?

V.

This is a Clash between:

- ❑ "Fundamental" English law meaning of "*losses occurring during*" term in proportional fac reinsurance
- ❑ Strong presumption of contractual interpretation for back to back cover

Under English law:

- not a follow form issue
- not a follow settlements issue
- proportional reinsurance not analysed as a liability for whatever liability cedent found to have

Vesta/Catatumbo

- The availability objectively to the parties at inception of a foreign law dictionary

Per Lord Collins in *Wasa*:

> ***"In each of those cases, the substance of the foreign law as to the consequences of a non-causative breach of warranty could be ascertained at the outset, if necessary by recourse to a relevant Norwegian (or Venezuelan) legal source ..."****(emphasis added)*

Wasa

- Service of suit, but no governing law, clause in insurance.
- Ratio – service of suit clause meant underlying law was not discernible, and parties would never have anticipated Pa law in any event. Therefore English law meaning of LOD.

Per Lord Mance:

"The reinsurance has a clear English law meaning. There was here no identifiable legal dictionary (formal or informal), still less a Pennsylvanian legal dictionary, which can be derived from the interaction or operation of the terms of the insurance and reinsurance and which could lead to any different interpretation of the reinsurance wording"

Discernible law but not then “all sums” (ICSOP)?

- Reinsurers take risk of change in law creating greater insurer exposure, but subject to the terms of their English law reinsurance (which has not changed)
- How could there conceivably have been a Hawaiian legal dictionary available which identified “all sums”?
- Also basic principle of English law that contracts interpreted at conclusion, and cannot change meaning by later events

Law then “all sums” (or above wrong)?

- Wasa: pervasive references to period of cover being fundamental under English law. Reinsurers would have same liability even if reinsurance were for one day.
- Lord Mance:

“…reinsurers may still sometimes be entitled to respond, with reference to the clear meaning that their contract has under the law governing it: what more could we as reinsurers have done to make clear the basis of reinsurance? A sensible principle of construction…cannot be made into an inflexible rule of law, which would impose on reinsurers a liability for which, under the law applicable to the reinsurance, they did not bargain.”

- *Lord Brown:*

“The [authorities on back to back cover] do not warrant its application in all circumstances, certainly not so as to override so clear a temporal limitation as the reinsurance contracts stipulated here with regard to the risks covered. ”

- Given the importance of reinsurance to the UK, there is a policy reason to seek to ensure reinsurances are back to back as expected. But there is equal reason to ensure the certainty of English law (and many reinsureds are also reinsurers in London). See also Equitas v MMI below.

ICSOP – The Second Circuit goes awry

- Second Circuit engaged in its own private research - identified that English law has imposed "all sums" equivalent on EL insurers for mesothelioma liability where basic position is liability only for the proportional extent of asbestos exposure during the policy period (4-3 in Supreme Court)
- It predicted that English Courts would therefore also do so at reinsurance level. But the Court failed to research properly and did not identify Equitas v MMI (Court of Appeal).
- Reinsurance there on a back to back basis as to basis for cover. But the Court invented a new implied term on allocation in effect to revert to the fundamental position of "LOD" at reinsurance level:

"***Once the courts can be confident that the objective of ensuring victim protection has been achieved, it is desirable that the anomalies should be corrected and that the law should return to the fundamental principles of the common law. Put shortly, once unorthodoxy has served its purpose, we should revert to orthodoxy***."

- On its own logic, had it known, the Second Circuit would and should have reached a different decision.
- And to makes matters worse, the Second Circuit then refused to review its decision….

Response: Second Circuit Did Not Go Awry

- Whether English law recognizes the all sums rule is irrelevant when the reinsurance covers foreign law policy on a back-to-back basis
  - *Catatumbo* (L.J. Tuckley) – that foreign law may differ from English law "is a risk [reinsurers] must be taken to have assumed by writing international business."
- The fact that Hawaii adopted the "all sums" rule after the reinsurance bound is irrelevant:
  - Rejected in *Wasa*: It is "elementary" that insurers and reinsurers alike "take the risk of changes in the law" (Lord Collins)
  - Second Circuit: "[W]hen parties fail to define … a term such as 'all sums' … they adopt the meaning a common law court will ascribe to it, and thereby bear the rewards and risks of the common law's dynamic nature."
- Meaning of reinsurance didn't change – from outset reinsurer knew Hawaii law governed and reinsurance would be back-to-back with Hawaii law construction of coverage terms

Arbitrator's Perspective

Arbitrator Viewpoint

- ❑ Arguments remote and esoteric
- ❑ Not a Supreme Court of Conflict of Laws
- ❑ Practical, real-world decisions

Judge v. Arbitrator Perspective

- ❑Use market place experience
- ❑Informed by, but not bound by law
- ❑Follow custom and practice
- ❑Latitude to fashion remedies

Commercial Perspective

- ❑Men and women of the marketplace
- ❑Underwriters specialize in US Risks
- ❑Variations and changes in US law (across 50 states) expected
- ❑Part of the risk assumed

Cedent/Reinsurer expectations

- ❑ Follow the Form
- ❑ Follow the Settlements
- ❑ Deeply troubled by contrary decisions

Conclusion from Arbitrator's Perspective

- Likely similar result to Second Circuit decision in *ICSOP v. Equitas*
- Based on Follow the Form and Follow the Settlements
- Pay losses consistent with law of the subject jurisdiction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2nd Circ. Reinsurance Ruling Correctly Applied English Law

By **Peter Chaffetz and Andrew Poplinger** (June 15, 2023, 5:34 PM EDT)

In a **recent Law360 guest article**, our friend and well-known English insurance solicitor Chris Foster, argued that English facultative reinsurers should not be required to pay their share of an American cedent's all sums settlement, because English law does not recognize the all sums principle.

Peter Chaffetz

According to the article, the U.S. Court of Appeals for the Second Circuit's ruling to the contrary in The Insurance Company of the State of Pennsylvania v. Equitas Insurance Limited misapplied English law and is therefore wrongly decided.[1]

We respectfully disagree with the article's analysis and conclusion. In the interests of full disclosure, we were counsel to ICSOP in the case at issue.

Andrew Poplinger

In ICSOP, the ceding company, ICSOP, had paid the full limits of a three-year policy to settle its insured's environmental liabilities that had accrued over a period of 40 years.

The policy was governed by the law of Hawaii, one of several American jurisdictions that apply the all sums approach, under which third-party liability insurance is construed to cover all liability — based on the insuring clause's reference to "all sums" — arising over a period of years out of an indivisible process of environmental contamination, as long as any part of that contamination occurred during the policy period.

Equitas, the successor in interest to Lloyd's of London syndicates, which had issued two facultative certificates reinsuring the ICSOP policy, had denied the claim, but the Second Circuit affirmed summary judgment in favor of ICSOP, holding that, as a matter of English law, the English law reinsurance certificates were back to back, i.e., concurrent, with the ICSOP policy they reinsured. Therefore, although the reinsurance was governed by English law, Equitas had to cover the loss in accordance with Hawaii law governing the underlying policy.

There was no dispute that the reinsurance contracts were governed by English law. Therefore, the task before the Second Circuit was to predict how the U.K. Supreme Court — formerly the House of Lords — would have decided the issue.

Noting that the Second Circuit conducted its own research into English case law not cited by either party, the article argues that the court missed a key English Court of Appeals precedent — Equitas v. Municipal Mutual Insurance — that should have led it to reach the opposite conclusion.[2]

As we explain below, the unanimous Second Circuit decision is entirely consistent with English law. Its limited reliance on the English cases the article discusses was apt, and the Equitas v. MMI decision that the article says the court failed to consider — to the extent it is relevant at all— supports rather than undermines the Second Circuit's conclusion.

The Dispute and Decision in ICSOP

Equitas did not dispute that Hawaii law applied the all sums rule, nor that it was reasonable for

ICSOP to settle with its insured on that basis. Instead, Equitas claimed that it had no obligation to pay its share of the loss because the reinsurance was governed by English law, which did not recognize the all sums rule.

Equitas acknowledged that, under English law, it is generally accepted that facultative reinsurance written on an as-original basis — incorporating the terms of the underlying policy — is presumed to be back to back with the underlying policy, such that the scope of reinsurance coverage is coextensive with the scope of coverage under the law governing the underlying policy, even if English law would take a different view.

However, Equitas argued that the back-to-back presumption cannot apply to bind an English reinsurer to a U.S. cedent's all sums settlement, because the policy period is fundamental under English law, and the all sums rule requires insurers and reinsurers to pay for losses occurring outside the coverage period of their contracts. In Equitas' words, the all sums rule was anathema to English law, and could never apply under an English law reinsurance contract, regardless of whether the reinsurance was otherwise back to back.

Alternatively, Equitas argued that the back-to-back presumption was inapplicable to this case, because Hawaii did not adopt the all sums rule until after the reinsurance was bound, and therefore, even if the reinsurers knew they were reinsuring a Hawaii law risk, they did not know that Hawaii would later adopt the all sums rule.

Equitas relied principally on the House of Lords' decision in Wasa International Insurance. Co. Ltd. v. Lexington Insurance Co., which held that, under the facts of that case, English reinsurance contracts, although written as original, did not cover the cedent's payment for 40 years of environmental contamination under a policy determined to be subject to Pennsylvania's all sums rule.[3]

The Second Circuit rejected Equitas' interpretation of Wasa. It concluded that the reason the House of Lords found the back-to-back presumption to be rebutted in Wasa was that the underlying policy in that case did not specify a governing law, and the reinsurers could not otherwise have anticipated at the time of contracting that the policy would ultimately be governed by Pennsylvania law and its all sums rule.

The present case was distinguishable because the ICSOP policy included an express Hawaii choice-of-law provision, and therefore the reinsurers knew at the outset that they were reinsuring a Hawaii law risk. Whether it was sensible for the House of Lords to make the presence or absence of a governing law clause the basis for its ruling in Wasa is a separate question on which the Second Circuit did not comment.

The Second Circuit further held that Wasa did not stand for the proposition that the period of cover is fundamental. The principal basis for this conclusion was that one judge in Wasa, Lord Simon Brown, stated explicitly in a short, separate opinion that the case should have been decided on that basis, but no other judge joined in that opinion. Rather the two Lords whose opinions gained support from a majority of the five-judge panel relied on the choice-of-law issue.

Finally, the court also rejected Equitas' change-in-law theory, again relying principally on Wasa, where the majority opinions noted that it was elementary that insurers and reinsurers alike take the risk of changes in the law.

The court succinctly summarized its conclusion: "We do not believe that the United Kingdom Supreme Court would condition [the back-to-back] presumption on the importance of a policy term or the predictability of how a foreign court might later interpret that term."

The Second Circuit's Reliance on English Authorities Not Cited by the Parties

Reflecting the seriousness with which the Second Circuit panel took its responsibility to assess the likely outcome under English law, and in particular to assess Equitas' contention that the period of cover was so fundamental under English law as to defeat the back-to-back presumption, the court reviewed developments in English law subsequent to Wasa, including two U.K, Supreme Court decisions not cited in the briefs of either party.

Those cases, Durham v. BAI (Run off) Ltd.[4] and International Energy Group Ltd. v. Zurich Insurance PLC,[5] followed the passage of legislation that made employers jointly and severally liable for the entire injury of any mesothelioma victim who was exposed to asbestos at the employer's facility for any period of time, regardless of how many years that employee may have faced similar exposure while working for other employers.

In Durham, the court held that insurers had to cover their policyholders' newly created joint-and-several liability for mesothelioma claims, essentially changing the trigger of coverage under such policies. Subsequently, in Zurich, the U.K. Supreme Court extended Durham to adopt a version of the all sums rule, holding that insurers are jointly and severally liable for the entirety of their insured's liability under the Compensation Act.

The Second Circuit observed that the adoption of the all sums rule in Zurich rebutted Equitas' argument that the all sums rule was anathema to English law. The court explained the narrow basis of its reliance on Zurich:

> The point of our reliance on Zurich is that the case recognized a circumstance where an insurer can be jointly and severally liable for the whole of the insured's tort liability even though that liability might have accrued after the policy period's expiration. That recognition defeats Equitas's argument that the all sums rule is anathema to English law.

The court again drew secondary support from Durham and Zurich for its conclusion that Equitas assumed the same risk as ICSOP of changes in Hawaii law. It noted that in those cases, the U.K. Supreme Court acknowledged "that the relevant policies were executed before the various legal developments leading to those decision had occurred … but that did not stop the Lords from imposing liability on insurance carriers in [Durham] and joint-and-several liability upon insurance carries in Zurich."

It would therefore be "incongruent to make the change-of-law point decisive here where it was not in those cases."

The Second Circuit was careful to note that these cases were limited to the narrow context of mesothelioma claims, and it was not suggesting that these cases predict that English law would adopt a similar all sums rule in the context of long-tail environmental liability cases.

Equitas v. MMI Supports Second Circuit's Decision

This brings us to the article's principal criticism of the Second Circuit ruling: that the court misconstrued English law because it failed to consider the MMI decision, in which the U.K. Court of Appeal disallowed a ceding company's all sums allocation of its asbestos settlement to a reinsurer. The article asserts that, "had the court been aware of [that] decision, it would and should have reached the opposite view"

Initially, we note that after the article was published, the Second Circuit denied Equitas' petition for rehearing based on the same theory — that the MMI decision, properly considered, would have required an opposite ruling. The Second Circuit gave no reasons for that denial, but it is clear that the MMI decision does not support the article's or Equitas' criticism of the Second Circuit ruling.

First, the MMI decision did not involve an underlying policy governed by foreign law, a fact at the crux of both Wasa and ICSOP. In MMI, both the insurance and reinsurance at issue were governed by English law. Rather, MMI turned entirely on whether the cedent, although having the right to present its reinsurance claims on an all sums basis, following Zurich, acted in bad faith in doing so under the facts of that case.

Specifically, MMI had issued 30 annual employers' liability policies, each of which, under Durham and Zurich, covered 100% of all claims arising from any exposure to asbestos during the policy period. Based on that all sums liability, MMI paid the full amount of the insured's liability for these claims. But, it did so without allocating its payment across the 30 potentially responding annual policies.

However, when it came to the reinsurance cession of that loss, MMI ceded the entire claim arising from multiple years of exposure to a single reinsurance year. By doing that, it avoided years with high deductibles or insolvent reinsurers, thereby maximizing its reinsurance recovery. The court

described that one-year allocation as "spiking."

The Court of Appeal held that: (1) as a matter of construction, the reinsurance contracts covered the claims on the same all sums basis as the underlying insurance policies, i.e., they were back to back; but (2) MMI's contractual discretion to allocate the claims on an all sums basis for reinsurance purposes was subject to an implied limitation of good faith.

As former Lord Justice Andrew Leggatt explained in the MMI decision, "the justification for implying this [good faith] term is that the implication is necessary to prevent the insurer's power to allocate its loss among policy years from being abused."

The first of those holdings actually supports the result in ICSOP, because the only question before the Second Circuit was whether the reinsurance should be construed as back to back with the ICSOP policy. What the court did in MMI is entirely consistent with what the Second Circuit did in ICSOP.

Also, importantly, the Court of Appeal construed the insurance and reinsurance in MMI as back to back, notwithstanding that the U.K. Supreme Court did not impose the all sums construction on insurers until its ruling in Zurich, long after the insurance and reinsurance policies were bound. This refutes the suggestion that the reinsurers' liability cannot be expanded by post-binding legal developments.

The article's criticism of the Second Circuit's ruling in ICSOP illogically rests on the result of the second holding in MMI, i.e., rejection of the attempted reinsurance cession. But the reason for that rejection was that MMI's right to present its reinsurance claims on an all sums basis was tempered by an implied obligation of good faith, and that spiking the cession of claims that were covered by multiple of MMI's policies to the single year that would yield the largest recovery was not in good faith.

That reasoning is irrelevant to the dispute in ICSOP, where there were no such allocation issues, because the reinsurance claim arose from a single policy and ICSOP presented the claim to its reinsurers on the same basis on which it had settled with its policyholder.

Equitas conceded that ICSOP's settlement decision was reasonable, and its only argument against payment was that the reinsurance should not be construed as back to back with the ICSOP policy. As shown, on that issue, MMI actually confirms that the Second Circuit decision in ICSOP properly construed English law.

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Disclosure: Chaffetz and Poplinger were counsel to ICSOP in the case at issue.

[1] Case No. 20-3559-cv (2d Cir. May 22, 2023).

[2] [2019] WLR 613.

[3] [2010] 1 AC 210.

[4] [2012] UKSC 1.

[5] [2015] UKSC 33.

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2nd Circ. Reinsurance Ruling Misconstrues English Law

By **Christopher Foster** (June 8, 2023, 3:17 PM EDT)

Christopher Foster

The U.S. Court of Appeals for the Second Circuit has considered whether, under English law, a proportional reinsurance contract was back to back with the underlying insurance that covered pollution losses on an all sums basis. In this article, I discuss the judgment and how the decision has gone awry.

Introduction

There is a strong presumption in English law that a facultative proportional reinsurance contract is to be construed on a back-to-back basis with the terms of the underlying insurance, the parties' objective intention being to cover part of the same risk as the underlying insurance.

This presumption has been of such strength as to change the English law meaning of reinsurance terms, express or incorporated through a full reinsurance clause, to that of the foreign law of the underlying insurance, the legal analysis being that the parties objectively intended to use a foreign law dictionary at inception to interpret the reinsurance contract and thus ensure it was back to back.

However, what if the reinsurance term is fundamental and has a settled meaning under English law, such as a losses occurring during, or LOD, coverage trigger? And does it make a difference if the foreign law has changed since inception, the law being treated as always having been such?

The majority in the well-known 2009 House of Lords decision in Wasa v. Lexington left these questions open, resolving that case on the basis that the underlying governing law of Pennsylvania was not discernible at the time of the reinsurance contract.[1]

The Second Circuit in the Insurance Company of the State of Pennsylvania v. Equitas Insurance Ltd. has now sought to address these questions.[2]

In a thoughtful and balanced, but ultimately flawed, decision issued on May 22, **the court found** that an English law-governed proportional reinsurance covering losses occurring during its policy period did cover reinsurance losses occurring outside that period on the basis that this was the effect of the underlying Hawaii law insurance, and even though no Hawaiian legal dictionary would have so identified at reinsurance inception.

Facts

ICSOP provided umbrella liability insurance, written on an occurrence-based trigger, to the Dole Food Co. for the period 1968-1971 and subject to the law of Hawaii. Part of that risk was facultatively reinsured via a slip policy, albeit with J1 jacket, with a full reinsurance clause to what is now Equitas Insurance Ltd. The parties proceeded on the basis that English law governed the reinsurance and, as in Wasa, that the reinsurance cover was likewise written on a LOD basis.

Dole settled claims by homeowners in respect to a housing development, which had been polluted over a continuous period of some 44 years starting in the 1960s. Hawaii is one of a number of U.S. states that has now adopted — subsequent to the reinsurance — what is termed the "all sums" doctrine, a doctrine noted as "[surprising] to English eyes" by Judge Jonathan Mance in Wasa.

While the pollution damage is divisible, occurring both before and for some considerable time after the insurance period, the doctrine provides that the insurer is joint and severally liable to indemnify up to its policy limits for all the damage on the basis the insuring clause provides it is liable to indemnify for all sums for which the insured is itself liable.

Equitas refused to indemnify ICSOP other than on the basis of the relevant proportion of damage actually occurring during the reinsurance period, arguing that this construction of the reinsurance was fundamental to English law, with English law prorating continuing pollution damage across its period.[3]

On the basis of the approach in Wasa, the presumption of back-to-back coverage should therefore be overridden. Further, or in the alternative, there was in any event no Hawaiian law dictionary at the time of the reinsurance contract on which an alternative construction of the reinsurance could be based.

Decision

The Second Circuit set itself the task of resolving how the English Supreme Court would resolve the reinsurance claim under English law.

The fundamental premise for its approach was its consideration by analogy of the "Fairchild enclave" chain of authorities — relating to mesothelioma as a result of exposure to asbestos — which it perceived by analogy established that the English courts had been prepared to adopt the all sums approach in circumstances where the law on an employer's exposure had changed with retrospective effect.

The Second Circuit therefore opined that while the position was not without doubt, the better view was that the reinsurance would be construed under English law on a back-to-back basis in accordance with Hawaii law as it stands today.

Analysis and Comment

It is necessary first to address the Fairchild enclave under English law, and the Second Circuit's view on it.

Mesothelioma is an indivisible injury. In other words, material exposure to asbestos does not in itself cause any injury at that time; it creates a risk of developing mesothelioma many years later at which point all the injury is actually suffered. The injury is not proportionate to the extent of the exposure, although the risk of injury is generally thought to be proportionate to materially the same exposure.

These facts historically rendered it difficult, if not impossible, for victims employed by a number of employers to identify which had, on the balance of probabilities, actually caused their injury in fact. Therefore, in 2002, in Fairchild v. Glenhaven Funeral Services Ltd., the House of Lords developed a new and unique rule of causation in tort to permit recovery for claimants. Any employer that had made a material contribution to the risk was to be treated as having actually caused it.[4]

However, in a later case in 2006, Barker v. Corus UK Ltd., the House of Lords decided as a matter of common law that although an employer had caused the loss, it was only to be liable to the proportionate extent to which it had exposed the employee to asbestos — as a quid pro quo for the relaxation of ordinary rules of causation in relation to that employer.[5]

With the prospect of employees failing to recover in full, in particular due to employer insolvency, Parliament immediately stepped in and enacted the Compensation Act 2006, reversing Barker and making employers liable 100% for any exposure, prospectively where liability had not already been established or settled.

At the insurance level, a number of employers' liability insurances are written with a damage/injury occurring during trigger, and accordingly victims where employers no longer existed or were insolvent faced a shortfall or failure in recovery.

In Durham v. BAI (Run off) Ltd., a policy decision portrayed as an exercise in contractual construction, the U.K. Supreme Court found, in 2012, that all employers' liability wording was to be treated as having a damage/injury caused during trigger, i.e., an exposure-based trigger.[6]

Further, and more importantly, by a majority the Supreme Court found in International Energy Group Ltd. v. Zurich Insurance Plc UK Branch in 2015 that the employers' liability insurer was liable to the employer for 100% of the loss in each year of exposure, namely to the same extent as the employer was liable to its victim.[7]

However, and creating a new right of contribution/recoupment, the insurer could recover from other insurers — or indeed the employer if uninsured — on a proportionate basis.

The employers' liability insurances in IEG covered the employers' liability and, as noted in Wasa, insurers generally take the risk of a change in law expanding the ambit of their insureds' liabilities, and the benefit where liability is reduced.

The outcome protected victims, through placing the solvency risk of employers/insurers on insurers themselves. However, even then three of the seven justices, led by Justice Jonathan Sumption, dissented, and would have reverted to the common law position at the insurance level due to the fundamental importance of the policy period of cover.

What, then, of the position at the reinsurance level? At that level, the policy decision of protecting the position of victims of mesothelioma is no longer applicable. The reinsurance is not a type of liability insurance of the insured but one of the underlying risk, and subject to the terms of the reinsurance itself.

IEG created a significant debate in the reinsurance market for many years. If the reinsured was liable for 100% of the loss in each year of exposure, could it not claim 100% from its reinsurers in a particular year — what became known as "spiking"?

This issue was finally resolved in 2019 in Equitas v. Municipal Mutual Insurance.[8]

The Court of Appeal found that the IEG majority line of jurisprudence should not apply at the reinsurance level and "we should revert to orthodoxy" in circumstance where the position of the victim has been protected. The orthodoxy was that (1) insureds should not be able to elect which insurance to recover under, and (2) the common law position as expressed in Barker.

Some judicial contortions were required to reach this result, with the court finding a term was to be implied into reinsurance that reinsurance claims must be made in a manner that is rational, which in this context meant

> that they be presented by reference to each year's contribution to the risk, which will normally be measured by reference to time on risk unless in the particular circumstances there is a good reason (such as differing intensity of exposure) for some other basis of presentation.[9]

The strength of the period of cover issue is such that "all sums" is inapplicable, despite the fact that the reinsured's own liability is established on such basis.

The Second Circuit, which appears to have engaged in its own research on English law, has mistakenly overlooked this reinsurance decision, commenting that "[t]here is no reason to think [the fundamental importance of a policy period] would stop that majority [in IEG] from imposing joint-and-several liability on a reinsurer in the present circumstances either."[10]

On its own logic, had the court been aware of the MMI decision, it would and should have reached the opposite view.

Would that be the correct decision regardless? The answer is that it would be. The key is that the issue turns on a matter of policy construction of the reinsurance, where English law has not changed. That is fundamentally different to a liability insurance where there is a change in law in relation to the insured's duty.

The risk still has to fall within the terms of the reinsurance. It is trite English law that contracts are construed as at the date of their formation — see per Justice Lawrence Collins in Wasa[11] — and matters occurring thereafter cannot affect their proper construction.[12]

There was simply no legal dictionary the parties could have looked at in Hawaii, or indeed anywhere in the U.S., which would have identified all sums at the relevant time.[13] Put another way, even if a later decision changed the law with retrospective effect, no legal dictionary would have so identified at the time.

Nor are there any broader policy reasons, such as protecting victims of asbestos, which would persuasively suggest a different approach should be adopted.

It is, of course, right that foreign reinsureds expect coverage to be back-to-back, and insurance is an important industry in the U.K. — a point made by Justice Collins in Wasa. But reinsureds also expect the certainty of English law and may well also be reinsurers themselves — as here, ICSOP being part of the AIG group.

As emphasized in Wasa, a contrary view would have the extraordinary result of the reinsurer being liable in full even if it wrote and received premium for just one day of risk. No objective reinsured and reinsurer at the time of the Equitas reinsurance would ever have considered that a possibility under an English law governed reinsurance, whether written on a back-to-back basis or otherwise.

In conclusion, the Second Circuit decision should not be relied on as an accurate statement of English law.

Christopher Foster is a partner and head of the insurance and reinsurance practice at Holman Fenwick Willan LLP.

[1] [2009] UKHL 40.

[2] Case No. 20-3559-cv (2d Cir. May 22, 2023).

[3] See MMI v Sea [1998] Lloyd's Rep IR 421 - unless particular loss can be proven at a particular time on the balance of probabilities.

[4] Fairchild v Glenhaven Funeral Services Ltd [2002] UKHL 22.

[5] Barker v Corus UK Ltd [2006] UKHL 20.

[6] Durham v BAI (Run off) Ltd [2012] UKSC 1.

[7] International Energy Group Ltd v Zurich Insurance Plc UK Branch [2015] UKSC 33.

[8] [2019] 3 WLR 613.

[9] Id.

[10] The 2nd Circuit was it appears looking to how the Supreme Court would resolve matters as shorthand for English law. Even if that were not right, one of the members of the Court of Appeal in MMI is now in the Supreme Court (Leggatt LJ).

[11] It is to be noted that in Wasa, Lord Mance, in obiter dicta, refused to approve the approach of Longmore LJ in the Court of Appeal. Lord Mance stated that the reinsured could have specified the underlying governing law to seek to protect itself on back to back cover, but even doing so "would not necessarily foreclose all argument."

[12] Per Lord Parmoor in Union Insurance Society of Canton Ltd v George Wills & Co [1916] 1 AC 281:"It is immaterial to the construction of the contract to consider subsequent events. The intention of the parties must be gathered from the language of the contract, the subject-matter, and the circumstances in existence at the time it was made". See generally Lewison on the Interpretation of Contracts 7th Ed, Section 9.

[13] A more difficult question is whether English law would adopt the same approach to the period of cover if "all sums" has applied in Hawaii at the relevant time. It is likely that it would do so when squarely faced with the issue. See in particular per Lord Brown in Wasa, who in the minority decided the case on the basis the English position would apply to the reinsurance come what may.

Neutral Citation Number: [2019] EWCA Civ 718

Case No: A4/2017/1278

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM AN ARBITRATION AWARD MADE BY
LORD JUSTICE FLAUX
SITTING AS A JUDGE-ARBITRATOR
PURSUANT TO SECTION 93 OF THE ARBITRATION ACT 1996

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 17/04/2019

Before :

LORD JUSTICE PATTEN
LORD JUSTICE LEGGATT
and
LORD JUSTICE MALES

- -

Between :

EQUITAS INSURANCE LIMITED	**Appellant**
- and -	
MUNICIPAL MUTUAL INSURANCE LIMITED	**Respondent**

- -
- -

Colin Edelman QC and **Keir Howie** (instructed by **Norton Rose Fulbright LLP**) for the **Appellant**
Alistair Schaff QC and **Tim Kenefick** (instructed by **Cooley (UK) LLP**) for the **Respondent**

Hearing dates : 18th to 20th March 2019

- -

Approved Judgment

Lord Justice Males :

Introduction

1. In 2002 the House of Lords created a special rule of causation in the law of tort to enable claimants suffering from mesothelioma as a result of exposure to asbestos to recover damages even though it was not possible to prove on the balance of probabilities which of two or more employers was responsible for the exposure which caused the claimant's disease: *Fairchild v Glenhaven Funeral Services Ltd* [2002] UKHL 22, [2003] 1 AC 32. This decision together with the subsequent intervention of Parliament in the Compensation Act 2006 gave rise to what has become known as "the *Fairchild* enclave", an area of law within which conventional principles have had to be adjusted to take account of the implications of this decision and to ensure that the anomalies which it has thrown up do not result in injustice – or, as Lord Sumption, taking a less sanguine view, was to describe the process, in which the law has moved from "each one-off expedient to the next", generating "knock-on consequences which we are not in a position to predict or take into account": see his dissenting judgment in *International Energy Group Ltd v Zurich Insurance Plc UK Branch* [2015] UKSC 33, [2016] AC 509 ("*IEG*") at [114].

2. The initial challenge posed by *Fairchild* was to determine whether and how liability should be apportioned between employers when there could be many employers over a period of years, any one of whom might have been responsible for the critical exposure. The solution eventually adopted, that each of the employers was liable in full, no matter how short the period of exposure for which it was responsible, created a different problem. If an employer had a series of annual Employers' Liability ("EL") policies, perhaps with different insurers, and perhaps some years when there was no insurance in place, which policy responded to the loss and how should the loss be apportioned between the various insurers on risk or (in cases where there was a period during which an employer had no insurance) between the insurers and the employer?

3. The present appeal raises similar questions, but in the context of reinsurance. They fall to be decided within the *Fairchild* enclave and potentially require the adaptation of conventional principles of causation, double insurance, self-insurance and (perhaps) subrogation in order to achieve a just solution to the problems raised as between the EL insurer which has paid a claim without allocating it to any particular policy year and its reinsurers.

4. These novel and difficult questions arise on an appeal pursuant to section 69 of the Arbitration Act 1996 from an award made by Flaux LJ sitting as a judge-arbitrator in accordance with section 93 of the Act. Leave to appeal was given by a previous decision of this court on the basis that they are questions of general public importance ([2018] EWCA Civ 991). I will come in due course to their precise formulation, but in broad terms the question is whether an insurer which settles a claim for liability for mesothelioma arising under EL insurance policies which span several years of exposure to asbestos can claim an indemnity for its full loss under whichever annual reinsurance within this period it chooses in order to maximise its reinsurance recovery, or whether it is limited to claiming under each annual reinsurance policy a *pro rata* share of the settlement sum; and, if the former, what rights of contribution and recoupment are available to the reinsurer(s) against which the claim is made.

5. It is apparent that the decision in *Fairchild* itself and the subsequent developments within the *Fairchild* enclave have been heavily driven by the policy that victims of mesothelioma should be fully compensated, without having to make multiple claims and without bearing the risk that one or more of the potential defendants is insolvent. The position which the law has reached so far is that any employer who has exposed a victim to asbestos in breach of duty, for however short a period, is liable in full to a victim of mesothelioma, while any EL insurer of such an employer is liable in full to indemnify the employer, again regardless of the period for which it has provided insurance and received premium. Provided, therefore, that there is at least one solvent employer or solvent EL insurer who can be identified as having provided cover at some time during the period of wrongful exposure, the victim will have a remedy against a defendant who is good for the money.

6. This policy driven outcome has resulted in some significant anomalies when judged by reference to fundamental principles of tort and liability insurance law. This has been regarded as necessary and acceptable in order to ensure that victims of mesothelioma are fully compensated. So far, the law has devised novel principles and solutions within the *Fairchild* enclave to accommodate these anomalies. Viewed broadly, the issue in the present case is whether it can now be said, at the reinsurance level, that the policy of ensuring compensation to victims has successfully worked itself out so that, as between reinsured and reinsurer, the law can return in a principled way to a more orthodox approach.

The facts

7. I begin by summarising the facts found by the judge-arbitrator.

8. The respondent, Municipal Mutual Insurance Ltd ("MMI"), was established in 1903 as a mutual insurance company providing insurance, including EL insurance, to local authorities and other public bodies. During the period between 1 January 1950 and 31 December 1981 MMI provided EL policies to numerous insured entities. Although the wording varied in immaterial respects over the years, its policies provided cover in the event of the insured employer's liability for an employee sustaining bodily injury or disease arising out of or in the course of his employment. Each policy was an annual policy. It appears that the cover provided by MMI was without limit and without any deductible.

9. MMI reinsured its liability under these policies with Lloyd's syndicates whose liabilities have since been transferred to the appellant ("Equitas"). These were annual excess of loss policies, although the retention varied. In the early years the retention was only £1,000 each and every accident, but it increased over the years and eventually by 1981 the retention was £150,000. There were various layers of reinsurance with Lloyd's syndicates and in some cases with other reinsurers. One higher level reinsurer, for example, was Mercantile & General Reinsurance Company Ltd ("M & G"), but that company ceased to provide cover in 1969 and, in 2005, entered into a Solvent Scheme of Arrangement.

10. The layers also changed over time. In 1950 the first layer was £50,000 excess of £1000, while by 1981 it was £100,000 excess of £150,000. After 1974 Lloyd's did not participate in the first layer of the programme, but only in higher layers. Other reinsurers also participated on some layers in later years.

11. The wording of the reinsurance provided by the Lloyd's syndicates varied from time to time, but not in material respects for present purposes. Taking the figures from the earlier policies, the reinsurers agreed to pay MMI:

> "the excess of loss of £1,000 … up to but not exceeding £51,000 … ultimate net loss on account of each and every accident but unlimited as to the number of accidents during the period of this Agreement which the Company may be called to pay under any one or more of their policies which may be involved in any one accident. Underwriters' liability hereon being limited to £50,000 … ultimate net loss on account of each and every accident".

12. The term "ultimate net loss" (or "UNL") was defined to mean "the sum actually paid by the Company in settlement of their liability …". It is common ground that this does not refer to actual payment by MMI but to the sum which was payable by it when its liability was finally ascertained either by judgment or agreement: *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313.

13. The reinsurance policies provided also (in a clause not set out in the award but which we were shown without objection) that:

> "The Liability of the Reinsurers hereon shall follow the liability of the Company to their respective Policyholders and the Reinsurers shall not be entitled to object to any of the terms and conditions either general or special of any of the original Policies."

14. MMI's employer insureds have faced a large number of claims from employees who were exposed to asbestos during their periods of employment and who have contracted mesothelioma. As a result of the Compensation Act 2006, an insured employer who has tortiously exposed an employee to asbestos is liable in respect of the whole of the damage caused to the victim by the disease irrespective of whether the victim was also exposed to asbestos by another employer. So far as the employee claimant is concerned, there is no need to prove which employer caused the critical exposure. Moreover, it is unnecessary and irrelevant for the employee, in a case where the employment extended over more than one year, to identify the year in which the critical exposure occurred.

15. In handling and paying claims by its insureds, MMI did not need to wrestle with these questions either and did not do so, despite the fact that its policies were written on an annual basis. Provided that MMI provided cover for some of the period of the alleged exposure and the underlying claim could be proved, each MMI policy providing such cover was 100% liable for the claim. MMI made no attempt to apportion claims to individual policies or periods. In cases where it was on risk for more than one policy year, the claim was not settled with reference to any particular policy year and there was no apportionment between particular policies or years. As the judge-arbitrator put it at [33] of his award:

> "… the amount being claimed against MMI by the insured and for which MMI was liable, was always treated by MMI for all purposes as a claim for one amount under all the responding MMI policies without any apportionment to individual policies or periods. There was no reason for such apportionment, on the basis that each policy was liable in full."

16. Thus, where the insured was the only employer to have exposed the underlying claimant to asbestos and was insured by MMI for the whole period of such exposure (so that there was only one employer and one insurer involved), MMI simply paid the whole claim. The judge-arbitrator found that it did so without regard to the precise start or finish date of the exposure in question, although it does not appear that there was anything to prevent it from ascertaining these dates if it had wished to do so. This was the position in 66 of the 178 claims with which the arbitration was concerned.

17. If other employers had exposed the underlying claimant to asbestos or if there were other insurers who had issued relevant policies, MMI would seek to obtain a contribution from them or (if there were periods when the employer had not taken out insurance) from its insured, generally by reference to time on risk, that is to say the proportion which the self-insured employer's or other insurer's time on risk bore to the whole period of culpable exposure. This was in accordance with Guidelines issued by the Association of British Insurers in 2003 following the decision in *Fairchild*. Such a contribution was sometimes but not always achieved.

18. Initially MMI presented claims to Equitas under its reinsurances on the basis of a time on risk allocation, so that each loss was divided *pro rata* between the years of reinsurance in which each employee claimant was exposed to asbestos. That is the method for which Equitas contends.

19. Mr Alistair Schaff QC for MMI pointed out that in the cases where the inwards insurance claims had been settled without regard to the precise start or finish date of the exposure period, a precise time on risk allocation could not have been achieved. For example, if the exposure period began and ended part way through the policy year in question as would generally be the case, but the precise dates were not known, it would be impossible to say what the period of exposure was. Unless it happened to have begun at the beginning of January and ended at the end of December, it would be inaccurate to count the full year and impossible to say how much of the year should be counted. No doubt that is true, but in practice it does not seem to have troubled the parties and the judge-arbitrator found as a fact that claims had been presented on the basis of a time on risk allocation.

20. However, a time came when MMI changed its method of presentation so that it presented the whole claim to one year of reinsurance. It did so on the basis that its inwards claims had been settled without apportionment to particular years or policies and that, because each insurance policy was liable in full, so too each reinsurance policy was liable in full and it was entitled to present its reinsurance claim to any policy year of its choice in which the underlying claimant had been exposed by its insured to asbestos. This has been described as "spiking".

21. In practice MMI would claim either against the reinsurance in force in the first year in which it was exposed to an inwards claim (which happened in all but 33 of the 178 claims with which the arbitration was concerned) or (if that would not provide a full recovery) against the reinsurance in force in the year which would give MMI the fullest recovery. That year was often 1969, the year after M & G ceased to participate in its reinsurance programme. Thus MMI avoided any need to present a claim to a year in which one of its reinsurers was insolvent.

The questions of law

22. It was that revised method of presenting claims which gave rise to the parties' dispute. MMI contends that it is entitled to present claims by spiking in this way. Equitas disputes this, contending that MMI is only entitled to claim against each applicable reinsurance contract a *pro rata* proportion of the loss attributable to the underlying claim, calculated on a time on risk basis. If MMI is correct, further issues arise as to the calculation of the rights of contribution and recoupment acquired by the reinsurer of the "spiked" year.

23. The judge-arbitrator decided these issues in favour of MMI (together with a further issue relating to defence costs which no longer arises) and Equitas now appeals. The questions arising on this appeal for which leave has been given are as follows:

(1) In the event of an insured employee being tortiously exposed to asbestos in multiple years of EL insurance, and the EL insurer settling the employer's claim without allocating the loss to any particular year of exposure, is the EL insurer obliged (in the absence of specific provision for this situation in the corresponding reinsurances) to present any outwards claim in respect of that loss on a *pro rata*, time on risk basis for the purpose of calculating reinsurance recoveries, either because:

a. the contribution to the settlement of each engaged policy must by necessary implication be treated as having been on that basis ("question 1"); or

b. the doctrine of good faith requires the claim to be presented on that basis ("question 2")?

(2) If the EL insurer is not so obliged, and may present a claim to a single year of his choice, how are the rights of recoupment and contribution acquired by the reinsurers of that year to be calculated ("question 3")?

The *Fairchild* jurisprudence

24. In order to explain how these issues arise it is necessary to summarise the effect of what is now a substantial body of case law which applies within the *Fairchild* enclave. As this is well trodden ground, I shall do so as briefly as possible.

Fairchild

25. In *Fairchild* itself the House of Lords held that where a mesothelioma victim was tortiously exposed to asbestos by two or more employers but due to the limitations of medical science could not prove on the balance of probabilities which of them had caused his mesothelioma, both (or all) employers were jointly and severally liable for the loss. It is important in the light of subsequent debate to emphasise two points as to precisely what *Fairchild* must be taken to have decided. The first is that the employers' liability was for causing the disease (which might not be suffered for many years or even decades after the critical exposure) and not merely for exposing the employee to the risk of doing so. Thus an employee who was exposed to risk but had not (or had not yet) developed the disease had no claim. The second was that, because it was impossible to prove which exposure or exposures had actually caused the disease to develop, a modified rule of causation would be applied, whereby any employer who made a material contribution to the risk of mesothelioma being

contracted was treated as having caused the disease. In later cases this was referred to as a "weak" or "broad" test of causation.

Barker

26. Although *Fairchild* decided that each of two or more employers would be liable, it did not decide for what damages they would be liable. That was decided by *Barker v Corus UK Ltd* [2006] UKHL 20, [2006] 2 AC 572, in which the House of Lords held that the liability of each employer was several and should be calculated according to each defendant's relative degree of contribution to the risk, usually measured by the duration and intensity of the exposure involved. To take a simple example, therefore, if an employee who contracted mesothelioma had been exposed to asbestos for 10 years, but had worked for one employer for only four of those years, that employer would (in the absence of some good reason for a different allocation) be liable for 40% of the employee's damages. That would be so regardless of whether, during the other six years, the employee was working for other employers who were similarly liable for their proportionate share or (as might be the case) was exposed to asbestos in ways which did not give rise to liability on the part of anyone.

27. Good reason for a different allocation might exist if it was possible to say, for example, that the exposure to asbestos by one employer was more intense or that the asbestos encountered in one employment was more aggressive than in other cases. Absent some such feature, however, the duration of the exposure was the fairest measure of an employer's share of liability.

28. It is apparent from the speeches that the House of Lords recognised explicitly that *Fairchild* had created an exception to the normal rules of liability in negligence and was seeking to find the fairest way of applying this exception in the special circumstances where conventional proof of causation was not possible. Lord Hoffmann put it this way, in a section of his speech under the heading of "Fairness":

> "40. So far I have been concerned to demonstrate that characterising the damage as the risk of contracting mesothelioma would be in accordance with the basis upon which liability is imposed and would not be inconsistent with the concept of damage in the law of torts. In the end, however, the important question is whether such a characterisation would be fair. The *Fairchild* exception was created because the alternative of leaving the claimant with no remedy was thought to be unfair. But does fairness require that he should recover in full from any defendant liable under the exception?
>
> …
>
> 43. In my opinion, the attribution of liability according to the relative degree of contribution to the chance of the disease being contracted would smooth the roughness of the justice which a rule of joint and several liability creates. The defendant was a wrongdoer, it is true, and should not be allowed to escape liability altogether, but he should not be liable for more than the damage which he caused and, since this is a case in which science can deal only in probabilities, the law should accept that position and attribute liability according to probabilities. The justification for the joint and several liability rule is that if you caused harm, there is no reason why your liability should be reduced because someone else also

> caused the same harm. But when liability is exceptionally imposed because you *may* have caused harm, the same considerations do not apply and fairness suggests that if more than one person may have been responsible, liability should be divided according to the probability that one or other caused the harm."

29. Lord Scott and Lord Walker expressed their full agreement with Lord Hoffmann. Lady Hale also emphasised the need to find the right balance of fairness between claimant and defendant in determining the boundaries within which the *Fairchild* principle should be applied.

30. Thus *Barker* decided that, within what later came to be called the *Fairchild* enclave, the common law rule was that liability between defendants should be apportioned according to relative contribution to risk and that this was what fairness demanded.

The Compensation Act 2006

31. If *Barker* had stood, the problems relating to insurance and reinsurance with which we are now concerned would not have arisen, but it was promptly reversed by the Compensation Act 2006. Section 3 provided, in short, that where a person was liable to a victim of mesothelioma as a result of tortiously causing or permitting him to be exposed to asbestos, he would be liable in respect of the whole of the damage caused to the victim irrespective of whether there were in addition other exposures to asbestos and irrespective of whether those other exposures gave rise to any other liability.

32. The section therefore assumed, but did not create, liability in tort in accordance with *Fairchild* but, as between the employer ("the responsible person") and employee ("the victim") it reversed *Barker* by allowing the employee to recover damages for the whole of the damage caused by the mesothelioma from any one of the employers which *Fairchild* had made liable. Parliament thereby made clear that, as between employer and employee, it took a different view of what fairness required from the view taken by the House of Lords in *Barker*, its priority being to ensure full compensation to victims of mesothelioma as a result of exposure to asbestos dust.

33. Section 3 went on to say that it did not prevent one employer from claiming a contribution from another. Typically such a claim for contribution would be made under the Civil Liability (Contribution) Act 1978 as the effect of *Fairchild* was that, even though the employers had exposed the victim to asbestos in different periods of time, they were each liable for "the same damage". Section 3(4) provided that:

> "In determining the extent of contributions of different responsible persons … a court shall have regard to the relative lengths of the periods of exposure for which each was responsible; but this subsection shall not apply –
>
> a) if or to the extent responsible persons agree to apportion responsibility amongst themselves on some other basis, or
>
> b) if or to the extent that the court thinks that another basis for determining contribution is more appropriate in the circumstances of the particular case."

34. Once the victim had received full compensation, therefore, Parliament recognised that as between employers or other responsible persons it would be fair, in accordance with *Barker*, for liability to be apportioned according to each employer's contribution to the risk and that this contribution was to be determined on a time basis unless there was some good reason for adopting another method of apportionment.

"*Trigger*"

35. The impact of the *Fairchild* rule of causation on EL insurance was considered in *Durham v BAI (Run off) Ltd* [2012] UKSC, [2012] 1 WLR 867, generally referred to as the "*Trigger*" litigation. The Supreme Court held that conventional policy wordings (including MMI's) which referred to injury or disease "contracted" or "sustained" during the policy period responded in the event that an employee was exposed to asbestos during the policy period even though the mesothelioma did not develop or was not manifest until many years later and as a matter of ordinary language the disease would not generally be regarded as having been contracted or sustained until the mesothelioma had developed. On the basis that terms such as "contracted" or "sustained" were construed as referring to causation, the concept of a disease being "caused" during the policy period had to be interpreted flexibly in the light of the special rule of causation established by *Fairchild*. This was an application of the "weak" or "broad" causal link which exists within the *Fairchild* enclave. Lord Mance summarised this reasoning in *IEG* at [22] as being that:

> "If causation is given a weak or broad meaning as against the person tortiously responsible, the same weak or broad meaning should be treated as carrying through into a liability insurance covering an insured on a causation basis."

36. The alternative would have been to say that the insurer was liable merely for making a material contribution to the risk (which was not what *Fairchild* had decided) or that the EL insurance did not respond at all in mesothelioma cases, which as a matter of policy was clearly unacceptable. It was essential that EL policies should respond in order to ensure compensation to victims in the event that employers were insolvent.

IEG

37. However, the "*Trigger*" litigation was not concerned with and did not need to examine the extent of the liability which arose under each EL policy. That question arose in *IEG*. It is necessary to look closely at what that case decided.

38. In *IEG* the question was whether an EL insurer who had provided cover for only part of the period during which the victim was exposed to asbestos was required to bear the whole of the employer's liability in the same way that each employer was liable in full. If it was, the further question arose whether it was entitled to a proportionate contribution from other insurers who had provided cover in other years of exposure or to recoup a proportionate share of its loss from the employer in respect of years when there was no insurance in place or no identifiable insurer who had provided cover.

39. A complication of the case was that it was decided in accordance with Guernsey law and that the Compensation Act 2006 did not apply in Guernsey. Rather, Guernsey law was in all relevant respects the same as English common law. Accordingly the first question was whether the proportionate recovery rule in *Barker* remained part of the

English common law or whether (as the insured employer contended) it had been fatally undermined and in effect overruled by the 2006 Act and the decision in the "*Trigger*" litigation. The Supreme Court held unanimously that *Barker* remained a correct statement of the common law: see Lord Mance at [31], Lord Hodge at [100] and Lord Sumption at [179] and [180].

40. Applying the common law set out in *Barker*, the Court held that the insurer's liability to the employer was limited to a proportionate part of the damage suffered by the employee victim, the proportion being measured by reference to the time which the insurer had been on risk. On the facts, the insurer had provided cover for six out of the 27 years during which the employee had been employed by the employer and exposed to asbestos. Accordingly the insurer was obliged to indemnify the employer for only 6/27 of the damages which the employer had paid to the employee.

41. However, the Court was divided as to the route by which this result was achieved. In the majority Lord Mance and Lord Hodge (with whom Lord Clarke and Lord Carnwath agreed) held that this was an application of the indemnity principle. As the Compensation Act 2006 did not apply in Guernsey and the common law position established by *Barker* remained, the employer's liability to its employee during the six years in which it had insurance cover was limited to a proportionate part of the full compensation to which the employee was entitled and the fundamental principle of indemnity which governs liability insurance meant that it could not recover more than this from its insurer: see Lord Mance at [25] and [26]. Leaving aside the distinct issue of the employer's defence costs, this was sufficient for the majority to decide the appeal, as Lord Mance recognised at [35].

42. In the minority, however, Lord Sumption (with whom Lord Neuberger and Lord Reed agreed) held that the same result would be reached regardless of whether *Barker* remained good law: see [178]. This was because, as a matter of construction of the insurance policy, the insurer's liability must be prorated between every policy year during which the insured employer exposed the victim to asbestos:

> "160. The theory that an insurer is liable in respect of any year of insurance when the employee was exposed to the risk of contracting mesothelioma is a perfectly satisfactory answer to the question whether the insurer is liable at all, which was the only relevant question at issue in the '*Trigger*' litigation. But it cannot be applied without modification when the question is how much of the loss is attributable to particular years. If, as '*Trigger*' teaches, the insurer's liability is triggered in each policy year, the rational response of the law is not to assign the whole of that loss to a policy year of the insured's choice. That would be to assume that the whole loss was caused in that year, whereas the law proceeds from the premise that we cannot know that. The rational response is that the loss must be prorated between every policy year during which the insured employer exposed the victim to asbestos. In my opinion, once one rejects the conclusion that the insurer is not liable at all, proration on that basis is the only way of giving effect to the overriding requirement of each annual policy that the liability should be assigned to policy years. If exposure to the risk of contracting mesothelioma is equated with causation, the natural consequence is that the resultant liability falls to be apportioned to policy years according to the duration and intensity of the exposure. What is being prorated as between the insurer and the employer is the employer's liability, not the indivisible harm of the mesothelioma itself. The

> chances of contracting mesothelioma, as Lord Hoffmann observed in *Barker* [2006] 2 AC 572, para 35, are infinitely divisible, even if mesothelioma itself is not."

43. The majority firmly rejected this analysis and considered at some length what the position would be in the event that the Compensation Act 2006 applied. Although strictly speaking this part of Lord Mance's judgment was *obiter*, it was clearly intended as a definitive statement of English law which would guide the insurance market in dealing with mesothelioma claims on EL policies. Mr Colin Edelman QC for Equitas did not suggest, either before the judge-arbitrator or on appeal before us, that Lord Mance's judgment should not be followed. On the contrary his submission was that it was an accurate statement of the law as it applies at the insurance level, but that a different solution to the problems thrown up by the *Fairchild* jurisprudence is needed at the reinsurance level.

44. Lord Mance began by emphasising at [40] the novelty of the situation created by *Fairchild* and "*Trigger*" in an insurance context where the period of insurance is fundamental to the insurer's liability and insurance is placed on the basis that liability or loss will fall into a particular period. He continued, describing features of conventional liability insurance as follows:

> "In short, insurance would have been and was placed on the basis that a particular liability for loss would fall into one, not a series of separate periods. If an insured wanted complete cover, it would have to maintain it for all such periods. The relevant period would also be ascertained by objective criteria, which meant that insureds could not select it at will or to obtain the advantage of the cover most favourable from their viewpoint. Thus: (i) Under a liability insurance where the trigger is causation in its traditional sense based on probability, no problem exists about allocating tortious liability to one and only one policy period. (ii) Under a claims made policy, claims must be notified and will attach at latest when they arise, while specific clauses dealing with the notification of circumstances likely to give rise to a claim may attach a claim to an earlier policy than that during which it actually arises. (iii) An insured may, for one reason or another, have double insurance. In that context, it may elect which to invoke, but well established principles exist for the two insurers to share liability equally up to the common limit. (iv) An insured may also agree to carry an excess or franchise, in which case it will have to bear that amount before looking to its insurer, and will as a self-insurer rank last in any recoveries made by way of subrogation from any third party: *Lord Napier & Ettrick v Hunter* [1993] AC 713."

45. In contrast, the special features existing within the *Fairchild* enclave had thrown up a series of anomalies. To permit an insured employer to spike an insurance claim to the policy year of its choice, leaving that insurer to bear the whole liability, would run counter to fundamental principles of insurance law:

> "43. If matters stop there, and the insurer ends up carrying the whole liability, the anomalies are self-evident. (a) It is contrary to principle for insurance to operate on a basis which allows an insured to select the period and policy to which the loss attaches. This is elementary. If insureds could select against insurers in this way, the risks undertaken by insurers would be entirely unpredictable. (b) It is anomalous for a liability insurance underwritten for a premium covering losses

> arising from risks created during its particular period to cover losses about which all that can be said is that they arise from risks extending over a much longer period, in respect of which no premium has, or could have, been assessed or received by the insurer. (c) An insured is able to ignore long periods in respect of which he himself has chosen not to insure, or has not kept any record of any insurance which he may have taken out, or has chosen to entrust his insurance to an insurer who has become insolvent. (d) An insured has no incentive to take out or maintain continuous insurance cover. On the contrary, it is sufficient to take out one year's cover, or even to arrange to be held covered for only one day, during whatever happens subsequently to prove to have been the overall exposure period – whether this is done at the very start of the overall exposure period, or later after many decades of exposure, perhaps due to a sudden appreciation of the virtues of insurance under the special rule."

46. Despite these anomalies, Lord Mance concluded at [45] to [51], rejecting Lord Sumption's analysis, that the reasoning in "*Trigger*" bound the court to hold that mesothelioma was caused in each and every period of any overall period of exposure, with the consequence that any insurer on risk during that overall period was liable for the full extent of the damage:

> "51. An insurer, whether for the whole or part of the period for which the insured employer has negligently exposed the victim to asbestos, is on the face of it liable for the victim's full loss."

47. Nevertheless, said Lord Mance, the analysis could not stop there:

> "51. … The court is faced with an unprecedented situation, arising from its own decisions affecting both tort and insurance law. A principled solution must be found, even if it involves striking new ground. The courts cannot simply step back from an issue which is of their own making, by which I do not mean to suggest that it was in any way wrong for the courts, from *Fairchild* onwards, to have been solicitous of the needs of both victims and insureds. But by introducing into tort and liability insurance law an entirely new form of causation in '*Trigger*', the courts have made it incumbent upon themselves to reach a solution representing a fair balance of the interests of victims, insureds and insurers."

48. The solution adopted was to accept the insurer's liability in full, even if it had provided cover for only a part of the period of exposure, but to temper the consequences of this by invoking by analogy the concepts of co-insurance (or double insurance) and self-insurance. Although not precisely applicable, these concepts could be adapted and developed to meet the special requirements of the *Fairchild* enclave and to eliminate or reduce the anomalies to which it gave rise:

> "52. In my view the law has existing rules which can be adapted to meet this unique situation. The concepts of co-insurance and self-insurance are both at hand. Co-insurance is relevant in so far as the insured has other insurance to which it could also have resorted on the basis that it had also exposed the victim during the period of that insurance. Self-insurance is relevant, because an insured who has not (i) taken out or (ii) kept records of or (iii) been able to recover under such other insurance must be regarded as being its own insurer in respect of the period in question for which it has no cover. A sensible overall result is only

> achieved if an insurer held liable under a policy like the Midland policy is able to have recourse for an appropriate proportion of its liability to any co-insurers and to the insured as a self insurer in respect of periods of exposure of the victim by the insured for which the insurer has not covered the insured."

49. Lord Mance recognised that this was not strictly a case of co-insurance because that exists when there are two policies covering the same period. That was not the position in *IEG*, where in the usual way each policy was written for a separate year and covered only risks occurring during that year. Nor was it really a case of self-insurance as that concept had previously been deployed. Nevertheless, the court had to do something:

> "53. … the court would be abrogating its role to achieve a just solution consistently with what any sensible commercial party would have contemplated if it does not adapt and develop conventional principles to meet an unconventional, indeed unique, challenge. … To say (as Lord Sumption JSC does: para 185) that there has here been a 'contractual allocation of risks' which precludes the court taking steps to avoid evident absurdity which no contracting party can sensibly have contemplated or intended appears to me unrealistic. …"

50. Ultimately Lord Mance held that the principles which underlay rights of contribution were flexible principles of equity and justice which could be invoked when there was more than one insurer, each covering a separate period of exposure to asbestos:

> "63. In my view, the principles recognised and applied in *Fairchild* [2003] 1 AC 32 and '*Trigger'* [2012] 1 WLR 867 do require a broad equitable approach to be taken to contribution, to meet the unique anomalies to which they give rise. … If a broad equitable approach is taken in the present unique circumstances, then it should no doubt also be possible in the present context to overcome the presumption with double insurance that loss should be shared equally. Contribution between insurers covering liability on the basis of exposure should take account of differing lengths of insured exposure. Conventional rules need to be adapted to meet unconventional problems arising from the principles recognised and applied in *Fairchild* and '*Trigger*'."

51. As to self-insurance, resort to this concept was necessary because there would be some periods of exposure to asbestos when there was no insurance in place or none which was available to provide contribution. (Indeed, in *IEG* itself there were two insurers, who between them had provided cover for eight years, and 19 years when the employer was uninsured). The insured should therefore be treated as its own insurer in respect of such periods. There was no inconsistency between recognising that the terms of the policy meant that the insurer was liable in full for the damage suffered by the victim and requiring the insured to contribute towards the insurer's cost of meeting that liability:

> "77. In the present case, an insured who insures for a limited period necessarily accepts that it is only liability incurred during that period for which he has cover. The unique feature of the present situation is that the whole substratum of the relevant insurance policies has changed fundamentally since they were underwritten, and the law has, for the first time ever, imposed liability on the basis of risk, rather than the probability, that negligence during the insurance

> period led or contributed to the illness complained of. The concomitant of insurance liability in this situation must be a recognition that the law can and should address the unjust and wholly anomalous burden which would otherwise fall on any particular insurer with whom insurance was only taken out for part of the total period of exposure by the insured, by recognising an obligation on the part of the insured to contribute *pro tanto* to such liability as a self-insurer."

52. In a concurring judgment with which the other judges in the majority also agreed, Lord Hodge at [104] and [105] expressed his agreement that the effect of the "*Trigger*" litigation was that an insurer which had provided cover for only part of the period of the employee's exposure must meet the entirety of the employer's liability, recognising that this would enable the insured employer to select the insurer against which to claim. He recognised also that this created anomalies which had to be addressed, and agreed with Lord Mance's proposed solution. One reason for doing so was his understanding that it would not create major practical difficulties:

> "110. Finally, the practical solution which Lord Mance JSC offers appears to be consistent with the way in which the London insurance market has operated in handling mesothelioma claims. That may suggest that the solution will not give rise to major practical difficulties."

53. Although the solution adopted by the majority was to say that each insurer was liable in full and (in effect) that spiking was permitted, but that the spiked insurer would then have rights of contribution from other insurers and recoupment from the insured, Lord Mance's understanding was that (save in cases of insolvency) this would lead to the same ultimate financial outcome as the construction adopted by the minority:

> "78. … I believe that this leads in practice, at least in the case of a solvent insured, to substantially the same result as that at which Lord Sumption JSC arrives, but by a different route, which in my opinion reflects the reasoning and result in '*Trigger*' [2012] 1 WLR 867. The difference between the two routes may however be important in the context of an insured who is not solvent."

54. If the practical difference between the two rival approaches in *IEG* is limited to cases of insolvency, the view of the majority can be seen to be consistent with the policy of ensuring that victims of mesothelioma receive full compensation. This was explicit in Lord Hodge's judgment, where one of his reasons for agreeing with Lord Mance was that:

> "106. … it is consistent with the policy of the United Kingdom Parliament that the employee-victim should be able to obtain damages for his loss in a straightforward way."

55. In contrast the approach of the minority would mean that in the case of an insolvent employer, a victim would be left with no recourse against an EL insurer which had provided cover for only part of the period during which he was exposed to asbestos. Lord Neuberger recognised this at [203] ("unlike Lord Sumption JSC's solution, [Lord Mance's] ensures that every employee whose employer was insured for any period of his employment, can look to any such insurer who is still solvent for full compensation").

56. As commentators on *IEG* have recognised, it was only a matter of time before the issues raised by reference to EL insurance contracts recurred at the reinsurance level. That time has now arrived.

The award

57. The judge-arbitrator stated the issues for decision in the present case in the following terms:

(1) Is MMI to be treated as having settled the inwards claims on the basis that each EL policy on risk was contributing a *pro rata* share of the loss being paid by MMI?

(2) If not, is the basis on which MMI is presenting its reinsurance claims contrary to the duty of utmost good faith or an implied contractual duty requiring MMI to present its reinsurance claims in good faith?

(3) If issues (1) and (2) are determined in favour of MMI, on the proper construction of the reinsurance contracts, is MMI contractually entitled to recover the full amount it has paid in respect of each inwards claim from any reinsurance contracts of its choice which provided cover for any part of the exposure period for which it was on risk, subject to the limits and retentions for those reinsurance contracts and subject to the paying reinsurers' rights of contribution and recoupment?

(4) If so, what rights of contribution and recoupment do the reinsurers which are called upon to pay the claim acquire against any other reinsurers who were also on risk for the claim, and against MMI in respect of any deemed "self-reinsurance", and how do those rights fall to be calculated? In particular, should they be calculated using:

a. the "from the ground up" *pro rata* method of apportionment, taking into account the first layer retention in every year of reinsurance exposure, as Equitas contends; or

b. the "independent liability" method as MMI contends?

58. The judge-arbitrator decided all of these issues in favour of MMI. What follows can be no more than a summary of a detailed and carefully reasoned award.

59. In relation to the first issue he held, in accordance with "*Trigger*" and *IEG*, that each year's insurance policy was 100% liable for the insured employer's loss and that the settlement of each claim without allocating the loss to any particular year settled in full MMI's 100% liability under each and every EL policy on risk. That settlement ascertained MMI's liability under each policy, from which it followed that MMI was contractually entitled to present its reinsurance claim to any given year of reinsurance on the basis that that year was 100% liable in the same way as the insurance on that year which it was reinsuring. This was a matter of absolute contractual entitlement. As a matter of fact it was impossible to say that any of the settlements had been concluded on a *pro rata* basis and there was nothing in law to require them to be treated as if they had been.

60. Thus there was no justification for any implied term requiring the loss to be divided up and allocated to different years of reinsurance on a time basis. There was no justification for saying that the "real basis" on which MMI had settled its liability was that each year had made a contribution to the risk and bore a proportionate responsibility for the loss. The argument that *Barker* continued to apply as between reinsured and reinsurer provided no greater support for allocating loss to each policy on a time on risk basis than had been the case as between insured and insurer, but that argument was ruled out by the decision of the majority in *IEG*.

61. As to the second issue, the judge-arbitrator concluded that it was no part of the function of an arbitral tribunal to extend the scope of the post contractual duty of good faith in insurance contracts, particularly as that duty had been held by the House of Lords in *The Star Sea* [2001] UKHL 1, [2003] 1 AC 469 to be limited, in a claims context, to a duty not to act dishonestly in connection with the making of a claim, a decision which had recently been confirmed by the majority of the Supreme Court in *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG* [2016] UKSC 45, [2017] AC 1. He derived no real assistance from the New York cases on which Equitas relied where a wider concept of good faith had been adopted than applies in English law and regarded the English cases involving the exercise of a discretion or power (e.g. *Socimer International Bank v Standard Bank London Ltd* [2008] EWCA Civ 116, [2008] 1 Lloyd's Rep 558) as irrelevant in circumstances where MMI had an absolute contractual right to present the whole of its loss to any reinsurance policy of its choice, a distinction recognised by *Mid Essex Hospital Services NHS Trust v Compass Group UK & Ireland Ltd* [2013] EWCA Civ 200, [2013] BLR 265.

62. Moreover, the judge-arbitrator found that even if there were a duty of good faith in relation to the allocation of the settlements to particular reinsurances or an implied term that a decision to allocate should be *Wednesbury* reasonable, there was no want of good faith or irrationality in circumstances where MMI expressly acknowledged that there was a need for equitable recoupment and contribution to redress any anomalies.

63. Having reached these conclusions on the first two issues, the judge-arbitrator said that the third issue answered itself. MMI was contractually entitled to recover the full amount of its inwards settlement from any reinsurance contract or contracts of its choice which provided cover for any part of the period at risk. In other words it was entitled to spike. This was subject to the retention under the contract for the spiked year and to the reinsurers' rights of contribution and recoupment, but how these were to be dealt with arose for decision under the fourth issue. The judge-arbitrator noted that his conclusion was "entirely in accordance with the well-established principle in the law of reinsurance that the reinsurance is on the original subject-matter so that insurance and reinsurance are to be treated in the same way and each year of reinsurance is 100% liable in the same way as each year of insurance is 100% liable".

64. Finally, the judge-arbitrator dealt with the issues concerning contribution and recoupment. As already noted, it was common ground that those concepts had a role to play if (as the arbitrator had held) MMI had been successful so far. The issue was how they should be applied. Equitas contended for a *pro rata* method of apportionment with two related aspects: (1) that MMI had to give credit in full for its retentions in each year of reinsurance even though the claim was "spiked" into one year and (2) that, by analogy with principles of subrogation, the higher layers of

reinsurance in subsequent years should be made good first in any contribution and recoupment process (the so-called "top-down" approach).

65. The judge-arbitrator rejected both submissions. He said that there was nothing in the existing authorities which assisted on the issue of retentions. He concluded that MMI need only give credit for a single retention, namely that applicable in the year into which the claim was spiked. He held that MMI was to be regarded as a self-insurer as regards the retention in each policy year, and therefore that Equitas should have no right of recoupment as regards the retentions in years before or after the year to which the 100% claim was presented as it had never provided an indemnity for that part of the loss. It would be unfair if MMI had to give credit for retentions in each and every year. Rather, he said, the approach should be that which applied in cases of double insurance where only one retention would be borne by the insured.

66. As to the "top-down" approach to contribution, the judge-arbitrator concluded that the proposed justification for the proposition that the higher layers of reinsurance were more remote from the loss and should therefore get the first benefit of contribution and recoupment was a proposition derived from principles of subrogation and that the doctrine of subrogation had no place in the apportionment exercise.

The scope of review

67. For MMI as the respondent, Mr Schaff emphasised that this is an appeal under section 69 of the Arbitration Act 1996 in which the court's task is confined to deciding the questions of law for which permission to appeal has been given. He submitted that on some issues, particularly those concerned with good faith and with equitable contribution and recoupment, the judge-arbitrator's conclusions depended on his view of what was fair and equitable and that these were an exercise of arbitral judgment which we could not go behind.

68. I accept entirely that the role of the court is limited to determining the questions of law and that we are bound by the facts found in the award and only those facts. This is basic. However, the questions of how principles of good faith (if applicable) and of contribution and recoupment should be applied at the reinsurance level within the *Fairchild* enclave are questions of law on which ultimately we must reach our own decision, albeit giving proper weight to the view of the judge-arbitrator. That is what I shall seek to do.

Equitas's submissions in outline

69. Mr Colin Edelman QC for Equitas began by emphasising the novelty of the *Fairchild* jurisprudence and the anomalies which it has created as a result of the courts having cast off into uncharted waters. In consequence it had already been necessary to devise novel solutions, for example the new rights of contribution and recoupment created by the majority in *IEG*, and the courts remained under a responsibility to face up to the consequences of *Fairchild* which they themselves had created, if necessary by further innovation. While *IEG* had provided a solution at the insurance level, in a way which was necessary to ensure full compensation to victims of mesothelioma, that objective had now been achieved for all practical purposes and the same policy considerations did not apply at the reinsurance level. At that level, the victim having received his compensation from his employer or its insurer, it was possible and desirable to revert

to the principles of the common law whereby liability should be apportioned in accordance with *Barker* by reference to time on risk. Thus each reinsurance policy should bear its proportionate share of liability calculated from the ground up.

70. Mr Edelman recognised that this would need to be achieved in a principled way and submitted that there were three routes by which this might be done.

Deemed allocation/implied term

71. The first was to say that MMI must be deemed to have settled its inwards insurance claims on a time on risk basis, such that the value represented by the settlement consideration should be regarded as implicitly allocated in *pro rata* shares across all triggered policies in proportion to the contribution to the overall risk made during the period of each policy. This could be regarded as the "real basis" of the settlement of the inwards claims, by analogy with cases where courts had been prepared to investigate the true or real basis of the settlement of insurance claims (*Assicurazioni Generali SpA v CGU International Insurance Plc* [2003] EWHC 1073 (Comm), [2003] 2 All ER (Comm) 425 at [40]; and *Enterprise Oil Ltd v Strand Insurance Co Ltd* [2006] EWHC 58 (Comm), [2007] Lloyd's Rep IR 186 at [170] and [171]). Mr Edelman did not suggest that these cases were directly applicable, recognising as the judge-arbitrator had held that they were concerned only with a factual investigation which does not arise here. He submitted, however, that they illustrate a willingness to look beyond the terms of any settlement to the underlying reality and can usefully be adopted within the *Fairchild* enclave where for policy reasons liability has been imposed on an insurer on an artificial and unconventional basis and the reality is that the settlement discharges the insurer's liability under each and every triggered EL policy.

72. Adopting this approach, Mr Edelman submitted that *pro rata* allocation is necessarily implicit in an unallocated settlement of a mesothelioma EL claim by virtue of the special legal features of the liabilities being settled, so that spiking to a single year of reinsurance would be inconsistent with the basis on which the claims had been (or must be deemed to have been) settled. Alternatively, he submitted that the same result may be achieved by implying a term to the effect that the reinsured's UNL must be formulated by reference to the contribution to risk made in the period of each reinsurance in accordance with the *Barker* principles. Whichever of these two possible courses was adopted would restore the "elementary" principle that insurance cannot "operate on a basis which allows an insured to select the period and policy to which a loss attaches" (*IEG* at [43]).

Duty of good faith

73. Alternatively Mr Edelman invoked what he described as a duty of good faith requiring the presentation of reinsurance claims to be made on a *pro rata* basis in accordance with the *Barker* principles unless there was some rational basis (which would not include a desire to maximise reinsurance recoveries) for presenting them in some other way. He recognised that the concept of good faith has not previously been applied in this manner and that to do so would involve a development of existing legal doctrine in order to address the special problems raised within the *Fairchild* enclave, in particular the ability of the insurer to select the policy to which a loss should be attached which is contrary to elementary principles of liability insurance.

74. For this purpose Mr Edelman drew upon three sources, namely (1) the nature of an insurance or reinsurance contract as a contract of the utmost good faith, (2) cases which have held that contractual discretions must be exercised in good faith (or, more fully, in a manner which is not irrational, arbitrary or capricious: see e.g. *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116, [2008] Bus LR 1304; and *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661); and (3) New York authority where a wider concept of good faith in insurance contracts applies (e.g. *United States Fidelity & Guaranty Co v American Re-Insurance Company* 20 N.Y. 3d 407 (2013)). Mr Edelman did not suggest that any of these sources mandated the development for which he contended. He relied upon them as illustrations of principles which might be invoked by analogy in much the same way as the majority of the Supreme Court had drawn upon a number of principles, none of which applied directly, in order to develop the rights of contribution and recoupment established in *IEG* as a response to the anomalies thrown up by *Fairchild*.

Contribution and recoupment

75. The third and final route relied on to achieve a result whereby each reinsurance policy would bear its proportionate share of liability by reference to time on risk was by means of contribution and recoupment just as in *IEG* at the insurance level. As it was common ground that the spiked reinsurer would have rights of contribution and recoupment, the issue here was how those rights should be calculated. Equitas's case is that they should be calculated in each year from the ground up, applying the *Barker* approach just as if a proportionate part of the claim had been presented under each reinsurance policy, in a manner explicitly intended to achieve the same ultimate outcome as would be achieved by the first or second route – or as would have been achieved if the minority view in *IEG* had prevailed. In this regard Mr Edelman relied on Lord Mance's comment at [78] in *IEG* that the rights of contribution and recoupment favoured by the majority would lead "in practice, at least in the case of a solvent insured, to substantially the same result as that at which Lord Sumption JSC arrives, but by a different route".

76. For practical purposes the disagreement between the parties as to the method of calculating rights of contribution and recoupment was significant in three respects. First, under the Equitas method, MMI would have to bear a retention in each policy year whereas, under the MMI method, there would only be a single retention. Second, under the Equitas method higher layers of reinsurance would not contribute until the lower layers had been exhausted whereas, under the MMI method, each layer would be liable to contribute to the equivalent layer in the spiked year. Third, under the MMI method, MMI would be treated as a self-insurer of the retentions and of any gaps in the cover and would have the same rights of contribution as a reinsurer of an equivalent layer would have had. That would not be so under the Equitas method. We were told that the treatment of retentions is likely to be the most significant issue in financial terms.

77. Although this third route was intended, if Equitas's approach to contribution and recoupment was adopted, to achieve in principle the same financial outcome as either of the first two routes, Mr Edelman submitted that it would in practice lead to severe difficulties due to the complexities of the reinsurance programmes existing from year to year and the fact that the reinsurers in the spiked year who were left to claim

contribution would have no knowledge of MMI's reinsurance arrangements in other years. For this reason, he submitted that, if legally possible, either of the first two routes was to be preferred as a solution to the anomalies thrown up by *Fairchild* at the reinsurance level. Indeed he used words like "chaos" and "mayhem" to describe the situation with which the market would be faced in circumstances where each year's reinsurance might have multiple excess layers, some of which would have multiple participants, in ways which would not correspond to the arrangements in other years.

MMI's submissions in outline

78. Mr Schaff for MMI supported the reasoning and conclusions of the judge-arbitrator.

79. He pointed out that it is authoritatively established by the Supreme Court in *IEG* that spiking to a single year of cover is permitted at the insurance level despite the anomalies which it creates. That is so despite *Barker*, which in reality has little or nothing to do with the current issue. Those anomalies were expressly recognised by the Supreme Court, but were to be dealt with by resort to principles of contribution and recoupment.

80. Mr Schaff submitted next that there is no principled basis on which to distinguish insurance and reinsurance in this respect. The market operates on the basis that reinsurance is simply a form of insurance on the original subject matter insured (e.g. *Wasa International Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40, [2010] 1 AC 180 at [33] where Lord Mance described this as "an accepted analysis with business significance" which should not be unnecessarily thrown into doubt). As a matter of construction, the reinsurance contracts are triggered in the same way as the insurance contracts, so that exposure to asbestos is an "accident or occurrence" occurring during the policy period to which (within the *Fairchild* enclave) a weak test of causation must be applied. It was not suggested by Equitas that a process of construction could lead to a conclusion whereby the insurance and reinsurance contracts respond differently. For example, Equitas did not suggest that Lord Sumption's construction of the insurance contracts in *IEG* can be applied to the reinsurance contracts here. That being so, consistency and principle require that the same approach be adopted at the insurance and the reinsurance level, and any distinction would be artificial, unprincipled and liable to make the situation worse rather than better. That would be so in any event, but was reinforced by the follow settlements clause in the reinsurance policies which demonstrates that the insurance and reinsurance were intended to operate in the same way.

81. Accordingly, just as at the insurance level, at the reinsurance level also the anomalies should be dealt with by means of contribution and recoupment principles. This was a principled solution to the anomalies created by *Fairchild* which can equally operate at the reinsurance level.

Deemed allocation/implied term

82. Against this background Mr Schaff submitted that when the employer settled with the victim there would be no attempt to allocate any part of the employer's liability to different periods of time as it would be irrelevant to do so. That would be so regardless of whether the victim should be regarded as having multiple causes of action against the employer or a single cause of action. In this respect the position as

between victim and employer was exactly the same as between employer and insurer. So far as the settlement by MMI of the insured claims was concerned, the judge-arbitrator's findings were unreviewable. Each triggered policy was liable in full and that was the basis on which claims were settled.

83. Mr Schaff submitted that in these circumstances there was no scope for any argument that the "real basis" of the inwards settlements was something different. Having settled each inwards claim on the correct basis that each triggered policy was liable in full, MMI was entitled to present its reinsurance claim to any one of its reinsurance policies (e.g. for 1969) on the basis that its UNL on the underlying contract of insurance for 1969 was 100% liability. This was not a case like *Assicurazioni Generali SpA v CGU International Insurance Plc* or *Enterprise Oil Ltd v Strand Insurance Co Ltd* where the argument was that the terms of a settlement had artificially concealed what was actually happening. The principle applied in those cases had no application here. The fact that the settlement had also discharged MMI's liability under each and every policy on risk in other years did not mean that any part of the settlement consideration had to be allocated to the settlement of liability in those other years. Nor was there any basis for implying an obligation to allocate in this way. Such an implication was unnecessary, not least in circumstances where principles of contribution and recoupment (however they fall to be applied) were available.

Duty of good faith

84. Mr Schaff submitted that the judge-arbitrator could not be criticised for having declined an invitation to develop the law in a novel way and that his decision was therefore unassailable. He submitted further that none of the sources prayed in aid by Mr Edelman provided a sound basis for any such development; that if any analogy is appropriate, the closest analogy is double insurance where the insured is entitled to choose under which policy to present its claim; that it would be wrong to introduce a fetter on what was, *ex hypothesi*, the exercise of an absolute contractual right; that if spiking is permitted (as it is) at the insurance level, it cannot be contrary to a duty of good faith at the reinsurance level; and that such a duty should not be introduced when principles of contribution and recoupment are available. Those principles would either yield the result for which Equitas contended, in which case the duty of good faith was not needed, or they would not, in which case its application was an unprincipled way of arriving at the minority approach in *IEG* which the majority had rejected. Contribution and recoupment were the principles which the majority in IEG had invoked, not a duty of good faith, and there was no basis for any different approach at the reinsurance level.

85. Finally on this point, Mr Schaff relied on the judge-arbitrator's statement that even if there were some duty of good faith or some implied term that a decision to allocate should be *Wednesbury* reasonable, he was "quite satisfied that there was no breach of duty or of any such implied term in this case … presentation of the claim to one reinsurance year in circumstances where it is expressly acknowledged by MMI that there is a need for equitable recoupment and contribution to redress any anomalies cannot conceivably be said to be in bad faith or *Wednesbury* unreasonable".

Contribution and recoupment

86. As already noted, Mr Schaff accepted and indeed asserts that the reinsurers in the spiked year will have rights of contribution and recoupment, although it appears that this was not MMI's position when it first began to present claims on a spiked basis. The issue is how those rights should be calculated, as already explained.

87. Mr Schaff submitted that by this stage of the argument it has been established as between insurer and reinsurer that the insurer is entitled to present its reinsurance claim to the policy year of its choice, bearing whatever is the retention applicable to that year but otherwise recovering in full. That, he submitted, was the contractual analysis under the reinsurance policy. In contrast, as explained by Lord Mance in *IEG*, rights of contribution and recoupment were not dependent on contract but on broad equitable principles drawing on an analogy with principles of double insurance in order to enable a sharing of the burden between reinsurers of the same loss in different years. Following this logic through, the way that contribution should work was to enable the reinsurer who was liable for one layer in the spiked year to obtain contribution from reinsurers who would have been liable for the equivalent layer in other years. Thus, to take a simple example, if there were three years of exposure to asbestos and three years of reinsurance, each with a retention of £10,000, a primary layer of £40,000 XS £10,000, and a higher layer of £50,000 XS £50,000, the reinsurers' total outlay would be £90,000. It is therefore that £90,000 which needs to be distributed across other years. The primary layer reinsurer in the spiked year who had paid out £40,000 would recover one third of that amount (£13,333.33) from each of the primary layer reinsurers in the other two years, while the higher layer reinsurer who had paid out £50,000 would recover one third of that amount (£16,666) from each of the higher layer reinsurers in the other two years. That example is concerned only with contribution, but recoupment would arise if (for example) in one year MMI had chosen not to obtain reinsurance for one of the layers. In such a case MMI would be liable to contribute in the same way that a reinsurer of that layer would have done.

88. As already indicated, the MMI method of contribution produces the practical effect that MMI bears only a single retention, that higher layer reinsurers in non-spiked years must contribute even though the lower layers in that year are not exhausted, and that in some circumstances MMI may itself have rights of contribution to exercise even where it has accepted a higher retention or chosen to be uninsured for some layers.

89. In response to Mr Edelman's apocalyptic warnings of chaos and mayhem, Mr Schaff pointed out that there are no findings in the award that the working out of the principles of contribution and recoupment, however that needs to be done, would give rise to any practical difficulty.

Overview

90. There is no doubt that the *Fairchild* decision together with the Compensation Act 2006 and the cases which have applied these principles have created significant anomalies in the law. That jurisprudence, intended as it was to ensure a remedy for victims of negligent exposure to asbestos, has extended into liability insurance and (now) reinsurance in ways which seem unlikely to have been intended or predicted.

91. I would accept that, once the courts can be confident that the objective of ensuring victim protection has been achieved, it is desirable that the anomalies should be

corrected and that the law should return to the fundamental principles of the common law. Put shortly, once unorthodoxy has served its purpose, we should revert to orthodoxy. That does not preclude development of the law to meet new challenges, but does serve the interests of business where certainty and predictability are paramount if commercial entities including the reinsurance market are to conduct business and settle claims when they arise as efficiently as possible. It serves also the interests of those who ultimately have to pay the premiums if unpredictable liabilities to which in reality insurers and reinsurers never agreed are confined as closely as is possible consistent with the policy that victims should be compensated.

92. The result of the jurisprudence so far, culminating in *IEG*, is that a victim of mesothelioma as a result of negligent exposure to asbestos is assured of a remedy. That will be either a solvent employer or a solvent insurer or, in cases where the insurer is insolvent, a statutory or industry compensation scheme. While the anomalies described by Lord Mance in *IEG* served a purpose at the insurance level, it is unnecessary to perpetuate them at the reinsurance level.

93. I would therefore accept Mr Edelman's submission that it is desirable, if possible, to revert to the principles of the common law whereby liability should be apportioned in accordance with *Barker* by reference to contribution to the risk. That is the closest approximation to what the parties actually agreed at a time when the weak causal link introduced by *Fairchild*, section 3 of the Compensation Act 2006 and the application of these rules to insurance contracts in "*Trigger*" could not have been anticipated. It reflects also the common law's view of fairness which, as between insurer and reinsurer, is unaffected by section 3 of the Compensation Act. However, reversion to the approach of the common law must be principled. We cannot just do whatever we like. Nor should we introduce new distortions which may themselves have unpredictable consequences in order to patch over the existing ones. That said, however, there is in my judgment some scope to respond to Lord Mance's call at [51] in *IEG* that "a principled solution must be found, even if it involves striking new ground" and that "the courts have made it incumbent on themselves to reach a solution representing a fair balance of the interests of victims, insureds and insurers", to which I would add "reinsurers".

94. I would accept also that it would be preferable, again if possible, to achieve a solution by one or other of Mr Edelman's first two routes (deemed allocation/good faith) rather than the third (contribution and recoupment). In the absence of findings in the award I would not go so far as to accept that confining the spiked reinsurers' rights to equitable contribution and recoupment would lead inevitably to chaos in the market, but it would undoubtedly mean significantly greater complexity and expense. The judge-arbitrator referred to helpful examples produced by the parties to show how their respective methods of contribution would work in what he described as "factual situations of increasing complexity". These examples, which were also before us, were greatly simplified for illustrative purposes, but even so gave a flavour of some of the complexities which would arise. In addition there is the practical problem for any reinsurer seeking to exercise a right of contribution that only MMI has knowledge of the detail of its reinsurance arrangements in each of the relevant years.

95. I acknowledge that it is unusual explicitly to begin at the end by stating the objective which the law ought to achieve as distinct from applying the law to the facts found to see where that takes us. However, in the unprecedented and unique situation which

the courts have now created within the *Fairchild* enclave, I consider that this is a legitimate approach.

Analysis

96. I come now to examine the three routes for which Mr Edelman contended.

Deemed allocation/implied term

97. In circumstances where the employee was exposed to asbestos over a period of several years, where the critical exposure(s) may have occurred in any one or more of those years, where it is impossible to say in which year(s) that did occur, and where the law has determined that each EL policy year is liable in full, it seems to me that the fairest way for an EL insurer's inwards claims to be settled would be by allocating a share of liability to each policy year, the allocation to be determined by reference to time on risk unless there is some rational basis (such as intensity of exposure in any particular year(s)) for a different allocation. That would apply with even greater force if an employer faced claims from a number of employees, where it would appear to be statistically improbable, all other things being equal, that the critical exposures for each employee all occurred in the same year. Such a proportionate allocation would accord with that underlying reality, with the annual nature of EL insurance and reinsurance, and with the common law view of fairness as reflected in *Barker*. It would also avoid running foul of the elementary principle referred to by Lord Mance at [43] in *IEG* that insurance does not operate on a basis which allows the insured to select the period and policy to which a loss attaches, a basis which would render (and has rendered) entirely unpredictable the risks undertaken by insurers and reinsurers and has thereby falsified many years after the event the basis on which the premium to be charged was calculated.

98. However, while it would have been fair for MMI to allocate its inward risks in this way, that is not what happened. Mr Edelman proposes that it should be deemed to have happened in order to produce a fair result. Tempting as it is to impose a deemed allocation on the parties by reference to time on risk, I do not think that this is permissible. It would involve a significant extension of the "real basis of settlement" cases which it would be difficult to confine within the *Fairchild* enclave. So far those cases have been concerned with investigating as a matter of fact what it is that the parties actually did. To apply them here would be a different exercise, when there was no doubt about what the parties actually did but the law was imposing on them its view of what they ought to have done. That is a very different thing. It seems to me that there would be a danger in seeking to counteract what is effectively one deeming provision (the weak causal link in *Fairchild*) with another (a principle of deemed inwards allocation).

99. More fundamentally, while the imposition of a deemed allocation would remove one anomaly (the elementary principle referred to by Lord Mance that the insured cannot select the period and policy to which a loss attaches), it would collide headlong with other fundamental principles as there is no valid basis on which to distinguish insurance and reinsurance contracts in this respect. If, as the majority of the Supreme Court has held in *IEG*, spiking is permissible at the insurance level, there is simply no room for a principle of deemed allocation to avoid spiking at the reinsurance level. That follows from the nature of reinsurance as a form of insurance on the original

subject matter insured (cf. *Wasa International Insurance Co Ltd v Lexington Insurance Co* at [33]) and from the absence of any valid basis on which to distinguish the insurance and reinsurance contracts as a matter of construction. If we were to avoid one set of problems by imposing a principle of deemed allocation, there is a real risk that we would be introducing other distortions into insurance and reinsurance law. Again it might be difficult to ensure on any principled basis that any distortions were confined within the *Fairchild* enclave.

100. For the same reasons is not possible to achieve the desired result by way of an implied term. The implied term would be contrary to the proper construction of the reinsurance contracts.

101. In these circumstances the analysis must be, consistently with the decision in *IEG* and in the absence of any valid basis on which to distinguish insurance and reinsurance, that MMI's inwards claims were settled on an unallocated basis by which each and every relevant policy year was 100% liable and those liabilities were discharged; that there was a 100% liability ascertained under each and every policy year; that there was an undivided UNL for each year; and that as a matter of construction of the reinsurance contracts MMI was *prima facie* entitled to present the whole of its UNL to any reinsurance year of its choice.

102. Accordingly I agree with the judge-arbitrator that MMI had a contractual right to present its reinsurance claims to the policy year of its choice, but I would not describe this as an "absolute" contractual right. Whether that is a valid description depends on whether there exists any constraint on the exercise of that right. That is the issue to which I now turn.

Duty of good faith

103. As already noted, Mr Edelman did not suggest that any of the sources on which he drew in support of finding a duty of good faith operating within the *Fairchild* enclave was directly applicable. He relied on them rather as analogies which might usefully be invoked. That being so, it is unlikely to be fruitful to consider at any length why (for example) the insurance duty of utmost good faith or the concept of good faith in New York law does not apply here.

104. As to the former, it is sufficient to say that I agree with the judge-arbitrator that the post-contractual duty of good faith in insurance contracts, which in any event gives rise to a remedy of avoidance of the contract rather than a constraint on the exercise of *prima facie* contractual rights, has been confined by cases such as *The Star Sea* and *Versloot Dredging BV* and that it has no part to play in the current context. It is true that Rix LJ may have left the door open, or at least ajar, to further development of the doctrine of good faith so as to equate it to "a concept of proportionality implicit in fair dealing" (see *Drake Insurance Plc v Provident Insurance Plc* [2003] EWCA Civ 1834, [2004] QB 601 [89]). However although this latter case was referred to in the parties' written submissions, it was not the subject of oral argument, nor were there any submissions addressed to us as to how the doctrine should be developed. It seems to me that it would be difficult to confine any such development within the *Fairchild* enclave and that if such a development is to be made, it should be in another case.

105. As to New York law, it is unnecessary to explore the detail of what was decided by the New York Court of Appeals in the *United States Fidelity & Guaranty Co* case. The case illustrates that in New York there is a wider concept of good faith in insurance contracts, which extends, at least in some contexts, to a requirement of reasonableness in the making of contractual choices, although that concept does not go so far as to require an insured to disregard its own interests or to put the reinsurer's interests ahead of its own. However, I agree with the judge-arbitrator that this wider concept does not represent English law. Moreover, there is a risk that any borrowing of this wider concept of good faith in the present case would be difficult to confine within the *Fairchild* enclave.

106. However, the line of cases which have imposed a constraint upon the exercise of contractual choices merits further consideration. The leading case is now *Braganza* in the Supreme Court, where Lady Hale said at [18]:

> "Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest. That conflict is heightened when there is a significant imbalance of power between the contracting parties as there often will be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused. They have done so by implying a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given."

107. Lady Hale went on to approve Rix LJ's summary in *Socimer* at [66] of the position which the authorities had reached:

> "It is plain from these authorities that a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The concern is that the discretion should not be abused. Reasonableness and unreasonableness are also concepts deployed in this context, but only in a sense analogous to *Wednesbury* unreasonableness, not in the sense in which that expression is used when speaking of the duty to take reasonable care, or when otherwise deploying entirely objective criteria: as for instance when there might be an implication of a term requiring the fixing of a reasonable price, or a reasonable time. In the latter class of case, the concept of reasonableness is intended to be entirely mutual and thus guided by objective criteria … Laws LJ in the course of argument put the matter accurately, if I may respectfully agree, when he said that pursuant to the *Wednesbury* irrationality test, the decision remains that of the decision-maker, whereas on entirely objective criteria of reasonableness the decision-maker becomes the court itself."

108. The same passage was also approved in the minority opinion of Lord Neuberger at [102].

109. One of the earlier decisions was *Gan Insurance Company Ltd v Tai Ping Insurance Company Ltd (Nos 2 & 3)* [2001] Lloyd's IR 667, a reinsurance case where a Claims Co-operation Clause prohibited the reinsured from concluding a settlement or making an admission without the prior approval of the reinsurer. The Court of Appeal held that there were constraints, necessarily implicit from the circumstances, on the reinsurer's right to withhold such approval. Approval could only be withheld "in good faith after consideration of and on the basis of the facts giving rise to the particular claim and not with reference to considerations wholly extraneous to the subject matter of the particular reinsurance" and not "arbitrarily, or … in circumstances so extreme that no reasonable company in its position could possibly withhold approval" (see in particular [67] and [70]). Mance LJ emphasised that this constraint was not derived from the insurance duty of utmost good faith but from the nature and purpose of the particular contractual provisions, and was therefore not inconsistent with cases such as *The Star Sea*:

> "68. Contrary to Mr Edelman's submission, this conclusion does not involve an inadmissible extension of the duty of good faith in insurance law or of the consequences of breach of any such duty. The qualification that I have identified does not arise from any principles or considerations special to the law of insurance. It arises from the nature and purpose of the relevant contractual provisions."

110. The case illustrates also that although this line of authority often refers to contractual discretions, its application is not limited to cases where the contract in question speaks in terms of one party having a discretion to exercise.

111. On the other hand, not all contractual choices are constrained in this way. In *Mid Essex Hospital Services NHS Trust v Compass Group UK & Ireland Ltd* the contractual term in question was a right to award service failure points in a contract to provide catering and cleaning services in the event of a failure to meet performance standards. These points formed part of contractual machinery to determine the payments to which the contractor was entitled and the circumstances in which the contract might be terminated. The Court of Appeal distinguished the *Socimer* line of cases, but nevertheless acknowledged that when a party has a right to choose from a range of options, a term will often be implied to preclude an arbitrary, capricious or irrational choice. Jackson LJ said at [83]:

> "An important feature of the above line of authorities is that in each case the discretion did not involve a simple decision whether or not to exercise an absolute contractual right. The discretion involved making an assessment or choosing from a range of options, taking into account the interests of both parties. In any contract under which one party is committed to exercise such a discretion, there is an implied term. The precise formulation of that term has been variously expressed in the authorities. In essence, however, it is that the relevant party will not exercise its discretion in an arbitrary, capricious or irrational manner. Such a term is extremely difficult to exclude, although I would not say it is utterly impossible to do so. …"

112. In *Mid Essex* the term was excluded, in part because of the nature of the contract as a contract with a public authority which was entitled to exercise its rights to ensure the highest standards in a vital service and in part because the contract contained its own

remedy in the event that the NHS trust awarded more than the correct number of points. As Jackson LJ explained:

> "91. The discretion which is entrusted to the Trust in relation to service failure points and deductions in the present case is very different from the discretion which existed in the authorities discussed above. The Trust is a public authority delivering a vital service to vulnerable members of the public. It rightly demands high standards from all those with whom it contracts. There may, of course, be circumstances in which the Trust decides to award less than the full amount of service failure points or to deduct less than it is entitled to deduct from a monthly payment. Nevertheless the Trust could not be criticised if it awards the full number of service failure points or if it makes the full amount of any deduction which it is entitled to make. The discretion conferred by clause 5.8 simply permits the Trust to decide whether or not to exercise an absolute contractual right.
>
> 92. There is no justification for implying into clause 5.8 a term that the Trust will not act in an arbitrary, irrational or capricious manner. If the Trust awards more than the correct number of service failure points or deducts more than the correct amount from any monthly payment, then there is a breach of the express provisions of clause 5.8. There is no need for any implied term to regulate the operation of clause 5.8."

113. The judge-arbitrator appears to have regarded the *Mid Essex* case as drawing a sharp distinction between cases of absolute contractual rights and cases where the duty not to act in an arbitrary, irrational or capricious manner could be implied. In my judgment, however, the position is more nuanced. Although the *Mid Essex* case uses the expression "absolute contractual right" that is the result of a process of construction which takes account of the characteristics of the parties, the terms of the contract as a whole and the contractual context, not a starting point intrinsic to the term itself. It is only possible to say whether a term conferring a contractual choice on one party represents an absolute contractual right after that process of construction has been undertaken. To say that a term provides for an absolute contractual right and therefore no term can be implied puts the matter the wrong way round.

114. In my judgment there are powerful reasons to support the implication of a term in the very specific reinsurance context existing within the *Fairchild* enclave that the insurer's right to present its reinsurance claims must be exercised in a manner which is not arbitrary, irrational or capricious, and that in that context rationality requires that they be presented by reference to each year's contribution to the risk, which will normally be measured by reference to time on risk unless in the particular circumstances there is a good reason (such as differing intensity of exposure) for some other basis of presentation. That is because spiking is inconsistent with the presumed intentions and reasonable expectations of the parties at the time when the contracts were concluded. On that basis the insurer remains the decision maker, so that a rational view that (for example) the intensity of exposure had been greater in one year than another could not be challenged, but the decision must be made by reference to each year's contribution to the risk.

115. In summary, the *Fairchild* jurisprudence has presented the insurer with the opportunity to make a choice of the year to which a claim should be presented, but

that choice is entirely fortuitous so far as the parties are concerned, was not something which they could have contemplated at the time of contracting or taken into account in setting the premium to be paid, and is moreover inconsistent with fundamental (or "elementary") principles of liability insurance law, as already explained. It results in a situation, spiking, which does not accord with common law notions of fairness as explained in *Barker* and is contrary to the underlying statistical reality that in fact the critical exposure(s) of employees to asbestos will not all have occurred in the same year. It is a situation in which there is a clear conflict of interest between the parties and a significant imbalance of power between them. That imbalance is not the result of a relationship such as employer and employee which existed in *Braganza*, but arises out of the control which the insurer can exercise in allocating its inwards claims and its exclusive knowledge of its reinsurance arrangements over an extensive period.

116. In an area of the law in which considerations of fairness and policy have explicitly loomed larger than usual, and bearing in mind the willingness of the Supreme Court to "strike new ground" if necessary to achieve a fair balance of all the interests concerned, I would hold that such a term should be implied. The term can conveniently be described as requiring "good faith", but this is merely a label. Its content and rationale are as I have described. Such a term achieves an outcome which is as close as possible to what the parties can be taken to have intended if they had foreseen the development of the *Fairchild* jurisprudence. (Although in general parties must take the risk of future developments in the law, to invoke that principle here would be extreme: *Fairchild* and its progeny represented a unique and unprecedented development which could not have been foreseen, and it would be harsh to impose on a reinsurer who wrote an annual policy for (say) 1969 the risk of developments in the law affecting his liability which did not take place for another third of a century). It is a solution which is specific within the *Fairchild* enclave and will not have wider ramifications. Although it may be objected that it is contrary to principle to imply such a term at the reinsurance level but not at the insurance level, there is a material distinction. At the insurance level, as already explained, such a term would risk subverting the policy of ensuring full compensation to victims, but that risk no longer exists or at any rate is minimal at the reinsurance level.

117. If a term is to be implied as I have formulated it, the judge-arbitrator's statement that there was no breach of duty or of any implied term does not stand in the way of allowing the appeal. Plainly that statement was not directed to a situation where the insurer is under an obligation to make its allocation decision by reference to each year's contribution to the risk. It is in effect no more than a statement that an insurer seeking to maximise its reinsurance recovery by exercising a contractual right cannot be said to be acting with a want of good faith, but that as I have sought to explain begs the question.

118. On this ground, therefore, I would provisionally allow the appeal. At this stage I say "provisionally" because it remains to evaluate Mr Schaff's submission that there is no scope for any duty of good faith when principles of contribution and recoupment are available. That submission is best considered after I have dealt with the contribution and recoupment issues.

Contribution and recoupment

119. The question how principles of contribution and recoupment should operate must be addressed on the basis that MMI is entitled to present its reinsurance claim to the policy year of its choice and that the reinsurers of this spiked year, having paid MMI, seek to recover from other policy years a proportion of what they have paid.

120. The starting point in considering how these principles should operate in the reinsurance context must be Lord Mance's exposition of their sources and nature in *IEG*. In summary, he drew upon doctrines of double insurance and suretyship, including "a more relaxed view of double insurance" taken in Australian cases, in order to fashion a novel remedy. He concluded that "the root principles" were "principles of equity and justice which lie behind the law's recognition of rights of contribution", that these must be applied with "breadth and flexibility", requiring "a broad equitable approach to be taken to contribution, to meet the unique anomalies to which [*Fairchild* and '*Trigger*'] give rise" (see in particular at [59] to [63]).

121. So far as the sources are concerned, Lord Mance expressly recognised that concepts of double insurance and suretyship could not be directly applied. In the present case the reinsurance policies on different years were not an instance of double insurance which exists only when there are two or more different policies in respect of the same interest and covering the same risk in the same period (see [56] to [58], citing *National Farmers Union Mutual Insurance Society v HSBC Insurance (UK) Ltd* [2010] EWHC 773 (Comm), [2010] 1 CLC 557 at [15]). However, it was a doctrine whose broad principles could be adapted to meet the unconventional problems arising from *Fairchild*. Similarly with suretyship, the conventional rule was equality between sureties so that "it should not rest with the creditor by his selection of remedies open to him to determine where ultimately the burden was to fall", but this too could be adapted to give effect to an allocation of liability by reference to the insurer's contribution to the risk.

122. I would accept there is no specific guidance in *IEG* to enable us to choose between the rival methods advanced by the parties in the present case. The Supreme Court was not focusing on this issue. Nevertheless, the guiding principle is clear, which is that the objective must be to achieve a just solution. That solution will eliminate so far as possible the anomalies resulting from the *Fairchild* jurisprudence and will take account of the reality of the underlying claims, that is to say that nobody can know in which year the critical exposure occurred in the case of any given victim and that considering the position of victims as a group, such exposures will have occurred in a variety of years. The best available measure of such exposures is by reference to each policy year's contribution to the risk. That is not to revert to the now discredited theory of liability for making a material contribution to risk but recognises the artificiality of saying that an exposure which in fact occurred only once, even if we do not know when, is regarded in law as having occurred in each and every year.

123. Viewed in this light, in my judgment the Equitas method of contribution is to be preferred. It reflects three fundamental considerations which the MMI method avoids. First, the reality is that critical exposures to a group of victims will have occurred in a number of years, in each of which MMI agreed to bear a retention, so that it is unjust that under the MMI method only a single retention applies. Second, the basis on which higher layer reinsurers agreed to participate was that they would not be liable until the retention and any lower layers had been exhausted. No doubt their premium was calculated accordingly. The MMI method subverts that principle. Third, I see no

reason why MMI should have rights of contribution in respect of years or layers where it chose not to insure. That was its choice.

124. In my judgment the broad equitable principles which we must apply are sufficiently flexible in these circumstances to enable effect to be given to the Equitas method of calculation. I would hold accordingly.

125. The judge-arbitrator recognised that "the process of contribution and recoupment is to be carried out in practice in order to iron out any anomalies or unfairness which arise from the presentation of the entire claim to one reinsurance year", but in my judgment the MMI method which he adopted does not achieve this. I would respectfully suggest that there are two errors in his reasoning.

126. The first was to exclude as totally irrelevant the doctrine of subrogation which, as expounded in *Lord Napier & Ettrick v Hunter* [1993] AC 713, a case to which Lord Mance referred in *IEG*, illustrates how an insurer of a higher layer is entitled to be fully indemnified out of any recoveries before those recoveries are available to the insured or to insurers of lower layers. Although it is not suggested that subrogation operates in this case when equitable rights of contribution are applied between reinsurers of different years, the principle is nevertheless one which needs to be borne in mind in determining how those rights should be applied in order to achieve a just outcome.

127. The second was to apply too closely the concept of double insurance in which only one retention would be applied. The judge-arbitrator recognised that the present case is "not strictly speaking" a case of double insurance, but his view was that "the only difference is that, whereas double insurance is two insurances covering the same loss in the same period, the present case and *IEG* involved (re)insurances in successive years covering the same loss, because of the special rules derived from *Fairchild* and developed in the insurance context in '*Trigger*' and *IEG*". It was largely for this reason that the judge-arbitrator thought that it would be unprincipled and anomalous if MMI had to bear multiple retentions. However, while double insurance is a helpful broad analogy, when focusing on the issue of retentions this difference is critical.

128. The judge-arbitrator also thought that the Equitas method was anomalous and unfair because, as Equitas accepted, if there had been one continuous reinsurance contract covering a number of years, MMI would only have to give credit for one retention. However, with respect that is only part of the picture. If there had been one continuous reinsurance contract, it is highly probable that the reinsurers would have insisted either on a higher retention than applicable to a single policy year or a higher premium. No conclusion about any unfairness of the Equitas approach can be reached without taking this into account.

The duty of good faith revisited

129. In the light of my conclusion that the Equitas method of calculating the rights of contribution and recoupment is correct, there is no conflict between the application of those principles and the existence of a duty of good faith. There is therefore no obstacle, such as any such conflict might have created, to what I regard as the preferred solution which is that such a duty should be implied. There remains the alternative argument that the implication of such a duty is unnecessary if principles of

contribution and recoupment are available to the reinsurers, but for the reasons already given I do not regard that objection as well founded.

Conclusion

130. I would therefore allow the appeal, answering the questions of law for which leave has been given as follows:

Questions

(1) In the event of an insured employee being tortiously exposed to asbestos in multiple years of EL insurance, and the EL insurer settling the employer's claim without allocating the loss to any particular year of exposure, is the EL insurer obliged (in the absence of specific provision for this situation in the corresponding reinsurances) to present any outwards claim in respect of that loss on a *pro rata*, time on risk basis for the purpose of calculating reinsurance recoveries, either because:

a) the contribution to the settlement of each engaged policy must by necessary implication be treated as having been on that basis ("question 1"); or

b) the doctrine of good faith requires the claim to be presented on that basis ("question 2")?

(2) If the EL insurer is not so obliged, and may present a claim to a single year of his choice, how are the rights of recoupment and contribution acquired by the reinsurers of that year to be calculated ("question 3")?

Answers: (1) No; (2) Yes, unless there is some other rational basis for ascertaining the contribution to the risk in each triggered policy year; (3) Does not arise unless the answer to question 2 is held to be wrong, in which case the Equitas method should be applied.

Lord Justice Leggatt :

131. I agree entirely with the judgment of Males LJ but wish to add further reasons of my own to explain why I consider that the doctrine of good faith requires the reinsurance claims at issue in this case to be presented on a basis which apportions the insurer's ultimate net loss between each policy year in respect of which the insurer was liable to indemnify the insured employer for the damage caused to a victim by mesothelioma.

IEG and the nature of insurance

132. The basic nature of an insurance contract is that the insurer, in return for a sum of money (the insurance premium), takes the risk of an event occurring during the period covered by the policy and promises to provide a benefit to the insured (often an indemnity against loss) if the event occurs. The event insured against may be a loss occurring or a liability incurred or a claim made against the insured. But in each case it is fundamental that the event is one which happens during the period of risk and not

during any earlier or later period. As Lord Mance said in the *IEG* case, at para 40, referring to the EL policies in issue in that case:

> "In short, insurance would have been and was placed on the basis that a particular liability or loss would fall into one, not a series of separate periods. If an insured wanted complete cover, it would have to maintain it for all such periods. The relevant period would also be ascertained by objective criteria, which meant that insureds could not select it at will or to obtain the advantage of the cover most favourable from their viewpoint."

133. In *IEG* it was recognised by all the members of the Supreme Court that the extension to insurance law of the special rule of causation (or, more accurately, proof of causation) developed in *Fairchild* to govern liability in tort within what has become known as the '*Fairchild* enclave' threatens to confound this fundamental principle of insurance. The difficulties derive from dispensing with the requirement that the victim – or, in the context of liability insurance, an insured employer who is liable to the victim in tort – must prove that the employer's wrongful act or omission caused the victim to contract mesothelioma. Under the special *Fairchild* rule it is sufficient to show that the employer negligently or in breach of statutory duty exposed the victim to asbestos and that the victim later developed mesothelioma which *may* have been (but cannot be shown on the balance of probabilities to have been) caused by this exposure. In *Barker* the House of Lords mitigated this departure from principle by holding that the liability founded on the *Fairchild* rule is proportionate to the defendant's contribution to the risk of developing mesothelioma measured by the duration and intensity of the exposure to asbestos for which the defendant was responsible. Parliament immediately legislated, however, to displace this holding in relation to employers (and any other persons) liable in tort to mesothelioma victims. Pursuant to section 3 of the Compensation Act 2006, every person who is liable in tort as a result of exposing to asbestos a victim who later contracts mesothelioma is liable to the victim for the whole of the damage caused by the disease.

134. All the Supreme Court Justices in the *IEG* case were agreed that applying the special rules applicable as between employee-victims and their employers to the relationships between the employers and their insurers produces results which are unacceptable. In particular, as Lord Mance observed at para 43:

> "(a) It is contrary to principle for insurance to operate on a basis which allows an insured to select the period and policy to which a loss attaches. This is elementary. If insureds could select against insurers in this way, the risks undertaken by insurers would be entirely unpredictable. (b) It is anomalous for a liability insurance underwritten for a premium covering losses arising from risks created during its particular period to cover losses about which all that can be said is that they arise from risks extending over a much longer period, in respect of which no premium has, or could have, been assessed or received by the insurer."

Lord Sumption, who gave the main minority judgment, agreed at para 156 that these consequences "are not just remarkable in themselves, but are directly inconsistent with the language of the … policies and the fundamental characteristics of insurance."

135. Lord Sumption considered that the rational response of the law to the situation in which the insurer's liability is triggered in more than one policy year is not to assign the whole of the loss to a policy year of the insured's choice. Rather, it is to prorate the loss between every policy year during which the insured employer exposed the victim to asbestos: para 160. Lord Sumption reached that result through a contextual interpretation of the words "caused during any period of insurance" used in the EL policies when applied to an insured liability with the unusual legal incidents of an employer's liability for mesothelioma: para 161.

136. The majority of the Supreme Court did not accept this approach. Lord Mance, who gave the lead judgment, observed, at para 46, that it involved interpreting the insurance policy wording in a way which none of the parties or interveners before the court had suggested. He also regarded the interpretation proposed by Lord Sumption as inconsistent with the earlier decision of the Supreme Court in the "*Trigger*" litigation, which treated proof of exposure to asbestos during any period of insurance as sufficient to prove that the victim's mesothelioma had been "caused" during the relevant period: ibid. Lord Mance nevertheless shared the view that, at least ultimately and in so far as employers and their insurers are good for the money, fairness requires the loss to be apportioned across years in a way which reflects the contribution to risk of each year of exposure to asbestos which is treated as having caused the employee's disease. Thus, he said at para 52:

> "A sensible overall result is only achieved if an insurer held liable under [an EL] policy is able to have recourse for an appropriate proportion of its liability to any co-insurers and to the insured as a self-insurer in respect of periods of exposure of the victim by the insured for which the insurer has not covered the insured."

137. To achieve this overall result, Lord Mance considered that a "broad equitable approach" should be taken to contribution between insurers so as to allow an insurer who is liable as a result of exposure to asbestos during one period of insurance to recover contribution from insurers who are liable in respect of other periods during which exposure occurred which under the *Fairchild* rule is treated as having caused the same loss: para 63. He further held, at para 77, that:

> "The concomitant of insurance liability in this situation must be a recognition that the law can and should redress the unjust and wholly anomalous burden which would otherwise fall on any particular insurer with whom insurance was only taken out for part of the total period of exposure by the insured, by recognising an obligation on the part of the insured to contribute *pro tanto* to such liability as a self-insurer."

Lord Mance believed that this approach would lead in practice, albeit by a different route, to substantially the same result as that at which Lord Sumption arrived, except where an insured is insolvent: para 78.

138. Lord Hodge (with whose judgment the other Justices in the majority, including Lord Mance, also agreed) gave several reasons for concluding that Lord Sumption's approach was "not an option" and that "the anomalies must be addressed in some other way": para 108. First, like Lord Mance, he thought that the interpretation of the insurance policy wording proposed by Lord Sumption was inconsistent with the decision of the Supreme Court in *Trigger*. Second, Lord Hodge was influenced by the fact that allowing an insured employer to recover its whole loss from any insurer who was on risk for any part of the period of exposure to asbestos, despite the "heavy burden" imposed on the insurer selected, was a result for which all the parties to the proceedings, including the defendant insurers and the interveners, had contended. One of the interveners was the Association of British Insurers, which represents the interests of the insurance industry. Lord Hodge found it "striking that the insurance industry in this appeal has shown no enthusiasm for the elegant and less complex idea of construing the insurance contract to restrict the insurer's liability to a proportionate part of the loss": para 105.

139. Thirdly, Lord Hodge said, at para 106, that allowing the employer to select the insurer from which to claim its full indemnity is "consistent with the policy of the United Kingdom Parliament that the employee-victim should be able to obtain damages for his loss in a straightforward way". By contrast:

> "Confining the insurer's liability to a time-related proportion of the employer's liability would not be in line with this policy of the legislature and would probably engender further legislation."

140. A further reason given by Lord Hodge, at para 110, was that:

> "the practical solution which Lord Mance proffers appears to be consistent with the way in which the London insurance market has operated in handling mesothelioma claims. That may suggest that the solution will not give rise to major practical difficulties."

141. Lord Neuberger and Lord Reed, while agreeing with Lord Sumption, nevertheless expressed the view, at para 203, that Lord Mance's solution had "a number of attractions":

> "First, it is more in line with the parliamentary approach as demonstrated by section 3 of the 2006 Act, because, unlike Lord Sumption's solution, it ensures that every employee whose employer was insured for any period of his employment, can look to any such insurer who is still solvent for full compensation. Secondly, unlike Lord Sumption's solution, it has been supported by one of the parties to this appeal: despite being raised by the court at a reconvened hearing, Lord Sumption's solution has not been adopted by either party."

Lord Neuberger and Lord Reed suspected that these two points were connected, in that the insurance market might fear that, if Lord Sumption's solution were adopted,

Parliament would intervene to reverse the court's decision, as had happened following *Barker*.

142. For Lord Neuberger and Lord Reed, further attractions of Lord Mance's approach were that it was far closer to the approach which the London insurance market had worked out in practice and did not clash with the court's reasoning in the *Trigger* litigation, as Lord Sumption's solution arguably did. However, they regarded these considerations as outweighed by the fact that the construction of the insurance contract on which Lord Mance's conclusion was based "is inconsistent with the link between risk and premium which lies at the heart of a contract of insurance": para 205. They were also concerned that the legal innovations introduced by Lord Mance to mitigate this result might have "unfortunate wider ramifications": para 207. In particular, it might well be argued that:

> "this court is invoking a new and wide general equitable power, which is, to put it at its lowest, close to inconsistent with an express contractual term, in order to reconstitute a contractual relationship so as to achieve what it regards as a fair result in a purely commercial context."

143. Without seeking to question the necessity of adopting Lord Mance's approach in the *IEG* case, I respectfully share this last concern. While recognising a "broad equitable right" of contribution between insurers may be regarded as an extension of existing principle, giving an insurer an equitable right to recoup part of the insured loss from its insured is not just close to inconsistent, but is clearly inconsistent, with the contract between the parties as it was interpreted by the majority in *IEG*. As Lord Sumption observed, at para 183:

> "If the insured is contractually entitled to the whole amount, there cannot be a parallel right of recoupment in equity on the footing that it is inequitable for the insured to have more than part of it."

144. Although Lord Mance sought to rely on a thesis of Professor Andrew Burrows to suggest that there are exceptions to the general rule that a claimant will not be entitled to restitution where the defendant is legally entitled to the enrichment, commentators have convincingly argued that the authorities relied on do not support this thesis and that there is no legal principle which allows a claim to recoup money based on equity or unjust enrichment to override an unconditional contractual right to be paid the sum in question: see R Merkin "*Insurance and reinsurance in the Fairchild enclave*" (2016) 36 Legal Studies 302; KV Krishnaprasad, "*Unjust enrichment in the 'Fairchild enclave': International Energy Group Ltd v Zurich Insurance Plc*" (2017) 80 MLR 1150; R Stevens, "*The Unjust Enrichment Disaster*" (2018) 134 LQR 574, 597-8. As Lord Sumption put it at para 183:

> "The basis of the suggested right of recoupment is that it is unjust for the insurer to have to bear the whole loss. But I do not understand by what standard it is said to be unjust when the parties have agreed that it should be so."

145. The response of allowing an equitable principle or restitutionary claim to override a valid and binding contract should in my view be regarded as an absolutely last resort, if not a counsel of despair.

The reinsurance level

146. The thrust of MMI's arguments in the present case, which the judge-arbitrator accepted, is that, within the *Fairchild* enclave, the analysis of the relationship between an insured employer and its liability insurers adopted by the majority of the Supreme Court in *IEG* must apply equally to the relationship between a liability insurer and its reinsurers. As Mr Alistair Schaff QC for MMI emphasised, a contract of reinsurance is simply an insurance of the same subject-matter as the underlying insurance contract where the interest insured is the original insurer's liability under the underlying contract. There is in these circumstances, Mr Schaff submitted, no principled distinction between insurance and reinsurance of the risk of an employer being held liable in tort for causing an employee to contract mesothelioma through exposure to asbestos, and the legal approach which applies to the settlement of mesothelioma claims at the insurance level must also operate at the reinsurance level.

147. Compelling as the logic of this argument at first sight seems, it in my view overlooks the reasons which drove the majority of the Supreme Court in *IEG* to adopt a solution to the problem confronting the court which created a result that Lord Mance himself described as "contrary to principle" and then to seek to mitigate that result by devising yet further new special rules of law. I am satisfied that those reasons do not compel the courts to resort to a similar expedient at the reinsurance level. To the contrary, a principled solution has been proposed by Equitas which does not allow the reinsured to select the period and policy to which the whole of its loss attaches – contrary to the basis on which the reinsurance was placed. The proffered solution also does not allow the reinsured to obtain under a contract to provide cover for one year an indemnity for the whole of a loss which arises from risks extending over a number of years – a result which, as Lord Sumption put it, "entirely severs the functional connection between premium and risk": see *IEG* at para 155. The solution which avoids subverting the basis of the reinsurance contracts in these ways rests on the now well established and orthodox principles developed by the common law to control the exercise of contractual powers.

Implied constraints on the exercise of contractual powers

148. An important development in the English law of contract which has gathered momentum in recent years is the readiness of courts to imply a term as to the manner in which a contractual power may be exercised so as to ensure that the power is not abused and is exercised in good faith. The doctrine of good faith in this context requires a contractual power to be exercised in a way which is consistent with the justified expectations of the parties arising from their agreement, construed in its relevant context.

149. The conceptual basis for this approach appears most clearly from the decision of the House of Lords in *Equitable Life Assurance Society v Hyman* [2000] UKHL 39; [2002] 1 AC 408. In that case with profits policies of life insurance issued by a mutual society provided for the payment when the policies matured on the policyholder's retirement of a guaranteed rate annuity. The contractual relationship

between the policyholder and the Society was also governed by the Society's articles of association under which the directors had the power to award a financial bonus when the policy matured. The relevant article of association (article 65) stated that the amount of this bonus was in the "absolute discretion" of the directors. The House of Lords held that it was necessary to imply a term into article 65 which precluded the directors from exercising their discretion in a way which depended on whether the policyholder would be receiving an annuity at a guaranteed rate. In approaching the question whether a term was to be implied, Lord Steyn (with whom the rest of the appellate committee agreed) identified the inquiry as:

> "entirely constructional in nature: proceeding from the express terms of article 65, viewed against its objective setting, the question is whether the implication is strictly necessary."

Lord Steyn concluded that the implication of a term which precluded the directors from exercising their discretion so as to pay different (and lower) bonuses to policyholders entitled to guaranteed rate annuities was strictly necessary, as it was "essential to give effect to the reasonable expectations of the parties": [2002] 1 AC 408 at 459.

150. I agree with the analysis of Sir Kim Lewison in his book on *The Interpretation of Contracts* (6th Edn, 2015) at para 6.08 that Lord Steyn was here applying the test of whether the implication was necessary to give business efficacy to the contract by asking whether, without the implied term, the contract would work in the way the parties would reasonably have expected it to work. This accords with the original statement of the business efficacy test in *The Moorcock* (1889) 14 PD 64 at 68 as seeking to give to the transaction "such efficacy as both parties must have intended that at all events it should have." That included, in Bowen LJ's classic statement, making each party promise in law to bear such perils or chances as it must have been in the contemplation of both parties that he should be responsible for: ibid.

151. In identifying the scope of any term which it is necessary to imply for the contract to work in the way that the parties must have intended or reasonably expected it to work, the courts recognise that, where the contract permits a party to make a choice or requires it to make an evaluative judgment, it is for that party and not the court to make the relevant choice or evaluation. Consequently, the term implied often imports a standard of review similar to that applied in judicial review of administrative action whereby the decision-maker is required only to act honestly and reasonably in the *Wednesbury* sense: see *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116; [2008] 1 Lloyd's Rep 558, para 66; *Braganza v BP Shipping Ltd* [2015] UKSC 17; [2015] 1 WLR 1661, paras 19-30. What is honest and reasonable is judged by reference to the purpose(s) which the contract requires or permits the party exercising the relevant power to pursue.

152. There is now a large body of case law in which this approach has been applied. An early but pertinent example is *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (Nos 2 & 3)* [2001] EWCA Civ 1047; [2001] Lloyd's Rep IR 612. In that case a contract of reinsurance contained a claims cooperation clause which provided that, in relation to any claim made under the underlying insurance policy, "no settlement and/or compromise shall be made [by the insurer] and liability admitted without the prior approval of reinsurers." The Court of Appeal held that the power of the

reinsurers to withhold approval to a proposed settlement was not an absolute right but was subject to an implied limitation that it must "be exercised in good faith after consideration of and on the basis of the facts giving rise to the particular claim, and not with reference to considerations wholly extraneous to the subject-matter of the particular reinsurance or arbitrarily": para 76. By "arbitrarily" was meant not "in circumstances so extreme that no reasonable company in its position could possibly withhold approval": para 73.

153. Mance LJ (who gave the lead judgment) derived this implication from the context in which and purpose for which the claims cooperation clause gave reinsurers the right to withhold approval. The context included the fact that the reinsured was the company through which the financial burden of liability passed to the reinsurers, while the purpose was to protect the reinsurers' interests in relation to the claim: para 67. He gave as one possible example of an unreasonable exercise of the contractual power a refusal to approve the settlement of a claim because the reinsurer had decided, for reasons unrelated to the particular claim, that it wished to prolong payment of any claims for as long as possible, however obvious it might be that they would have to be met in full and should as claims be settled on the best terms possible: para 68.

154. The context in which the contract conferring the relevant power has to be construed may include a relevant legal regime. For example, in *British Telecommunications plc v Telefónica O2 UK Ltd* [2014] UKSC 42; [2014] Bus LR 765 an "interconnection" agreement under which BT gave various mobile network operators access to certain landlines with associated numbers conferred on BT a power unilaterally to fix or vary its charges. The Supreme Court held that the exercise of this power was impliedly limited by reference to objectives set out in an EU Directive (referred to as "the Framework Directive") which regulated the arrangements made between telephone network operators. Lord Sumption (with whose judgment the other Justices agreed) said, at para 37:

> "As a general rule, the scope of a contractual discretion will depend on the nature of the discretion and the construction of the language conferring it. But it is well established that in the absence of very clear language to the contrary, a contractual discretion must be exercised in good faith and not arbitrarily or capriciously. This will normally mean that it must be exercised consistently with its contractual purpose." (citations omitted)

Construing the interconnection agreement in the context of the legal environment in which the parties were operating, Lord Sumption considered that "the intention of the parties must be to comply with the [regulatory] scheme as it stands from time to time so far as the contract permits" and that this intention necessarily informed the scope and operation of BT's power under the contract to set its own charges. It followed that BT was only entitled to vary its charges if the variation was consistent with the purposes set out in the Framework Directive.

155. There are occasions when no term will be implied to fetter the exercise of a contractual power. But that conclusion, when reached, is also the result of a process of construction. The language in which the power is expressed is not decisive. For example, in the *Equitable Life* case the discretion of the directors to decide what final

bonus should be paid was held to be limited, even though the discretion was expressed to be "absolute". An example of a case in which a contractual power was found, on analysis, to be unfettered is *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200; [2013] BLR 265. In that case a contract for the provision by a private contractor of catering and cleaning services to a hospital trust contained very detailed rules for measuring the contractor's performance through a system of awarding "service failure points" for specified "performance failures" and deducting sums from the price paid to the contractor each month according to the number of service failure points incurred.

156. The Court of Appeal found that the award of service failure points and calculation of deductions did not involve the exercise of any discretion. In relation to any question whether points had been correctly awarded, there was only one right answer determined by the rules set out in the contract. In the event of disagreement about the answer, the contract provided for a dispute resolution procedure. The hospital trust was not contractually obliged to award the number of service failure points stipulated by the contract or to make the deduction from a monthly payment stipulated by the contract, and in that sense had a discretion whether or not to do so. But the trust could not be criticised if it chose to award the full number of points and levy the full deduction provided for in the contract. Thus, the only discretion which the trust had was to decide whether or not to exercise an absolute contractual right.

The term implied in this case

157. Applying the principles illustrated by these authorities, the relevant contractual power in the present case is the power of MMI under each of its policies of reinsurance with Equitas to claim an indemnity for its "ultimate net loss" (so far as it falls within the policy limits) resulting from an accident that occurred during the policy year. Without doubt, the ordinary expectation is that the exercise of this power is completely unfettered such that MMI has an absolute right to claim and be indemnified for the whole of this sum. That expectation, however, rests on the assumption – which, as discussed earlier, is a fundamental feature of an insurance contract – that MMI has no choice about the policy period to which a loss attaches and that, if a loss falls within one period, it cannot also fall within another. The ordinary expectation also assumes that the amount of the loss falling within a particular policy year does not depend on what risks the reinsured has underwritten in any other policy year. Again, this simply reflects the basic nature of insurance and reinsurance.

158. As discussed, within the *Fairchild* enclave, these assumptions no longer hold good. The same indivisible loss is treated as having been caused in multiple policy years, thus giving an insurer which provided EL cover to the employer for two or more of those years the ability to choose the policy year (or years) to which it will attribute the loss for the purpose of making a reinsurance claim. The amount of the insurer's ultimate net loss also depends, entirely anomalously, on whether or to what extent the insurer provided EL cover for other years in which the insured employer wrongfully exposed its employee to asbestos. In this topsy-turvy world it is impossible for the applicable contracts of reinsurance to work exactly as the parties intended and reasonably expected them to work. To make the contracts work as consistently as is possible with the parties' presumed intention and reasonable expectations, it is

necessary to imply a term which restricts the exercise of the reinsured's power to select how it will present its claim as between policy years.

159. True it is that the question whether a term must be implied is to be judged at the date when the contract was made (see *Marks & Spencer plc v BNP Paribas Securities Services* [2015] UKSC 72; [2016] AC 742, para 23) and that when the relevant reinsurance contracts were made the parties could not have foreseen the situation that has arisen as a result of the law's response to mesothelioma claims. The court's task is nevertheless to consider how reasonable parties should be taken to have intended the contract to work in the circumstances which have in fact arisen. As Chadwick LJ explained in *Bromarin AB v IMD Investments Ltd* [1999] STC 301 at 310, in this type of case:

> "The task of the court is to decide, in the light of the agreement that the parties made, what they must have been taken to have intended in relation to the event … which they did not contemplate. That is, of course, an artificial exercise, because it requires there to be attributed to the parties an intention which they did not have (as a matter of fact) because they did not appreciate the problem which needed to be addressed. But it is an exercise which the courts have been willing to undertake for as long as commercial contracts have come before them for construction."

See also *Lloyds TSB Foundation for Scotland v Lloyds Banking Group plc* [2013] UKSC 3; [2013] 1 WLR 366, para 1, where the legal and accounting context in which a contract had to be construed by the Supreme Court was "unthinkable" when the contract was entered into.

160. I think it clear that the way in which reasonable parties would have intended the reinsurance contracts at issue in this case to work if they had contemplated the legal regime which now applies within the *Fairchild* enclave, is by requiring the insurer / reinsured to present its claims in a way which spreads its ultimate net loss across the period covered by the EL policies under which it is liable to indemnify its insured. Such an apportionment matches the claim as closely as possible to the underlying risk (of wrongful exposure to asbestos) which is treated as having caused the loss and provides the closest achievable approximation to how the reinsurance contracts were justifiably expected to operate. It also reflects the common law principle of apportionment established by *Barker*, which has been displaced by legislation only in relation to the liability of employers (and other wrongdoers) to mesothelioma victims in UK law and not in relation to insurers and reinsurers.

161. The way in which I would formulate the term implied is to say that MMI may claim under reinsurance policies covering a particular year only such share of its ultimate net loss as reflects the extent to which exposure to asbestos in that year contributed to the risk which arose during periods covered by MMI's policies of the victim contracting mesothelioma as a result of the insured employer's wrongdoing. In accordance with the common law, the default method of assessing this contribution is simply by reference to time on risk; but there could be facts (for example, more intense or frequent exposure to asbestos or exposure to a particularly dangerous type of asbestos) which would justify treating one year's contribution to the risk as greater

than that of another. Where the insurer's apportionment of the loss is based on such an evaluative judgment, the insurer's judgment will only be open to challenge if it has not been honestly and reasonably made.

162. At a higher level of abstraction, the justification for implying this term is that the implication is necessary to prevent the insurer's power to allocate its loss among policy years from being abused. The power to 'spike' a loss to a particular year is not one for which the reinsured can reasonably be said to have bargained since it was not within the reasonable contemplation of the parties when the reinsurance contracts were made that the reinsured might be able to choose the year to which a loss will attach. Nor was it within the reasonable contemplation of the parties that the reinsured might be able to claim under a policy providing one year of cover loss that results from risks that arose in other policy years. Both these possibilities are inconsistent with the essential nature and purpose of the parties' agreement. In these circumstances good faith requires that the reinsured should not exploit this power which it was not intended to have for its own commercial advantage but should exercise it in a way which is as consistent as possible with the assumption of risk for which the reinsurance premium was paid.

The grounds for distinguishing *IEG*

163. MMI contends that this analysis proves too much because, if correct, it would similarly require an insured employer to limit its claim under an EL policy, by reason of an implied term in the insurance contract, in a similar way. It is argued that such a conclusion would be inconsistent with the approach taken by the majority of the Supreme Court in *IEG*.

164. In my view, there are at least five answers to this argument which provide solid grounds for distinguishing the reasoning of the majority in *IEG*.

165. First (although I would be reluctant to rely on this ground alone), the solution proposed by Equitas based on the doctrine of good faith, which in my opinion is well founded, was not proposed or considered in *IEG*. It therefore cannot be said that it is a solution which did not commend itself to the Supreme Court or which the Supreme Court has rejected.

166. Second, the fact that no such solution was proposed in *IEG* is a reflection of the position taken by insurers and the Association of British Insurers in that case who, as mentioned earlier, supported an approach that allows the insured employer to select the insurer from which to claim a full indemnity. The insurance industry took this position even though Lord Sumption had proposed an alternative solution and even though the position taken was on its face contrary to insurers' own interests. The majority of the Supreme Court was clearly influenced by this "striking" feature of the case. By contrast, in the present case reinsurers are not arguing for such an approach and are pressing for a different solution (which is not the solution suggested by Lord Sumption).

167. Third, I have little doubt that the stance taken by the insurance industry in *IEG* was, as Lord Neuberger and Lord Reed deduced, driven by a fear that, if the courts did not allow an insured employer to recover its full loss from any insurer which had provided cover for any part of the period of exposure to asbestos, Parliament would

intervene to procure that result. Such a fear was plainly rational given the policy of the legislature, demonstrated by its enactment of section 3 of the Compensation Act 2006, that an employee-victim should be able to recover full compensation for asbestos-related mesothelioma. The practical difference between the approach of the majority and that of the minority in *IEG*, as Lord Mance identified, arises where the insured employer is insolvent. In such a situation, which seems likely to be common given that decades may pass between exposure to asbestos and the development of the disease and given the potential number and size of claims, Lord Mance's approach enables the victim to recover full compensation even if his former employer is insolvent, provided the employer had insurance for any part of the relevant period with a solvent insurer. It is the insurer which, in such circumstances, will suffer the consequences of the insured's insolvency, as its right of recoupment will be worthless.

168. This policy reason for allowing the insured to recover its full loss from any solvent insurer does not exist at the reinsurance level. It has not been – and could not realistically be – suggested that, unless the insurer is allowed to recover its entire loss from those reinsurers who provided cover for any one year during the relevant period, there is a significant risk that the employee-victim will not be fully compensated. Accordingly, and in my view most importantly, the policy reason which justified the approach taken by the majority in *IEG* does not apply at the reinsurance level.

169. Fourth, the implication of a term which requires the reinsured to confine its claim under its reinsurance for each year to an appropriate proportion of its loss is not inconsistent with the decision of the Supreme Court in the *Trigger* litigation. This solution therefore does not suffer from the defect which the majority in *IEG* considered fatal to Lord Sumption's approach.

170. Fifth, the solution proffered in the present case has the same merit at the reinsurance level as the solution adopted by the majority in *IEG* has at the insurance level of being consistent with the way in which the market has operated in handling mesothelioma claims. As Males LJ has noted at para 18 above, MMI initially presented claims under its reinsurance policies on the basis of a time on risk allocation. This changed, we were told, after the decision of the Supreme Court of Appeal in the *Trigger* litigation.

171. Furthermore, even the simplified examples used in these proceedings to illustrate the parties' rival cases as to how contribution and recoupment should operate at the reinsurance level show the very real practical difficulties that would be likely to arise whatever precise method of contribution and recoupment is adopted. At the insurance level, an insurer who pays the insured employer's full loss and wishes to exercise rights of contribution and recoupment only needs to find out what insurance, if any, the employer had in other years in which the employee was exposed to asbestos and then to calculate each insurer's proportion of the risk along with any proportion to be borne by the employer if it was uninsured for part of the exposure period. That is likely to be a relatively straightforward task. At the reinsurance level the position is far more complex. Where, as may well be the case, an insurer has multiple layers of excess of loss reinsurance in each relevant year, many different reinsurers may potentially be involved. Moreover, there may be no direct correspondence between the limits of layers of reinsurance placed in different years. A solution which avoids the need to calculate and settle what may be a large number of contribution and

recoupment claims (for what may be quite small amounts of money) arising from any one loss has obvious practical advantages.

172. The short of the matter is that the courts need not and should not impose a complicated, burdensome and, to put it charitably, unconventional solution on the reinsurance market when a simple, principled and orthodox solution is at hand.

Conclusion

173. For these reasons, as well as those given by Males LJ, I would allow the appeal and answer the questions of law raised on the appeal in the terms that he has indicated.

Lord Justice Patten :

174. I agree with both judgments.

68 F.4th 774
United States Court of Appeals, Second Circuit.

The INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, Plaintiff-Appellee,

v.

EQUITAS INSURANCE LIMITED, Defendant-Appellant.

Docket No. 20-3559-cv
|
August Term, 2022
|
Argued: December 1, 2022
|
Decided: May 22, 2023

Synopsis

Background: Reinsured brought action against reinsurer to recover for its failure to pay any portion of $20 million allocated in settlement to reinsured's umbrella policy under "all sums" approach for homeowners' personal injuries and property damage related to environmental contamination occurring over periods of multiple policies. The United States District Court for the Southern District of New York, Laura Taylor Swain, J., 2020 WL 4016815, granted reinsured's motion for summary judgment making reinsurance coverage co-extensive with reinsured's coverage obligations. Reinsurer appealed.

Holdings: The Court of Appeals, Lynch, Circuit Judge, held that:

[1] under English law as predicted by Court of Appeals, facultative reinsurer's obligations were co-extensive with reinsured's obligations, and

[2] reinsured's failure to provide timely notice of claim did not allow reinsurer to fully repudiate the policy.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (12)

[1] **Federal Courts** Summary judgment

Court of Appeals reviews a grant of summary judgment de novo.

[2] **Federal Courts** Conflict of Laws; Choice of Law

Federal court sitting in alienage jurisdiction applies the choice-of-law rules of the forum state. 28 U.S.C.A. § 1332(a)(2).

[3] **Action** What law governs

Under New York choice-of-law rules, where the parties agree that a certain jurisdiction's law controls, this is sufficient to establish choice of law.

[4] **Insurance** Definitions

Insurance Coverage

Under English law, a facultative reinsurance contract is a separate contract that is not an insurance against liability; thus, an insurer seeking indemnity under a reinsurance contract must, in the absence of special terms, establish both its liability under the terms of the insurance and its entitlement to indemnity under the terms of the reinsurance.

[5] **Insurance** Continuous acts and injuries; trigger

Whether insurance coverage is "triggered" refers to question of what events, from point of exposure to point of manifestation, trigger coverage.

[6] **Insurance** Proration and Allocation

Insurance Contribution Among Insurers

Under California and Hawai‘i law, once liability insurer is on hook for "all sums," dispute between insured and insurer ends, and contribution dispute between coinsureds begins; in light of that understanding, policyholder may obtain full recovery from one insurer even if it was insured by several successive insurers or uninsured for part of when damages accrued.

[7] **Insurance** Following fortunes, form, and settlement

Insurance Evidence

Under English law as predicted by Court of Appeals, facultative reinsurer's obligations were co-extensive with reinsured's obligations to pay $20 million allocated in settlement to reinsured's three-year umbrella policy under "all sums" approach for homeowners' personal injuries and property damage related to environmental contamination occurring over periods of multiple policies; Hawai‘i law following the all sums rule in environmental suits involving continuous and indivisible injuries applied to umbrella policy, and presumption of back-to-back coverage applied.

More cases on this issue

[8] **Insurance** Following fortunes, form, and settlement

Insurance Evidence

English law recognizes strong, though not conclusive, presumption that liability under proportional facultative reinsurance is coextensive with the insurance; thus, it will almost invariably be case that losses falling within original insurance policy will also fall within reinsurance, even if losses are payable under foreign law which takes view different from English law on liability.

[9] **Contracts** Application to Contracts in General

Under English law, a contract has a meaning which is to be ascertained when it is concluded.

[10] **Insurance** Construction in general

Under English law, absent an ability to predict the governing legal regime at the outset, an unspecified foreign law cannot dictate the meaning of a reinsurance contract.

[11] **Insurance** Claim procedures

Under English law, reinsured's failure to provide timely notice of claim did not allow reinsurer to fully repudiate the reinsurance policy, since timely notice was not a condition precedent to coverage.

More cases on this issue

[12] **Insurance** Claim procedures

Under English law, reinsured's failure to give notice to reinsurer for approximately six years after becoming aware of possible claim under reinsurance policy and reinsured's failure to do so even in response to queries about other claims did not show serious prejudice allegedly allowing reinsurer to repudiate the reinsurance policy and refuse to pay, even if some failures by reinsured were deliberate.

More cases on this issue

***776** Appeals from an order of the Southern District of New York (Swain, C.J.)

Attorneys and Law Firms

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Sean Thomas Keely, Freeborn & Peters LLP, New York, NY, for Defendant-Appellant (Jill C. Anderson, Freeborn & Peters LLP, Chicago, IL, on the brief).

Before: Calabresi, Lynch, and Nardini, Circuit Judges.

Opinion

Gerard E. Lynch, Circuit Judge:

This is a reinsurance dispute between Defendant-Appellant Equitas Insurance Limited ("Equitas") and Plaintiff-Appellee the Insurance Company of the State of Pennsylvania ("ICSOP"). In the late 1960s, ICSOP provided umbrella insurance to a predecessor of Dole Food Company for a policy period from October 1968 to October 1971 (the "ICSOP-Dole policy"). Equitas then reinsured part of ICSOP's exposure for the same three-year period.

Many years later, in 2009, homeowners in Carson, California, sued Dole for polluting their soil and groundwater. Dole and ICSOP settled those claims and allocated $20 million of the settlement liability to the ICSOP-Dole policy, even though the Carson plaintiffs' property damages and personal injuries continued to accrue after the ICSOP-Dole policy period had ended. In doing so, the settlement followed California law's approach to allocation, known as the "all sums rule," which treats any insurer whose policy was in effect during any portion of the time during which the continuing harm occurred as jointly and severally liable (up to applicable policy limits) for all property damages or personal injuries caused by a pollutant.

ICSOP thereafter sought reinsurance coverage from Equitas for its liability, only for Equitas to deny its claim on the basis that English law, which governs the reinsurance policy, would not have allocated ICSOP's liability on an all sums basis. Instead, Equitas asserted, English law would have prorated ICSOP's liability based on the number of years it provided coverage to Dole. Accordingly, Equitas contended that its reinsurance obligations were similarly limited. Equitas also defended its denial on the theory that ICSOP had deliberately delayed notice of claim, and thus forfeited any claim under the reinsurance policy.

ICSOP then brought this suit, claiming that Equitas was liable on the policy for the reinsured portion of ICSOP's settlement liability. Rejecting both of Equitas's arguments for denying coverage, the district court (Laura Taylor Swain, *C.J.*) granted summary judgment to ICSOP.

We agree with the district court. Although the question is not without doubt, we conclude that under the better reading of English law, Equitas's obligations under the reinsurance policy are co-extensive ***777** with ICSOP's obligations under the ICSOP-Dole policy. The question is not whether English law would have allocated ICSOP's liability on an all sums basis; English law does not govern ICSOP's liability. Instead, the question is whether, once ICSOP's liability was properly allocated, as Equitas concedes that it was, English law would then interpret the reinsurance policy as providing co-extensive coverage. Under English law, there is a strong presumption that facultative reinsurance policies provide back-to-back coverage, meaning that the liability of the insured is generally equivalent to the liability of the reinsured.

Searching for a way around that presumption, Equitas urges that the United Kingdom Supreme Court would never apply the back-to-back presumption where, as here, a foreign jurisdiction's law has the effect of avoiding a reinsurance policy's coverage period. But the United Kingdom Supreme Court has never limited the presumption in that way, and it has in fact applied a version of the all sums rule in limited instances. Separately, English law has never recognized the defense of full repudiation based on late notice of claim where, as here, timely notice is not a condition precedent to coverage. While Equitas urges that English law would recognize such a defense on extreme facts, no such facts are present here.

We therefore **AFFIRM** the judgment of the district court.

BACKGROUND

In the late 1960s, a subsidiary of Castle & Cooke Inc. purchased land in Carson, California, where Shell Oil Company had formerly operated an oil and petroleum containment facility. The Castle & Cooke subsidiary demolished the facility and developed a housing tract. Decades later, in 2008, the California Department of Toxic Substances Control tested a site adjacent to the housing tract and found hazardous levels of petroleum hydrocarbons, including benzene, a known carcinogen, in the soil and groundwater. Soon after that discovery, Carson homeowners sued Dole Food Company (with which Castle & Cooke had, by then, merged) and Shell in California state court. According to their complaint, long-term benzene exposure can cause various latent diseases, such as anemia and leukemia, that can manifest many years after exposure. Thus, the homeowners sued for personal injuries and property damage related to the environmental contamination.

Shortly after suit was filed in October 2009, Dole notified its insurers. One insurer was ICSOP, a wholly-owned subsidiary of the American International Group, Inc. In 1968, ICSOP had issued umbrella insurance to Castle & Cooke (the "ICSOP-Dole policy"). The ICSOP-Dole policy covers up to $20 million for "all sums" for which Dole might be liable in damages "caused by or arising out of each occurrence happening during" a three-year policy period, from October 1, 1968, to October 1, 1971. J. App'x 754.

Dole and its insurers settled the homeowners' and other related lawsuits, assigning $20 million in liability to the ICSOP-Dole policy – even though that policy contained a three-year coverage period and even though the plaintiffs' losses accrued over four decades. The parties do not dispute either the fact or the extent of ICSOP's liability under the ICSOP-Dole policy. As for ICSOP's liability in general, the ICSOP-Dole policy sets "occurrence" as the relevant thing that must happen during the policy period, *id.*, and it defines occurrence to include "an event or a continuous or repeated exposure to conditions which result in Personal Injury or Property Damage," *id.* at 755-56. As for the *extent* ***778** of ICSOP's liability, the settlement followed the "all sums" rule, a rule that is followed by the State of California, whose laws governed the settlement. *See Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 45 Cal.App.4th 1, 52 Cal. Rptr. 2d 690, 710-11 (1996). While the ICSOP-Dole policy is governed by the laws of the State of Hawaii, neither party disputes that Hawaii, like California, follows that rule. *See Sentinel Ins. Co., Ltd. v. First Ins. Co. of Hawai'i, Ltd.*, 76 Hawai'i 277, 875 P.2d 894, 917 (1994), *as amended* (June 24, 1994).

As discussed more fully below, the all sums rule applies in long-tail liability cases – cases that involve, for example, injuries that manifest many years after exposure to a pollutant – and holds insurers jointly and severally liable, up to applicable policy limits, for all property damages or personal injuries caused by the pollutant so long as some of the continuing harm occurred while each policy was in effect. *See Montrose Chem. Corp. of Cal. v. Superior Ct. of L.A. County*, 9 Cal.5th 215, 260 Cal.Rptr.3d 822, 460 P.3d 1201, 1206-07 (2020), *as modified* (May 27, 2020).

To cover part of its losses, ICSOP notified Equitas, its reinsurance carrier, of Dole's claim against the ICSOP-Dole policy. In 1969, ICSOP had obtained facultative reinsurance [1] from underwriters at Lloyd's of London to hedge some of the risk stemming from the ICSOP-Dole policy; Equitas later inherited those reinsurance obligations from Lloyd's. The reinsurance policy spans the same three-year period as the ICSOP-Dole policy, and it covers up to $7,234,125 for each $20 million limit that ICSOP pays to Dole. It provides that reinsurance coverage is "[a]s [o]riginal," J. App'x 779, 796, and it contains a follow-the-settlements clause, which reads:

> Now We the Underwriters hereby agree to reinsure against loss to the extent and in the manner hereinafter provided.
>
> Being a Reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the Company ....

Id. at 777, 793.

Equitas has refused to cover any portion of ICSOP's part of the settlement and to pay ICSOP's claim.

In September 2017, ICSOP filed suit against Equitas for reinsurance coverage in the Southern District of New York. At the close of discovery, the parties cross-moved for summary judgment. Equitas principally argued that ICSOP is not entitled to indemnity under the reinsurance policy because, while it did not dispute ICSOP's liability *to Dole* under the all sums rule, Equitas's liability *to ICSOP* under the reinsurance policy is governed by English law, which does not follow that rule. Equitas also asserted a separate repudiation defense, contending that it may fully repudiate the reinsurance policy because ICSOP deliberately delayed notice of claim for about six years after becoming aware that a claim was likely, and misled Equitas into believing that ICSOP had no claim against the reinsurance policy.

For its part, although it agreed that English law governed the reinsurance policy, ***779** ICSOP argued that English law would interpret the reinsurance policy as "back-to-back" – that is, providing co-extensive coverage – with the ICSOP-Dole policy. ICSOP also argued that English law has never recognized a defense of full repudiation based on late notice of claim, and that in any event ICSOP's conduct did not reflect untimely notice or the extreme bad faith that, on one reading of English law, might permit such a defense.

The district court agreed with ICSOP, holding that the parties' obligations are co-extensive and rejecting Equitas's full repudiation defense. *See Ins. Co. of State of Pennsylvania v. Equitas Ins. Ltd.*, No. 17-6850, 2020 WL 4016815, at *2-5 (S.D.N.Y. July 16, 2020). Consequently, it awarded ICSOP $7,234,125 in damages. *Id.* at *6. Equitas appeals from that judgment.

DISCUSSION

[1] **[2]** **[3]** We review a grant of summary judgment de novo. *Bey v. City of New York*, 999 F.3d 157, 164 (2d Cir. 2021). We first consider the scope-of-coverage issue – whether Equitas's obligations under the reinsurance policy are, as the district court held, co-extensive with ICSOP's obligations under the ICSOP-Dole policy. We then consider Equitas's repudiation defense. Because, as the parties agree, English law governs the reinsurance policy, our role is to predict how the United Kingdom Supreme Court would resolve those issues. *See Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc.*, 716 F.3d 296, 299-300 (2d Cir. 2013) (predicting that "a rebuttable presumption of reliance" that attaches to some claims for "fraudulent misrepresentation" is "a burden-shifting device" under English law). [2]

I. Scope of Coverage

[4] Under English law, a facultative reinsurance contract is "a separate contract" that "is not an insurance against liability." *Wasa Int'l Ins. Co. v. Lexington Ins. Co.* [2010] 1 AC 180 (HL) ¶ 32 (Lord Mance); *see also Delver v. Barnes* [1807] 127 Eng. Rep. 748 (CP) 749-50 (Mansfield, C.J.). Thus, "an insurer seeking indemnity under a reinsurance must, in the absence of special terms, establish *both* [1] its liability under the terms of the insurance *and* [2] its entitlement to indemnity under the terms of the reinsurance." *Wasa* [2010] 1 AC 180 (HL) ¶ 35 (Lord Mance) (emphasis added). To be entitled to indemnity, ICSOP therefore must show that its liability was properly allocated under the terms of the ICSOP-Dole policy and that it is entitled to indemnity for that liability under the reinsurance policy.

A. Liability under the ICSOP-Dole Policy

Equitas does not dispute ICSOP's liability to Dole under the ICSOP-Dole policy or ***780** the settlement's apportionment of damages. Nonetheless, because some of Equitas's arguments against indemnity under the reinsurance policy concern whether English law is receptive to the all sums rule, it is helpful to outline some general principles of American and English law that inform those arguments. Those principles aid our prediction of how the United Kingdom Supreme Court would decide the contested question of indemnity in the reinsurance context.

i. American Tort and Insurance Law

As one commentator has put it, "[v]ery few developments have ever transformed either tort or insurance law, ... and only one[ ] [development] has transformed both ...." Kenneth S. Abraham, *The Long-Tail Liability Revolution: Creating the New World of Tort and Insurance Law*, 6 U. Pa. J.L. & Pub. Aff. 347, 349 (2021) (emphasis omitted). That development is the rise in tort and insurance litigation concerning "long-tail harms," a term that "describes a series of indivisible harms, whether bodily injury or property damage, that are attributable to continuous or repeated exposure to the same or similar substances or conditions that take place over multiple years or that have a long latency period." Restatement of the Law of Liability Insurance § 33 cmt. *f* (Am. L. Inst. 2019) (identifying "asbestos-related bodily injuries and environmental property damage" as two "paradigmatic examples").

In tort law, long-tail harms present "quintessentially difficult causation questions, largely because of the length of time between the defendant's allegedly tortious conduct and the manifestation of injury, disease, or damage that may have been caused by that conduct." Abraham, *supra*, at 357-58. Those quandaries inspired judicial innovations regarding but-for causation. In the seminal case on market-share liability, for example, the Supreme Court of California addressed claims brought by the daughters of mothers who had ingested diethylstilbestrol ("DES") during their pregnancies, which led to latent injuries manifesting in their daughters many years later. *See Sindell v. Abbott Lab'ys*, 26 Cal.3d 588, 163 Cal.Rptr. 132, 607 P.2d 924, 925-26 (1980). Ordinarily, the doctrine of but-for causation would have required the plaintiff-daughters to prove which of many manufacturers had produced the DES that their mothers had ingested. *See id.*, 163 Cal.Rptr. 132, 607 P.2d at 927-28. But the Supreme Court of California relieved them of that near-impossible burden, holding that "[e]ach defendant will be held liable for the proportion of the judgment represented by its share of that market unless it demonstrates that it could not have made the product which caused plaintiff's injuries." *Id.* 163 Cal.Rptr. 132, 607 P.2d at 937.

Similarly, when it comes to asbestos-related injuries, it is nearly impossible to prove with "absolute certainty which particular exposure to asbestos dust resulted in injury to" a particular plaintiff, especially for an employee who

was exposed to several different sources of asbestos from several different employers. *Borel v. Fibreboard Paper Products Corp.*, 493 F.2d 1076, 1094 (5th Cir. 1973). In responding to that issue, courts developed more plaintiff-friendly causation rules. In *Borel*, for example, the Fifth Circuit (applying Texas law) held that it was enough for a victim of mesothelioma and asbestosis to show that he was tortiously "*exposed* to the [asbestos-contaminated] products of all the defendants on many occasions." *Id.* (emphasis added). Mere tortious exposure was sufficient, the court held, because "[i]t was ... established that the effect of exposure to asbestos dust is cumulative, that is, each exposure may result in an additional and separate injury." *Id.* Similarly, in ***781** *Rutherford v. Owens-Illinois, Inc.*, the Supreme Court of California held that "plaintiffs may prove causation in asbestos-related cancer cases by demonstrating that the plaintiff's *exposure* to defendant's asbestos-containing product in reasonable medical probability was a substantial factor in contributing ... to the *risk* of developing asbestos-related cancer. 16 Cal.4th 953, 67 Cal.Rptr.2d 16, 941 P.2d 1203, 1219 (1997), *as modified* (Oct. 22, 1997) (first emphasis added; footnote omitted). Under that approach, a plaintiff need not "demonstrate that fibers from the defendant's particular product were the ones, or among the ones, that actually produced the malignant growth." *Id.* (emphasis omitted).

Those judicial innovations and others like them expanded the universe of liable defendants, and thus spawned ever more difficult questions concerning how to allocate that liability. Those questions still remain. There appears to be no majority American rule, for instance, governing how to allocate liability when multiple defendants are liable for an indivisible injury – like mesothelioma or other cancers or property damage – flowing from environmental contamination; some jurisdictions appear to employ hybrid approaches to apportioning liability. *See* Restatement (Third) of Torts: Apportionment Liab. § 17 cmt. *a* (Am. L. Inst. 2000) (collecting various approaches). On the one hand, eight years after *Sindell*, the Supreme Court of California rejected the imposition of joint-and-several liability in the context of market-share liability, confining liability instead to the defendants' respective share of the market. *See Brown v. Superior Court (Abbott Lab'ys)*, 44 Cal.3d 1049, 245 Cal.Rptr. 412, 751 P.2d 470, 485-87 (Cal. 1988). On the other, the *Borel* court (again applying Texas law) imposed joint-and-several liability. 493 F.2d at 1095-96.

Related developments occurred in the world of insurance law as claims for long-tail harms made their way through the courts. With rising long-tail tort liability and a competitive American insurance market in the 1960s, comprehensive general liability insurance shifted from covering tort liability caused by an "accident," which arguably covered only abrupt events that resulted in immediate harm, to covering tort liability caused by an "occurrence." Abraham, *supra*, at 369-71.[3] That change was "a recognition that the policy was to cover liability for harm caused by pollution and other similar, slowly-occurring processes." *Id.* at 371.

The ICSOP-Dole policy descends from that lineage. Executed in the late 1960s, it covers Dole for "all sums" that Dole "shall be obligated to pay by reason of liability imposed upon [Dole] by law," and for "all damages, direct or consequential, ... on account of personal injuries ... and property damage, caused by or arising out of each *occurrence* happening *during* the policy period." J. App'x 754 (emphases added). Notably, the ICSOP-Dole policy defines "occurrence" broadly to include "an event or a continuous or repeated *exposure* to conditions which result in Personal Injury or Property Damage." *Id.* at 755-56 (emphasis added).

[5] That language appears to codify the so-called "continuous injury" trigger ***782** in insurance law. Whether insurance coverage is "triggered" refers to the question of "what events, from the point of exposure to the point of manifestation, trigger coverage." *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1042 (D.C. Cir. 1981). In answering that question, courts within the United States have developed several approaches: (1) the manifestation theory, where coverage is triggered when an injury manifests, even if the injury occurred many years earlier; (2) the injury-in-fact theory, where coverage is triggered when an injury actually occurs, even if the injury might manifest many years later; (3) the exposure theory, where coverage is triggered when the injured person or property is exposed to the risk that later manifests into harm; and (4) the continuous injury trigger, where coverage is triggered throughout the progression of a disease or property damage, from initial exposure to the risk all the way to manifestation of harm. Restatement of the Law of Liability Insurance § 33 cmt. *f*; *see also Sentinel Ins. Co.*, 875 P.2d at 914-15.[4] There is no consensus rule. Importantly for our purposes, California and Hawaii have adopted the continuous injury trigger when interpreting occurrence-based policies like the ICSOP-Dole policy. *See Montrose Chem. Corp. of Cal.*, 260 Cal.Rptr.3d 822, 460 P.3d at 1206-07; *Sentinel Ins. Co.*, 875 P.2d at 917 (Hawaii law; adopting an

"injury-in-fact" theory in general, but adopting the continuous injury theory where the "injury-in-fact occurs continuously over a period covered by different insurers or policies, and actual apportionment of the injury is difficult or impossible to determine"). Hence, there is no dispute that ICSOP was liable to Dole.

The *extent* of ICSOP's liability to Dole presents a different, though also undisputed, question. The continuous injury trigger implicates distinct allocation issues because that trigger presents circumstances where multiple insurers, like multiple defendants in a tort action, might be liable. It also presents circumstances where, as here, a single insurer is liable even though that insurer provided coverage during only a short part of the period of exposure to the risk that later evolved into harm. [5]

[6] In those circumstances, some jurisdictions, like California and Hawaii, follow ***783** the all sums rule. That rule resolves the allocation issue in favor of the insured by holding the insurer jointly and severally liable for "all sums for property damage attributable to the polluted site, up to their policy limits, if applicable, as long as some of the continuous property damage occurred while each policy was on the loss." *Montrose Chem. Corp. of Cal.*, 260 Cal.Rptr.3d 822, 460 P.3d at 1207 (internal quotation marks, citation, and brackets omitted); *see also Sentinel Ins. Co.*, 875 P.2d at 915 (similar under Hawaii law). That rule reflects the understanding that an insurer's duty to the insured is an issue distinct from apportionment and allocation between multiple insurers. *See Armstrong World Indus., Inc.*, 52 Cal. Rptr. 2d at 710-11, 742. In other words, once an insurer is on the hook for "all sums," the dispute between the insured and insurer ends, and a contribution dispute between co-insurers begins. In light of that understanding, a policyholder may obtain full recovery from one insurer even if it was insured by several successive insurers or uninsured for part of when the damages accrued. *Id.*

Courts have applied the all sums rule where language in the policy required the insurer to pay "all sums" for which the insured becomes liable on account of an event during the policy period. *California v. Cont'l Ins. Co.*, 55 Cal.4th 186, 145 Cal.Rptr.3d 1, 281 P.3d 1000, 1007-08 (2012), *as modified* (Sept. 19, 2012); *see also Keene Corp.*, 667 F.2d at 1047-50. The ICSOP-Dole policy contains that language. *See* J. App'x 754. Thus, Equitas does not dispute the extent of ICSOP's liability to Dole under California law.

An alternative approach is to prorate responsibility "by year among triggered policy years." Abraham, *supra*, at 380. For example, "[i]f a $200 million liability triggered twenty policy years, then each policy year would be potentially responsible for its pro-rata share of $10 million." *Id.*

"There is some disagreement over the precise number of jurisdictions that have adopted each position" – the all sums rule or the *pro rata* approach – "in part because of variation in policy language and in part because of differing possible interpretations of the holdings in some cases." Restatement of the Law of Liability Insurance § 41 cmt. *c*. What seems to be clear, however, is that "a significant number of courts" have adopted the all sums rule, "a clear majority" have adopted the *pro rata* approach, and "many courts have not yet taken a position." *Id.*; *see also Rossello v. Zurich Am. Ins. Co.*, 468 Md. 92, 226 A.3d 444, 451 nn.12-13 (2020) (collecting some of the divide).

Whether to relax causation in tort, set a default rule that more expansively triggers insurance coverage, or allocate liability on a *pro rata* or all sums basis, are quintessentially public policy questions. As a federal court sitting in alienage jurisdiction, it is not our role to answer those questions. Instead, our role is to determine how English law would resolve those issues in the context of *reinsurance*. How English law has approached those issues in the context of tort liability and *insurance* is therefore helpful to understanding the parties' arguments.

ii. English Tort and Insurance Law

As with American law, we begin our discussion of English law with torts. In *Fairchild v. Glenhaven Funeral Services Ltd.*, the House of Lords heard an appeal involving three claimants whose long-term and substantial exposure to asbestos caused them to develop mesothelioma. [2003] 1 AC 32 (HL) ¶¶ 3-5 (Lord Bingham). The Lords considered whether there were "special circumstances," in light of the medical uncertainty concerning how ***784** asbestos exposure causes mesothelioma, that would justify deviating from the ordinary rule of but-for causation. *Id.* ¶ 9; *see also id.* ¶¶ 41, 43 (Lord Nicholls); *id.* ¶¶ 56, 63 (Lord Hoffmann). Citing California's approach, the Lords in *Fairchild* agreed to deviate from the traditional rule, holding that an employer is liable if the employer "wrongful[ly] expose[d] ... its employee to asbestos dust" and that exposure was not "insignificant" but rather materially increased the risk that the employee would

contract disease. *Id.* ¶ 42 (Lord Nicholls); *see also id.* ¶¶ 31, 34 (Lord Bingham); *id.* ¶¶ 47, 63, 73 (Lord Hoffmann); *id.* ¶¶ 105, 107-09 (Lord Hutton); *id.* ¶¶ 161, 168 (Lord Rodger). [6]

After *Fairchild*, the House of Lords faced the allocation issue in *Barker v. Corus UK Ltd.* [2006] 2 AC 572 (HL). Ordinarily, under English law, if two tortfeasors are the proximate cause of an indivisible injury, like mesothelioma, both tortfeasors are jointly and severally liable. *See id.* ¶ 28 (Lord Hoffmann). Applying that apportionment rule, liability under *Fairchild* would seem to result in joint-and-several liability, because a necessary condition for *Fairchild* liability is that the claimant suffer an indivisible injury. *Id.* ¶ 61 (Lord Scott). But that would be incongruent with the basis of *Fairchild* liability, which is the creation of a material increase in risk, even if the defendant did not factually cause the injury. *Id.* ¶ 53 (Lord Scott); *see also id.* ¶ 126 (Baroness Hale) ("For the first time in our legal history, persons are made liable for damage even though they may not have caused it at all ...."). Thus, in *Barker*, the House of Lords rejected a rule that apportioned tort liability on a joint-and-several basis between multiple employers who exposed their employee to asbestos and were thereby liable under the *Fairchild* rule. *Id.* ¶ 48 (Lord Hoffmann); *id.* ¶ 62 (Lord Scott); *id.* ¶¶ 109-10 (Lord Walker); *Id.* ¶ 127 (Baroness Hale). The House of Lords instead allocated liability on a *pro rata* basis. *Id.*

In response, however, Parliament passed the Compensation Act 2006 c. 29 § 3, effectively reversing that aspect of *Barker*. *See Durham v. BAI (Run off) Ltd.* [2012] UKSC 14 ¶ 78 ("*Trigger*") (Lord Clarke) ("Th[e] [allocation] decision [in *Barker*] was reversed by the Compensation Act 2006, so that such employers are jointly and severally liable for the whole of the consequences."). The Compensation Act 2006 holds "that when a victim contracts mesothelioma each person who has, in breach of duty, been responsible for exposing the victim to a significant quantity of asbestos dust and thus creating a 'material increase in risk' of the victim contracting the disease will be held to be jointly and severally liable in respect of the disease." *Id.* ¶ 5 (Lord Mance).

English insurance law followed that development. In *Trigger*, the United Kingdom Supreme Court held that insurers who cover employers who are liable under the Compensation Act 2006 are likewise liable for such claims against the employers. *Id.* ¶¶ 49-50, 71-74. Lord Mance explained that "[w]here two contracts are linked" – as in the reinsurance context – "the law will try to read them consistently with each other." *Id.* ¶ 69. Thus, "[t]he intention under the present insurances must be taken to have been that they ***785** would respond to whatever liability the insured employers might be held to incur within the scope of the risks insured and within the period in respect of which they were insured." *Id.*

Then in *Zurich Insurance PLC UK Branch v. International Energy Group Ltd.*, the United Kingdom Supreme Court extended *Trigger*, holding that insurers are jointly and severally liable on an all sums basis for their insured's liability when that insured is jointly and severally liable pursuant to the Compensation Act. [2015] UKSC 33 ¶¶ 45-51, 54, 94-97 (Lord Mance). In so holding, the Court explained that "facultative liability insurance" – again, like facultative reinsurance – "normally responds to whatever may prove to be the liability incurred by the insured." *Id.* ¶ 45. Thus, "[o]nce one accepts that causation equates with exposure, in tort and tort liability insurance law," as was held in *Fairchild* and *Trigger*, "there is no going back on this conclusion simply because there was exposure by the insured of the victim both within and outside the relevant insurance period." *Id.* ¶ 46. That is so despite, as a dissenting Lord pointed out, "the fundamental importance under English law of the temporal scope of a time policy," *id.* ¶ 153 (Lord Sumption), quoting *Wasa* [2010] 1 AC 180 (HL) ¶ 15 (Lord Brown). Just as the California Court of Appeal recognized in *Armstrong World Industries*, 52 Cal. Rptr. 2d at 710-11, the United Kingdom Supreme Court recognized that the "primary question" concerns the duty that the insurer owes to the insured – in *Zurich*, to cover the insured's liabilities flowing from exposure to asbestos – not the relative position "between two insurers." *Zurich* [2015] UKSC 33 ¶ 48 (Lord Mance). Viewed that way, "there is ... nothing illogical about a conclusion that each of successive insurers is potentially liable in full, with rights of contribution inter se." *Id.*

But the Compensation Act is limited to the particular situation of asbestos-related mesothelioma. Where that Act does not apply, as is the case here, neither does *Zurich*'s adoption of joint-and-several liability. *See id.* ¶¶ 8-9, 35; *cf. Wasa* [2010] 1 AC 180 (HL). That is because policy periods are accorded fundamental importance under English law. *See Municipal Mutual Ins. Ltd. v. Sea Ins. Co. Ltd.* [1998] Lloyd's Rep. (Civ) 421, 436 (Hobhouse, L.J.) ("When the relevant cover is placed on a time basis, the stated period of time is fundamental and must be given effect to.").

B. Indemnity under the Reinsurance Policy

[7] As we have already noted, both parties agree that the reinsurance policy is governed by English law. And because the Compensation Act does not apply here, English law would not have allocated ICSOP's liability under the underlying ICSOP-Dole policy on an all sums basis. But that fact does not resolve the question whether the United Kingdom Supreme Court would construe the *reinsurance* policy as entitling ICSOP to indemnity for its properly allocated liability.

Under English law, the terms of a reinsurance policy must be interpreted in light of its "commercial purpose" and circumstances. GRAYDON S. STARING & HON. DEAN HANSELL, LAW OF REINSURANCE § 13:1 (Mar. 2022 update), quoting *Reardon Smith Line Ltd. v. Hansen-Tangen* [1976] 2 Lloyd's Rep. 621 (HL) 624-25 (Lord Wilberforce); *see also Charrington & Co. v. Wooder* [1914] AC 71 (HL) 82 (Lord Dunedin). In the context of facultative reinsurance, the original insurer reinsures part of its risk by paying the reinsurer "a proportional share of the premium." *Wasa* [2010] 1 AC 180 (HL) ¶ 55 (Lord Collins). "[T]he obvious commercial intention" of that arrangement ***786** is "for the reinsurer to accept that part of the risk." *Id.* ¶ 60. "Consequently, the *starting point* is that normally reinsurance of that kind is *back-to-back* with the insurance, and that the reinsurer and the original insurer enter into a bargain that if the insurer is liable under the insurance contract, the reinsurer will be liable to pay the proportion which it has agreed to reinsure." *Id.* ¶ 55 (emphases added).

[8] English law therefore recognizes a "strong" – though not conclusive – presumption that "liability under a proportional facultative reinsurance is co-extensive with the insurance." *Id.* ¶ 116. Thus, it will "almost invariably be the case" that losses falling within the original insurance policy will also fall within the reinsurance, "even if the losses are payable under a foreign law ... which takes a view different from English law" on liability. *Id.* That "obvious" outcome "is simply commercial common sense." *Id.* ¶ 60. While a facultative reinsurance contract can deviate from that presumption, "[s]uch a contract would ... be wholly exceptional" and constitute "a departure from the normal understanding of the back-to-back nature of reinsurance." *Id.* ¶ 62 (internal quotation marks and citation omitted).

A seminal English case applying that presumption is *Forsikringsaktieselskapet Vesta v. Butcher* [1989] 1 AC 852 (HL) ("*Vesta*"). There, an insurance policy covered a fish farm and contained a warranty requiring the farm to keep a 24-hour watch; the reinsurance policy in question, which covered that original insurance policy, contained the same warranty. *Id.* at 890-91 (Lord Templeman). The owner of the fish farm failed to keep the watch as required, and the farm was destroyed. *Id.* What destroyed the farm, however, was not failure to keep a watch, but rather a storm. *Id.* Under Norwegian law, which governed the original insurance policy, the breach of warranty was no defense to liability because the owner's failure to keep a watch was not what destroyed the fish farm. *Id*. at 891. Had the original policy been governed by English law – which governed the reinsurance policy – that same non-causative breach *would* have entitled the original insurer to refuse payment. *Id*. However, the House of Lords held that absent some "express declaration to the contrary in the reinsurance policy, a warranty must produce the same effect in each policy." *Id.* at 892. It reasoned that the parties, who had access to a "Norwegian legal dictionary" when they agreed upon the original contracts, must have intended the clause to have the same meaning in both the insurance and the reinsurance – that is, the meaning given by Norwegian law – and thus provide back-to-back coverage. *Id.* at 911 (Lord Lowry).

Equitas argues that *Vesta* and, more broadly, the back-to-back presumption do not apply here. It insists that *Wasa*, a case with similar facts to this one, limits the back-to-back presumption. In *Wasa*, an insurance company, Lexington, issued a $20 million insurance policy to Aluminum Co. of America ("Alcoa"), which Lexington then reinsured in the London market with two English reinsurers. [2010] 1 AC 180 (HL) ¶¶ 18-21 (Lord Mance). Neither contract specified a governing law, although the insurance included a "service of suit clause" that required Lexington to "submit to the jurisdiction of any court of competent jurisdiction within the United States." *Id.* ¶ 19 (internal quotation marks omitted). Both contracts covered a three-year period, but the Washington Supreme Court held that Pennsylvania law, which followed the all sums rule, applied to a group of consolidated claims and that the underlying Alcoa policy could therefore cover environmental damages spanning 44 years. *Id.* ¶¶ 12-13 (Lord Brown); *id.* ***787** ¶¶ 19-20, 25-26 (Lord Mance). Lexington sued its English reinsurers to cover their share of the risk. But this time, unlike in *Vesta*, the House of Lords held that the back-to-back presumption did not apply, and it instead strictly construed the reinsurance contract's three-year temporal provision. *Id.* ¶ 54 (Lord Mance); *id.* ¶ 116 (Lord Collins).

But *Wasa* differs from this case in one important aspect. There, the underlying Alcoa policy did not contain a

choice-of-law clause, and it was unpredictable at the time of contracting that Pennsylvania law would govern the Alcoa policy. Here, by contrast, the underlying ICSOP-Dole policy contains an express choice-of-law clause directing the application of Hawaii law, which, Equitas concedes, like California law, follows the all sums rule in environmental suits involving continuous and indivisible injuries.

In *Wasa*, the absence of a choice-of-law clause was significant to Lords Collins and Mance, whose speeches garnered support from a majority of the Lords. Lord Mance explained that the Washington Supreme Court found that Pennsylvania law governed the Alcoa policy by "taking into account matters and events extraneous to th[at] policy." *Id.* ¶ 49. The choice of Pennsylvania law could not, therefore, "be regarded as in any sense predictable at the time when the reinsurance was placed." *Id.* It was for that reason that *Wasa* presented "materially different" circumstances from those presented in *Vesta*. *Id.* While in *Vesta* it was possible "to identify the foreign law which would govern the insurance" when the contract was formed, *id.* ¶ 44, in *Wasa* "[t]here was ... no identifiable legal dictionary (formal or informal), still less a Pennsylvanian legal dictionary," at the time of contracting that "could lead to any different interpretation of the reinsurance wording," *id.* ¶ 49. Lord Collins distinguished *Vesta* on the same basis. "[I]n complete contrast to the *Vesta* case," Lord Collins explained, "there was in 1977, when the [*Wasa*] insurance contract and the reinsurance contract were concluded, no identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract of reinsurance in a manner different from its ordinary meaning in the London insurance market." *Id.* ¶ 108. Meanwhile, in *Vesta*, "the substance of the foreign law as to the consequences of a non-causative breach of warranty could be ascertained at the outset, if necessary by recourse to a relevant Norwegian ... legal source." *Id.*

[9] **[10]** Here, as in *Wasa*, the ability or inability to predict the law governing the original insurance when the parties execute reinsurance is no small factor. Under English law, "a contract has a meaning which is to be ascertained ... when it is concluded." *Id.* ¶ 45 (Lord Mance). Thus, absent an ability to predict the governing legal regime at the outset, an unspecified foreign law cannot dictate the meaning of a reinsurance contract. The presence of a choice-of-law clause in the ICSOP-Dole policy therefore distinguishes this case from *Wasa*.

To be sure, *Wasa* left open whether the presence of a choice-of-law clause would have revived the back-to-back presumption. In the course of arguing *Wasa*, counsel for Lexington asked the House of Lords, "what more could Lexington have done to reinsure themselves on a fully back to back basis?" *Id.* ¶ 51. Tellingly, among other responses, Lord Mance replied that "steps could ... be taken to make the insurance subject to an identifiable governing law, *though this would not necessarily foreclose all argument*." *Id.* (emphasis added).

But, even as *Wasa* does not altogether foreclose Equitas's arguments, we do not ***788** believe that the United Kingdom Supreme Court would be persuaded by them.

i. The Fundamental Importance of a Policy Period

Equitas argues that *Wasa* hinged not just on the lack of a choice-of-law clause, but also on the fundamental importance of a policy period to English insurance law. That argument is not without force. As Equitas argues, a policy period is indeed accorded "fundamental importance" under English law. *Id.* ¶ 15 (Lord Brown). As Lord Brown pointed out in *Wasa*, if the policies were back-to-back, then Lexington, the insurer in that case, could have recovered the full loss no matter how short the period of cover, whether it was three years or "only three months." *Id.* Disregarding a policy period would, Lord Collins wrote in *Wasa*, lead to some "very uncommercial consequences." *Id.* ¶ 111. Similarly, Lord Mance explained that the "all sums" doctrine was a "fundamental and surprising change[ ] in the ordinary understanding ... of a reinsurance period." *Id.* ¶ 40. *Vesta* did not involve a policy period. Instead, it involved "uncommercial and technical points" of English law: the ability of an insurer to deny coverage based on a breach of a warranty that had no causal relationship to the insured's losses. *Id.* ¶ 56 (Lord Collins). In that area, Lord Mance explained in *Wasa*, "English law has long been recognised as unduly stringent and in need of review." *Id.* ¶ 50.

Even so, Equitas's theory falls short for several reasons. To start, the opinion of Lord Brown, who relied most heavily on the fundamental nature of the policy period, did not gain majority support. Lords Mance and Collins, who were joined by a majority, put decisive weight on the inability to predict the governing legal regime at the time the contract was executed. *See id.* ¶ 49 (Lord Mance) (distinguishing *Vesta* on the basis that there was an "identifiable legal dictionary"

to interpret the contracts in that case); *id*. ¶ 108 (Lord Collins) (describing the lack of an "identifiable system of law" as in "complete contrast" to *Vesta*). [7] Moreover, as even Equitas's English law expert acknowledges, the back-to-back presumption is not "confined to such unattractive types of case[s]" like *Vesta*. J. App'x 1178, ¶ 41. Rather, Lord Collins in *Wasa* explained that modern English law would likely apply the presumption even in a case involving a dispute about the definition of the very risk that the parties bargained to insure. [2010] 1 AC 180 (HL) ¶¶ 64-65, citing *St. Paul Fire & Marine Ins. Co. v. Morice* [1906] 11 Com. Cas. 153, a case that involved the meaning of "all risks of mortality" in an insurance dispute about coverage of a bull who was slaughtered on board a ship after contracting foot and mouth disease.

More significantly, Equitas's "fundamental importance" argument relies on its view that the all sums rule is "anathema" to English insurance law. Appellant's Br. 21-22, 32. That view, however, rests on a misreading of *Municipal Mutual* [1998] Lloyd's Rep. (Civ) 421, as well as an incomplete account of English law. In *Municipal Mutual*, England's Court of Appeal declined to apply the back-to-back presumption to hold that the coverage period of an insurance policy was co-extensive with the coverage periods of several ***789** successive reinsurance policies. *Id.* at 435-36 (Hobhouse, L.J.). All policies, however, were given an English law construction, and the reinsurances' coverage periods were textually narrower than the original insurance's coverage period. *Id.* Additionally, the Court of Appeal rejected an all sums allocation of liability in part because the case did not involve "the special problems of liability for asbestosis claims arising from long periods of potential exposure." *Id.* at 436. Instead, the facts of *Municipal Mutual* presented "much simpler questions." *Id.*

And as outlined above, while English law does not generally follow the all sums rule, in more complex cases involving asbestos liability, English law *has* followed a version of the all sums rule, albeit in circumstances that are not present here. After the House of Lords initially eschewed apportioning tort liability jointly and severally between multiple employers who exposed their employees to asbestos, *see Barker* [2006] 2 AC 572 (HL) ¶ 49 (Lord Hoffmann), Parliament passed the Compensation Act 2006 c. 29 § 3, making "each" employer who materially increases the risk that its employee would develop mesothelioma jointly and severally liable "in respect of the whole of the damage caused by the mesothelioma." *Trigger* [2012] UKSC 14 ¶ 57 (Lord Mance). True, the text of the Act applies to employer tort liability, not insurance liability. But that did not stop the United Kingdom Supreme Court from holding that where the Act holds an employer jointly and severally liable, its insurers are likewise jointly and severally liable, on an all sums basis, with various rights to contribution, even if the employer has multiple successive insurers or was uninsured for part of the employee's exposure. *Zurich* [2015] UKSC 33 ¶¶ 45-51, 54, 94-97 (Lord Mance); *see also Trigger* [2012] UKSC 14 ¶¶ 49-50, 71-74 (Lord Mance). In so holding, the Court analogized "facultative liability insurance" to facultative reinsurance, in that both "normally respond[ ] to whatever may prove to be the liability incurred by the insured." *Zurich* [2015] UKSC 33 ¶ 45 (Lord Mance); *see also Trigger* [2012] UKSC 14 ¶ 69 (Lord Mance). Notably, one dissenting Lord invoked *Municipal Mutual* and *Wasa* – as Equitas does here – to emphasize the fundamental importance of a policy period under English insurance law. *Zurich* [2015] UKSC 33 ¶¶ 153-55 (Lord Sumption). But, again, that did not stop the majority, which acknowledged that principle, from imposing joint-and-several liability upon insurers nonetheless. *Id.* ¶¶ 40, 46 (Lord Mance). There is no reason to think it would stop that majority from imposing joint-and-several liability on a *reinsurer* in the present circumstances either.

To be clear, we do not know whether *Zurich*, if applied here, would lead to the same outcome concerning ICSOP's liability to Dole or Equitas's liability to ICSOP. *Zurich* recognizes various rights of contribution, including under principles of self-insurance, *see* [2015] UKSC 33 ¶¶ 65-82, which may or may not differ from California's and Hawaii's approaches to contribution. The point of our reliance on *Zurich* is that the case recognizes a circumstance where an insurer can be jointly and severally liable for the whole of the insured's tort liability even though that liability might have accrued after the policy period's expiration. That recognition defeats Equitas's argument that the all sums rule is anathema to English law. Accordingly, *Zurich* reinforces the conclusion that English law would construe the reinsurance policy in this case as co-extensive with the ICSOP-Dole policy.

ii. Change in Law

Equitas next underscores that even if the presence of a choice-of-law clause distinguishes ***790** this case from *Wasa*, the all sums rule first came into existence long after the parties executed the ICSOP-Dole policy and the reinsurance policy (and, for that matter, long after the policy periods ended). For

that reason, Equitas insists, the parties here could not have predicted an all sums approach to allocating liability, and an English court would therefore not impose that approach.

Again, that argument has some merit. The Lords in *Wasa* were troubled not only by the inability to predict the governing legal regime but also by the resulting inability to predict the substantive rules of that regime. For example, Lord Phillips suggested that it was "unlikely" that the parties could have anticipated that the same words in the original insurance and the reinsurance would mean "radically" different things under different legal systems. *Wasa* [2010] 1 AC 180 (HL) ¶¶ 4-5. Lord Collins explained that in *Vesta* the "substance of the foreign law as to the consequences" of the 24-hour watch clause "could be ascertained at the outset," whereas, in *Wasa*, it was impossible to predict that a U.S. court would apply the all sums rule because U.S. courts had not yet developed that rule when the parties executed their agreements. *Id*. ¶¶ 108-09.

That point cannot be decisive, however. The reinsurers in *Wasa* made the exact same argument. Assuming that the reinsurers were correct that Pennsylvania law had only later adopted the all sums rule, Lord Mance asked, "would that matter?" *Id.* ¶ 53. Noting an observation of Lord Justice Longmore, who sat on the appellate court from which the reinsurers had appealed, Lord Mance explained the Court of Appeal's view that "[i]t would have been 'nothing to the point' " if in *Vesta*, for example, " 'the relevant Norwegian statute had been enacted after the inception of the policy.' " *Id.* (citation omitted). "[R]einsurers must," Lord Justice Longmore had explained, "take the risk of any change in the law." *Id.* And there, as here, "one is only talking at most about a change in the construction put at common law on a particular contract wording." *Id.* Likewise, Lord Collins explained that "[i]t is elementary" that insurers and reinsurers "take[ ] the risk of changes in the law" and cannot "be heard to say that [they] rated the risk by reference to the then current scope of the original insured's duty ... provided that the risk is within the reinsurance." *Id.* ¶ 110.

Thus, when parties fail to define in their insurance agreements a term such as "all sums" – the term that invokes the all sums rule – they adopt the meaning a common law court will ascribe to it, and thereby bear the rewards and risks of the common law's dynamic nature. *See Trigger* [2012] UKSC 14 ¶ 70 (Lord Mance), citing *Kleinwort Benson Ltd v. Lincoln City Council* [1999] 2 AC 349 (HL) 378-79 (Lord Goff) (explaining that "when ... judges state what the law is, their decisions ... have a retrospective effect" not only "in relation to the particular case" but "also inevitabl[y] in relation to other cases in which the law as so stated will in future fall to be applied" because no "common law system ... can operate otherwise if the law is [to] be applied equally to all and yet be capable of organic change"); *Woodland v. Essex County Council* [2013] UKSC 66 ¶ 28 (Lady Hale) ("The common law is a dynamic instrument. It develops and adapts to meet new situations as they arise. Therein lies its strength. But therein also lies a danger, the danger of unbridled and unprincipled growth to match what the court perceives to be the merits of the particular case.").

To that end, turning back to *Zurich* and *Trigger*, the United Kingdom Supreme Court acknowledged in those decisions ***791** that the relevant policies were executed before the various legal developments leading to those decisions had occurred. *See Zurich* [2015] UKSC 33 ¶ 149 (Lord Sumption); *Trigger* [2012] UKSC 14 ¶ 70 (Lord Mance). But that did not stop the Lords from imposing liability upon insurance carriers in *Trigger* and joint-and-several liability upon insurance carriers in *Zurich*. It would be incongruent to make the change-of-law point decisive here where it was not in those cases, and unfaithful to our mandate to predict how the United Kingdom Supreme Court would decide an issue to do something directly contrary to what it has done in the past. That is especially true because the reinsurance policy in this case expressly warrants that coverage is "[a]s [o]riginal" and that it will provide the "same gross rate, terms and conditions as and [will] follow the settlements of [ICSOP]." J. App'x 777, 779, 793, 796. Equitas therefore cannot confine its current obligations to what those obligations would have been had this dispute arisen fifty years ago.

* * *

This case unquestionably presents an issue that was expressly left open in *Wasa*, and has not since been resolved by the United Kingdom Supreme Court. We thus cannot be certain that our prediction as to how that Court would resolve this case had it been litigated in England is correct. But it remains our responsibility to make our best considered judgment of how that Court would decide the issue, based on the available precedents. [8]

We have carefully reviewed those precedents, and for the reasons set forth above, we conclude that under English law the back-to-back presumption is strong, and we do not believe that the United Kingdom Supreme Court would condition

that presumption on the importance of a policy term or the predictability of how a foreign court might later interpret that term. Accordingly, the back-to-back presumption applies to the reinsurance policy, thus rendering the parties' obligations co-extensive.

B. Late Notice of Claim

[11] Separately, Equitas claims that ICSOP's failure to provide timely notice of claim allows it to fully repudiate the reinsurance policy. Equitas concedes, however, that timely notice is not a condition precedent to a claim for coverage under the reinsurance policy. Where timely notice is not a condition precedent, English law rejects the defense of partial repudiation – that is, an insurer's ability to reject a claim for coverage. *See Friends Provident Life & Pensions Ltd. v. Sirius Int'l Ins.* [2005] EWCA (Civ) 601 ¶ 32 (Lord Mance). That would seem to foreclose Equitas's more radical defense of *full* repudiation based on late notice of claim.

Nevertheless, Equitas's English law expert opines that on "extreme facts," "dishonest non-notification" that causes "serious prejudice to" an insurer might give ***792** rise to the defense of full repudiation of the contract. J. App'x 1189-90, ¶¶ 70-73. Conspicuously, neither he nor Equitas cite a case reaching that result, which would in any event sit in some tension with English law's rejection of a partial repudiation defense.

[12] Even accepting for a moment the expert's proposed standard, however, the facts that Equitas alleges – that ICSOP notified Equitas some six years after becoming aware that a claim was likely under the reinsurance policy, that ICSOP failed to inform Equitas of the likely claim in response to queries about other claims, and that some of ICSOP's failures may even have been deliberate – do not suffice to show serious prejudice. Equitas's expert defined serious prejudice as something that goes to the "root of the whole" contract. *Id.* at 1189-90, ¶¶ 68, 72. We see none of that in this record, and thus no reason to go where no English court has gone. Accordingly, we agree with the district court that Equitas's late-notice defense is unavailing.

CONCLUSION

For the reasons set forth above, we **AFFIRM** the judgment of the district court.

All Citations

68 F.4th 774

Footnotes

1 "In a facultative reinsurance transaction, the company purchasing reinsurance ... 'cedes[ ]' all or a portion of the risk under a single insurance policy to the reinsurance provider," which in turn obtains a portion of the original premium. *Glob. Reinsurance Corp. of Am. v. Century Indem. Co.*, 22 F.4th 83, 88 (2d Cir. 2021). "In contrast to facultative reinsurance, 'treaty reinsurance' involves the transfer of a portion of the risk of numerous insurance policies issued to different policyholders covering an entire class of risk." *Id.* at 88 n.4.

2 As a federal court sitting in alienage jurisdiction under 28 U.S.C. § 1332(a)(2), we apply the choice-of-law rules of the forum state – here, the State of New York. *See Int'l Mins. & Res., S.A. v. Pappas*, 96 F.3d 586, 592 (2d Cir. 1996) (applying the forum state's choice-of-law rules in dispute arising under § 1332(a)(2)); *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941) (holding "that the prohibition declared in *Erie Railroad v. Tompkins*, 304 U.S. 64 [58 S.Ct. 817, 82 L.Ed. 1188 (1938)], against such independent determinations by the federal courts extends to the field of conflict of laws"). Because the parties agree that New York's choice-of-law rules compels the application of English law, we need not undertake a complicated choice-of-law analysis. "Under New York choice-of-law rules, 'where the parties agree that [a certain jurisdiction's] law controls, this is sufficient to establish choice of law.' " *Alphonse Hotel Corp. v. Tran*, 828 F.3d 146, 152 (2d Cir. 2016), quoting *Fed. Ins. Co. v. Am. Home Assurance Co.*, 639 F.3d 557, 566 (2d Cir. 2011) (alterations added in *Alphonse Hotel*).

3 Ironically, that shift appears to have been led by Lloyd's seeking to tap into the American insurance market. Abraham, *supra*, at 370-71. Lloyd's faced a "financial disaster," however, when "the long-tail chickens" came "home to roost." *Id.* at 371. To stave off financial ruin, it "established and funded" Equitas "to be the repository of its syndicates' liability under CGL policies issued prior to 1992." *Id.* at 402. Thus, Equitas hatched from a problem its predecessor helped sire, the same problem ICSOP confronted with Dole, that ultimately led to ICSOP's claim against Equitas.

4 Some courts apply different theories that, depending on the circumstances, result in "little ultimate difference" between types of triggers. *See* Restatement of the Law of Liability Insurance § 33 cmt. *f*. For example, in jurisdictions that follow the injury-in-fact theory, "when the available scientific evidence is not able to determine the precise amount of harm attributable to a particular year or to particular years, most courts have concluded either that the continuous-trigger rule applies or, applying the injury-in-fact trigger, that the bodily injury or property damage actually takes place continuously from the moment of first exposure to asbestos or environmental contaminants." *Id.*

5 Recall that ICSOP insured Dole only for a three-year policy period but was deemed liable for damage that continued to accrue for decades after the policy period had ended. As far as the record discloses, Dole obtained other insurance during that time, but apparently many (or all) of its policies for later periods contained pollution *exclusions*, while the ICSOP-Dole policy did not. Pollution exclusions were not an uncommon response in occurrence-based policies issued following legal developments beginning in the 1960s. *See* Abraham, *supra*, at 372-73 (explaining that insurers "got cold feet" and began to include " 'qualified' pollution exclusion[s]" in the 1970s). We cannot independently verify the extent to which Dole had other insurance coverage against which ICSOP could assert a contribution claim. But that does not matter for our purposes because whether or not other insurance coverage was available to Dole, the all sums rule deems ICSOP jointly and severally liable, up to the ICSOP-Dole policy limit, for Dole's settlement liability. *See Montrose Chem. Corp. of Cal.*, 260 Cal.Rptr.3d 822, 460 P.3d at 1207.

6 *Barker v. Corus UK Ltd.* [2006] 2 AC 572 (HL) ¶ 1 (Lord Hoffmann) (explaining that *Fairchild* held "that a worker who had contracted mesothelioma after being wrongfully exposed to significant quantities of asbestos dust at different times by more than one employer or occupier of premises could sue any of them, notwithstanding that he could not prove which exposure had caused the disease").

7 While on the Supreme Court of the United Kingdom, Lord Mance gave a speech to an association of insurers, during which he repeated that *Wasa* was based on the absence of a "special dictionary meaning" of the terms of the original insurance that "could [have] be[en] carried through into the reinsurance." Lord Mance, Supreme Court of the United Kingdom, Keynote Address to Association internationale de Droit des Assurances, Copenhagen ¶ 10 (June 12, 2015), https://www.supremecourt.uk/docs/speech-150612.pdf.

8 In certain domestic cases, where a federal court must decide an unsettled question of the law of a State, it is possible for that court to certify the question to the highest court of that State. *See, e.g.*, 2d Cir. Local R. 27.2(a) ("If state law permits, the court may certify a question of state law to that state's highest court."); 22 N.Y.C.R.R. § 500.27(a) (authorizing the New York Court of Appeals to review certain certified questions). No such procedure is available here, so we are left to our own reading of English law. *See Terra Firma Invs. (GP) 2 Ltd.*, 716 F.3d at 301 (Lohier, *J.*, concurring) (explaining that, "[i]n the context of cross-border commercial disputes, there is every reason to develop a similar formal certification process pursuant to which federal courts may certify an unsettled and important question of foreign law to the courts of a foreign country").

House of Lords

Wasa International Insurance Co Ltd *v* Lexington Insurance Co

AGF Insurance Ltd *v* Same

[2009] UKHL 40

2009 May 5, 6; July 30

Lord Phillips of Worth Matravers, Lord Walker of Gestingthorpe, Lord Brown of Eaton-under-Heywood, Lord Mance, Lord Collins of Mapesbury

Insurance — Reinsurance — Construction — Liability under contract of reinsurance — Insurance company insuring US company for specified period in respect of occurrences of property damage — Contract of reinsurance covering same period — Insurance company settling claims as determined by US court — Settlement including losses occurring outside period of cover — Whether reinsurer liable to indemnify insurer in relation to whole amount of settlement — Whether retention under reinsurance agreed to be single amount or per occurrence

The defendant, an insurance company based in Massachusetts, insured an aluminium company, incorporated and having its centre of business in Pennsylvania but operating throughout the United States and abroad, under a property damage insurance policy issued for a three-year period from 1 July 1977 to 1 July 1980. The policy provided, inter alia, for a limit of liability of $20m for loss or damage arising from any one occurrence and contained a standard service of suit clause that in the event of dispute the defendant would submit to the jurisdiction of any court of competent jurisdiction within the United States. A number of reinsurance companies including the claimants, two London reinsurers, provided reinsurance to the defendant for the same risks, in the same amount and for an identical three-year period as the defendant had insured the aluminium company. The reinsurance contracts issued by the claimants were governed by English law and provided for a retention of $1,675,000 in the event of a successful claim. The aluminium company subsequently found itself liable for the cost of cleaning up contamination caused by waste products it had generated at 58 different sites it operated across the United States and abroad. It therefore issued proceedings against the many insurers, including the defendant, who had provided property damage or comprehensive general liability insurance to it at any time between 1956 and 1985. The proceedings were issued in the State of Washington, where the aluminium company had itself been the subject of proceedings brought by the state authorities, but the judge decided that the one commonality between all the sites and all the various insurers was Pennsylvania, the location of the aluminium company's headquarters, and that, accordingly, the law of Pennsylvania would apply to the litigation. The Supreme Court of Washington State, applying the law of Pennsylvania, declared that the defendant was liable under the insurance policy for property damage occurring both before and during the three-year policy period. Consequently the defendant settled the aluminium company's claim under the policy for $103m, for which it sought reimbursement by the reinsurers. Simon J granted the claimants a declaration that, as a matter of English law, they were not liable to indemnify the defendant for damage occurring before the policy period; and, further, that the retention of $1,675,000 was per occurrence. The Court of Appeal reversed his decision on the grounds that, unless there were clear indications to the contrary, the same period of cover should receive the same interpretation in both the insurance and reinsurance contracts and that the retention under the reinsurance was a single amount and not per occurrence.

On the claimants' appeal—

Held, allowing the appeal, that where an insurance contract and a reinsurance contract were governed by different laws it was a question of the construction of each contract under its applicable law as to what risk had been assumed; that there was no special rule of the conflict of laws which governed the consequences of any inconsistency; that, although normally any loss within the coverage of the insurance would be within the coverage of the reinsurance, there was no rule of construction or law that a reinsurer had to respond to every valid claim under the insurance irrespective of the terms of the reinsurance; that in order to apply the principle that the effect of terms in a reinsurance contract governed by English law should, where possible, be interpreted to be in accordance with the effect of the terms of the insurance contract governed by foreign law, the relevant foreign law had to have been within the reasonable contemplation of the parties when the contracts had been entered into; that in the instant case the effect of the service of suit clause was that litigation could have taken place anywhere in the United States; that the decision to apply the law of Pennsylvania to the policy, since it had been taken for reasons extraneous to the terms of the insurance contract itself or the claims arising under it, could not be regarded as having been predictable at the time when the insurance had been placed; that, consequently, at the time the contracts had been entered into there had been no identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract of reinsurance in a manner different from its ordinary meaning in the London insurance market; and that, accordingly, there was no principled basis for treating the three-year term of the reinsurance as covering losses arising outside the specified policy period (post, paras 1, 2, 4, 6–9, 10, 11, 15–17, 44, 49, 54, 58, 63, 94, 107, 108, 111, 112, 116, 118).

Forsikringsaktieselskapet Vesta v Butcher [1989] AC 852, HL(E) and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350, CA distinguished.

Per curiam. The retention agreed under the reinsurance was a single amount and not per occurrence (post, paras 10, 11, 22, 118).

Decision of the Court of Appeal [2008] EWCA Civ 150; [2008] Bus LR 1029 reversed.

The following cases are referred to in the opinions of the Committee:

Allstate Insurance Co v Dana Corpn (2001) 759 NE 2d 1049
Aluminum Co of America v Aetna Casualty & Surety Co (2000) 998 P 2d 856
American National Fire Insurance v B & L Trucking & Construction Co Inc (1998) 951 P 2d 250
Amin Rasheed Shipping Corpn v Kuwait Insurance Co [1984] AC 50; [1983] 3 WLR 241; [1983] 2 All ER 884, HL(E)
Assicurazioni Generali SpA v CGU International Insurance plc [2003] EWHC 1073 (Comm); [2003] 2 All ER (Comm) 425; [2003] Lloyd's Rep IR 725; [2004] EWCA Civ 429; [2004] 2 All ER (Comm) 114; [2004] Lloyd's Rep IR 457, CA
Balfour v Beaumont [1984] 1 Lloyd's Rep 272, CA
Bolton Metropolitan Borough Council v Municipal Mutual Insurance Ltd [2006] EWCA Civ 50; [2006] 1 WLR 1492, CA
Borel v Fibreboard Paper Products Corpn (1973) 493 F 2d 1076
Boston Gas Co v Century Indemnity Co (2008) 529 F 3d 8
British Dominions General Insurance Co Ltd v Duder [1915] 2 KB 394, CA
Certain Underwriters at Lloyd's, London v Foster Wheeler Corpn (2007) 822 NYS 2d 30
Charter Reinsurance Co Ltd v Fagan [1997] AC 313; [1996] 2 WLR 726; [1996] 3 All ER 46, HL(E)
Cie Tunisienne de Navigation SA v Cie d'Armement Maritime SA [1971] AC 572; [1970] 3 WLR 389; [1970] 3 All ER 71, HL(E)

Commercial Union Assurance Co plc v NRG Victory Reinsurance Ltd [1998] 2 All ER 434; [1998] 2 Lloyd's Rep 600, CA
Consolidated Edison Co of New York Inc v Allstate Insurance Co (2002) 774 NE 2d 687
Dubai Electricity Co v Islamic Republic of Iran Shipping Lines (The Iran Vojdan) [1984] 2 Lloyd's Rep 380
Erie Railroad Co v Tompkins (1938) 304 US 64
Forsikringsaktieselskabet National (of Copenhagen) v Attorney General [1925] AC 639, HL(E)
Forsikringsaktieselskapet Vesta v Butcher [1986] 2 All ER 488; [1989] AC 852; [1989] 2 WLR 290; [1989] 1 All ER 402, HL(E)
France (JH) Refractories Co v Allstate Insurance Co (1993) 534 Pa 29
Goodyear Tire & Rubber Co v Aetna Casualty & Surety Co (2002) 769 NE 2d 835
Groupama Navigation et Transports v Catatumbo CA Seguros [2000] 2 Lloyd's Rep 350; [2000] 2 All ER (Comm) 193, CA
Guy v Liederbach (1983) 459 A 2d 744
Hill v Mercantile and General Reinsurance Co plc [1996] 1 WLR 1239; [1996] 3 All ER 865, HL(E)
Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd [1985] 1 Lloyd's Rep 312, CA
Insurance Co of North America v Forty-Eight Insulations Inc (1980) 633 F 2d 1212; cert den (1981) 454 US 1109
Joyce v Realm Marine Insurance Co (1872) LR 7 QB 580
Keene Corpn v Insurance Co of North America (1981) 667 F 2d 1034; cert den (1982) 455 US 1007
Knight v Faith (1850) 19 LJQB 509; 15 QB 649
London Marine Insurance Association, In re (1869) LR 8 Eq 176
Mackenzie v Whitworth (1875) 1 Ex D 36
Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd [1998] Lloyd's Rep IR 421, CA
Outboard Marine Corpn v Liberty Mutual Insurance Co (1996) 670 NE 2d 740
Peabody Essex Museum, Inc v United States Fire Insurance Co 2009 WL 901869, (unreported) 31 March 2009, D Mass
Rubenstein v Royal Insurance Co of America (1998) 694 NE 2d 381
St Paul Fire and Marine Insurance Co v Morice (1906) 11 Com Cas 153
Stonewall Insurance Co v City of Palos Verdes Estates (1996) 54 Cal Rptr 2d 176
Toomey v Eagle Star Insurance Co Ltd [1994] 1 Lloyd's Rep 516, CA
Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd [1970] AC 583; [1970] 2 WLR 728; [1970] 1 All ER 796, HL(E)
Youell v Bland Welch & Co Ltd [1992] 2 Lloyd's Rep 127, CA

The following additional cases were cited in argument:

CGU International Insurance plc v AstraZeneca Insurance Co Ltd [2005] EWHC 2755 (Comm); [2006] Lloyd's Rep IR 409
Hiscox v Outhwaite (No 3) [1991] 2 Lloyd's Rep 524

APPEAL from the Court of Appeal

This was an appeal by the claimants, Wasa International Insurance Co Ltd and AGF Insurance Ltd, with leave of the House (Lord Hoffmann, Lord Walker of Gestingthorpe and Lord Neuberger of Abbotsbury) given on 22 May 2008, from a decision of the Court of Appeal (Pill, Sedley and Longmore LJJ) given on 29 February 2008, allowing an appeal by the defendants, Lexington Insurance Co, against a declaration made by Simon J in the Commercial Court of the Queen's Bench Division on 25 April 2007 that the claimants were under no liability pursuant to reinsurance contracts to indemnify the defendants in respect of a settlement agreement

made between the defendants and the insured, the Aluminum Corporation of America.

The facts are stated in the opinion of Lord Mance.

Alistair Schaff QC and *Siobán Healy* (instructed by *Addleshaw Goddard LLP*) for the claimant in the first case.

As a matter of English law, under an insurance or reinsurance contract providing cover for loss of damage to property on an occurrence basis the (re)insurer will be liable to indemnify the (re)insured in respect of loss and damage which occurs within the period of cover but will not be liable to indemnify the (re)insured in respect of loss and damage which occurs either before inception or after expiry of the risk: see *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421, 436 and *Knight v Faith* (1850) 19 LJQB 509; 15 QB 649. The express wording of the NMA 1779 form, one of the two alternative forms provided for by the reinsurance slip, puts the matter beyond doubt: see Weir, "A matter of Forms and substance" [2009] LMCLQ 210. The insurance market would have had no doubt that this contract of reinsurance only applied to losses arising during the period during which cover was provided. No one would have said that it covered claims arising before or after its term.

The fact that the defendant has been found liable to the aluminium company by the Washington Supreme Court under the terms of the insurance contract is determinative of the position as between the defendant and the aluminium company under the insurance contract (see *Aluminum Co of America v Aetna Casualty & Surety Co* (2000) 998 P 2d 856) but it does not determine the position between the defendant and the claimant under the reinsurance contract because a contract of reinsurance is an independent contract to be construed in accordance with its own applicable law and its own terms. The subject matter of a contract of reinsurance is the original subject matter insured (in respect of which the reinsured has an insurable interest by virtue of his policy of insurance), rather than an insurance of the reinsured's liability under the policy of insurance: see *Mackenzie v Whitworth* (1875) 1 Ex D 36; *British Dominions General Insurance Co Ltd v Duder* [1915] 2 KB 394, 400; *Forsikringsaktieselskabet National (of Copenhagen) v Attorney General* [1925] AC 639, 642; *Toomey v Eagle Star Insurance Co Ltd* [1994] 1 Lloyd's Rep 516, 522–523 and *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 392. Consequently, Sedley LJ [2008] Bus LR 1029, paras 49, 50, was entirely correct to recognise the central significance of the "independent contract" or "liability insurance" issue but his analysis and conclusion on that issue are contrary to long standing and high authority. The practice and vocabulary of reinsurance law are to opposite effect.

In order to recover under a contract of reinsurance, and absent express provision to the contrary, the reinsured has to establish that the loss falls under both the underlying insurance contract and the reinsurance contract. An appropriate "follow the settlements" clause may dispense with the need for the reinsurance to prove (or reprove) as against the reinsurer the true factual basis of the underlying claim or that the reinsured was liable to the primary insured under the insurance. However, it always remains open to the reinsurer to dispute that the loss falls within the risks covered by the reinsurance as a matter of law: see *Hill v Mercantile and General*

Reinsurance Co plc [1996] 1 WLR 1239, 1252–1253. Moreover, that remains the position even where the two contracts are of materially similar (or "back to back") terms: see *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd* [1985] 1 Lloyd's Rep 312. It is therefore a question of the proper construction of the reinsurance contract, viewed in the light of relevant principles of English law, whether the loss falls within the scope, including the chronological scope, of the reinsurance contract as a matter of law. That question is not answered simply by proving that the loss falls within the chronological scope of the insurance contract or that the insurer/reinsured has been held liable on that basis.

It is accepted that as a matter of substantive English reinsurance law provisions in a contract of reinsurance governed by English law may, on the facts of a particular case, be intended by the parties to bear the same meaning and effect as that of the equivalent provisions in the underlying insurance contract. However, that is a nuanced question of the construction of the particular contract of reinsurance, in its context, and not the result of some general rule of law or some a priori assumption in favour of the reinsured: see *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350, para 23. *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and the *Groupama* case [2000] 2 Lloyd's Rep 350 were very clear cases on their own facts. In particular (i) they involved warranties to be performed by the original insured in relation to which reinsurers would have had no reason to believe that a draconian and domestic English law regime as regards the consequences of a non-causative breach would necessarily be replicated under the law of the governing insurance; (ii) the relevance of Norwegian law and Venezuelan law, respectively, to the underlying insurance contracts were known and certain at the outset; and (iii) the substance of that Norwegian and Venezuelan law (as to the consequences of a non-causative breach of warranty) could be ascertained at the outset, if necessary by recourse to a relevant Norwegian or Venezuelan legal dictionary or other source. Those facts enabled the courts in those cases to treat the warranties in the English law reinsurance contracts as having the same meaning and effect as they had in the underlying insurance contracts by a process of construction. It is inappropriate to read observations made in those cases out of context and elevate them into some overarching principle of construction which applies to all reinsurance contracts.

The fundamental difference between those cases and the claimants' case is the application and effect of Pennsylvania law which was completely unpredictable when the reinsurance contracts were entered into. The London reinsurance market has not generally contracted on the basis of Pennsylvania law. Further, for the reinsurance policies to be back to back with the underlying insurance contracts one has to construe them as if the parties will abide by Pennsylvania law whatever it might turn out to be. *CGU International Insurance plc v AstraZeneca Insurance Co Ltd* [2006] Lloyd's Rep IR 409 and *St Paul Fire and Marine Insurance Co v Morice* (1906) 11 Com Cas 153 emphasise the limits of the back to back approach.

The arguments of the claimant in the second case on the retention issue are adopted.

Neil Calver QC and *Stephen Midwinter* (instructed by *Carter Perry Bailey LLP* (preceded by *Charles Russell LLP*)) for the claimant in the second case.

A The arguments of the claimant in the first case are adopted.

In the final analysis the retention issue is essentially a matter of impression. It is difficult to see how the decision of the judge is wrong. Even if others might choose a different construction, that adopted by the judge is plainly a sensible and reasonable interpretation of the terms of the reinsurance contract. The Court of Appeal ought not to have disturbed his conclusion.

B *Jonathan Sumption QC* and *Christopher Butcher QC* (instructed by *Chadbourne & Parke LLP*) for the defendant.

The outcome of the appeal turns on the language of the particular reinsurance and on established principles of law which regularly come before the English courts. The Court of Appeal was right on both of the points in issue for the reasons given by Longmore LJ: see [2008] Bus C LR 1029.

It is important to understand what the Washington courts decided. The trial judge decided that the proper law of the original insurance was Pennsylvania based on orthodox principles: see *American Law Institute, Restatement of the Law, Conflict of Laws,* 2d (1969), section 193. The Supreme Court decided that the effect of the "perils insured" clause, D combined with the definition of "occurrence", was that the insurance covered the whole of any damage which was in being during the period of insurance, irrespective of when it began: see *Aluminum Co of America v Aetna Casualty & Surety Co* 998 P 2d 856. It is important to note that the Supreme Court did not hold the defendant liable for losses arising from damage occurring outside the period of the original insurance. The question which it was addressing was what insured damage had occurred within that E period. It held the defendant liable on the basis that the peril insured against was damage which "manifested itself" at any time during that period. In doing so the Supreme Court was using the test applied to trigger liability in asbestosis cases: see *Keene Corpn v Insurance Co of North America* (1981) 667 F 2d 1034 and *JH France Refractories Co v Allstate Insurance Co* (1993) 534 Pa 29. The consistent theme of those cases is that the court is asking F what is the extent of the coverage rather than what is its chronological scope. The decision on coverage would not necessarily have been arrived at by an English court applying English law. But it was never contemplated that the original insurance would come before an English court or that English law would apply to it.

The period of the reinsurance is the same as the period of the original insurance. The settlement reflected the Supreme Court's decision as to what G constituted insured damage occurring within that period. Since the terms defining the insured damage are precisely the same in the insurance and the reinsurance, the parties must have intended them to mean the same thing. Therefore, the reinsurance also covers damage in being at any time within the period, irrespective of whether it began before. The only basis on which it is possible to argue otherwise is that, notwithstanding the use of the same terms in both contracts, a difference has been introduced by the mere choice H of a different proper law. That argument is contrary to principle and inconsistent with the express terms of the reinsurance. The intention of the parties, in framing the reinsurance as they did, was that the coverage of the reinsurance should be defined by the terms of the original. That depends on what the words of the original mean, not just as words, but in the textual,

factual and legal context of the original. The defendant could have done no more to reinsure the potential liability under the insurance. Consequently, if the original means that the losses claimed by the aluminium company are within the scope of coverage of the original insurance, then the reinsurance means that the same losses are within the scope of coverage of the reinsurance. Thus the reinsurers are exposed to risks associated with the way in which the original is understood according to the law which governs it by the courts which have jurisdiction to decide the matter, but that is neither surprising nor objectionable. The reinsurers accepted those risks when they contracted by reference to an American underlying policy.

Very similar questions were considered in *Forsikringsaktieselskapet Vesta v Butcher* [1986] 2 All ER 488; [1989] AC 852 and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350. In both cases it was held that a clause in a facultative reinsurance which was in the same or similar terms to a clause in the original insurance should be given the same effect notwithstanding that the two contracts were governed by different laws. Those decisions are correct and directly in point. The distinctions suggested by the claimants, in particular the suggestion that the decisions were concerned with warranties to be performed by the assured, are unconvincing. In the words of Longmore LJ [2008] Bus LR 1029, para 32, they are distinctions of fact rather than principle. By comparison, very little assistance is to be had from cases such as: *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421; *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239; *St Paul Fire and Marine Insurance Co v Morice* (1906) 11 Com Cas 153 and *CGU International Insurance plc v AstraZeneca Insurance Co Ltd* [2006] Lloyd's Rep IR 409. In those cases the issue in this case did not arise. Compare: *Commercial Union Assurance Co plc v NRG Victory Reinsurance Ltd* [1998] 2 All ER 434 and *Hiscox v Outhwaite (No 3)* [1991] 2 Lloyd's Rep 524.

Any judicial interpretation of a contract involves retrospectively attaching to it a meaning which hypothetical persons in the position of the parties are assumed to have intended at the time when it was made, but which may have been unclear or unknown to those particular parties. Any contract therefore falls to be construed according to the law which is subsequently held to be its proper law by a court of competent jurisdiction and it means what the court applying that law subsequently says it means. The reasoning of the Court of Appeal on this point in *Commercial Union Assurance Co plc v NRG Victory Reinsurance Ltd* [1998] 2 All ER 434 is adopted. The claimants have not established that the law of Pennsylvania was thought to be any different in 1977 from what it was declared to be in 2000. There is no evidence on the point. However, their argument is also wrong in principle. The parties to the original insurance, having implicitly or explicitly chosen a developing system of law, have necessarily chosen to be bound by its developments, so far as that law treats them as applicable to existing contracts. The defendant has reinsured the original risk on that basis.

The issue of whether reinsurance should be seen as liability insurance, as raised by Sedley LJ [2008] Bus LR 1029, paras 49, 50, does not need to be answered in this case. The policy does not mean what Weir says it does in "A matter of Forms and substance" [2009] LMCLQ 210. It makes no

A difference whether the NMA 1779 form was incorporated or not, although the defendant maintains it was not incorporated.

As to the retention issue, "per occurrence" relates to the limit and not the deductible. The retention, as a matter of language, naturally applies to the aggregate amount of the cover.

Schaff QC in reply.

B Reinsurance is a separate contract rather than a form of liability insurance. If the defendant had wished to do more to secure its coverage under the reinsurance policy it could have chosen to have back to back choice of law policies. The London market is historically loathe to contract on American law terms. [Reference was made to *Keene Corpn v Insurance Co of North America* 667 F 2d 1034; *JH France Refractories Co v Allstate* C *Insurance Co* 534 Pa 29; *Aluminum Co of America v Aetna Casualty & Surety Co* 998 P 2d 856 and *Commercial Union Assurance Co plc v NRG Victory Reinsurance Ltd* [1998] 2 All ER 434.]

Calver QC replied. [Reference was made to *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421.]

D The Committee took time for consideration.

30 July 2009. **LORD PHILLIPS OF WORTH MATRAVERS**

1 My Lords, I have had the benefit of reading in draft the opinions of my noble and learned friends, Lord Mance and Lord Collins of Mapesbury. I agree with their conclusion that this appeal should be allowed and the E reasons that each gives for that conclusion, for those reasons are in harmony. I propose to explain shortly why I agree with their reasoning.

2 Essentially the result of this appeal is dictated by the agreed fact that the reinsurance contract that is the subject of the appeal is governed by English law and by the well established principle, not challenged in this case, that under English law a contract of reinsurance in relation to property is a contract under which the reinsurers insure the property that is the subject of F the primary insurance; it is not simply a contract under which the reinsurers agree to indemnify the insurers in relation to any liability that they may incur under the primary insurance: *British Dominions General Insurance Co Ltd v Duder* [1915] 2 KB 394, 400.

3 The following matters are common ground. (i) There is no significant difference between the terms of the primary insurance and the reinsurance. G (ii) Under English principles of construction, the reinsurance covers only damage to property caused during the period of the cover. (iii) The Supreme Court of Washington, applying Pennsylvanian law to the construction of the primary insurance, has held that it covers incremental damage to property that includes damage that occurred both before and after the period of cover, provided only that part of the damage occurred during the period of cover. (iv) The decision of the Supreme Court of Washington is not perverse.

H **4** This last agreed fact is significant. The principle of the English law of construction that confines recovery to damage occurring during the period covered by the policy is no more nor less than the fundamental principle that the words of a contract should normally be given the meaning that they naturally bear. It has not been suggested, nor could it, that the alternative

construction given to the policy by the Supreme Court of Washington is an alternative meaning that the words of the policy can naturally bear. The reason why the Washington Supreme Court has reached such a radically different interpretation of the scope of cover is because it has adopted a principle of construction that has been applied to contracts of insurance of property by the courts of Pennsylvania, and a minority of other American states. That principle, as Lord Collins has demonstrated, has its origin in the approach to insurance claims for the consequences of asbestos. I suspect that this may, in its turn, be derived from a similar approach to claims in tort.

5 It is unlikely that those who were party to the contract of reinsurance in 1977 can have anticipated that the interpretation of the wording common to the primary insurance and the reinsurance would differ so radically dependent on the law applied to its interpretation. Did the parties agree, or are they to be implied to have agreed, that in such an event the principles of interpretation adopted in respect of the primary insurance should be adopted, in preference to the principles of English law?

6 I agree with Lord Mance, for the reasons that he gives, that the "full reinsurance" clause in this case, and "follow the settlements" clauses in general, did not and do not have the effect of bringing within the cover of a policy of reinsurance risks that, on the true interpretation of the policy, would not otherwise be covered by it.

7 Longmore LJ concluded that, at the time that the reinsurance was written those parties to it would have anticipated that the interpretation of the primary insurance would be determined according to the law of Pennsylvania and implicitly agreed that the same law would apply to the interpretation of the reinsurance. For the reasons given by Lord Mance and Lord Collins, I do not consider that this finding was justified.

8 The vital issue is, I think, reduced to this. Did the parties to the reinsurance implicitly agree that whatever law might be applied to interpretation of the primary cover, and whatever result this might produce, would apply equally to the reinsurance? An affirmative answer to this question would, effectively, treat the contract of reinsurance as one to indemnify the primary insurer in respect of any liability sustained under the primary cover. There might, as Sedley LJ considered, be much to be said for adopting this approach, and it is an approach that it would be open to the market, by appropriate contractual terms, to follow. Those who, in 1977, were party to this reinsurance did not do so.

9 It is for these reasons that I agree with Lord Mance and Lord Collins that this appeal should be allowed and the judgment of Simon J restored.

LORD WALKER OF GESTINGTHORPE

10 My Lords, I have had the privilege of considering in draft the opinion of my noble and learned friend, Lord Collins of Mapesbury. I am in full agreement with it and for the reasons given by Lord Collins I would allow this appeal.

LORD BROWN OF EATON-UNDER-HEYWOOD

11 My Lords, I have had the advantage of reading in draft the opinion of my noble and learned friend, Lord Collins of Mapesbury. I entirely agree with it and add a brief opinion of my own only to stress the comparatively

A narrow basis on which I conclude that this appeal ought to succeed. All the relevant facts, law and argument I gratefully adopt from Lord Collins's opinion and none of these shall I repeat.

12 That the defendant insurers ("Lexington") were liable under the terms of their policy ("the insurance contract") to the insured ("Alcoa"), as held, however surprisingly to English eyes, by the Supreme Court of Washington, cannot now be disputed. This liability was for the clean-up B costs of pollution and contamination damage to Alcoa's sites occurring during the 44-year period 1942 to 1986. No matter that the insurance contract was against the risk of "all physical loss of or damage to" Alcoa's property only for the three-year period 1 July 1977 to 1 July 1980, the Supreme Court, applying Pennsylvania law, held (in *Aluminium Co of America v Aetna Casualty & Surety Co* (2000) 998 P 2d 856, 883) that:

C

> "It seems clear from the policy language that any physical loss or damage manifesting itself during the time a . . . policy was in effect was covered by the policy, including pollution damage starting before the policy inception."

The language of the policy, the court said, at p 883:

D

> "is very broad and contains no limitation as to time of the physical loss or damage to property. There is no exclusion in the policy for physical loss or damage that may have begun spreading before the policy inception."

13 That was the basis of Lexington's liability to Alcoa and that Lexington was properly held thus liable is not in issue before your E Lordships. What *is* in issue is the claimant reinsurers' liability to Lexington under the reinsurers' policies ("the reinsurance contracts"). The reinsurance contracts provided cover in respect of the same three-year period as the insurance contract and ostensibly in respect of the same loss: "All risks of physical loss or damage" (to the relevant property). In all material respects, save one, the terms of the reinsurance contracts mirrored those of the insurance contract. That one respect, central to the resolution of these F appeals, was with regard to the applicable law respectively governing them. The insurance contract was subject to Pennsylvania law (albeit, as Lord Collins explains, not predictably so at the date these contracts were entered into); the reinsurance contracts were subject to English law. Under Pennsylvania law, as already stated, the fact that cover was expressly provided only for the three years 1 July 1977 to 1 July 1980 was of no G relevance in limiting the extent of the recoverable loss provided only that *some* physical damage became manifest during the three-year period. Plainly, however, that is not the position under English law. Under English law nothing could be clearer than that a contract providing cover for loss and damage occurring only during a specified three-year period could not be construed as covering in addition damage occurring before (or for that matter after) that three-year period.

H

14 Lexington's response I understand to be essentially this. The all-important question is what constituted the insured damage under the respective contracts. The insured damage under the insurance contract was held to be that resulting from all damage to the property whensoever occurring providing only that some of it became manifest during the actual

period of cover. It is, submit Lexington, possible to construe the reinsurance contracts similarly and, because of the strong presumption that liability under a proportional facultative reinsurance policy is co-extensive with liability under the primary policy, that, therefore, is the construction which the reinsurance contracts should be found to bear.

15 For my part I would reject this argument. Were it correct, indeed, it would follow, as Mr Sumption rightly acknowledged in the course of his submissions, that Lexington would be entitled to recover to the self same extent as they now claim even had the reinsurance cover extended not for the coincident period of three years but, say, for only three months (provided always, as stated, that some damage became manifest during that period). Given the fundamental importance under English law of the temporal scope of a time policy, I find it impossible to construe the reinsurance contracts in the way contended for.

16 "Physical loss or damage" under a policy providing cover for three years simply cannot be construed under English law to include pre-existing damage. The respective contracts are not, of course, back to back as to their governing laws. However powerful and far-reaching the presumption that reinsurance is intended to respond to claims payable under the primary policy, it could not avail Lexington here unless English law were to regard it in effect as tantamount to a rule of law—unless, in short, English law were to dictate that reinsurance must always respond. English law does not, in my opinion, go so far. *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350, clearly the decisions closest in point, are authority for the presumption. They do not warrant its application in all circumstances, certainly not so as to override so clear a temporal limitation as the reinsurance contracts stipulated here with regard to the risks covered.

17 I too therefore would allow these appeals.

LORD MANCE

Introduction

18 My Lords,the long-term effects of damage to the environment are debated worldwide. The issue in this case is whether certain financial consequences can be passed by a Massachusetts insurer, Lexington Insurance Co ("Lexington"), to two London reinsurers, Wasa International Insurance Co Ltd ("Wasa") and AGF Insurance Ltd ("AGF"). Lexington insured Aluminum Co of America ("Alcoa") of Pennsylvania and its subsidiary, Northwest Alloys Inc ("NWA") of Delaware, under an American "all risks difference in conditions" ("DIC") property damage insurance policy issued for the period from 1 July 1977 to 1 July 1980. Under this policy, Lexington has paid Alcoa and NWA some US$103m in respect of environmental damage to property. It paid this sum in settlement of an even larger potential liability flowing from a decision of the Supreme Court of Washington. That decision exposed Lexington to liability to Alcoa and NWA for contamination occurring at particular sites over periods much longer than the three-year policy period. Wasa and AGF had a $2\frac{1}{2}$% line on a London market slip reinsuring Lexington for the three-year period. They maintain that, whatever the position under the insurance, the reinsurance as a matter of construction only covered property damage occurring during

A that period. The issue in short is whether the English law reinsurance mirrors or follows the American insurance, so as to oblige Wasa and AGF to pay their relevant percentages of what Lexington have paid.

The insurance and reinsurance

19 There is an almost complete absence of background to the placing of
B the insurance and reinsurance. "Information", said in the reinsurance slip to be "on file C E Heath & Co Ltd", has not been located. The insurance was formalised on Lexington's special floater form signed and dated at Boston, Massachusetts on 22 August 1977. The limit of liability was $20m for loss or damage arising from any one occurrence, subject however to an aggregate limit of $20m any one policy year in respect of the peril of flood and surface
C waters and $20m any one policy year in respect of the peril of earthquake. "Occurrence" was defined as "any one loss(es), disaster(s), or casualty (ies) arising out of one event or common cause". There was a property damage deductible of $250,000 per occurrence. The premium was a total of $818,000 (payable in three annual instalments) for the policy's three-year term from 1 July 1977 to 1 July 1980 "beginning and ending at noon standard time at the location of the property involved". Against the heading
D "Perils insured", the wording stated that: "This policy insures against all physical loss of, or damage to, the insured property . . ." Under the next heading "Coverage excluded", the wording, reflecting the nature of DIC insurance, excluded a substantial number of risks, including those which might be expected to be insured under other policies. Although there was no express choice of law clause, the insurance contained a standard
E US service of suit clause:

> "In the event of the failure of [Lexington] to pay any amount claimed to be due hereunder, [Lexington] at the request of the insured, will submit to the jurisdiction of any court of competent jurisdiction within the United States and will comply with all requirements necessary to give such court jurisdiction and all matters arising hereunder shall be
F determined in accordance with the law and practice of such court."

20 The reinsurance slip read as follows:

"Type:	Contributing facultative reinsurance
Form:	J1 or NMA 1779 covering all risks of physical loss or damage excluding fire and allied perils and/or as original.
G	
Reassured:	Lexington Insurance Co
Assured:	Alcoa Aluminium
Period:	36 months 1.7.77 L/U and/or pro rata to expiry of original.
H Interest:	All property of every kind and description and/or business interruption and OPP and/or as original.
Sum insured:	Policy to pay up to $20m each occurrence and in the aggregate annually in respect of flood and earthquake.
Situated:	Worldwide and/or as original

Conditions:	Retention $1,675,000 subject to excess of loss and/or treaty R/I
	Full R/I clause no 1 amended
	CC as original plus 30 days
Premium:	Calculated at GOR [gross original rate]
Brokerage:	25% and tax.
Information:	On file C E Heath & Co Ltd."

21 No amended full reinsurance clause No 1 has been identified, but the slip condition has been taken as referring to the reinsurance warranty clause (Full R/I clause No 1) dated 3 June 1943, which provided:

> "Being a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the company and that said company retains during the currency of this policy at least . . . on the identical subject matter and risk and in identically the same proportion on each separate part thereof, but in the event of the retained line being less than as above, underwriters' lines to be proportionately reduced."

It is unnecessary to consider whether this clause alone would incorporate into the reinsurance all the terms of the insurance which could be germane in that context. The slip's references "&/or as original" against the headings "Form" and "Interest" on any view incorporate the relevant insurance provisions relating to the subject matter and risks into the reinsurance.

22 As between the brokers and Lexington, 10% of the 25% brokerage was returned to Lexington. Perhaps surprisingly, this was not disclosed on the slip, whether as ceding commission or in any other way. How far reinsurers were aware of it is unclear. Unless they were, they must, in view of Lexington's retention of $1,675,000, have thought that Lexington was for some reason prepared to enter into a reinsurance which would be loss-making if Lexington had to pay any claims at all under the insurance. That, though possible, seems unlikely. Simon J and the Court of Appeal were asked to consider as a secondary issue whether the retention of $1,675,000 was agreed as a simple aggregate sum or on a per occurrence basis. On this, I agree with the Court of Appeal, rather than the judge. The retention was a simple aggregate sum for the whole three-year reinsurance period. This is what the slip on its face provides. The absence of any provision for the retention to be either "per occurrence" or on an annual aggregate basis contrasts with the slip provisions relating to the sum (re)insured. Secondly, the reinsurance cover would not make much commercial sense if the retention were on a per occurrence basis. A retention of $1,675,000 per occurrence equates with 8·375% of the maximum sum reinsured in respect of each occurrence (or with 8·375% of the maximum annual aggregate reinsured in the case of the perils of flood and earthquake). Although Lexington, through its share in the brokerage, was retaining 10% of the premium, in practice each occurrence would be very unlikely to give rise to the maximum loss reinsured. So, if the retention operated on a per occurrence basis, Lexington would in reality be retaining more than 10% of the risk for only 10% of the reinsurance premium.

History

23 For determination of the main issue argued on this appeal, it is necessary to know more of the history. Alcoa and NWA commenced proceedings against Lexington in the state of Washington in December 1992 in respect of damage involving 35 sites within the United States (18 owned by Alcoa or NWA, 17 not so owned) and in May 1996 in respect of damage involving a further 23 owned sites, some outside the United States. The proceedings were brought not only under Lexington's DIC policy, but also against numerous other DIC insurers (some 67, including "Underwriters at Lloyd's") participating in policies for various periods between 1 July 1980 and 1 July 1984 and against numerous insurers (some 98, including Lexington during a ten-year period from 1974 to 1984, and "Underwriters at Lloyd's") issuing comprehensive general liability policies for various periods between 29 March 1956 and 1 March 1985. The explanation of these periods is uncertain, but it may be that Alcoa did not have (or perhaps could no longer locate) any relevant insurances outside such periods or that any relevant insurers outside such periods had ceased to be in business.

24 The proceedings related to contamination of the 58 sites by waste products generated and disposed of by Alcoa and NWA over periods going back to the 1940s. Alcoa and NWA pleaded that "in recent years" the United States Environmental Protection Agency ("EPA") had made claims against Alcoa and NWA for the clean-up of such contamination, as a result of which Alcoa and NWA would incur loss. (It appears that the Comprehensive Environmental Response, Compensation, and Liability Act of 1980—"CERLA" or "Superfund"—rendered those responsible for past as well as future contamination liable for its remediation.) The pleading instanced contamination in the state of Washington at Alcoa's L-Bar Products site in respect of which Alcoa and NWA were sued by the state of Washington in 1988 and at Alcoa's Vancouver Facility, in respect of which the Washington Department of Ecology issued various orders from 1986 to 1990, leading to the discovery of contamination of the soil and groundwater beneath landfill.

25 The proceedings against insurers were tried before Judge Learned. She selected for "Phase 1" of the trial three sites (the Vancouver Facility and sites in New York and Texas). In a preliminary ruling dated 10 June 1994 she held that the law of Pennsylvania should be applied to "those issues of contract interpretation which raise conflict of law issues" under the policies.

26 At an early stage during the trial, and in the light of written jury answers the judge further ruled on 15 May 1996 that most if not all of the claims on insurers were barred under the combination of the relevant contractual or statutory limitation provisions. Condition 17 in the DIC policy provided:

> "*Suit against company.* No suit, action or proceeding for the recovery of any claim under this policy shall be sustainable in any court of law or equity unless the same be commenced within twelve (12) months next after discovery by the assured of the occurrence which gives rise to the claim. provided, however, that if by the laws of the state within which this policy is issued such limitation is invalid, then any such claim shall be void unless such action, suit or proceeding be commenced within the

shortest limit of time permitted by the laws of such state to be fixed herein." A

Massachusetts law provides that:

"No company . . . shall make, issue or deliver any policy of insurance . . . containing any condition, stipulation or agreement . . . limiting the time for commencing actions against it to a period of less than two years from the time when the cause of action accrues . . . Any such condition, stipulation or agreement shall be void." B

Judge Learned's ruling was evidently based on the jury's findings that Alcoa had learned of property damage by the late 1970s and early 1980s, and discovered the occurrence which gave rise to its claims then. That ruling was set aside as regards Lexington's DIC insurance by the decision of the Supreme Court of Washington dated 4 May 2000: *Aluminium Co of America v Aetna Casualty & Surety Co* (2000) 998 P 2d 856. Although at an early point in its judgment the Supreme Court recited, at p 862, that "The trial court determined the law of Pennsylvania applied, largely because Alcoa's headquarters are located in Pittsburgh", and that "On appeal, no party disputes the trial judge's order on choice of law applying Pennsylvania law to resolve the issues before us", when it came to deal with the suit limitation, the Supreme Court said that, the Lexington DIC policy having been issued in Massachusetts, "The parties agree Massachusetts law controls for the interpretation of these policies"; applying the relevant Massachusetts statute as interpreted by Massachusetts case law, it held that no time bar applied since the cause of action against Lexington only accrued when Lexington denied coverage. In consequence of this ruling, Lexington appears to have been one of few insurers not entitled to the benefit of a contractual or statutory time bar. C D E

27 At a later stage in the trial before Judge Learned, the jury made further findings in written answers given on 3 October 1996. In answer to question No 2, the jury found both that some portion of the relevant property damage occurred in each area of each of the three sites in each of the years from 1 July 1977 through to 1 July 1984, and that each portion so occurring during each year contributed to the costs of the repair in each such area. In its answer No 4, the jury held that Alcoa knew of property damage or became substantially certain such damage would incur in many of such areas before 1 July 1977 or after 1 July 1984. In a few cases it held that Alcoa acquired such knowledge during the period of the Lexington DIC policy, and in yet others it made no finding. It found itself largely unable to answer question No 5, which asked it to give the proximate cause of any damage unknown to and unintended by Alcoa as of 1 July 1977. In answer to question No 12 the jury found itself also unable to say whether there was "a reasonable basis or bases on which to allocate to each separate policy year the costs related to the property damage that occurred during that policy year". F G

28 Judge Learned issued two further rulings dated 3 March 1997. In the first, she concluded that there were "two cause(s) of the property damage at each of the three Phase I sites", being in the case of "property damage surrounding the manufacturing units at each plant . . . releases from such units" and in the case of "property damage in and around the treatment, storage and disposal units . . . the placement and release of wastes in such H

A units or areas". In the second, she held, in the absence of any answer from the jury to question No 12, that there existed in law a reasonable basis for allocating to each separate policy year the costs related to the property damage that occurred during that policy year. She said that Alcoa could reasonably expect the insurer on risk when the damage occurred to pay for the repair of whatever damage occurred during the policy year, even if the damage was a continuous process occurring over a number of years and even
B if it was not discovered until much later, but that it could not reasonably expect that the insurer would cover the entire loss, much of which occurred outside the policy period. As a matter of fact, she held that the best estimate of actual damage in any policy period was reached by simply dividing the damage over the time it took to develop.

29 On appeal on 4 May 2000 Judge Learned's second ruling was
C emphatically disapproved by the Washington Supreme Court. The Supreme Court held as follows, *Aluminum Co of America v Aetna Casualty & Surety Co* (2000) 998 P 2d 856, 882–884:

"G *Allocation*

"The final issue we address in this case is the damages available to Alcoa upon a finding of coverage under the DIC policies. The jury found
D pollution damage to all three test sites occurred during the entire time the various DIC policies were in effect. The jury also found, however, pollution damage had occurred to portions of the three sites prior to the inception of insurance coverage. Because the pollution damage occurred both before and during the various policy periods, a question arose as to how to attribute the remediation costs of the pollution damage. The jury was unable to reach a verdict on whether there is a reasonable basis or
E bases to allocate to each separate policy year costs related to the property damage that occurred during that policy year . . .

"Missing from the trial court's analysis of this issue is a close examination of the applicable policy language. The insuring clause in the DIC policy states: 'Perils insured: This policy insures against all physical loss of, or damage to, the insured property as well as the
F interruption of business, except as hereinafter excluded or amended.' . . . This language is very broad and contains no limitation as to time of the physical loss or damage to property. There is no exclusion in the policy for physical loss or damage that may have begun spreading before the policy inception. The policy definition of occurrence likewise compels a broad reading of the policy: 'The word "occurrence" shall mean any one loss(es), disaster(s), or casualty(ies) arising out of one event or common
G cause(s).' There are no words of limitation here. It seems clear from the policy language that any physical loss or damage manifesting itself during the time a DIC policy was in effect was covered by the policy, including pollution damage starting before the policy inception. The trial court's written decision does not indicate why the court chose to allocate coverage on a pro rata basis rather than simply reading the
H policy as it is written and ordering full policy coverage for the damage Alcoa incurred.

"In *JH France Refractories Co v Allstate Ins Co* (1993) 534 Pa 29; 626 A 2d 502, the Pennsylvania Supreme Court considered the issue of multiple insurance coverage over time in the case of asbestos disease. France was an asbestos manufacturer and seller from 1956 to 1972.

The wife of a person who had died from asbestos exposure to France's products that occurred between 1948 and 1978 sued France. France sought a defence and indemnification from its insurers for those years, but the insurers denied any duty to defend or indemnify France. France then filed a declaratory judgment action to force the insurers to defend and indemnify.

"The six insurers at trial had provided policies at varying times and all the policies contained the same general liability language: '[The insurer] will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury . . . to which this insurance applies, caused by an occurrence, and [the insurer] shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury.' . . . One of the issues the trial court in that case considered was whether and how to allocate coverage among the six insurers. The trial court prorated the obligations of the insurers based on the time their respective policies were in effect (the *France* court did not explain the details of this proration).

"On appeal, the Pennsylvania Supreme Court rejected the proration approach: 'First, and most compelling, is the language of the policies themselves. Each insurer obligated itself to "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury to which this insurance applies". We have already ascertained that any stage of the development of a claimant's disease constitutes an injury "to which this insurance applies" under each policy in effect during any part of the development of the disease. Under any given policy, the insurer contracted to pay all sums which the insured becomes legally obligated to pay, not merely some pro rata portion thereof.'

"Likewise, in the 'perils insured' clause of the DIC policies here, the insurers obligated themselves to insure 'against all physical loss of, or damage to, the insured property', not merely to some prorated portion thereof. The trial court attempted to distinguish this case from *JH France* by describing the difference between asbestos disease and environmental contamination: 'Asbestos that has been inhaled may have no adverse effects for years and then may suddenly cause myriad physiological problems which are not necessarily related to the length of exposure or the number of asbestos fibres taken into the body. Asbestos disease is not merely a corollary of the volume ingested. Environmental contamination, on the other hand, is merely the sum of all its parts—each part per million of a particular contaminant that is discharged to the environment equally damages the insured property either by increasing the concentration of a particular area (if movement of the pollutant is retarded) or by increasing the size of the impacted area (if the pollutant readily migrates)' . . .

"It may be true, as the trial court stated, that the progression of pollution damage can be measured and apportioned more certainly year to year than can the progress of asbestos disease, but that understanding begs the question of whether the express DIC policy language compels proration. It is the policy language that determines the scope of coverage. The policy language here does not provide for any limitations to the scope of damage . . .

A "The insurers vigorously contend that while *JH France* may be correct as to third party coverage, it is not appropriately applied to first party coverage, citing the 'all sums' language from the policy in *JH France*. We are not persuaded by this distinction. The language of the insuring agreement in the DIC policies is exceedingly broad, covering all physical loss or damage to Alcoa's property. This language is at least as broad as the policy language in *JH France*. Moreover, if DIC policies mean what B the insurers claim they mean, the policy language should reflect that meaning. The policies in this case do not, and we decline to write a proration of coverage into the policies when the insurers failed to do so themselves. The trial court erred in its decision to prorate coverage according to the years the various DIC policies were in force. We reverse the trial court on this issue . . ."

C

Analysis

30 Wasa and AGF do not submit that the decision of the Supreme Court of Washington on the extent of Lexington's liability under the law of Pennsylvania as insurers of Alcoa and NWA was perverse or wrong under that law. For the purposes of this appeal, they accept it as correct. Its effect D was that Lexington was liable for all damage "manifesting" itself during the three-year insurance period, although such damage had, in the Supreme Court's words, "occurred both before and during" that period or had "begun spreading" or "start[ed]" before that period. The force of the word "manifesting" is unclear, in the light of the jury's findings that Alcoa did not know of some of the property damage or become substantially certain that it would occur until well after the expiry of that period (indeed until after E 1 July 1984). Mr Sumption for Lexington submitted that all that the Supreme Court meant by "manifesting" was "in being". Further, the Supreme Court did not expressly address property damage occurring after the expiry of the three-year period of Lexington's insurance. However, its judgment appears to have been read as rendering Lexington liable for all aspects or consequences of any property damage in any area at any site, F whenever occurring, any part of which could be said to have occurred during the three-year insurance period. In response to this last point, Mr Sumption submitted that any property damage occurring after the three-year period could only be responsible for a small part of the overall loss suffered by Alcoa and NWA, and, critically (as he submitted), that Lexington had, following the Supreme Court's judgment settled for only $103m potential claims for over $180m and that it was common ground that this was an G honest and business-like settlement.

31 Lexington accepts that the reinsurance was and is subject to English law, while the insurance was an American policy. But it submits that this can and should make no difference. Reinsurers would and should have expected claims under the insurance to be brought in a court of competent jurisdiction in the United States under the service of suit clause. The Washington court was such a court, and Judge Learned selected the law of Pennsylvania to H govern the issue of policy interpretation under principles of private international law recognised in Washington. The language of the English law reinsurance should be read in the same sense as that which the American insurance was by this process authoritatively established to have. The Washington court had done no more than decide what constituted damage

occurring within the three-year insurance period, and the reinsurance should respond on a like basis. The last submission involves a verbal gloss which I would not accept. The Washington court acknowledged that its ruling enabled recovery under the insurance in respect of pollution damage occurring both before and during the policy period. Instead of identifying whether and how far such damage, or the disposal or leakage of waste causing it, occurred during the insurance period, it treated all pollution damage "manifesting" itself, or as Mr Sumption submits "in being", at any site during the policy period as covered by the insurance, whether it occurred before, during or, it appears, after that period.

32 The appeal can in my judgment be resolved by reference to certain propositions which are as such largely undisputed. First, a reinsurance is a separate contract, which may contain its own independent terms requiring to be satisfied before insurers can claim indemnity under it. To take an obvious example, the present reinsurance was not a perfectly proportional reinsurance, by virtue of the retention of $1,675,000. More fundamentally, even a perfectly proportional reinsurance is not an insurance against liability, still less against any liability which the reinsured may be held to incur under the insurance. Statements were made in the Court of Appeal by Sedley LJ [2008] Bus LR 1029, para 49, to the effect that the "need for the fiction that reinsurance covered the primary risk and not the insurer's own potential liability" is "long spent" and that the "reality" is that "what is reinsured is the insurer's own liability". Sedley LJ appears to have thought that a contrary view might have enabled Lexington to claim its percentage of $180m, rather than $103m, from its reinsurers. I do not consider these thoughts well-founded.

33 Reinsurance is a settled business conducted worldwide by experts, often (even if past experience indicates not invariably) possessing very considerable legal knowledge and expertise. The well-recognised analysis which neither side gainsaid before your Lordships is that a reinsurance such as the present is an independent contract, under which the subject matter reinsured is the original subject matter. The insurable interest which entitles the insurer to reinsure in respect of that subject matter is the insurer's exposure under the original insurance. The principle of indemnity limits any recovery from reinsurers to the amount paid in respect of that insurable interest. See generally *Forsikringsaktieselskabet National (of Copenhagen) v Attorney General* [1925] AC 639, 642, per Viscount Cave LC; *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 392E–H, per Lord Hoffmann; *Toomey v Eagle Star Insurance Co Ltd* [1994] 1 Lloyd's Rep 516, 522, per Hobhouse LJ and Marine Insurance Act 1906, section 9. (As noted in the *Toomey* case, a stop-loss or similar policy taken out by an insurer is not a reinsurance in this sense and operates as a whole account protection on a different basis.) Reinsurance business is classified in accordance with this well-settled analysis for regulatory purposes: Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544). Reinsurance slips are underwritten identifying the subject matter insured (here, against the headings "Interest" and "Situated") as the original insured's property, rather than the insurer's exposure or liability under the original insurance. On Sedley LJ's analysis, the decision in *Mackenzie v Whitworth* (1875) 1 Ex D 36, that an insurer "on goods" may reinsure by the same description without disclosing that he is a reinsurer rather than the goodsowner, could

not stand. There is no basis or justification for courts to throw unnecessarily into doubt an accepted analysis with business significance.

34 The first proposition is not critical to the resolution of this appeal. Both sides in fact accepted its correctness before the House. A conclusion that "what is insured is the insurer's own liability" would not entitle the insurer to indemnity against whatever liability it might be found to have in any court in which it was sued, under whatever law was there applied. Insurance against liability may, like any other insurance, be subject to specific terms which have to be satisfied before any indemnity can be sought.

35 That leads to the second point: an insurer seeking indemnity under a reinsurance must, in the absence of special terms, establish both its liability under the terms of the insurance and its entitlement to indemnity under the terms of the reinsurance. In practice, the former task is eased by express terms in a proportional reinsurance: originally, these took the form of a provision "to be paid as may be paid", but courts gave this a limited interpretation which confined it to questions of quantum, so that it would only assist insurers once they had proved that they had some liability to their insured; there thus developed "follow the settlements" clauses or the "full reinsurance" clause appearing in the present reinsurance. As interpreted by the Court of Appeal in *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd* [1985] 1 Lloyd's Rep 312, the effect of these clauses is to bind the reinsurer to follow settlements of the insurer (whether made by admission or compromise or, as in the *Scor* case itself, following a judgment against the insurer). The Court of Appeal in the *Scor* case identified two provisos: the first, that the claim so recognised falls within the risk covered by the policy of reinsurance and, the second, that the insurers acted honestly and took all proper and business-like steps in making the settlement: see per Robert Goff LJ, at p 330.

36 In *Assicurazioni Generali SpA v CGU International Insurance plc* [2003] 2 All ER (Comm) 425; [2004] 2 All ER (Comm) 114 Gavin Kealey QC, sitting as a deputy High Court judge, and the Court of Appeal considered how the principle in the *Scor* case [1985] 1 Lloyd's Rep 312 might apply when the relevant terms of the insurance and reinsurance are identical. They considered whether and how the second proviso applied to an insurer who, acting honestly and taking all proper and business-like steps, settled an insurance claim under insurance terms which were identical to those of the reinsurance. They concluded that the insurer remained obliged to show that the basis on which the claim had been settled was "one which fell within the terms of the reinsurance as a matter of law or arguably did so": per Tuckey LJ [2004] 2 All ER (Comm) 114, para 18. The last three words must be read in the context of that case, where the insurance and reinsurance incorporated materially identical terms with materially identical effect (and the issue was whether and on what basis the facts fell within such terms). It is less obvious that they could apply in a case like the present where, if reinsurers are right, the like terms in the insurance and reinsurance have different effects due to the application of different governing laws.

37 Thirdly, the present appeal is to be determined on the basis that reinsurers were and are bound by the follow the settlements provision to accept that Lexington's settlement of Alcoa's and NWA's claims fairly reflected Lexington's liability under the original insurance; and, accordingly, that, if and so far as the loss was insured and reinsured on the same basis, the

reinsurer must indemnify the insurer (subject only to the second *Scor* proviso, that the insurer acted honestly and took proper and business-like steps in making the settlement). In his case (though not, I believe, in oral submissions) Mr Sumption supported the view that, even without the follow the settlements clause, reinsurers would, as a matter of contractual implication, have been bound by the Washington Supreme Court's interpretation of the scope and application of the original cover. His case cited in this respect the obiter rejection by the Court of Appeal of submissions which Mr Sumption had made on the same point in *Commercial Union Assurance Co v NRG Victory Reinsurance Ltd* [1998] 2 Lloyd's Rep 600. It is unnecessary to decide upon the correctness or otherwise of the Court of Appeal's obiter observations on the effect under reinsurance of a judgment against the insurer. I note only that there was no suggestion in the *Scor* case [1985] 1 Lloyd's Rep 312, where there was such a judgment, that this judgment could be binding in the absence of a follow the settlements clause; and that the basis for such a contractual implication has been questioned by a powerfully constituted Bermudian arbitration panel in an interim award dated 12 December 2000 in *Gold Medal Insurance Co v Hopewell International Insurance Ltd*, as well as by specialist writers: *O'Neill & Woloniecki, The Law of Reinsurance in England and Bermuda*, 2nd ed (2004), pp 191–193. Here, there is a follow the settlements clause, and any issue which might have arisen regarding the actual settlement (see para 30 above) was not canvassed below or before the House. The only issue raised by reinsurers is whether the loss arising from Lexington's settlement with Alcoa falls within the terms of the indemnity provided by the reinsurance slip.

38 Fourthly, it is common ground that, if the present reinsurance slip, including such terms of the original insurance as it incorporates, is to be construed according to purely English law principles, it does not have a meaning or effect similar to that which the Washington Supreme Court gave to the insurance. The only property damage which the reinsurance, construed according to purely English law principles, covers is property damage occurring during the three-year reinsurance period. This is under English law clear beyond argument upon its wording. It insures property against risks during a stated period. The reference in the slip to the use of form J.1 (designed for use with a full policy wording) or NMA 1779 (designed for use with the slip to constitute a slip policy) is itself not without interest, even though neither a formal nor a slip policy has been identified (one may question how premium was ever closed, unless at least the latter at some time existed). The understanding must have been that any formal policy would be on terms consistent with those of any slip policy. Form NMA 1779 provides for reinsurers "to pay . . . all such loss as aforesaid as may happen to the subject matter of this reinsurance, or any part thereof during the continuance of this policy"—confirmation of the basic nature of the reinsurance.

39 This construction of the slip also reflects the basic principle of English property insurance law, that "the insurer is liable for a loss actually sustained from a period insured against during the continuance of the risk": *Knight v Faith* (1850) 15 QB 649, 667 per Lord Campbell CJ. (The emphasis in that case was on the need for the peril insured against to occur during the continuance of the risk—damage materialising or developing

A from it after the policy period would still be covered. Usually, the occurrence of the peril and of loss concur, although one may contemplate the disposal or leakage of waste causing spreading contamination over a period.) Hobhouse LJ summarised the legal principle in *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421, 435–436:

> "The judge came to the surprising conclusion that each reinsurance
B contract covered liability in respect of physical loss or damage whether or not it occurred during the period covered by the reinsurance contract and he went on expressly to contemplate that the same liability for the same physical loss or damage might be covered under a number of separate contracts of reinsurance covering different periods. This is a startling result and I am aware of no justification for it. When the relevant cover is
C placed on a time basis, the stated period of time is fundamental and must be given effect to. It is for that period of risk that the premium payable is assessed. This is so whether the cover is defined as in the present case by reference to when the physical loss or damage occurred, or by reference to when a liability was incurred or a claim made. Contracts of insurance (including reinsurance) are or can be sophisticated instruments containing a wide variety of provisions, but the definition of the period of
D cover is basic and clear."

The insurance in this case was not against liability incurred or claims made. It is clear that the Washington Supreme Court approached it as property damage insurance, and held Lexington liable on that basis, because of its conclusion that the insurance should be seen as covering all contamination whenever caused or occurring at any site, so long as any part of it could be
E said to have manifested itself (or been in being) at the site during the three-year insurance period.

40 Viewing the reinsurance through purely English law eyes, it cannot therefore be construed as a contract to indemnify Alcoa in respect of all contamination of Alcoa sites, whenever caused or occurring, provided that part of such contamination manifested itself or was in being during the
F reinsurance period. That would involve reinsurers in an unpredictable exposure, to which their own protections might not necessarily respond. It would mean that the same exposure would arise, even if they had granted the reinsurance for a shorter period than the three-year period matching the original—since the original itself would, even if in force for only one year, have had effectively the same exposure as that for which the Washington Supreme Court held it answerable. Under the approach taken by the
G Washington Supreme Court, reinsurers must have incurred liability (in practice probably up to the reinsurance limits), as soon as they wrote the reinsurance. The retention must likewise have been exhausted before the reinsurance period began, and cannot have fulfilled any object of introducing an element of discipline into insurers' handling of the insurance. These represent as fundamental and surprising changes in the
H ordinary understanding of reinsurance and of a reinsurance period as those to which Hobhouse LJ was referring in the *Municipal Mutual* case [1998] Lloyd's Rep IR 421.

41 The reference in the reinsurance slip to the retention as "subject to excess of loss &/or treaty R/I" is a reminder that an insurance and reinsurance such as the present are likely to be part of a larger programme of

protections. Excess of loss reinsurance is underwritten on either a losses occurring or risks attaching basis: *Balfour v Beaumont* [1984] 1 Lloyd's Rep 272. In other words, it is fundamental that such a reinsurance will respond in the one case to losses occurring during the reinsurance period, in the other to losses occurring during the period of policies attaching during the reinsurance period. To treat excess of loss policies as covering losses through contamination occurring during any period, so long as some of the contamination occurred or existed during the reinsurance period, would be to change completely their nature and effect. The reference in the slip to excess of loss reinsurance underlines the difficulty about interpreting the terms of the reinsurance as covering the losses which the Washington Supreme Court have held to be recoverable under the insurance.

42 Fifthly, and crucially to the outcome of this appeal, it is said that all objections to treating the reinsurance as covering Lexington's liability are dispelled by giving appropriate recognition to the fact that the reinsurance was placed expressly to cover the original DIC insurance; the relevant language of the insurance and reinsurance was identical; and Lexington's evident intention in reinsuring was to cover itself in respect of the whole risk after the exhaustion of the retention. The two contracts should be treated as back to back, and a mere difference in governing law should not lead to any other result. On the contrary, English law should read the language of the reinsurance in the sense given it by the Washington court.

43 Mr Sumption submits that this line of reasoning is supported, indeed compelled, by the House's decision in *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and the Court of Appeal's decision in *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350. In the *Vesta* case, a 90% reinsurance of a Norwegian insurance company was placed before, and on wording which was later copied into, the insurance. The reinsurance was however subject to English law, while the insurance was subject to Norwegian law. Both included a 24-hour watch warranty, as well as a claims control clause which expressly provided that failure to comply with any warranty was to "render the policy null and void". Despite these express words, under Norwegian law, breach of warranty was only relevant if causative of the loss, while under general English law (reinforced in the *Vesta* case by the claims control clause) breach automatically discharges reinsurers. The House held that, by virtue of the "back to back" nature of the reinsurance, the 24-hour watch warranty was to be read in the English law reinsurance as having the same significance as it had in the Norwegian reinsurance. The *Catatumbo* case [2000] 2 Lloyd's Rep 350 was also concerned with proportionate reinsurance, in this case written facultatively in circumstances where London market reinsurers had no sight or direct knowledge of the terms of the insurance issued under Venezuelan law by the Venezuelan insurers who they undertook to reinsure. The reinsurance contained a guarantee of class maintained and was treated as incorporating the terms of the insurance, which itself contained a Spanish language "garantia" in like terms. Again, under Venezuelan law, a warranty was irrelevant unless causative of loss. Again, this was the effect to be given to the warranties contained or incorporated in the English law reinsurance.

44 Ultimately, however, the issue is one of construction of the particular reinsurance contract against its relevant background and surrounding circumstances. In both the *Vesta* and *Catatumbo* cases, it was possible at the

A time when the insurance and reinsurance were placed to identify the foreign law which would govern the insurance. The parties entering into the English law reinsurance could be taken to have had access to what Lord Lowry in the *Vesta* case described as a foreign "legal dictionary" to interpret the language of the reinsurance. Lord Templeman, in discussing in the *Vesta* case [1989] AC 852, 892B–E the extent to which the two contracts had the like effect, did so by reference to the circumstances and terms in which they were B entered into, not on the basis that the reinsurance was bound to respond to whatever liability the insurers might subsequently be held to incur. As Longmore LJ put it in the present case [2008] Bus LR 1029, para 25: "It must be sufficient if there is a way in which it would be possible to ascertain the legal position under the original insurance contract." That was so when the reinsurances were placed in the *Vesta* and *Catatumbo* cases.

C **45** Sixthly, under English law, a contract has a meaning which is to be ascertained at the time when it is concluded, having regard to its background and the surrounding circumstances within the parties' knowledge at that time. Mr Sumption submits that this is so here. The meaning is to be derived from reading the reinsurance terms in the sense they bore under Pennsylvanian law. The parties must have contemplated that any claim under the insurance issued to Alcoa would, if contentious, be litigated and D determined before the courts of one of the United States under the service of suit clause. Alcoa having exercised this right to bring suit in Washington, Judge Learned did no more and no less than what an English court would have done. She decided, under the conflict of laws rules of the state of Washington, what state's law governed the insurance contract. Having determined that the law of the state of Pennsylvania applied, she interpreted E and applied the jurisprudence of that state. This was, in short, a foreseeable and conventional exercise. Indeed, Longmore LJ considered that an English court would, if its own conflicts rules had been applicable, also have concluded that the law of the state of Pennsylvania applied, on the basis that the insurance contract had its closest and most real connection with that state where Alcoa was incorporated and had its principal place of business.

F **46** I am unable to agree with Longmore LJ on this last point. Applying English law conflicts principles, I think that the insurance would fall to be treated as governed by the law of the state of Massachusetts. The insurance policy was headed with Lexington's name followed by "Boston, Massachusetts", where Lexington's head office was, it was recorded as countersigned by Lexington at the same place, and as broked by Fairfield & Ellis, also of Boston. It was issued in Massachusetts to insure Alcoa and G its subsidiaries and affiliates whose address was given as Pittsburgh, Pennsylvania. It covered property in, and in various countries outside, the United States. For reasons given by my noble and learned friend, Lord Collins of Mapesbury, in paras 91–93, an English court applying English law would, I consider, have concluded that Massachusetts law governed the insurance.

H **47** Seventhly, however, Lexington's case does not depend on the attitude in relation to the original insurance of an English court applying English conflicts principles. What matters, in Mr Sumption's submission, is that the Washington court, properly seised of the case under the service of suit clause, determined under its conflicts principles that Pennsylvanian law governed. However, that was a decision reached in the context of large scale

litigation involving a wide range of insurers, insurances and periods. Judge Learned's decision falls to be viewed in this light. She read the direction in the service of suit clause to determine all matters arising under the insurance in accordance with the law and practice of whatever court of competent jurisdiction was selected by Alcoa as a direction to apply the full law of that court, including its choice of law principles. Any other conclusion would clearly have meant that the insurance fell to be interpreted by a substantive law which depended on Alcoa's ultimate choice of jurisdiction. She concluded that Washington had no special interest in applying its own substantive law, and turned to section 193 of the *American Law Institute, Restatement of the Law, Conflict of Laws*, 2d (1969), which pointed towards the law of the site insured as the natural governing law. Having regard to the multiplicity of sites in issue, she rejected that law on the basis that "it is generally presumed that contracting parties mean their contracts to have one meaning" and that, although the same language in different policies might be interpreted differently in different jurisdictions, the parties were unlikely to have expected the same policy to be subject to "multiple interpretations depending on the fortuity of where the damage occurs".

48 The key to Judge Learned's application of Pennsylvanian law lies in her statement that Pennsylvania was "the one commonality between all the sites and all the defendants". This was on the basis that placement originated from Alcoa's headquarters and was "in most cases . . . coordinated through the Pennsylvania broker or other brokers". She added:

> "Analysis of each policy for the details of contract formation to 'count' contacts in the formation of the contract would not be particularly fruitful. The coverage scheme was comprehensive, multilayered. The place of signature of the contract, or domicile or headquarters of the various defendants or other factors are of less significance than those associated with Pennsylvania. Overall, the record reflects that the meaningful centre of gravity for contract formation is Pennsylvania, for most, if not all of the contracts."

She also refused submissions made by some insurers that she should "defer ruling on choice of law and decide issue by issue and defendant by defendant", and concluded:

> "The court determines as a general rule that for those issues of contract interpretation which raise conflict of law issues, Pennsylvania law is deemed to have the most significant relationship and the court will apply Pennsylvania law. However, if specific or unique issues arise regarding one or more defendants or one or more sites, that raise significant considerations that override the general rule, they can be brought to the court's attention at that time."

As recorded above, the Supreme Court stated that there was no appeal against this conclusion by Lexington.

49 It is clear that Judge Learned's conclusion about the governing law was an overall conclusion, based on a general consideration of the "comprehensive, multilayered" insurance scheme arranged by Alcoa over the years and a reluctance to engage in analysis of the particular circumstances of individual insurances taken out individually and with different insurers at different times and in different places. It was arrived at

A therefore by taking into account matters and events extraneous to the policy issued by Lexington to Alcoa or the claims arising under that policy. The choice of the law of the state of Pennsylvania to govern Lexington's insurance of Alcoa cannot, as a result, be regarded as in any sense predictable at the time when the reinsurance was placed, or as following from the operation of the terms of the insurance as a contract independent of all the other insurance contracts held by Alcoa over several decades. B This point is underlined by the reference in condition 17 of the policy issued by Lexington to Alcoa to the law of the place of issue of the policy as the appropriate law to govern the validity and period of the time limit for proceedings and the parties's agreement in this connection that the policy was subject to Massachusetts law: para 26 above. Lexington's case depends on the application of a Pennsylvanian legal dictionary. Lexington C has not advanced its case on the basis that a Massachusetts legal dictionary could be relevant to or assist Lexington's position. In my view, the present case is materially different from both the *Vesta* case [1989] AC 852 and the *Catatumbo* case [2000] 2 Lloyd's Rep 350. The reinsurance has a clear English law meaning. There was here no identifiable legal dictionary (formal or informal), still less a Pennsylvanian legal dictionary, which can to be derived from the interaction or operation of the terms of the insurance D and reinsurance and which could lead to any different interpretation of the reinsurance wording. For reasons I have already given, the reinsurance is an independent contract, with its own terms which fall to be construed under English law, and I see no basis for interpreting it as covering any liability which might subsequently be held to arise under the insurance in any state whose law might, after disputes had arisen under it and other E separate insurances, be applied by reference to factors extraneous to the particular insurance to which alone the reinsurance related It follows that there is no basis for construing the two contracts as back to back in the present situation.

Other points

F 50 That is sufficient to dispose of this appeal. But I would make some short observations in relation to two further submissions advanced by Mr Schaff for Wasa, with the support of Mr Calver for AGF. First, the *Vesta* case [1989] AC 852 and the *Catatumbo* case [2000] 2 Lloyd's Rep 350 were both cases concerned with the effect of breaches of warranty. This is an area where English law has long been recognised as unduly stringent and in need of review. It was, as I said in the *Catatumbo* case, at para 30, commercially G and legally unattractive to treat the concept of warranty in the reinsurance as retaining "a stubbornly domestic English significance, trumping any limited significance of such a warranty included in the original and also incorporated by reference into the reinsurance"; a "harmonious result" could be achieved relatively easily by treating warranty in the reinsurance as taking its precise meaning and application from any equivalent warranty incorporated in the original. Like considerations would no doubt mean in H relation to the present contracts that the reinsurance period (expressed as a unitary period of 36 months at 1 July 1977) would be understood to run back to back with the insurance term of 36 months "beginning and ending at noon standard time at location of property involved": see *Knight v Faith* 15 QB 649. Similarly, any doubt about the meaning of the sum reinsured

of $20m in the aggregate in respect of flood and earthquake would be clarified by reference to the original, which makes clear that such aggregate applies to each of these perils separately. In each case, there is no doubt about the terms or effect of the original insurance wording and there would be no problem about making the necessary minor assimilation.

51 It may not, perhaps, always be so easy to assimilate an original insurance and reinsurance, when one is concerned with as fundamental an aspect of a reinsurance as its definition of the risks and period insured and the period for which they are insured: see paras 38–40 above. The almost complete absence of any context to the two placements in the present case is furthermore no assistance to such an exercise. Mr Sumption asked rhetorically: what more could Lexington have done to reinsure themselves on a fully back to back basis? The market has in the past adapted the nature of the protections arranged or their wordings to achieve the results which it believed appropriate. But another answer, under the present course of business, is to ensure that insurance and reinsurance are subject to one and the same identifiable or predictable governing law. Failing that, steps could at least be taken to make the insurance subject to an identifiable governing law, though this would not necessarily foreclose all argument. Absent a common governing law, reinsurers may still sometimes be entitled to respond, with reference to the clear meaning that their contract has under the law governing it: what more could we as reinsurers have done to make clear the basis of reinsurance? A sensible principle of construction, established in the *Vesta* case [1989] AC 852 and the *Catatumbo* case [2000] 2 Lloyd's Rep 350, cannot be made into an inflexible rule of law, which would impose on reinsurers a liability for which, under the law applicable to the reinsurance, they did not bargain. The consideration that Lexington probably did not reckon on the liability which it was held to have in America is not by itself a conclusive reason for passing that liability to reinsurers who were, on the face of it, also entitled to be confident that no such liability could arise under the clear and basic terms of the English law contract into which they entered.

52 At times during the argument, Mr Schaff submitted that no-one, even in the United States, could at the time of placement, have predicted that an American court would put on the insurance the construction adopted by the Washington Supreme Court. It is unnecessary to express any view about the factual basis for this submission, although the cases themselves tell at least part of the story. Asbestosis litigation was in its relative infancy in 1977, although a principle of joint and several liability of manufacturers to whose products a worker had been exposed over a period of years was developed in *Borel v Fibreboard Paper Products Corpn* (1973) 493 F 2d 1076. This was on the basis, at p 1095, that

> "Where the tortious acts of two or more wrongdoers join to produce an indivisible injury, that is, an injury which from its nature cannot be apportioned with reasonable certainty to the individual wrongdoers, all of the wrongdoers will be held jointly and severally liable for the entire damages."

In *Insurance Co of North America v Forty-Eight Insulations Inc* (1980) 633 F 2d 1212 it was affirmed that liability insurance policies taken out for various terms over a period of years were triggered by an asbestosis sufferer's

A exposure to asbestos over that period, but that insurers' liability for defence costs as well as for the policy indemnity should be apportioned pro rata among insurers, with the insured asbestos manufacturer itself bearing a pro rata share of any liability arising from the victim's exposure to asbestos during years when the manufacturer had no liability insurance. The court said, at p 1225, that "Neither logic nor precedent support" a contrary view according to which "a manufacturer which had insurance coverage for only
B one year out of 20 would be entitled to a complete defence of all asbestos actions the same as a manufacturer which had coverage for 20 years out of 20". However, in the famous case of *Keene Corpn v Insurance Co of North America* (1981) 667 F 2d 1034, the court developed the triple trigger theory according to which liability attached to all liability insurances which were in force at the time of injurious exposure, at the time of manifestation of
C disease or at any time inbetween (i e the time of "exposure in residence"). Further, in the *Keene* case and certain other cases, such as *JH France Refractories Co v Allstate Insurance Co* (1993) 534 Pa 29 (cited by the Washington Supreme Court in the present case) some courts differed from the *Forty-Eight Insulations* case 633 F 2d 1212 by holding that all such liability insurers were liable to the insured jointly and severally in full, rather than on a pro rata basis, and that any period when the insured manufacturer
D had no insurance was irrelevant to such liability. During the 1990s it appears that some courts began to apply similar reasoning to pollution damage resulting in remediation claims under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980: see e g *American National Fire Insurance v B & L Trucking & Construction Co Inc* (1998) 951 P 2d 250, 254, n 4, indicating that "in a continuing damage
E situation, each insurer is held jointly and severally liable for the full amount of damage, regardless of the amount that occurred during its policy period". The Washington Supreme Court's present decision cited this case and followed the same approach in relation to the property damage insurance issued by Lexington to Alcoa.

53 Assuming that Mr Schaff were to be right in his submission that no-one, even in the United States, could at the time of placement, have predicted
F that an American court would put on the insurance the construction adopted by the Washington Supreme Court: would that matter? Longmore LJ and Pill LJ [2008] Bus LR 1029, paras 30, 60, thought not, on the basis that reinsurers must take the risk of any change in the law. It would have been "nothing to the point", Longmore LJ said, at para 30, "if the relevant Norwegian statute had been enacted after the inception of the policy in
G *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852, but before the loss". Here, moreover, one is only talking at most about a change in the construction put at common law on a particular contract wording. However, it is unnecessary to say more about any such points in this case. They may, and one certainly hopes will, rarely arise, and the market may be advised to amend its reinsurance wordings to make it even less likely that they will.

H *Conclusion*

54 Although I see the general attraction of the answer which the Court of Appeal gave in the present case, I find it impossible to adopt in circumstances where Lexington's liability has been held to arise under a system of law which was applied to the insurance not by reason of the terms

of the insurance or their operation, but in the context of a choice of law on a blanket basis to cover also a large number of other independent insurances and claims. I note that Longmore LJ [2008] Bus LR 1029, paras 27–28, reached his opposite conclusion after taking an opposite view about the feasibility of identifying Pennsylvanian law as the law which would have been taken as governing the original insurance. In the upshot, I consider that this appeal should be allowed, and the decision of Simon J restored. I have also had the benefit of reading in draft the full and instructive judgment prepared by Lord Collins and I agree with the reasoning by which he reaches the same conclusion.

LORD COLLINS OF MAPESBURY

55 My Lords, after banking, insurance is the United Kingdom's largest invisible export, of which reinsurance forms a large part, and amounted to at least £1·2bn in 2007: Office for National Statistics, *United Kingdom Balance of Payments: The Pink Book 2008*, p 52. These appeals raise the question of the extent to which the coverage under a proportional facultative reinsurance contract is, or should be construed as being, co-extensive with the coverage under the insurance contract. The reinsurer takes a proportional share of the premium and bears the risk of the same share of any losses. Consequently, the starting point is that normally reinsurance of that kind is back-to-back with the insurance, and that the reinsurer and the original insurer enter into a bargain that if the insurer is liable under the insurance contract, the reinsurer will be liable to pay the proportion which it has agreed to reinsure. In the usual case, any loss within the coverage of the insurance will be within the coverage of the reinsurance. This is so, whether or not (as is often the case) the reinsurance is put in place before the insurance is put in place or written. It is not necessary to characterise the reinsurance policy as liability insurance to achieve this result, which is essentially a question of commercial intentions and expectations.

56 Those commercial intentions and expectations should not be frustrated by allowing reinsurers to take uncommercial and technical points based on the difference between the effect given to terms in the insurance and the reinsurance under their respective governing laws. That was the basis of the decision in *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852, when the relationship between a contract of insurance and a contract of reinsurance in the international context was considered by this House 20 years ago. But these appeals raise more difficult and fundamental questions than those in the *Vesta* case.

57 In the present case the insurer has become liable in the United States to the insured for losses suffered by the insured which could not have been anticipated in 1977, when the contracts of reinsurance and reinsurance were entered into. But insurers and reinsurers have to accept liability for losses which are not anticipated, and it is not that feature which distinguishes this case. What is unusual about this case is that the court which imposed the liability on the insurer, the Supreme Court of Washington, applied the law of a state (Pennsylvania) which is one of those states which imposes joint and several liability for the whole of the clean-up costs in environmental claims on all insurers at risk during the period when pollution occurred (which may be 50 years or more), provided that some pollution has occurred during the policy period in the relevant policy (in this case from 1977 to 1980).

The reinsurance covered the same 1977 to 1980 period. It is common ground that under English law those losses would not be covered by a policy providing cover for losses occurring during that period. In the judgment under appeal [2008] Bus LR 1029, the Court of Appeal (Pill, Sedley and Longmore LJJ, with Longmore LJ giving the main judgment) held that the reinsurance had to respond because the wording relating to the period of cover, which appeared in both the insurance and reinsurance, was to be given the same meaning in each of these contracts, namely the meaning which the Supreme Court of Washington had ascribed to it.

58 The solution to the question on these appeals, and the reasons why they should be allowed, seem to me to be found in these steps. (1) In order to establish liability against a reinsurer, the reinsured has to establish that the loss is within the risk assumed under the underlying insurance contract; and that the relevant risk has been assumed under the reinsurance contract. (2) Whether the relevant risk has been assumed under the reinsurance contract is a question of construction of that contract. (3) In principle the relevant terms in a proportional facultative reinsurance—and in particular those relating to the risk—should be construed so as to be consistent with the terms of the insurance contract on the basis that the normal commercial intention is that they should be back-to-back. (4) Where the insurance contract and the reinsurance contract are governed by different laws, it remains a question of construction of each contract under its applicable law as to what risk is assumed, and there is no special rule of the conflict of laws which governs the consequences of any inconsistency. (5) Both the insurance contract and the reinsurance contract were "losses occurring during" (or "LOD") policies (or "occurrence policies" as they are known in the United States), which in English law means that an insurer (or reinsurer) is liable to indemnify the insured (or reinsured) in respect of loss or damage which occurs during the policy period. (6) There was not in 1977, when the insurance contract and the reinsurance contract were concluded, any identifiable system of law applicable to the insurance contract which could have provided a basis for construing the contract of reinsurance in a manner different from its ordinary meaning in the London insurance market. (7) The effect of the decision of the Supreme Court of Washington is to impose liability on Lexington under the contract of insurance for loss and damage which occurred both before and after (as well as during) the policy period in the reinsurance contract. (8) It is common ground that under English law an insurer (or reinsurer) would not be liable for losses occurring before and after the policy period. (9) Although normally any loss within the coverage of the insurance will be within the coverage of the reinsurance, there is no rule of construction, and no rule of law, that a reinsurer must respond to every valid claim under the insurance irrespective of the terms of the reinsurance. (10) The reinsurance contract cannot reasonably be construed to mean that it would respond to any liability which "any court of competent jurisdiction within the United States" (the phrase in the service of suit clause) would impose on Lexington irrespective of the period of cover in the reinsurance contract.

Insurance, reinsurance and the construction of contracts

59 It is elementary and obvious that a reinsurer cannot be held liable unless the loss falls within the cover of the underlying insurance contract and

within the cover created by the reinsurance: *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239, 1251, per Lord Mustill. It is equally elementary that what falls within the cover of a contract of reinsurance is a question of construction of that contract.

60 In the case of proportional facultative reinsurance the obvious commercial intention is for the original insurer to reinsure part of its own risk and for the reinsurer to accept that part of the risk, and it is therefore equally obvious that the relevant terms in the reinsurance contract should be construed so as to be consistent with the contract of insurance. This is simply commercial common sense. Consequently, in proportional facultative reinsurance the starting point for the construction of the reinsurance policy is that the scope and nature of the cover in the reinsurance is co-extensive with the cover in the insurance. As Staughton LJ said in *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127, 132:

> "One can . . . readily assume that a reinsurance contract was intended to cover the same risks on the same conditions as the original contract of insurance, in the absence of some indication to the contrary."

61 An early example of this principle is *Joyce v Realm Marine Insurance Co* (1872) LR 7 QB 580. The insurance covered (inter alia) cargo from ports in West Africa with outward cargo to be considered homeward interest 24 hours after the ship's arrival at her first port of discharge. The reinsurance was at and from West African ports "to commence from the loading of the goods". Goods shipped at Liverpool were lost 24 hours after the ship's arrival at the port of Cabenda. It was held by the Court of Queen's Bench that "loading" in the reinsurance applied to outward cargo from Liverpool to West Africa which was left on board and considered as homeward cargo under the insurance. The terms in the reinsurance in the light of the insurance showed that

> "what was meant between the parties was not the actual loading, but a constructive loading, which was what the original underwriters had agreed to treat as a loading on board for the purpose of the homeward voyage": at p 586, per Lush J.

62 More than a hundred years later *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and *Groupama Navigation et Transports v Catatumbo CA Seguros* [2000] 2 Lloyd's Rep 350 affirmed the continuing significance of the principle. In the *Vesta* case [1989] AC 852, 895 Lord Griffiths said:

> "In the ordinary course of business reinsurance is referred to as 'back-to-back' with the insurance, which means that the reinsurer agrees that if the insurer is liable under the policy the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure. A reinsurer could, of course, make a special contract with an insurer and agree only to reinsure some of the risks covered by the policy of insurance, leaving the insurer to bear the full cost of the other risks. Such a contract would I believe be wholly exceptional, a departure from the normal understanding of the back-to-back nature of reinsurance and would require to be spelt out in clear terms. I doubt if there is any market for such a reinsurance."

The effect of different governing laws

63 Where the potential conflict between the insurance contract and the reinsurance arises from the fact that they are governed by different laws, the question whether the conflict can be resolved remains a question of construction. The solution cannot be found in any rules of the conflict of laws.

64 An early example of such a conflict is *St Paul Fire and Marine Insurance Co v Morice* (1906) 11 Com Cas 153. St Paul insured under a United States policy a bull shipped from New York to Buenos Aires against (inter alia) "all risks [of] mortality". The bull was infected with foot and mouth disease and slaughtered on board on arrival in Argentina pursuant to Argentine law and regulations. A Lloyd's policy of reinsurance ("subject to the same terms . . . as original policy") insured the bull against all risks "including mortality." The reinsured settled the claim under the United States insurance policy and claimed on the English law reinsurance. The policy was issued by a Minnesota insurance company, and referred to the potential liability of the insurer under "the rules and customs of insurance in Boston or New York." The reinsured called expert evidence on United States law, rather than the law of Minnesota, New York or Massachusetts, presumably because this case was decided before the Supreme Court ruled in *Erie Railroad Co v Tompkins* (1938) 304 US 64 that there was no federal common law, or because there was no difference between the laws of those states. The expert evidence was to the effect that under United States law the reinsured was liable to pay the insured under the words "all risks of mortality". The reinsurers (represented by Mr Scrutton KC) argued that mortality in both the insurance and the reinsurance meant death by such things as accident, but not by intentional killing.

65 In an unreserved judgment, Kennedy J said 11 Com Cas 153, 163 that after hearing the expert evidence he did not think that there was any strong reason for supposing that the words did include, as a matter of United States law, slaughter of the kind in question. But if he were wrong in that, he considered whether, as a matter of construction, the reinsurers were bound to pay. On that point, he decided that the natural construction of the reinsurance policy under English law was the same as the construction he had given to the United States policy, namely that mortality did not include death by the intentional act of the officials at Buenos Aires. If there had been no grounds for rejecting the evidence of United States law (or, as it would now be, the law of the state whose law governed the policy), it is likely that the case would have been decided differently today, and it does not give much support to the claimants' case.

66 The *Vesta* case [1989] AC 852 and the *Catatumbo* case [2000] 2 Lloyd's Rep 350 were cases where the insurance contracts and reinsurance contracts contained, or incorporated, the same or similar language, but were governed by different laws. In those cases the apparent conflict between the insurance and the reinsurance arose, not from a difference in wording between the policies, but from the different effect which identical or similar wording had under the different laws governing the insurance and the reinsurance. They were much easier cases than the present one. In each case the reinsurers were taking the wholly unmeritorious point that they were relieved from liability because the original insured (and not the reinsured) had been guilty of a breach of a warranty. In each case the warranty was

held to be a term of both the insurance and the reinsurance contracts. In each case the breach was not, or was assumed not to have been, causative of the loss. In each case the governing law of the insurance contract did not afford a defence where the breach was non-causative. A

67 In the *Vesta* case [1989] AC 852 the insurance was for loss or damage to a fish farm in Norway. As in the present case, the reinsurance policy was put in place before the original insurance was written. The insurance and the reinsurance were broked as part of a package. London underwriters and brokers had marketed insurance contracts for fish farms across the world. They did not do so directly but made use of a local insurance company to obtain the business. The brokers interested Vesta in the business on the understanding that the brokers would be able to obtain 90% reinsurance of Vesta's risk in the London market. B

68 The contract of insurance contained the terms: "It is warranted that a 24-hour watch be kept over the site . . . Failure to comply with any of the warranties will render this policy null and void." The reinsurance policy form was Form J.1, and the slip annexed the original insurance terms. The litigation was conducted on the basis that the warranty in the insurance contract was also a term of the reinsurance. Hobhouse J [1986] 2 All ER 488, 496–497 refused the brokers (who were being sued by Vesta for failure to obtain an effective reinsurance) leave to amend so as to plead that the 24-hour watch clause was not a term of the reinsurance. Lord Templeman (with whom Lord Bridge of Harwich and Lord Ackner agreed) treated Form J.1 as emphasising that the two policies were on the same terms [1989] AC 852, 891, and Lord Lowry (with whom Lord Bridge and Lord Ackner also agreed) approved Hobhouse J's statement to the same effect, at p 901. Lord Griffiths expressed doubts (which I have to say have considerable force) about whether the effect of Form J.1 was to incorporate the warranty in the reinsurance, at p 896. The insurance contract was governed by Norwegian law, and the reinsurance contract was held by the Court of Appeal to be governed by English law (and there was no appeal on that point to this House). C D E

69 In the *Catatumbo* case [2000] 2 Lloyd's Rep 350 the insurance gave hull and machinery cover for a fleet of vessels. There was a warranty as to maintenance of existing class in the insurance contract ("guarantee of maintenance of existing class") which had been incorporated in the reinsurance contract in similar but not identical terms ("Warranted existing class maintained"). The insurance policy had been issued in Spanish by a Venezuelan insurance company to a Venezuelan insured providing for jurisdiction of a Venezuelan court if the parties did not agree to arbitration. It was accepted that it was governed by Venezuelan law. It was common ground that the reinsurance contract was governed by English law. F G

70 In the *Vesta* case [1989] AC 852 the express term that failure to comply with the warranties rendered the policy null and void was ineffective under Norwegian law if the breach was non-causative, whereas a similar term in the reinsurance would be valid under English law. In the *Catatumbo* case [2000] 2 Lloyd's Rep 350 breach of warranty affected the insurance cover under Venezuelan law only if it were causative, while English law (Marine Insurance Act 1906, sections 33(3), 34(2)) discharged an insurer from the date of the breach irrespective of whether it had been remedied before the loss. H

A 71 In both cases the reinsurers failed because the reinsurance was held to have the same effect as the insurance. In the *Vesta* case [1989] AC 852 the speeches of both Lord Templeman and Lord Lowry commanded a majority. They were agreed that the question was one of construction of the reinsurance contract. Lord Templeman's conclusion was founded on his view that

B > "The effect of a warranty in the reinsurance policy is governed by the effect of the warranty in the insurance policy because the reinsurance policy is a contract by the underwriters to indemnify Vesta against liability under the insurance policy": p 892.

For Lord Lowry, the main point was that the relevant words in the reinsurance contract ("failure to comply") had the same meaning and effect
C as they had in the Norwegian insurance contract.

72 In the *Catatumbo* case [2000] 2 Lloyd's Rep 350 it was held that the parties to the reinsurance contract must be taken to have intended that the incorporation in the reinsurance contract of terms in the original insurance retained the same significance which they had in the original insurance. It was a question of construction, against the background that "reinsurers
D conducting international business must be taken to have intended that the warranties in the two contracts will have the same effect" (para 20, per Tuckey LJ) and that the "reinsurance is . . . a contract which in terms relates to and must be read in conjunction with the terms of the original insurance": para 26, per Mance LJ.

73 Tuckey LJ rightly emphasised, at para 20:

E > "reinsurers conducting international business must be taken to have intended that the warranties in the two contracts will have the same effect. They will be aware that the laws of some countries give more restrictive effect to warranties than English law, but that is a risk they must be taken to have assumed by writing international business. They will be protected to the same extent as the insurer."

F Mance LJ warned, at para 30, against a narrow English law-centred approach:

> "The . . . submission that the warranty of existing class maintained in the reinsurance retains a stubbornly domestic English significance, trumping any limited significance of such a warranty included in the original and also incorporated by reference into the reinsurance is, to my
G mind, both commercially and legally unattractive."

The period of cover

74 In English law, where an insurance or reinsurance contract provides cover for loss or damage to property on an occurrence basis, the insurer (or reinsurer) is liable to indemnify the insured (or reinsured) in respect of loss and damage which occurs within the period of cover but will not be liable to
H indemnify the insured (or reinsured) in respect of loss and damage which occurs either before inception or after expiry of the risk. As Lord Campbell CJ said in *Knight v Faith* (1850) 15 QB 649, 667: "the principle of insurance law [is] that the insurer is liable for a loss actually sustained from a peril insured against during the continuance of the risk." An early example of a

"losses occurring during" insurance policy is *In re London Marine Insurance Association* (1869) LR 8 Eq 176 (Sir William James V-C). I accept that there may be scope for considerable argument as to what would constitute loss or damage within the policy period: cf *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Ltd* [2006] 1 WLR 1492 (mesothelioma in the context of "loss or damage [which] occurs during the currency of the policy").

75 In the present case the contract of insurance is described as a "Special floater policy" and is expressed to have been issued by Lexington to Alcoa on 22 August 1977. The printed section (or "policy jacket") has a section for "From the . . . day of . . . 19 . . . To the . . . day of 19 . . . beginning and ending at noon (standard time at the place of issuance of this policy)" and the dates 1 July 1977 to 1 July 1980 have been added. The rest of the jacket contains standard conditions. The Supreme Court of Washington set out the history of the cover: *Aluminum Co of America v Aetna Casualty & Surety Co* (2000) 998 P 2d 856, 863. The lengthy tailor-made terms were prepared by Alcoa's internal insurance department and its brokers. Large firms of brokers shopped the terms to various insurers. The insurers responded with price quotations, and upon placement of coverage, the insurers sent the policy jackets with standard policy language to the brokers for inclusion in the policies to be added.

76 The reinsurance contract (which was put in place while the insurance policy was being marketed) covered "All risks of physical loss or damage" and provided cover in respect of loss and damage occurring between 1 July 1977 and 1 July 1980 ("Period: 36 months at 1.7.77"). Consequently this was reinsurance on the "loss occurring" basis, under which a reinsurer is obliged to pay its share of the loss suffered by the reinsured, if it occurred during the period when the reinsurance contract was in force: *Balfour v Beaumont* [1984] 1 Lloyd's Rep 272, 274, per Donaldson MR; *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127, 131, per Staughton LJ.

77 A case in which there was a mismatch between the periods of cover in the insurance contracts and the reinsurance contracts was *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421, where it was held that the reinsurance did not have to respond to the insurance because the vandalism for which the plaintiff insurers had had to indemnify the Port of Sunderland had occurred outside the policy period in the reinsurance. The importance of the period of cover was rightly emphasised by Hobhouse LJ, at pp 435–436:

> "It is wrong in principle to distort or disregard the terms of the reinsurance contracts in order to make them fit in with what may be a different position under the original cover . . . When the relevant cover is placed on a time basis, the stated period of time is fundamental and must be given effect to. It is for that period of risk that the premium payable is assessed. This is so whether the cover is defined as in the present case by reference to when the physical loss or damage occurred, or by reference to when a liability was incurred or a claim made. Contracts of insurance (including reinsurance) are or can be sophisticated instruments containing a wide variety of provisions, but the definition of the period of cover is basic and clear. It provides a temporal limit to the cover and does not provide cover outside that period; the insurer is not then 'on risk'."

The decision of the Supreme Court of Washington

78 In summary, what was decided by the Supreme Court of Washington (*Aluminum Co of America v Aetna Casualty & Surety Co* 998 P 2d 856) was that under Pennsylvania law (which Judge Learned had found applicable) all insurers were jointly and severally liable for all losses which flowed from the property damage even if the damage occurred before (or after) inception, because the policies were not limited as to time. The decision of the Supreme Court of Washington has to be read in the context of the development of the law in the United States on the liability of successive insurers on policies covering liability for asbestos-related claims and for environmental claims.

The context: joint and several liability or allocation pro rata

79 The central decision in the development of the law in the United States is *Keene Corpn v Insurance Co of North America* (1981) 667 F 2d 1034; cert den (1982) 455 US 1007. The Court of Appeals for the District of Columbia Circuit decided that, in asbestos-related claims, coverage under insurance policies was triggered by any one of: manifestation of disease, inhalation exposure, and exposure in residence (i e the subsequent development of the disease). The Court of Appeals then went on to consider the extent of coverage, and held that each insurer was liable to indemnify Keene in full (and not merely pro rata) for the whole of the damages for which it was liable to the plaintiffs in the underlying actions (more than 6,000 actions were pending). The policies typically provided that the insurer would "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury . . . to which this insurance applies, caused by an occurrence . . ." "Occurrence" was defined as "an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury . . ."

80 The Court of Appeals took the view that Keene did not expect, nor should it have expected, that its security was undermined by the existence of prior periods in which it was uninsured, and in which no known or knowable injury occurred. If an insurer were obliged to pay only on a pro rata basis, those reasonable expectations would be violated. There was nothing in the policies which provided for a reduction of the insurer's liability if an injury occurred only in part during a policy period. The court interpreted the policies to cover Keene's entire liability if an injury occurred only in part during a policy period. For an insurer to be only partially liable for an injury which occurred, in part, during its policy period would deprive Keene of insurance coverage for which it paid.

81 Shortly before the decision in *Keene Corpn v Insurance Co of North America* the Court of Appeals for the Sixth Circuit had held that the insurers were liable pro rata to the periods of coverage (with the insured being treated as a self-insurer for years when it was not covered): *Insurance Co of North America v Forty-Eight Insulations Inc* (1980) 633 F 2d 1212; cert den (1981) 454 US 1109.

82 These two approaches have spawned an enormous number of decisions in asbestos-related claims and in environmental claims, many of which are discussed or referred to in Holmes (ed), *Appleman on Insurance*, 2nd ed (2003), ch 145, and in *Ostrager & Newman, Handbook on Insurance Coverage Disputes*, 13th ed (2006), ch 9 (who point out, at p 618,

that the joint and several liability approach has been used more frequently in personal injury cases than in property damage). A

83 The position as it was in 2008 was reviewed by the Court of Appeals for the First Circuit in *Boston Gas Co v Century Indemnity Co* (2008) 529 F 3d 8. In cases such as the present a federal court must apply the law of the state in which it sits. The Massachusetts courts had not yet resolved the allocation question as a matter of law, at the highest level, although the joint and several liability approach had been adopted by lower courts: see *Rubenstein v Royal Insurance Co of America* (1998) 694 NE 2d 381, affd on other grounds (1999) 708 NE 2d 639; *Peabody Essex Museum, Inc v United States Fire Insurance Co* (2009 WL 901869) (unreported) 31 March 2009. Consequently, the Circuit Court of Appeals certified the question for decision by the Massachusetts Supreme Judicial Court. In so doing the Circuit Court of Appeals noted, 529 F 3d 8, 13–14, that a "growing plurality have adopted some form of pro rata allocation but a significant number of courts impose joint and several allocation". The Court of Appeals said 529 F 3d 8, 14: B C

> "Nor do policy arguments line up solely behind one solution. At first blush it may seem illogical to hold a single insurer, who may have only covered the insured for a single year, fully liable for the costs of environmental damage that may have accrued over the course of a century. But that insurer can seek contribution from other insurers 'on the risk' during the contamination period . . . And the alternative may force the insured to sue numerous companies in one suit, if this is possible at all, to avoid inconsistencies. Either method forces courts to indulge in a probable fiction as to when the event triggering coverage occurred. The pro rata method assumes an ongoing occurrence causing stable amounts of damage over time; the joint and several method pretends, even less plausibly, that a single occurrence caused all the damage, and allows the insured effectively to choose the year in which that happened. Both are crude approximations made under conditions of uncertainty." D E

84 Pennsylvania is among those states which apply the decision in the *Keene* case 667 F 2d 1034. In *JH France Refractories Co v Allstate Insurance Co* (1993) 534 Pa 29, which was also an asbestos-related claim, the Supreme Court of Pennsylvania rejected the insurers' contention that they should share the obligation to indemnify on a pro rata basis apportioned on the amount of time each policy was in effect. That was inconsistent with the terms of the policies which were similar to (but not identical with) the terms in the policies in the *Keene* decision. Each insurer obliged itself to pay on behalf of the insured "all sums" which the insured would become legally obliged to pay as damages, and the definition of "occurrence" (which had no specific reference to the policy period) was inconsistent with a pro rata allocation. In addition, there was no medical evidence to substantiate the assumption that the progression of asbestos related disease was linear. F G

85 The states in which there were Alcoa sites which were the subject of the clean-up requirements do not adopt a uniform approach to the coverage question. There were relevant Alcoa sites in the Washington litigation in states which, according to the textbooks referred to above and the decision of the Court of Appeals for the First Circuit in *Boston Gas Co v Century* H

Indemnity Co 529 F 3d 8, have adopted pro rata allocation and rejected the joint and several allocation method: they include New York, California and Illinois: *Stonewall Insurance Co v City of Palos Verdes Estates* (1996) 54 Cal Rptr 2d 176; *Outboard Marine Corpn v Liberty Mutual Insurance Co* (1996) 670 NE 2d 740; *Consolidated Edison Co of New York Inc v Allstate Insurance Co* (2002) 774 NE 2d 687. Those states in which the Alcoa sites in the litigation were situated and which had followed the *Keene* case 667 F 2d 1034, apart from Pennsylvania and Washington, included Indiana and Ohio: *Allstate Insurance Co v Dana Corpn* (2001) 759 NE 2d 1049; *Goodyear Tire & Rubber Co v Aetna Casualty & Sur Co* (2002) 769 NE 2d 835.

The decision of the Supreme Court of Washington

86 It is clear that the effect of the decision of the Supreme Court of Washington was to make Lexington liable for loss and damage which occurred both before and after inception (and indeed after expiry). I cannot accept Lexington's argument (written case in both appeals, para 4) that the Supreme Court did not hold Lexington liable for losses arising from damage occurring outside the period of the original insurance, and that the Supreme Court was simply addressing the question of what insured damage had occurred during the period. Lexington rightly accepted in the statement of facts and issues on these appeals (paras 8, 10–11) that (a) it had been determined at the trial before Judge Learned that the pollution and contamination damage in respect of the clean-up costs for which Alcoa sought indemnity had occurred in the period between 1942 and 1986; (b) the Supreme Court had decided that the policy language covered any physical loss or damage manifesting itself during the time the policy was in force, including pollution damage starting before the policy inception; and (c) Lexington had settled with Alcoa on the basis that it was not possible to limit Lexington's liability to the cost of remedying that part of the damage which could be said to have occurred within the three-year period of cover.

87 Judge Learned had decided that there was a basis in law for allocating to each separate policy year the costs relating to the property damage which occurred during that policy year. Although environmental contamination was not a purely linear process, the use of an average was reasonable. The reasoning of the Supreme Court of Washington reversing the decision of Judge Learned on the allocation issue was as follows: (a) there had been pollution damage to all three test sites occurring during the entire time the policies were in effect; (b) pollution damage had occurred to portions of the sites prior to the inception of insurance coverage; (c) because the pollution damage occurred both before and during the policy periods the question arose as to how to attribute the remediation costs of the pollution damage; (d) in allocating the pollution damage on a pro rata yearly basis, Judge Learned had not made a close examination of the applicable policy language.

88 The insuring clause in the Alcoa policy was:

> "Perils insured: This policy insures against all physical loss of, or damage to, the insured property as well as the interruption of business, except as hereinafter excluded or amended."

The Supreme Court held that the language was very broad and contained no limitation as to time of the physical loss or damage to property, and there

was no exclusion in the policy for physical loss or damage that might have begun spreading before the policy inception. The policy definition of "occurrence" compelled a broad reading of the policy. The Supreme Court concluded, at p 883:

> "It seems clear from the policy language that any physical loss or damage manifesting itself during the time a . . . policy was in effect was covered by the policy, including pollution damage starting before the policy inception."

89 This was not a decision that losses occurring during the policy period encompassed liability or losses flowing from damage which occurred during that period. It was a decision that, provided that there was some damage in the policy period, the insured had a right to an indemnity for liability flowing from damage whenever it occurred.

The relevance of the governing law

90 It is accepted that the contract of reinsurance is impliedly governed by English law. It is in English form and was broked and issued in the English market. The insurance contract was concluded in 1977, and determination of its proper law depended on common law principles, as it still does: see article 17 of the Rome Convention on the law applicable to contractual obligations (1980) (OJ 1980 L266, p 1), providing that the Convention applies only to contracts entered into after it becomes in force with regard to a contracting state, which was 1 April 1991 for the United Kingdom. The general rule was that, in the absence of an express choice, an intention with regard to the law to govern the contract could be inferred from the terms and nature of the contract and from the general circumstances of the case. When the intention was not expressed and could not be inferred from the circumstances, the contract was governed by the system of law with which the contract had its closest and most real connection: *Whitworth Street Estates (Manchester) Ltd v James Miller and Partners Ltd* [1970] AC 583; *Cie Tunisienne de Navigation SA v Cie d'Armement Maritime SA* [1971] AC 572; *Amin Rasheed Shipping Corpn v Kuwait Insurance Co* [1984] AC 50. The law so identified would have governed questions of construction.

91 Longmore LJ [2008] Bus LR 1029, para 28 thought that, if in 1977 the question of what law governed the insurance contract had been asked, the answer would have been that Pennsylvania law had the closest and most real connection with the insurance contract: . For reasons on which I shall elaborate I do not consider that the question what law, by English conflict of laws rules, governed the insurance contract is a relevant question, but in any event there is reason to doubt Longmore LJ's conclusion on this point. So far as insurance contracts in particular are concerned, in England the prevailing view in 1977 was reflected in *Dicey & Morris, Conflict of Laws*, 9th ed (1973), rule 159, which had first been formulated in the 8th edition (1967), in succession to a similar rule in previous editions limited to contracts of marine insurance. By rule 159(2):

> "If an intention to choose the proper law has not been expressed in the insurance policy and cannot be inferred from circumstances, and if there is nothing to show that the contract is more closely connected with

A another system of law, the contract is governed by the law of the country in which the insurer carries on his business, and, if he carries on his business in two or more countries, by the law of the country in which his head office is situated."

92 Consequently if an English lawyer had been asked in 1977 to advise on what law governed the underlying insurance contract according to the B rules of the English conflict of laws, it is likely that the following questions would have been addressed. The first question would have been whether the provision in the service of suit clause that "all matters arising hereunder shall be determined in accordance with the law and practice" of the court in the United States chosen by the insured for suit was an express choice of law. The answer to that would have been in the negative, because the proper law had to be capable of determination when the contract was entered into: C *Dubai Electricity Co v Islamic Republic of Iran Shipping Lines (The Iran Vojdan)* [1984] 2 Lloyd's Rep 380.

93 The second question would have been whether a choice of law could be inferred from the circumstances. It is not easy in the present case to find a basis for any such inference. The third question would have been with what system of law the policy had the closest and most real connection. It is likely D that this would have been the law of Massachusetts where the policy was broked and issued under cover of Lexington's standard policy form, and where Lexington had its head office. As I have said, it appears from *Boston Gas Co v Century Indemnity Co* 529 F 3d 8 that the approach in Massachusetts law to the joint and several approach to insurers' liability for damage occurring both within and without the period of cover is not finally settled. There might have been a case for Pennsylvania law on the basis that E the bulk of the policy terms originated from Alcoa's head office and were being broked across the United States. But I doubt whether the mere fact that Alcoa was incorporated and had its centre of business in Pennsylvania would have been a basis for concluding (as Longmore LJ did, [2008] Bus LR 1029, para 28) that Pennsylvania law had the closest and most real connection with the insurance contract.

F **94** But the question of what law governed the insurance contract by the English rules of the conflict of laws is not the relevant question. The issue is one of construction of the reinsurance contract. In order to apply the underlying principle that the effect of terms in a reinsurance contract governed by English law should where possible be interpreted to be in accordance with the effect of the terms of the insurance contract governed by foreign law, the relevant foreign law is not the law which by English conflict G of laws rules would have governed the contract, but the law which the parties would have had in reasonable contemplation when the contracts were entered into. In the normal case such as the *Vesta* case [1989] AC 852 there would be no difference between the approaches, but in this case the effect of the service of suit clause was that litigation could take place anywhere in the United States.

H **95** On a narrower view of the case (similar to that in the *Vesta* case) the relevant question would have been: what law would the parties have expected would be applied by a court in the United States had Alcoa taken advantage of the service of suit clause, and in particular would the parties to the reinsurance contract have reasonably had in mind that what losses were recoverable under the insurance contract would be determined ultimately by

the law of Pennsylvania? That would be a question for a United States lawyer. I would regard the possibility that a coverage dispute might have arisen in one of the countries outside the United States for which coverage was obtained as purely theoretical. Consequently I leave out of account the possibility, canvassed by the claimants, that since the service of suit clause was not an exclusive jurisdiction clause, the action by Alcoa against Lexington might have been brought outside the United States, where some of the sites were situated, and where wholly different principles of the conflict of laws may have applied.

96 But the fact that I accept that this is a relevant question does not mean that I accept Lexington's answer. In effect Lexington says that if Lexington and the reinsurers had asked for advice in 1977 as to what law would be applied by a United States court to the construction of the Alcoa insurance policy the answer would likely to have been the law of Pennsylvania. There was no expert evidence on this point before Simon J, but to test whether it is realistic it is necessary to look closely at the reasoning of Judge Learned in her decision that Pennsylvania law applied to the coverage issues.

97 It is clear that Judge Learned was applying in its entirety the approach of the *American Law Institute, Restatement of the Law, Conflict of Laws*, 2d (1969) ("the Restatement Second") to choice of law in contracts (and not simply the provision relating to insurance). Although she did not mention it expressly, it is plain from her reasoning that the starting point for Judge Learned was section 188(1) of the Restatement Second, which is the basic rule about choice of law in contracts. It provides:

> "The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in section 6."

98 Section 188(2) goes on to state that, in the absence of an effective choice of law by the parties, the contacts to be taken into account in applying the principles of section 6 to determine the law applicable to an issue include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. Those contacts are to be evaluated according to their relative importance with respect to the particular issue. Section 6(2) indicates the factors relevant to the choice of the applicable rule of law, which include the relevant policies of the forum, the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, the protection of justified expectations, the basic policies underlying the particular field of law, certainty, predictability and uniformity of result and ease in the determination and application of the law to be applied.

99 The reference in section 6(2)(c) to the "determination of the particular issue" is a fundamental part of the approach of the Restatement Second. The claimants argued that this necessarily means that the governing law can only be determined at the date of litigation rather than the date of contract, and drew the conclusion that it would have been impossible in 1977 to predict what law would have applied to the insurance contract.

A This submission was erroneous. What the approach of the Restatement Second entails is that, by contrast with the English approach at common law, different laws may be applied to different issues. It could plainly have been predicted in 1977 that a coverage issue might arise, and that it might have been necessary to determine what law applied to it.

100 The service of suit clause provided:

B "In the event of the failure of this company to pay any amount claimed to be due hereunder, this company, at the request of the insured, will submit to the jurisdiction of any court of competent jurisdiction within the United States and will comply with all requirements necessary to give such court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such court."

C 101 The first question was whether there was an express choice of law. Judge Learned rejected the argument that the reference to matters being "determined in accordance with the law and practice of such court" was a choice of law. The context addressed the venue of litigation and reflected the willingness of the defendants to submit to the jurisdiction and binding judgments of courts in the United States; and the reference to the law of the court did not distinguish between substantive law or the whole of its law D including its choice of law rules. To construe the clause as a choice of law clause would allow a plaintiff to forum shop within the United States for substantive law favourable to it. The judge then went on to consider which system of law had the "most significant relationship" between the parties and the involved states. She rejected the choice of Washington law as the law of the forum: (a) Washington did not have the most significant contacts; E (b) the fact that a plurality of the sites included in the litigation was in Washington was not particularly significant, since Washington did not have a plurality of the sites covered by the policies, nor of sites potentially subject to the type of claims involved, and even as to the sites included in the litigation the Washington sites had significantly less money at stake than sites in other states; (c) Washington had no public interest at stake in the law suit which was greater than any other state, since each state presumably had F a similar interest in and concern about the clean-up of toxic materials within its borders.

102 She did not apply section 193 of the Restatement Second, which points the court in insurance contracts to the law of the location of the insured risk, because a special problem was presented by multiple risk policies which insured against risks located in several states. In particular, G the same wording in the policies might be subject to many potentially different meanings from state to state. Her conclusion was that the law of Pennsylvania governed. Although it was not the place of contracting it had more contacts regarding the contract formation than any other state. It was the one state with a common connection between all the sites and all the defendants. It was the headquarters of Alcoa, and the insurance placement originated at the headquarters level rather than at the site level. In most H cases insurance was co-ordinated through the Pennsylvania broker or other brokers and not between Alcoa and an insurer in another state. The coverage scheme was comprehensive, and multilayered. The place of signature of the contract, or domicile or headquarters of the various defendants, were of less significance than those associated with

Pennsylvania. The meaningful centre of gravity for contract formation was Pennsylvania for most, if not all, of the contracts.

103 The approach by Judge Learned to the choice of law issue is, if I may so with respect, very clear and wholly understandable in the context of the litigation which she had to manage. It is, of course, quite different from the English approach, but it is entirely consistent with the approach in those states which apply the Restatement Second: see e g *Certain Underwriters at Lloyd's, London v Foster Wheeler Corpn* (2007) 822 NYS 2d 30.

104 Judge Learned was considering what law to apply for the purposes of contract interpretation to all claims involving coverage, with some 70 insurers, hundreds of policies and 58 sites, of which 43 were in the United States and 15 were outside the United States. The judge regarded herself as determining that Pennsylvania law applied as a general rule, but she said that if specific or unique issues arose regarding one or more defendants or one or more sites, which raised significant considerations which overrode the general rule, they could be brought to the court's attention.

105 Although there was no expert evidence on United States law, it is doubtful whether Lexington was right to say (case, para 17(3)) that there is no reason to believe that the choice of law would have been any different depending on the state in which Alcoa had chosen to sue. According to a leading authority in the United States, of the states in which the sites were situated, in 1977 the following states continued to apply the lex loci contractus: Florida, Tennessee, and Pennsylvania: *Symeonides, The American Choice-of-Law Revolution in the Courts: Past, Present and Future* (2006), pp 45–47. Pennsylvania courts have applied the contracts sections of the Restatement Second since 1983: *Guy v Liederbach* (1983) 459 A 2d 744 (a case involving third party beneficiaries under a will, but applied in many other contract cases).

No identifiable system of law

106 Longmore LJ in the Court of Appeal [2008] Bus LR 1029, para 21, identified the question being "whether [the] same period of cover should receive the same interpretation in both the original insurance and the reinsurance" or whether "the same or equivalent wording in each of the contracts should . . . be given the same construction" (at para 24, and also paras 25 and 33).

107 I consider that it is fanciful to suppose that in 1977 the hypothetical American lawyer asked to advise on what law governed the contract of insurance, and what law would govern questions of coverage, would have concluded that Pennsylvania law would have applied. To have reached that conclusion the lawyer would have had to advise or assume that (a) there would be claims based on damage to several sites being litigated together; (b) plaintiffs in the environmental litigation would be most likely to sue in a state which applied the principles in the Restatement Second; and (c) the courts of that state would apply those principles to conclude that the law which applied to the issues would be the law of Pennsylvania.

108 In my judgment, in complete contrast to the *Vesta* case [1989] AC 852 and the *Catatumbo* case [2000] 2 Lloyd's Rep 350, in the present case there was in 1977, when the insurance contract and the reinsurance contract were concluded, no identifiable system of law applicable to the insurance contract which could have provided a basis for construing the

A contract of reinsurance in a manner different from its ordinary meaning in the London insurance market. In each of those cases, the substance of the foreign law as to the consequences of a non-causative breach of warranty could be ascertained at the outset, if necessary by recourse to a relevant Norwegian (or Venezuelan) legal source: the *Vesta* case [1989] AC 852, 911, per Lord Lowry.

B **109** This is not a case involving the scope of liability. Nor is it a case about the interpretation of the policy period. I entirely accept Longmore LJ's example [2008] Bus LR 1029, para 20, of the case in which a loss occurred within the policy period in United States time, but outside the policy period in GMT. That would be a case of interpreting the reference to the date and time in the reinsurance policy to conform with the insurance. But this is a case in which the Washington court held in substance (in C common with the courts in those states which impose joint and several liability) that the original insurance contained no relevant time limitation. In 1977 the United States courts had not developed the theory of joint and several liability for all damage, even that occurring outside the policy period.

110 It is elementary that an insurer under the original insurance takes the risk of changes in the law. The insurer cannot escape liability by saying that the liability of the insured has been increased by judicial decisions D extending the scope of the insured's duty. Nor, correspondingly, can the reinsurer be heard to say that it rated the risk by reference to the then current scope of the original insured's duty, or by the scope of the insurer's duty to indemnify the original insured, provided that the risk is within the reinsurance.

111 In the present case, however, there is no principled basis for E treating the scope of the three-year reinsurance as the same as the insurance, which has been interpreted under the law of Pennsylvania not to contain any "limitation as to time of the physical loss or damage to property": 998 P 2d 856, 883. If Lexington were right, some very uncommercial consequences would flow if the reinsurers had agreed to accept only two years of the risk, rather than the three years of the underlying risk accepted by Lexington, leaving Lexington to reinsure the third year of cover elsewhere; or if the F London market had elected to reinsure Lexington by way of three separate one-year policies (as in *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421). The periods of cover under the insurance and reinsurances would not be back-to-back. But Lexington would still be maintaining that, in the light of the decision of the Washington Supreme Court, if any damage occurred within any relevant policy period, of any G duration, the relevant reinsurer would be liable for all of the damage, including damage occurring before inception or after expiry. That seems to me to be wholly uncommercial and outside any reasonable commercial expectation of either party.

112 That applies also to the wider way in which Lexington would support the decision of the Court of Appeal, namely that any loss within the coverage of the insurance is also within the loss of the reinsurance, and a loss H is within the loss of the insurance if so held by a court of competent jurisdiction, or if it is the subject of a settlement which cannot be impugned. The case for Lexington is not assisted by those authorities which decide that the reinsurer cannot go behind a determination of the reinsured's liability under the contract of insurance to the original insured, whether it is by way

of settlement under a follow settlements clause or by the decision of a court of competent jurisdiction: *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd* [1985] 1 Lloyd's Rep 312, 330, per Robert Goff LJ; *Commercial Union Assurance Co v NRG Victory Reinsurance Ltd* [1998] 2 Lloyd's Rep 600, 610–611, per Potter LJ. The reason is that a reinsurer will only be bound to follow its reinsured's settlement and indemnify the reinsured provided that the claim recognised by them falls within the risks covered by the policy of reinsurance as a matter of law: *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd* [1985] 1 Lloyd's Rep 312, 330, per Robert Goff LJ. This is because the reinsurer cannot be held liable unless the loss falls within the cover created by the reinsurance: *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239, 1251, per Lord Mustill. Consequently the question remains the same: what is the effect of the policy period in the reinsurance?

113 This conclusion is unaffected by the suggestion by Sedley LJ in the Court of Appeal [2008] Bus LR 1029, para 50, that if the contract of reinsurance were treated as liability insurance then it would be easier to find that it should respond when the insurer was held to be liable by a court of competent jurisdiction in circumstances where the reinsurer did not believe itself to be liable. For historical reasons the subject matter of reinsurance is treated as being the same as that of the original insurance. Lord Hoffmann said in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 392:

> "Contracts of reinsurance were unlawful until 1864. Such a contract [of reinsurance] is not an insurance of the primary insurer's potential liability or disbursement. 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, that is to say, the risk to the ship or goods or whatever might be insured. The difference lies in the nature of the insurable interest, which in the case of the primary insurer, arises from his liability under the original policy . . ."

114 All parties to these appeals are agreed that in legal theory reinsurance is not liability insurance, and that in any event it would make no difference to the disposition of these appeals if it were. There is much to be said for the view that in commercial reality reinsurance is liability insurance which provides cover for the reinsured in the event that the reinsured is liable to pay the original insured. The use of liability insurance language correctly emphasises the true commercial nature of reinsurance. Thus in the *Vesta* case [1989] AC 852, 892 Lord Templeman said:

> "By the reinsurance policy, the underwriters promised that if Vesta became liable for a loss under the insurance policy, then the underwriters would make good 90% of the loss. Vesta became liable for a loss under the insurance policy and the underwriters must perform and observe their promise in the reinsurance policy."

115 But the regulatory implications of departing from orthodox legal theory are considerable: see Gürses and Merkin, "Facultative reinsurance and the full reinsurance clause" [2008] LMCLQ 366, 370–371. It would be unwise for there to be judicial reconsideration of the question, in the context of litigation between parties who have no interest in the wider consequences, without being fully informed of those consequences, if necessary by

A submissions from such bodies as Lloyd's, the Association of British Insurers, or the British Insurance Law Association.

116 I would also accept that it would almost invariably be the case that losses for which the insurer has indemnified the original insured would be within the reinsurance even if the losses are payable under a foreign law or a foreign judicial decision which takes a view different from English law of what losses are recoverable. The presumption that the liability under a B proportional facultative reinsurance is co-extensive with the insurance should be a strong one because (as I have said) the essence of the bargain is that the reinsurer takes a proportion of the premium in return for a share of the risk. But this is an unusual case in which the express (and entirely usual) terms of the reinsurance are clear. This is not a case where the reinsurers are relying on a technicality to avoid payment. At the beginning and end of C these appeals remains the question whether the provision for the policy period in the reinsurance is to be given the effect it has under English law, or whether the parties must be taken to have meant that the reinsurance was to respond to all claims irrespective of when the damage occurred and irrespective of the period to which the losses related. There is, in my judgment, no principled basis for a conclusion in the latter sense.

117 For the sake of completeness I will mention that I derive no D assistance from the contractual provision in the slip that the form of policy was to be J.1 or NMA 1779. It was common ground that neither became a contractual document. Form J.1 adds nothing material for present purposes to the Full Reinsurance Clause No 1, which was incorporated. Neither can affect the interpretation of the policy period. Nor do I consider that the references in the slip to "as original" have any bearing on the meaning of the E policy period. Without expert evidence it is now too late to take account of the very interesting points made by Weir, "A matter of Forms and substance" [2009] LMCLQ 210, in support of the view that NMA 1779 must have been used. But I do not consider that the references in Form 1779 to loss "during the period as specified" or loss "during the continuance of this policy" add anything to the reference to the period in the slip.

118 I would therefore allow the appeals. I have had the benefit of F reading in draft the opinion of Lord Mance, and agree with his reasoning also. On my view of the appeals, the retention issue does not arise. If it had arisen, I would have dismissed the appeals on that issue for substantially the same reasons as those given by the Court of Appeal.

Appeal allowed with costs.

G BLS

H

What is the Practical Effect of an Honorable Engagement Clause?

By

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I. Introduction

Since time out of mind, the arbitration clauses of reinsurance contracts have included language to the effect that arbitrators shall consider the contract as an honorable engagement, rather than merely a legal obligation, are relieved of all judicial formalities and may abstain from following the strict rules of law. One commentator described honorable engagement provisions thusly:

> In recognition of the traditional duty of utmost good faith, an honorable engagement clause instructs the arbitrators that the parties wish to resolve their disputes based on fairness and custom and practice of the reinsurance industry. An honorable engagement clause means that the arbitrators are not to resolve disputes solely based on the strict rules of law and contract interpretation. It frees the arbitrators from following the strict rules of law and allows for a more commercial and pragmatic approach to dispute resolution.[1]

But how does this clause work in real cases with real facts? The purpose of this article is to review selected caselaw on the use and interpretation of the honorable engagement clause.

II. Cases in Which Courts Cited Honorable Engagement Clause as Basis for Declining to Vacate Panel Award

First State Ins. Co. v. National Cas. Co., 781 F.3d 7 (1st Cir. 2015) was a case in which the arbitration panel ordered a claim payment protocol in which the reinsurer was to pay 75% of contested claims subject to a reservation of rights and further review of the claim. The reinsurer

sought to vacate the order on the basis that it exceeded the panel's power by rewriting the parties' agreement. The court declined to vacate the order ruling:

> We believe that an honorable engagement provisions empowers arbitrators to grant forms of relief, such as equitable remedies, not explicitly mentioned in the underlying agreement. This is a huge advantage: the prospects for successful arbitration are measurably enhanced if the arbitrators have flexibility to custom-tailor remedies to fit particular circumstances. An honorable engagement provision ensures that flexibility.
> We therefor hold that the honorable engagement provisions in the arbitration clauses of the underlying agreements authorized the arbitrators to grant equitable remedies. We further hold that the reservation of rights procedure is such a remedy.[2]

Another relevant case from the first circuit is *National Casualty Co. v. First State Ins. Group,* 430 F.3d 492 (1st Cir. 2005). This was an allocation case in which the reinsurer sought the cedent's internal documents as to the basis for allocation. The cedent claimed privilege but the panel ordered that they be produced nonetheless. The cedent refused and the panel ruled that a negative inference would result. Nonetheless, the panel found for the cedent and the reinsurer sought to vacate the panel order on several bases including panel misconduct by failing to hear pertinent evidence *i.e.* the documents for which privilege was claimed. The court declined to vacate observing:

> Here, the relevant contract provisions not only relieved the arbitrators of any obligation to follow the 'strict rules of law,' but also released the arbitrators from 'all judicial formalities.' In the face of a clause that broad, which makes no mention of the production obligations of the parties or of the discovery procedures to be followed, and which so fully signs over to the arbitrators the power to run the dispute resolution process unrestrained by the strict bounds of law or of judicial process, a party will have great difficulty indeed making the showing, requisite to vacatur, that their rights were prejudiced,[3]

In *Banco de Seguros del Estdo v. Mutual Marine Office, Inc.,*344 F.3d 255 (2nd Cir. 2003), the panel ordered pre-hearing security. Citing to the honorable engagement clause and a security clause for unauthorized reinsurers, the court found that panel's order did not violate the Foreign Sovereign Immunities Act or public policy and that by ordering it, the panel did not exceed their

authority. *See also*, *Petersen-Dean, Inc. v. National Union Fire Ins. Co. of Pittsburgh,* 2020 U.S. Dist. LEXIS 23667 (S.D.N.Y.) in which the court ruled that an arbitration panel did not exceed its authority under the relevant contract by ordering security.

An allegation of understated reserves during placement led to an arbitration in *United States Life Ins. Co. v. Insurance Commissioner,* 160 Fed. Appx. 559 (9th Cir. 2005). The panel ordered that the losses ceded to the reinsurer should be reduced by 10%. Citing the honorable engagement clause, the court found that the order was not contrary to public policy, was not a manifest disregard of the law or irrational and that the panel did not exceed its authority.

The panel award in the third of three arbitrations was challenged in *American Centennial Ins Co. v. Global Int'l Reinsurance Co.*, 2012 U.S. Dist. LEXIS (S.D. N.Y. 2012). The panel granted the reinsurer a 15% reduction in claims and loss adjustment expenses and the cedent sought to vacate the order on several bases including failure to provided reasoning for the award and that it "overruled" the prior two arbitrations. The court found that contractual language allowing the reinsurer adjustments on claim payments due to the cedent's acquisition, "[c]onsidered in light of the honorable engagement clause . . . the [Arbitration] Panel cannot be said to have intentionally ignored or contradicted an unambiguous contractual term." [4]

Harper Insurance Ltd. v Century Indemnity Co., 819 F.Supp.2d 279 (S.D.N.Y. 2011) involved a reinsurance treaty without a reports and remittances clause governing reporting of losses to reinsurers and payment by such reinsurers. The panel issued an order requiring the reinsurer to pay accepted losses within 106 days of billing plus 75% of disputed billings with written objections for disputed billings. The reinsurer objected arguing that protocol for payment of claims was not submitted to the panel. Citing the honorable engagement clause, the court observed:

> [Reinsurers] conflate the question of whether an *issue* was presented to the arbitrators with the question of whether a *potential remedy* was presented to the arbitrators. It is indisputable that arbitrators have no authority to rule on an issue not submitted to them. However there is no parallel per se rule that it is beyond the authority of the arbitrators to issue a remedy directed to an issue squarely before them unless it was requested by the parties.[5]

The reinsurers in the *Harper* case argued that the panel exceeded its authority in creating reports and remittances provisions. Again citing the honorable engagement clause, the court ruled:

> [I]t is plainly obvious that the contract, although it did not include a Reports and Remittances clause, expected a prompt flow of funds between the [reinsurers] and [the cedent] to cover claims in which the Agreement was 'involved.' The Panel ultimately concluded that its protocol best effectuated the parties' purpose. We cannot conclude that it did not have, at a minimum, a barely colorable justification for its decision.[6]

Certain Underwriters at Lloyd's London v. Argonaut Ins. Co., 2009 U.S. Dist. LEXIS 87827 (N.D. Ill. 2009) is a case in which the cedent filed a motion to vacate a panel award of attorneys' fees as exceeding the panel's authority. The court declined to do so:

> It was Argonaut's conduct over almost two years of litigation that Underwriters characterized as "bad faith" performance under the arbitration clauses and a breach of the duties imposed by the parties 'honorable engagement.' Argonaut initially demanded arbitration, then sought to avoid it. It failed to adhere to the straightforward requirements for appointing an arbitrator and then litigated a dispute over the meaning of the words 'thirty days' to a federal court of appeals. Argonaut's entire performance under its 'honorable engagement' - - and a determination that this performance was dishonorable and conducted in bad faith - - constitutes a proper bases for the arbitration panel's decision.[7]

On a grant of attorneys' fees, *see also Catalina Holdings (Bermuda) Ltd. v. Muriel,* 2020 U.S. Dist. LEXIS 59812.

III. Cases in Which the Courts Vacated Panel Orders Despite an Honorable Engagement Clause

PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, LTD, 659 F. Supp. 2d 631 (E.D. Pa 2009) involved a profit sharing agreement with a deficit carryforward position. The issue posed by counsel to the panel was whether or not the reinsurer was entitled to carry losses forward into the 2003 underwriting year and if so, in what amount. Rather than answer those specific questions, the panel ordered the cedent to pay the reinsurer $6,000,000 and that thereafter, there would be no more deficit carryforwards. While acknowledging the discretion allowed the

panel under the honorable engagement clause, the court ruled that it did not allow the panel to read the deficit carryforward clause out of the contract:

> No court has held that such a clause gives arbitrators authority to re-write the contract they are charged with interpreting. . . .
> . . . .
> The 2003 'contract itself ' requires the enforcement of the Deficit Carry Forward Provision, not its elimination. . . . [I]t is obvious that the Arbitrators exceeded their authority on the Honorable Engagement Clause.[8]

Nationwide Mutual Insurance Co. v. Home Insurance Company, 330 F.3d 843 (6th Cir. 2003) involved a cessation by Nationwide to the Home. Subsequently, Home's book of business was taken over by CIGNA. (The decision does not reveal how exactly this take over was accomplished.) The arbitration panel decided that Nationwide was liable for certain administrative costs and ordered that they be paid to a CIGNA subsidiary rather than the Home. Notwithstanding the honorable engagement provision, the court ruled that the panel lacked the jurisdiction to order payment to a third party.

IV. Comments

The above caselaw indicates that pursuant to an honorable engagement clause, the courts will allow arbitration panels considerable latitude in interpreting reinsurance contracts and fashioning remedies. However, that latitude does not extend to ignoring or effectively changing the terms of reinsurance contracts.

ENDNOTES

1 Larry Schiffer, *The Honorable Engagement Clause (But I Thought I Had a Legal Contract,* IRMI Expert Commentary, March 2007.
2 781 F.3d 7 at 11 (internal citations omitted).
3 430 F. 3d 492 at 497 – 8.
4 2012 U.S. Dist. LEXIS 94754 *35.
5 819 F. Supp.2d 270 at 277 (S.D.N.Y. 2011)(emphasis in the original)
6 *Id.* at 278.
7 2009 U.S. Dist. LEXIS 87827 *15.
8 659 F. Supp. 631 at 637.

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November 9-10, 2023

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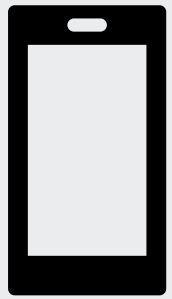

Audience:

Text ARIASUS400 to 22333 to Join The Session

Budgeting for Arbitration:

Hidden costs and savings opportunities

Presenters:

Ryan Russell, Allianz Reinsurance America

Tim Curley, Allianz Reinsurance America

Erin Valentine, Chaffetz Lindsey, LLP

Topics

I. Typical costs of an arbitration with a one-week hearing
II. How parties can streamline and save on costs
III. Why a party might not want to streamline

Poll Question 1

What was the total cost of the last “full blown,” one-week arbitration (from demand to award) that you participated in (as counsel, in-house client, or arbitrator)?

a. <$500K
b. $500K to $699K
c. $700K to $899K
d. $900K to $1.1M
e. >$1.1M

Build-a-Budget: Typical Costs

Line Item	Rate	Budget
Party arbitrator fees	$600 per hour	$70,000
Umpire	$700 per hour (cost split)	$40,000
Expert (assumes 1 expert)	$550 per hour	$35,000
Court reporting for depositions (assumes 4 depositions)	$5,000 per deposition	$20,000
Court reporting & facilities for hearing	$5,000 per day	$25,000
Trial technical support, graphics & equipment rental		$50,000
Travel, lodging & meals (party, counsel, witnesses, experts & arbitrators)		$55,000
TOTAL		**$295,000**

Build-a-Budget: Counsel Fees (Through Award)

Phase	Budget
Pre-Demand Analysis through Organizational Meeting (incl. arbitrator & umpire selection)	$40,000
Fact Discovery (incl. document discovery, fact depositions & motion practice)	$250,000
Expert Report & Discovery (incl. depositions)	$70,000
Dispositive Motions (assumes three briefs)	$90,000
Pre-Hearing Brief	$50,000
Hearing Prep & Hearing	$250,000
Post-Hearing Brief	$50,000
Total	**$800,000**

Build-a-Budget: Final Budget

Category	Cost
Costs	$295,000
Counsel Fees	$800,000
Total	**$1,095,000**

Poll Question 2

Have you participated in an arbitration using some version of the ARIAS Streamlined Rules?

The key components of the streamlined arbitration under the rules:

- **For money relief disputes < $1M (or on party consent)**
- **Decided by a single Umpire**
- **Limited discovery with no motions**
- **1-day hearing**

[ARIASU.S.-Streamlined-Rules.pdf (arias-us.org)]

a. Yes

b. No

Cost Saving Strategies

Pre-Arbitration Planning is Key

- **Map out your strategy prior to organizational meeting, i.e., what do you really need in terms of a discovery, experts, rounds of briefing and a hearing?**
- **Bifurcation**

Panel Composition

- **Single Neutral**

Discovery

- **Limited or no discovery**
- **Limited or no depositions**
- **Virtual depositions**
- **No interrogatories**
- **Limit number of document requests**

Client Resources

- **Client can in-house certain tasks – clients have legal, actuarial, accounting, modeling, file review, and auditing expertise**

Experts

- **No experts or limited to one - usurping role of panel?**
- **Rebuttal experts – do you really need them?**

Cost Saving Strategies (cont.)

Dispositive Motions

- None or only summary judgment
- Stipulated facts

Rounds of Briefing

- No reply briefs
- Panel questions in lieu of broad post-hearing briefs

Hearing

- Use the ARIAS Streamlined Rules ARIAS U.S.-Streamlined-Rules.pdf (arias-us.org)
- Do you need a live hearing with witnesses, or can it be decided on the papers?
- Witness statements, with live cross
- Limit arbitration days / hearing time
- Zoom the whole hearing?

Logistics

- Use “free space” to hold hearing – law firms have space, companies may have space – is renting a “neutral” hearing space really that critical?
- Use a common “jump seat” tech person at the hearing to display exhibits
- Choose venue and law firm carefully

Poll Question 3 (Arbitrators Only):

What role should you play with respect to costs?

a. Costs should not impact my work!
b. Consider amount in dispute when confirming scheduling order, in deciding scope of motions and discovery, etc.
c. Play an even more active role in guiding the parties through an efficient process.

When a party might not want to streamline…

- Amount at issue
- You want a three-person panel: you have a party arbitrator in mind that you know would be a great fit and/or you are not willing to risk a single neutral
- The disputed issue does or does not lend itself to streamlining (e.g., where you have complex factual dispute or legal issues)
- The parties want the issue fully and exhaustively adjudicated (e.g., affects core of business, program issue, recurring issue, etc.)

When a party might not want to streamline…

- Issue likely to repeat itself (informally word gets out)
- Tactical reasons:
  - Send a message!
  - Call the bluff on the other party's willingness to pay money to arbitrate their position. What are the risks? How do arbitrators view this tactic?
  - You have strong witnesses and/or strong documents
- Other reasons?

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ARIAS U.S.

Oh No! We Don't Have an Arbitration Clause! Where Should We File Suit Against Our Cedent or Reinsurer?

November 9-10, 2023

Janine Panchok-Berry, O'Melveny & Myers

Christopher Hemphill, Cohn Baughman

OVERVIEW.

- **Overview of Personal Jurisdiction in the U.S.**
- **Jurisdiction in the Reinsurance Context.**
- **The New Case on the Block: *Mallory v. Norfolk Southern.***
- **The Future of Jurisdiction for Reinsurance Disputes in a post-*Mallory* World.**

Arbitration Agreements.

- Arbitration Agreements.
  - Jurisdiction can be initially decided by contract. *Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co*., 774 F.2d 524, 527 (1st Cir. 1985) (consent to Maine forum in reinsurance agreement consents to Maine jurisdiction).
- Additional Jurisdiction Issues.
  - Contracts without arbitration provisions.
  - FAA issues such as motions to compel arbitration, arbitrator selection issues, and confirmation of an arbitral award. *Clarendon Nat'l Ins. Co. v. Lan*, 152 F. Supp. 2d 506, 517 (S.D.N.Y. 2001) (court had jurisdiction to rule on motion to compel because California reinsurer reinsured a New York company).

Personal Jurisdiction in the United States.

- Personal jurisdiction refers to a court's authority to hear a case involving a particular defendant. A judgment rendered by a court lacking personal jurisdiction is void. *Pennoyer v. Neff*, 95 U.S. 714 (1878).

Traditional Mechanisms for Personal Jurisdiction.

(1) Domicile.

(2) Physical presence, *i.e.,* "tag" jurisdiction.

(3) Consent.

(4) Waiver.

Constitutional Limits of Personal Jurisdiction.

- A nonresident defendant may not be sued unless the plaintiff has established sufficient “minimum contacts with [the forum] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.” *International Shoe v. Washington*, 326 U.S. 310, 316 (1945).

General Jurisdiction.

- Applies to “any and all claims” brought against a defendant.
  The claims need not relate to the forum state or the defendant’s activity there.
- A court may exercise general jurisdiction only when a defendant is “essentially at home” in the state. For a corporation, that means its place of incorporation and principal place of business. *Daimler AG v. Bauman,* 571 U.S. 117, 139 (2014).

Specific Jurisdiction.

- Purposeful availment: The defendant must take “some act by which [it] purposefully avails itself” of doing business in the state.
  - The contacts must be the defendant's own choice.
  - Litigation in the state must be foreseeable.
  - Plaintiff’s claims “must arise out of or relate to the defendant’s contacts.” *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011).

BNSF Railway v. Tyrrell (2017) (General Jurisdiction).

Background:

- Two railroad employees sued BNSF in Montana state court under the Federal Employers' Liability Act (FELA). Neither plaintiff alleged injuries arising from work performed in Montana.
- BNSF is incorporated in Delaware, has its principal place of business in Texas, but has 2,000 miles of railroad track and over 2,000 employees in Montana.

The Supreme Court (8-1, per Justice Ginsburg) held that the Montana court lacked personal jurisdiction over BNSF.

- FELA's text does not confer personal jurisdiction over BNSF.
- Montana lacks specific jurisdiction over BNSF because neither plaintiff alleged any injury from work in or related to Montana.
- Montana lacks general jurisdiction over BNSF because it is not incorporated there, does not maintain its principal place of business there, and is not "so heavily engaged in activity in Montana as to render it essentially at home in that State."

Ford Motor Co. v. Montana Eighth Judicial District (2021) (Specific Jurisdiction).

Background:

- Two plaintiffs brought products liability cases against Ford in Minnesota and Montana, stemming from car accidents that occurred in those states.
- Ford generally sells cars in Minnesota and Montana, including the Explorer and Crown Victoria models involved in the accidents, but did not sell the plaintiffs' particular cars in Minnesota or Montana, nor were the cars designed or manufactured in those states.

The Supreme Court (8-0, per Justice Kagan) held that specific jurisdiction existed.

- Specific jurisdiction existed because Ford "systematically served a market in Montana and Minnesota for the very vehicles that the plaintiffs allege malfunctioned and injured them in those States."
- The Court rejected Ford's argument that a causal connection was required; the defendant's contacts with the forum state may support jurisdiction without allegedly causing the plaintiffs' claims.
- "When a company like Ford serves a market for a product in a State and that product causes injury in the State to one of its residents, the State's courts may entertain the resulting suit."

Pre-*Mallory* Reinsurance Jurisdiction Cases.

- NICO, a Nebraska corporation, headquartered in Nebraska, issued insurance to the State of Montana. That insurance claim involved asbestos bodily injuries and NICO ceded claims to its reinsurers: TIG, Global Re, and R&Q.

- After disputes with reinsurers, each reinsurer also filed their own suits.

- NICO also filed a DJ in federal court in Nebraska.

- Thus, in total, there were four suits (Nebraska, Pennsylvania, New York, and New Hampshire).

Pre-*Mallory* Reinsurance Jurisdiction Cases.

- ***TIG Insurance Company v. National Indemnity Co.*, 1:22-cv-00165-SE (D. N.H., March 27, 2023).**
  - TIG filed suit in New Hampshire. At the time of contracting, Skandia was a Swedish company with a New York office. Today, the relevant reinsurer is TIG, which is a California corporation with a headquarters in New Hampshire.
  - Court ruled NICO had insufficient "minimum contacts" for personal jurisdiction in New Hampshire because New Hampshire was not involved in contract formation and the court did not have evidence of significant modern-day contacts i.e., the claim communications predated the reinsurance dispute.

Pre-*Mallory* Reinsurance Jurisdiction Cases.

- ***Global Reinsurance Corporation of America v. National Indemnity Co.*, 1:22-cv-03785-JSR (S.D.N.Y., Aug. 16, 2022) (J. Rakoff).**
  - Global Re filed suit in New York.
  - At the time of contracting, Constitution was a New York corporation, with a headquarters in New York. Today, the relevant reinsurer is Global Re, which is a New York corporation, with a headquarters in Pennsylvania.
  - Global argues that contract was negotiated in New York, older claim communications sent to New York, and modern claim communications sent to New York.
  - Court held that NICO had sufficient “minimum contacts” in New York State.

Pre-*Mallory* Reinsurance Jurisdiction Cases.

- ***R&Q Reinsurance Company v. National Indemnity Company*, 2:22-cv-01807-CDJ (E.D.P.A., 2022).**
  - R&Q predecessors were located in New Jersey. Today, R&Q is a Pennsylvania corporation with a headquarters in Pennsylvania.
  - R&Q argued that NICO engaged in lots of Pennsylvania business, one of its other reinsurers on the Certificate, and claim communications were sent to PA.
  - Case ends in stipulated dismissal and parties agree to litigate in Nebraska.

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Pre-*Mallory* Reinsurance Jurisdiction Cases.

***Stonegate Ins. Co. v. Fletcher Reinsurance Co.*, (N.D. Ill. Dec. 6, 2021).**

Illinois-based Stonegate entered into reinsurance agreements with Fletcher. Later, Enstar (US) Inc. and Cranmore, Inc. entered into an agreement with Fletcher to service Fletcher's reinsurance agreements, including the Stonegate agreements.

- Stonegate sued Fletcher in Illinois for breach of the reinsurance agreements and also filed tortious interference counts against Enstar and Cranmore.
- Enstar and Cranmore moved to dismiss counts against them due to lack of personal jurisdiction in Illinois, arguing that Enstar and Cranmore contracted with Fletcher and that that Fletcher contract did not involve Illinois.

The district court denied the Enstar and Cranmore motion to dismiss, pointing to Enstar and Cranmore communications with Illinois-based Stonegate, Cranmore and Enstar's physical audits of Stonegate's files, and that Enstar/Cranmore allegedly played in denying Stonegate's claim.

Mallory v. Norfolk Southern Railway Co. (June 27, 2023).

Background:

- Plaintiff, a longtime employee of Norfolk Southern Railway Co., lived in Virginia, alleged exposure to asbestos in Ohio and Virginia, and Norfolk Southern was both incorporated and headquartered in Virginia.
- Plaintiff filed his lawsuit in *Pennsylvania*, asserting that Norfolk Southern consented to jurisdiction "for any cause of action" by registering to do business in the state. The Pennsylvania Supreme Court disagreed.

The U.S. Supreme Court Allows Consent to Jurisdiction:

- The Due Process Clause does not prohibit a state from requiring a corporation to consent to general personal jurisdiction in order to do business in that state.
- The Court followed *Pennsylvania Fire Ins. Co. of Philadelphia v. Gold Issue Mining & Milling Co.*, 243 U. S. 93 (1917), where the Court upheld a Missouri law requiring an out-of-state company to appoint a Missouri official for service of process, and service on that official was valid in any suit.
- Justice Alito questioned whether this decision violates the Dormant Commerce Clause.
- Circumvents *International Shoe*'s minimum contacts.

Rule-Based Approach to General Jurisdiction.

The Supreme Court's pre-*Mallory decisions* indicate that corporations would be subject to general jurisdiction in only two locations: (1) their place of incorporation; (2) their principal place of business.

- *Daimler v. Bauman* (2014): Place of incorporation and principal place of business are "paradigm" general jurisdiction forums.
- Although the Court has nominally reserved the possibility that a corporation may be subject to general jurisdiction elsewhere, the scope of this exception appears exceedingly small.

***Mallory* creates an additional rule: whether the corporation has consented to jurisdiction by registering to do business in a forum state.**

Post-*Mallory* Reinsurance Jurisdiction Cases.

- In all of these cases, courts likely would have found personal jurisdiction if the state had a consent-to-jurisdiction statute.

- For example, thinking back to the four prior NICO cases, NICO does business in PA and we know that PA confers general jurisdiction.

- Factors to consider: In which cases might it have been more difficult to obtain jurisdiction even with a consent-to-jurisdiction statute?

States with Consent-to-Jurisdiction.

- **Justice Sotomayor forecasts that few states will pass statutes that make it easier to sue registered corporations.**
- **Pennsylvania.**
- **Minnesota.**
- **Puerto Rico.**
- **Georgia.**
- **Kansas.**
- **New York (Senate Bill S7476).**
  - Governor Hochul already vetoed once in 2021.

Future Litigation: Dormant Commerce Clause.

- **Do consent-to-jurisdiction statutes violate the Dormant Commerce Clause?**
- **Justice Alito's concurrence raised the Dormant Commerce Clause as an issue for remand.**
- ***Forum non conveniens* remains an issue.**

Questions?

Breakups with Insurtech Distributors:
How the Insurtech MGA Contract Provisions Affect a Potential Dispute

Panelists:

John S. Pruitt, Partner, Eversheds Sutherland (US) LLP

Jonathan Kline, VP& Deputy General Counsel, Arch Insurance Group Inc.

Fred Marziano, ARIAS Certified Arbitrator

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ARIAS U.S.

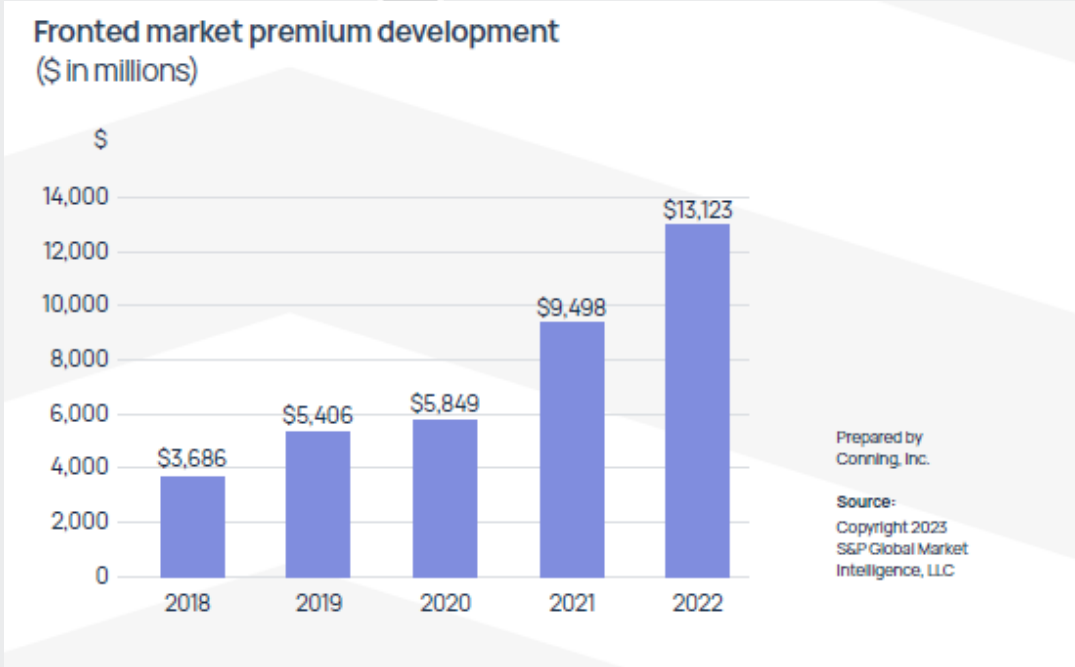
Introduction

MGAs are preferred structure for Insurtech startups

- Low barriers to entry
- Narrow focus on specific classes
- Better technology
- Better use of data
- Streamlined processes
- ROIs that full-stack insurers cannot match
- Scalability

KPIs

MGA and fronted premiums have grown in step



There can be multiple parties with different interests: MGA, fronting insurer, reinsurers, captives, investors, customers, third party vendors

Contracting Phase

Avoid unhappy outcomes by negotiating appropriate terms at outset, including exit

- Sets expectations
- Promotes compromise
- Confront difficult issues while there is mutual trust

Contracting Phase (cont'd)

Basic issues that can be addressed in program documentation

- Grounds for termination
- Termination notice period
- Continuing obligations post-termination
- Compensation post-termination
- Who owns what after parting ways

  ✓*Expirations*

  ✓*Technology*

  ✓*Books and records*

  ✓*Data*

- Dispute resolution

When Disagreements Become Disputes

Many agreements will contain arbitration clauses as the forum for dispute resolution

The benefits of arbitration:

- Confidentiality
- Resolution by industry professionals
- Business oriented solutions

Examples of Common Disputes Leading to an MGA Breakup

Disputes may differ from those that arise from traditional MGA relationships

- Disputes common to both "Traditional" and "Insurtech" MGAs
- Disputes most often occurring within the Insurtech Industry

Unique Features of the Arbitration Agreement

Agreements with Insurtech MGAs may have unique features in the arbitration agreement

- Who is a qualified arbitrator?
- Dispute Venue
- Form of the award

Who are Qualified to Serve as Arbitrators

The critical task of arbitrator selection

- MGAs want persons familiar with an MGA and how it functions
- Insurtechs look for technical expertise sufficient to understand applicable technology
- Each party wants an arbitrator who understands that party's position/role/situation

Potential Issues in Arbitrator Selection

Insurtech MGAs may appoint an arbitrator unfamiliar with the process

This can cause potential issues in the arbitration

- Organization and administration of the proceeding
- Conducting of hearing
- How an award is arrived at and delivered

Using the Contract to Prevent Arbitration Issues

Negotiating the arbitration clause is key

What should be considered in the arbitration agreement?

- Specify the process and conduct of the hearing in detail
- Incorporate known rules/procedures that are agreed to up front
- Include features unique to the insurtech landscape

Focus of Insurtechs is Different Than a Traditional MGA

What makes it different?

- Insurtechs view themselves as technology companies first and insurance distributors second
- The role of "broker" or "distributor" is often new to the insurtech, and that might color both the contracting process and the dispute

Program Structure Might Affect the Dispute

The interests of the parties create variables

Non-fronted programs

Fronted programs

- Captive
- Market reinsurer

Arbitrator's Perspective

The selection process: focus on a candidate's practical experiences

Do the candidate's experiences include:

- Fronting or otherwise partnering with an MGA
- Serving as a producing broker or agent
- Structuring an MGA agreement
- Auditing an MGA
- Financial/CFO experience to unravel claims of co-mingling of funds
- Claims management experience
- Serving as or with reinsurance brokers

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Enabling the Ethical Use of Ai in (Re)Insurance – AI Bias Testing

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Key Terminology

Data Science is a wide-ranging multi-disciplinary field that goes beyond exploratory analysis and statistics – using scientific methods, algorithms and mathematical formulas to extract, evaluate, and visualize structured and unstructured data. Data Science can be broken down further into Big Data, Data Mining, Data Modeling, and Artificial Intelligence.

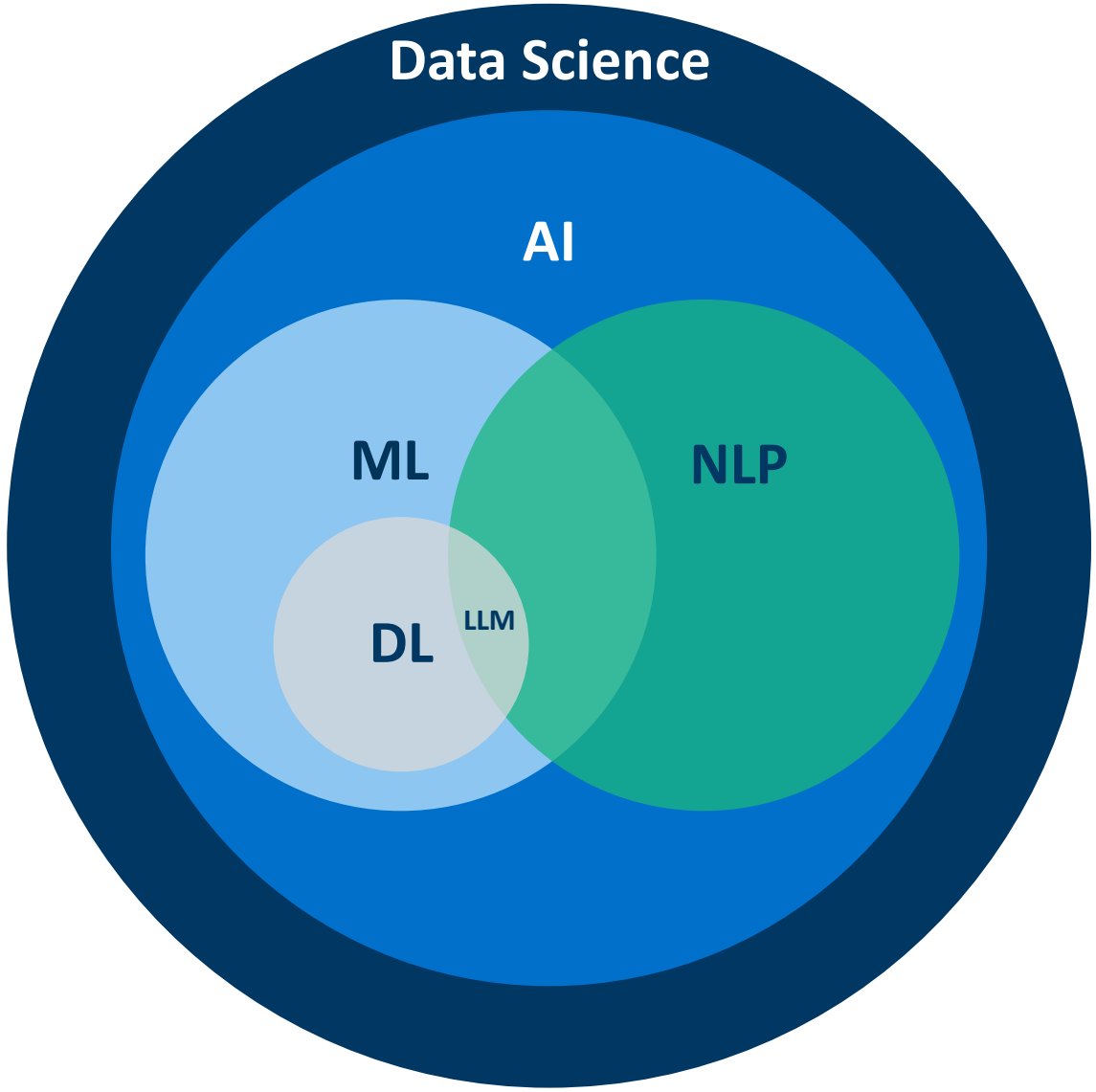
Artificial Intelligence (AI) is the capability of a computer system to mimic human cognitive functions such as learning, problem-solving, and reading. Through AI, a computer system uses math and logic to simulate the reasoning that people use to learn from new information and make decisions.

Machine Learning (ML) is an application of AI, which focuses on the automated use of data and algorithms to imitate the way that humans learn, gradually improving in accuracy over time.

Natural Language Processing (NLP) is an application of AI concerned with giving computers the ability to understand text and spoken words in much the same way human beings can.

Deep Learning (DL) is a subset of Machine Learning that attempts to mimic the human brain, using artificial neural networks to enable digital systems to learn and make decisions based on unstructured, unlabeled data.

Large Language Models (LLM) are language models consisting of a neural network with many parameters (typically billions of weights or more), trained on large quantities of un-labelled text using self-supervised learning. ChatGPT is built on top of OpenAI's GPT-3.5 and GPT-4 families of LLMs.



Model Risk Management Concepts

Model risk management and algorithmic bias are not new concepts. The Federal Reserve and Office of the Comptroller of Currency (OCC) have set a foundation for model risk management and governance that can be leveraged across industries.

SR - 117

Standard for model risk management across financial services, fintech, money service, etc.

"The purpose of this document is to provide comprehensive guidance for banks on effective model risk management. Rigorous model validation plays a critical role in model risk management; however, sound development, implementation, and use of models are also vital elements. Furthermore, model risk management encompasses governance and control mechanisms such as board and senior management oversight, policies and procedures, controls and compliance, and an appropriate incentive and organizational structure."

Key Areas related to:

- Development
- Implementation
- Use
- Conceptual Soundness
- Ongoing Monitoring
- Outcomes Analysis
- Governance
- Policies
- Controls

https://www.federalreserve.gov/supervisionreg/srletters/sr1107a1.pdf

Consumer Compliance Examination Manual

The **Consumer Compliance Examination Manual** is a framework for identifying and evaluating discriminatory conduct in lending. *It is intended to guide judgment in an examination, not support it*.

Part I – Examination Scope Guidelines and Background

- Pricing, steering, and underwriting risks and anecdotal guidance to understand what products or areas of an institution to target for procedures.

Part II – Compliance management review

- This qualitative analysis includes interviews and a review of practices, training, guidance, and marketing.

Part III – Examination Procedures

- Specific policy and procedure reviews,
- Data validation procedures and regression analysis to identify disparities/outliers.
- Sampling and transaction testing where outliers are identified.

Part IV - Obtaining and Evaluating Responses

- Document findings and responses

https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/index.html

Similarities w/ 3 CCR 702-4

- Requirement to maintain a model inventory and validate models.
- Prevention of unfair discrimination of protected classes, including gender identity, gender expression, disability status, and sexual orientation.
- Controls around the source data.
- Documenting how consumers could be adversely affected by ECDIS, algorithms, and predictive models.
- Training programs for employees to address concerns around unfair discrimination.
- Processes and procedures to enhance transparency using ECDIS, algorithms, and predictive models.
- Documenting organizational decisions using ECDIS, algorithms, and predictive models to verify that justification and accountability are clear.

Statistical Analysis: Disparate Impact Testing

Statistical analysis and, more specifically, regression analysis mathematically accomplish what would be done in a traditional file review but on a complete dataset:

I. Identify Data Sources & Prep Data

- Work with key stakeholders including Compliance, Business and IT to identify data sources that can be analyzed for different models and include key attributes such as:
  - Application decisioning/pricing;
  - Demographic details; and
  - Other attributes including risk score.
- For models where there is limited individual demographic information, leverage methods such as Bayesian Improved Surname Geocoding (BISG) to create a proxy probability for race and ethnicity.
- Cleanse data to remove any records that do not have key attributes captured such demographic information.
- Identify model attributes and run statistical tests to determine which have the most predictive power.

II. Perform Statistical Analysis

- Perform preliminary statistical tests to determine if the model decision/output was impacted by a protected class attribute and requires further analysis.
  - Chi-square tests independence and weather the attribute is associated with the action taken.
  - A t-test is used to test the difference between two group means.
- Where disparities exist, leverage **regression analysis**, to evaluate the data to determine if the attributes highly correlated with the decision are also correlated with a protected class.
- Use binomial tests using client data to analyze applications received from non-protected classes is proportional to those received from protected classes in relation to their population in each county.
- The analyses will include controls for key risk variables such as income and risk score, as well as geographic differences and policy types.

III. Transaction Testing, Findings and Recommendations

- Prepare and review draft results with client including findings and recommendations.
- Sample transactions and perform matched pair testing where applicable.
- Confirm results per client review and include a high-level summary of results and any relevant business justifications.

Quantitative Assessment: Identifying Proxy Variables

Developing fair or unbiased AI models is a complex endeavor that often requires us to go beyond excluding protected class variables. Even when not directly leveraging protected class inputs, AI models can produce biased results – often due to 'proxy variables.' Proxy variables are frequently used in modeling in place of variables that cannot be measured but can also "encode" protected class variables (*e.g.*, the type of music one listens could be a proxy for race, age, or gender). There are several approaches to identifying proxies:

Feature Linear Correlation

A standard linear approach to determine whether features correlate with protected attributes.

Calculate the **correlation between the protected class variable and any other feature.** Set a threshold for the maximum correlation acceptable before a feature is considered a proxy to the protected class.

For categorical attributes (*e.g.*, sex, ethnicity), the linear correlation will not work. Instead, other statistical methods, including **point biserial correlation, can be used to compare continuous and categorical variables and** the coefficient between two categorical variables.

This approach is popular and relatively simple but not ideal for non-linear models because it only evaluates one feature at a time.

Proxy Variable Prediction

This method checks **if a specific combination of proxy variables can accurately predict a protected attribute** (e.g., marital status and occupation alone are not strong predictors of genders, but when combined, they are strong predictors).

Checking all possible feature combinations is a time-consuming process. However, creating a function that automates the feature comparison procedure to streamline the testing is possible. Users identify features for evaluation, the combination of features to test, and the accuracy threshold. The function will then **build a linear/logistic regression model and a decision-tree model for each combination of the features specified and output the model accuracy**.

This approach requires internal knowledge of the use case to determine which combinations to test.

Feature Linkage

The **redundancy metric** helps detect proxy variables because it allows users to **understand the degree to which any two model features provide duplicate information when predicting the output**. Additionally, redundancy will capture the **non-linear effects** between features for non-linear models.

Additionally, you can create a **hierarchical clustering** by **calculating a linkage tree** for the features and then visualize it with color-coding by feature importance. This enables users to visualize both feature redundancy and feature importance simultaneously.

Spotlight: Assessing Bias When Protected Class Data Is Unavailable

Determining whether AI is biased against protected classes becomes further complicated when data related to protected classes isn't collected or available. When faced with data insufficiencies related to race and ethnicity, FTI leverages Bayesian Improved Surname Geocoding (BISG) to create a proxy probability for race and ethnicity.

Bayesian Improved Surname Geocoding (BISG)

What Is BISG?

- The **leading methodology for proxying race/ethnicity,** BISG uses Bayes' rule to compute a probability distribution over race/ethnicity categories conditional on an individual's surname and where they live.
- BISG typically uses **two sets of probabilities**, created by leveraging publicly available Census and voter registration data:
  - The probability of being a certain race given an individual's last name
  - The probability of being a certain race given the census tract in which an individual lives.

Who Uses It?

- In conducting fair lending analysis of non-mortgage credit products in both supervisory and enforcement contexts, the **CFPB's Office of Research (OR)** and **Division of Supervision, Enforcement, and Fair Lending (SEFL)** rely on BISG.
- BISG is also used in a range of applications across **financial services** (fair lending analyses performed by non-mortgage lenders), **healthcare** (comparing racial and ethnic differences in health care quality and outcomes), and **academia**.

Why Is It Widely Used?

- BISG has attained widespread popularity due to its **parsimony**, **computational efficiency**, and **superior performance** when compared to existing alternatives, namely spatial interpolation of Census racial-ethnic composition from Census geographies.

Supporting Evidence

Correlation

- Research has found that BISG produces proxies that **correlate highly with self-reported race and national origin** and is more accurate than relying only on demographic information associated with a borrower's last name or place of residence alone.
- Studies by RAND and the CFPB find that BISG proxies **correlate highly with self-reported race and national origin (0.70 – 0.80+)** for Hispanic, non-Hispanic White, Black, and Asian/Pacific Islander.

Area Under the Curve (AUC)

- Studies by the CFPB found that the **AUC statistics associated with the BISG proxy for Hispanic and non-Hispanic White, Black, and Asian/Pacific Islander are large and exceed 90%.**
- AUC represents the **likelihood that the proxy will accurately sort individuals** into a particular racial or ethnic group. An AUC value of 1 (or 100%) reflects perfect sorting and classification, and a value of 0.5 (or 50%) suggests that the proxy is only as good as a random guess (*e.g.*, a coin toss).

Sources:
https://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf, arXiv:2206.14583
Marc N. Elliott, Peter A. Morrison, Allen Fremont, Daniel F. McCaffrey, Philip Pantoja, and Nicole Lurie, "Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities," Health Services and Outcomes Research Methodology, Vol. 9, No. 2, June 2009, pp. 69–83.

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Joe Knight is a Senior Managing Director in FTI's Data & Analytics practice. Mr. Knight provides technical consulting services in the areas of electronic discovery, litigation and investigation support, advanced data analytics, machine learning, data visualization, and implementation of business intelligence solutions. Additionally, Mr. Knight has worked as an internal and external auditor identifying and evaluating financial reporting and operational risks in IT-intensive business processes.

Mr. Knight has experience on litigation consulting engagements managing the collection and analysis of complex data sets from systems, including Enterprise Resource Planning (ERP) systems such as Oracle, SAP and PeopleSoft Financials. He assisted in the consolidation, normalization and analysis of these complex data sets using various cutting-edge technologies.

Mr. Knight has extensive experience developing flexible statistical models and advanced analytics to solve client issues. He also has experience implementing data warehouse, business intelligence and reporting tools for clients based on reviews of key systems, data, and business processes which includes developing interactive web-based solutions that leverage Tableau or Power BI.

Mr. Knight holds a B.B.A in Information Systems from James Madison University.

Relevant Experience

- Conducted quantitative tests to measure disparate impact in predictive models by financial institutions to target consumers for new products.
- Built advanced analytical models using ML techniques for a large healthcare technology company to evidence ROI for customers.
- Developed and implemented controlled substance order monitoring program models for large pharmaceutical distributors that were data-driven, statistically sound, and defensible order.
- Designed and implemented data warehouse and web-based business intelligence solutions using Tableau and MS Power BI.
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Peter Kelly is a Senior Managing Director at FTI Consulting and is based in London. He is in the Global Insurance Services practice in the Forensic & Litigation Consulting segment. Peter is a senior insurance professional assisting management teams in strategy development and decision-making in the areas of technology and data. Peter has helped a number of insurers assimilate new tools and processes to make effective decisions. He brings expertise across a wide range of technical frameworks from underwriting rules, to actuarial models to machine learning and artificial intelligence.

Peter has 30 years of experience in the insurance industry in the US, UK and internationally and has particularly deep experience in areas of telematics and catastrophe reinsurance. He is a published author, sought-after speaker and advisor in the areas of strategy development, decision-making systems, applied behavioural and cognitive science, and automation.

He has worked in over 20 countries in senior management capacities, leading teams that have developed and successfully implemented solutions in pricing, marketing, claims channel optimisation, fraud, and distribution management.

Peter has direct experience in most lines of general insurance, including private motor, homeowners, landlord, commercial property, credit, finite risk, and business owners coverage and he has worked across the industry with primary insurers, reinsurers, brokers, captives, and advisory firms. Leveraging this experience, he has been a board member of various organisations in the insurance industry, including public, private, and residual insurers (including currently a Californian insurance analytics company). He has led projects to establish bespoke insurers and special purpose vehicles.

Relevant Experience

- Conducted a pricing sophistication gap analysis for a niche insurer seeking to develop a strategy to achieve breakthrough growth to maximize returns on their capital
- Delivered significant gains for an insurer by combining new machine learning technologies with process automation to achieve greater throughput and lower per-claim expenditure
- Developed the concept and design of a new fraud prediction model, alongside an insurer's team, resulting in simultaneous gains in referral rates, true-positive action rates, and per-case average revenue generation; all without any new investment
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Lisa Kuklinski is a Managing Director and consulting actuary with over 30 years of experience in the insurance industry. Prior to joining FTI Consulting, she ran her own consulting practice that included independent consulting with EY and FTI. Working with EY, projects included U.S. GAAP Long Duration Targeted Improvements (LDTI) implementations and mergers and acquisitions. Projects with FTI have included litigation support on life and annuity reinsurance matters, intellectual property disputes, and life and annuity sales suitability reviews.

Previously, Ms. Kuklinski served as SVP and Chief Actuary of MetLife's US and Latin America region, overseeing all actuarial aspects of individual and group life insurance, variable and fixed annuities, long-term care, pension risk transfer, and disability income in the region. She implemented the actuarial aspects of the Brighthouse separation and designed the U.S. Actuarial modernization plan. Prior to this role, she served as CFO of MetLife's Retail business, which included Individual Life, Individual Annuities, and Distribution.

Prior to this, she led Variable Annuity product development, where she was responsible for designing and pricing MetLife's suite of VA products, as well as implementing the hedging and reinsurance programs for the product line.

Ms. Kuklinski holds a Bachelor of Arts in Mathematics from Williams College, where she graduated with honors. She is a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries.

Relevant Experience

- Ms. Kuklinski's actuarial experience includes US STAT and US GAAP valuation and financial reporting, US GAAP LDTI, European embedded value/new business embedded value, fair value/market consistent valuation/embedded value, financial projections and analysis, pricing and product development, experience studies, mergers and acquisitions, financial controls/SOX, and NAIC variable annuity stautory reserve & capital reform as co-chair of the ACLI working group.
- Ms. Kuklinski was elected to the Board of Directors of the Society of Actuaries in 2019.
- Through the American Academy of Actuaries, Ms. Kuklinski serves on the Actuarial Standards Board Life Committee and was a member of the task force that authored Actuarial Standard of Practice 54, Pricing of Life Insurance and Annuity Products and chaired the task force updating Actuarial Standard of Practice 10, Methods and Assumptions for Use in Life Insurance Company Financial Statements Prepared in Accordance with US GAAP.
- Ms. Kuklinski also works with LICONY (Life Insurance Council of New York) to support regulatory lobbying efforts and is currently participating in the Society of Actuaries Ethical & Responsible Use of Data & Predictive Models Certificate Program.

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Jim Wrynn is a Senior Managing Director at FTI Consulting in the Global Insurance Services practice. He is one of the leading experts on insurance matters based on his more than 35 years of professional experience as an attorney, regulator, executive and advisor, and has served as an expert in various litigation matters.

Mr. Wrynn has also been involved in domestic and global insurance regulations, policies and standards; and in assisting clients in developing strategies and programs dealing with regulatory issues; claims administration and analysis; identification of strategic partners, mergers/acquisitions and portfolio transfers; new product development; geographic expansion strategies; distribution solutions; risk financing and captive insurance; restructuring and operational performance; inquiries and investigations; litigation; alternative dispute resolution (ADR); and a variety of other issues in the U.S. and globally.

Most recently, Mr. Wrynn was the Chief Commercial Officer and a Hearing Officer at National Arbitration and Mediation. Prior to joining NAM, Mr. Wrynn served as Senior Managing Director at FTI Consulting; Managing Director and Vice-Chair in the U.S. for Guy Carpenter's Global Strategic Advisory Group; and Senior Partner at the law offices of Goldberg Segalla, LLP.

Before joining Goldberg Segalla, Mr. Wrynn served as the 40th and last Superintendent of Insurance in the State of New York.

Relevant Experience

- Mr. Wrynn was very involved in the drafting of the new Financial Services law in New York and the merger of the Insurance Department with the NYS Department of Banking to form the new Department of Financial Services - at which time he served as the first Deputy Superintendent of the new department.
- Mr. Wrynn is admitted to practice law in the Federal and State courts of New York and New Jersey, and the U.S. Supreme Court. He has earned a Martindale-Hubbard Peer Review rating of AV Preeminent and has been rated a top lawyer in insurance law by American Lawyer Media and Martindale-Hubbell, in insurance coverage by New York Metro Super Lawyers, and the listing of Who's Who Legal Consulting Expert Guide: Insurance and Reinsurance from 2017 to 2019. He was recently designated a "Power 25 Lawyer" by Long Island Business News in 2021.
- Mr. Wrynn has earned an Associate in Captive Insurance (ACI), Associate in Risk Management (ARM) designation, and Workers' Compensation Professional (WCP) designation. He has also served as a registered foreign lawyer in the United Kingdom, and as an expert witness on matters involving his areas of concentration.

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Marc Zimmerman is Senior Advisor with the Global Insurance Services practice. He has more than 40 years of senior leadership experience in data & analytics, investment accounting technology and business/IT advisory with multiple leading financial services software and consulting firms.

Prior to joining FTI Consulting, Mr. Zimmerman was a senior executive at ClearPrism LLC, a boutique consultancy and FTI partner focused extensively on supporting the analytic insight, M&A due diligence and transformation needs of insurance industry clients across multiple domains, including claims fraud, financial ERP, and market growth.

Mr. Zimmerman also previously served as the global head of analytics solutions for Deloitte Consulting's financial services practice, working directly with clients such as a global top 20 P&C insurer and a U.S.-based life & health provider to develop and implement enterprise data management and analytics strategies, and design and execute InsurTech potential investment assessments.

Before joining Deloitte, Mr. Zimmerman successfully led the transformation of Capgemini Financial Services' Business Information Management practice into a recognized global market leader building a team of 1,500 professionals serving market-leading clients in 20+ countries.

Mr. Zimmerman's earlier career also included a global FS practice leadership role at Unisys with a significant focus on building and deploying next generation policy administration solutions for multiple leading life & pension and property & casualty insurers. He also co-founded and/or led strategic marketing and sales for two leading insurance sector investment accounting and portfolio management technology companies, SS&C Technologies and Princeton Financial Systems

Relevant Experience

- Mr. Zimmerman led the creation of an outsourced hub-and-spoke global analytics services capability for a leading P&C insurer with multi-continent operations.
- Mr. Zimmerman led the development and delivery of multiple data and analytics strategy assignments for U.S.-based insurers seeking to upgrade insights in support of underwriting decision-making and claims processing.
- Mr. Zimmerman jointly spearheaded delivery of a highly interactive InsurTech investment program for a global insurer seeking to invest in new technologies to enable enhanced operational efficiencies and growth that resulted in four separate investments being made.
- Mr. Zimmerman has served as a keynote and/or panel speaker at multiple data & analytics industry events in North America and the UK and has previously co-published two well-received papers on the role of the Chief Data Officer in financial services.
- Mr. Zimmerman also engaged early in his career in the private practice of corporate/ commercial law in New Jersey and is a retired member of the New Jersey State Bar and the Federal District Court for the District of New Jersey.

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GOVERNING ARTIFICIAL INTELLIGENCE

Managing business risks in a digital world

Ben Hoster
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INTRODUCTION

The explosion in the use of artificial intelligence (AI) by businesses over the past few years has driven an unmistakable inflection in corporate innovation, efficiency, and profitability. However, it has also exposed firms to ethical pitfalls and wasted investments, making effective governance and risk management vital.

A pervasive and critical element of corporate growth strategies, AI has fully extended its reach beyond the agendas of Big Tech and digital platform players. Predictably, companies are using AI-based solutions to augment critical business capabilities, such as advanced customer preference analytics, operational process optimization, cyber risk management, and customer and supplier engagement.[1] As the technology grows in sophistication and ubiquity, it becomes increasingly difficult both to monitor and understand how the algorithms derive outputs. This in turn presents challenges for anticipating downstream ramifications for a firm's business processes and the interconnections between these processes, partner companies, and society at large.

In the absence of appropriate risk management mechanisms, this opacity can expose businesses — and those individuals and communities dependent on them — to undesirable consequences. A poorly deployed AI solution may result in suboptimal decisions based upon flawed outputs and diminished returns on technology investments. Enduring reputational damage may arise from profit-driven overreach if businesses sell or otherwise capitalize on sensitive data and analytical or behavioral insights obtained in inappropriate ways.

Grappling with COVID-19 has also seen some organizations accelerate AI deployment to counter the impacts of the pandemic. Although valuable in supporting public health initiatives and improving efficiency, deployment without safeguards — especially at rapid speed — can expose organizations to risk (see sidebar: "*COVID-19 implications: accelerated AI deployment*").

Societal concerns have also emerged with regard to AI intruding on individual privacy, locking in systemic bias, and eroding social discourse. Lawmakers and regulators are being pressed to simultaneously keep pace with the impacts of a rapidly evolving technology while also addressing public concerns. Companies must therefore carefully navigate discontinuities across regulatory bodies as well as a diverse network of stakeholders in order to maintain their social license to employ AI capabilities.

Anticipating these growing business risks and external pressures, it is imperative that business leaders adopt effective governance practices. This requires a business-centric framework that is multifaceted and forward-looking, and one that addresses the diverse risks associated with the dynamic nature of AI technology. To that end, this paper sets out a five-dimensional governance framework, along with guidance on implementation practices.

1 Forbes. (2020). Roundup of Machine Learning Forecasts and Market Estimates, 2020. Retrieved October 12, 2020, from https://www.forbes.com/sites/louiscolumbus/2019/03/27/roundup-of-machine-learning-forecasts-and-market-estimates-2019/#29b08337695a

COVID-19 implications: accelerated AI deployment

The COVID-19 pandemic is accelerating the scale and usage of AI technology as governments and businesses alike respond to this unprecedented crisis.

AI is touted as a pandemic super tool that can profile infection risk, triage chest scans, catalyze vaccine development, and generally bolster response efforts to enhance contact tracing, facilitate social distancing, and more. It also has the potential to support economic recovery. Digital health surveillance tools can be pivotal in helping businesses facilitate a safe return to the workplace.[2]

Moreover, social distancing practices are leading businesses to introduce automated solutions for predicting consumer behavior, optimizing supply chains, and improving delivery efficiency. Research suggests that perhaps 40 percent of companies worldwide are increasing their use of workplace automation in response to the pandemic.[3]

The use cases for AI deployment can also make the balancing of risks and trade-offs a more acute challenge. Surveillance technologies such as facial recognition, contact tracing, and AI-enhanced infection risk profiling require both businesses and governments to weigh the dual imperatives of public health and individual liberty. Additionally, businesses deploying automation technology to maintain output with fewer workers and reduce the risk of COVID-19 outbreaks in the workplace may find themselves in the spotlight for exacerbating societal inequality and unemployment.

2 Marsh & McLennan Advantage. (2020). Digital Health Surveillance — A Balancing Act for Business. https://www.mmc.com/content/dam/mmc-web/insights/publications/2020/august/Digital-Health-Surveillance_Final.pdf

3 Wall Street Journal. (2020). Tech Workers Fear Their Jobs Will Be Automated in Wake of Coronavirus. Retrieved October 12, 2020, from https://www.wsj.com/articles/tech-workers-fear-their-jobs-will-be-automated-in-wake-of-coronavirus-11590571801

INTRINSIC RISKS IN AI TECHNOLOGY DEPLOYMENT

Businesses will be exposed to near-term financial and enduring reputational harm if they do not exhaustively identify and address the risks associated with the establishment and operation of AI-based applications.

While the risks associated with the use of AI applications loom large, they are generally able to be mitigated by organizations using those technologies, if they are properly identified and managed through an effective governance framework (see Exhibit 1).

IDENTIFYING NEAR-TERM FINANCIAL RISKS

Existing IT governance practices in many firms will help ensure the effective development and delivery of AI technologies. But they are typically not suited to foreseeing or addressing the potential for unexpected adverse outcomes.

These eventualities often occur due to the very nature of AI technology. Even simple rules and inputs — when implemented with self-learning, automated, algorithmic engines — can create outputs that are difficult to predict and therefore manage. Undetected errors in AI deployment or subsequent model drift could also affect other areas of an organization and create the possibility of positive feedback loops wherein detrimental outcomes become amplified over time and not detected until too late.

Exhibit 1: Intrinsic risks associated with the use of AI

Near-term financial risks

- Ineffective governance leads to misallocated investments, magnified risks, and limited gains
- Inability to explain adverse outcomes produced by "black box" AI systems harms credibility, consumer and stakeholder trust, and thus revenue
- Cyberattacks through direct and indirect AI output manipulation destabilize AI systems

Enduring reputational risks

- Profit-driven overreach from information misuse tarnishes the corporate brand and creates legal risk
- Limited training data diversity and homogeneous development teams lead to biased outputs
- Automation exacerbates unemployment and social inequality, creating public dissent

Source: Marsh & McLennan Advantage

Businesses are also susceptible when they use "black box" AI systems with minimal transparency or traceability. Unexplainable algorithms pose a risk that is particularly pertinent for firms that adopt AI solutions from external vendors or apply them in important decision-making processes such as credit-risk assessments and medical diagnoses. Especially when adverse outcomes to customers and staff are possible, firms must be able to explain and defend algorithm-based decision processes and their output to a range of stakeholders, including subject-matter experts and even the legal community in cases of alleged malpractice.

Due to increasing reliance on technology networks, AI-enabled cyberattacks also present an attractive threat vector and tool for cybercriminals. Given the rapidity with which AI applications make decisions, bad actors can cause disproportionate harm once they have infiltrated AI programs, maliciously tweaking input parameters or discrete lines of code, which may not be detected without proper checks and balances.[4] Moreover, the automated discovery and exploitation of cyber vulnerabilities through spear-phishing is now a "smarter" and more dangerous means of gaining access to sensitive systems and pilfering confidential information.[5] These attacks may destabilize firms' digital capabilities, disrupting their operations and revenue generation.

Certain business applications of AI technology may directly affect various groups within society, leading to reputational harm and revenue erosion

UNDERSTANDING ENDURING REPUTATIONAL RISKS

Certain business applications of AI technology may also directly affect various groups within society, leading to reputational harm and revenue erosion.

Profit-motivated overreach has exposed organizations to the risk of litigation and reputational impairment, such as when they use the personally identifiable information (PII) of citizens for purposes beyond those originally sanctioned. Companies may be tempted to find novel ways of monetizing consumer data — powering recommendation engines to steer unwitting consumers or harvesting and selling personal information to third parties — where limits on collection, processing, and distribution are not clearly defined. Other forms of overreach are also growing in frequency, such as the unauthorized surveillance of consumers or the exploitation of personal data to influence political processes.

AI applications can also inadvertently generate biased and potentially discriminatory outputs when the dataset used to "teach" an algorithm is insufficiently expansive. As is well known, even dominant data accumulators have been caught off-guard, such as when internal recruiting applications deprioritized female or ethnic minority candidates or when chatbots used racist and anti-Semitic language.[6] This is exacerbated when historical data is used for training, codifying and consolidating the systemic inequalities and discrimination that may subconsciously exist within societies and organizations. Biased training data is not the only issue: product teams — often predominantly male and white — can unintentionally perpetuate prejudice when their demographic homogeneity predisposes them to be unaware of divisive societal fault lines.[7]

4 TechGenix. (2019). AI cyber risks: What to look out for when deploying AI technology. Retrieved October 12, 2020, from http://techgenix.com/ai-cyber-risks/

5 United Nations Interregional Crime and Justice Research Institute. (2019). Artificial Intelligence and Robotics for Law Enforcement. Retrieved October 12, 2020, from http://www.unicri.it/news/article/Artificial_Intelligence_Robotics_Report

6 Reuters. (2018). Amazon scraps secret AI recruiting tool that showed bias against women. Retrieved October 12, 2020, from https://www.reuters.com/article/us-amazon-com-jobs-automation-insight/amazon-scraps-secret-ai-recruiting-tool-that-showed-bias-against-women-idUSKCN1MK08G

7 The Guardian. (2019, April 17). Disastrous lack of diversity in AI industry perpetuates bias, study finds. Retrieved October 12, 2020, from https://www.theguardian.com/technology/2019/apr/16/artificial-intelligence-lack-diversity-new-york-university-study

EXTERNAL PRESSURES FROM THE BROADER PUBLIC AGENDA

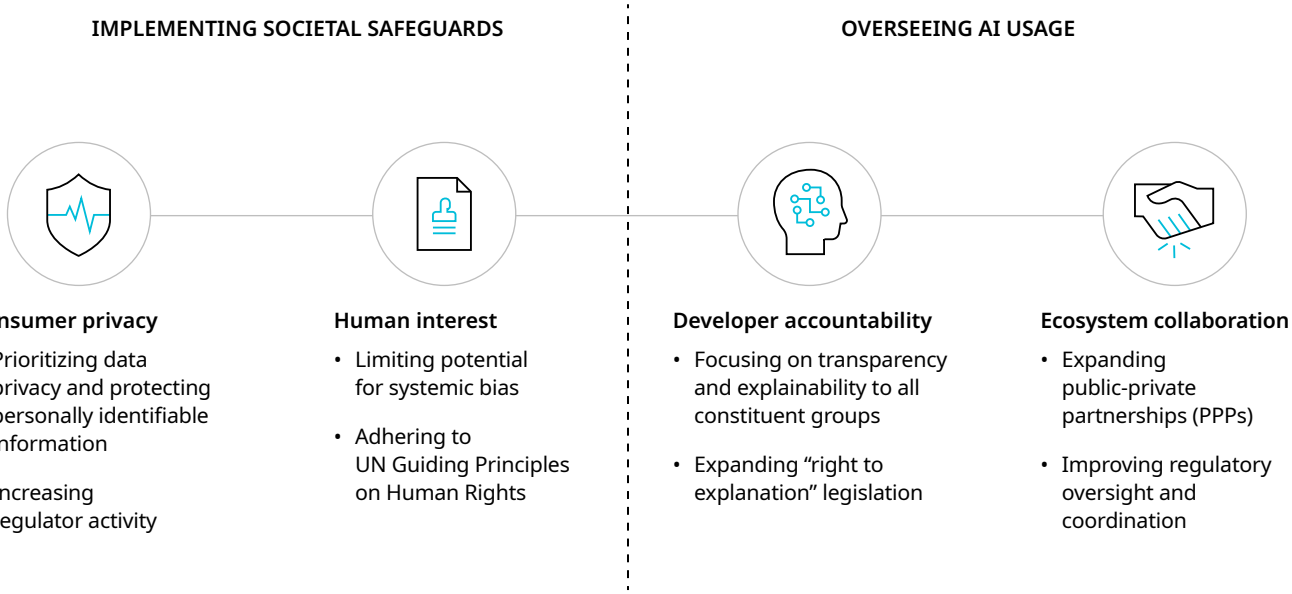
Businesses face external constraints as policymakers, regulators, and societies collectively work towards norms that balance private entrepreneurialism with public interest, instituting policies that govern the application of AI technology and sometimes herald long-term, often opaque, societal consequences.

Firms should be attuned to how policymakers and the public AI governance agenda may shape the business landscape in which organizations that leverage AI technology operate (see Exhibit 2).

IMPLEMENTING SOCIETAL SAFEGUARDS TO PROTECT THE PUBLIC INTEREST

Since AI algorithm inputs often include PII, consumers will predictably be exposed to new, powerful, and potentially meddlesome uses of their data.

Exhibit 2: Public governance agenda overview



Source: Marsh & McLennan Advantage

In widely disseminated press reports, some technology companies were much criticized over the alleged misuse of sensitive voice data recorded by their AI-powered digital assistants. In response, two US states enacted data privacy laws in 2018, and more than 17 others have since passed or drafted similar bills.[8] Given firms' enduring ability to generate insights from big data and subsequently exploit personal profiles in ways that consumers have not anticipated or accepted,[9] such scrutiny will surely persist.

In response to public concern about systemic bias in algorithm-based decision-making and also the potential for machines to usurp jobs, civil society organizations are calling on the business world to use AI in accordance with the UN Guiding Principles on Human Rights.[10] This might directly affect firms' bottom lines. Recent instances show users and, importantly, advertisers boycotting platforms, as well as employees advocating for change in sales practices.

Expanding the use of "right to explanation" laws is also being used in several US states to increase transparency in AI applications. Companies are quickly recognizing the importance of accountability in gaining and retaining public trust: many leading companies are already actively pledging to be transparent of their own accord.[11] However, while firms must be proactive in meeting these expectations, to balance risks, they should also be selective in what is disclosed. In some instances, algorithms can be reconstructed and intellectual property subsequently stolen based solely on the explanation of their output.[12]

OVERSEEING AI USAGE IN AN EVOLVING BUSINESS LANDSCAPE

As their use of AI solutions grows, businesses would benefit from taking soundings from a more expansive network. This might range from engaging with local academic institutions on the one hand to more formal public-private partnerships (PPPs) on the other. For instance, the National Science Foundation and the Partnership on AI, a network of more than 100 partners across 13 countries, is currently researching the sociotechnical dimensions of AI use.[13]

Since AI algorithm inputs often include PII, consumers will predictably be exposed to new, powerful, and potentially meddlesome uses of their data.

8 Virtu. (2020). Infographic: Data Privacy Law Momentum at the State Level. Retrieved October 12, 2020, https://www.virtru.com/education/data-privacy-law-infographic/

9 CNET. (2019). Amazon and Google are listening to you: Everything we know. Retrieved October 12, 2020, https://www.cnet.com/how-to/amazon-and-google-are-listening-to-your-voice-recordings-heres-what-we-know/

10 Global Future Council on Human Rights 2016-2018. (2018). How to Prevent Discriminatory Outcomes in Machine Learning. World Economic Forum. http://www3.weforum.org/docs/WEF_40065_White_Paper_How_to_Prevent_Discriminatory_Outcomes_in_Machine_Learning.pdf

11 IBM. (2019). IBM'S Principles for Data Trust and Transparency. Retrieved October 12, 2020, https://www.ibm.com/blogs/policy/trust-principles/

12 Milli, S., Schmidt, L., Dragan, A. D., & Hardt, M. (2019). Model reconstruction from model explanations. In Proceedings of the Conference on Fairness, Accountability, and Transparency (pp. 1-9). https://dl.acm.org/doi/abs/10.1145/3287560.3287562?download=true

13 Select Committee on Artificial Intelligence of the National Science and Technology Council. (2019). The National Artificial Intelligence Research and Development Strategic Plan: 2019 Update. https://www.whitehouse.gov/wp-content/uploads/2019/06/National-AI-Research-and-Development-Strategic-Plan-2019-Update-June-2019.pdf

Beyond allowing public and private sectors to share best practices for public benefit, partnership projects and networks can generate long-term advantages for companies. These include brand enhancement with customers, new commercial opportunities with different partners, and a stronger voice in policy debates. Trust and transparency regarding data ownership and access on co-developed AI platforms is critical for success, especially when these platforms operate in the public domain, such as Smart City arrangements. AI can be a tool for enhancing value but also for obscuring how data is used — and by whom — if its use is not governed by appropriate controls.

The complexity of operating within this network is compounded by the global fragmentation of data standards, which continues to impede the effectiveness of regionally focused regulatory efforts. The General Data Protection Regulation (GDPR), for example, cannot prevent personal information that was "forgotten" in the EU domain from being displayed in AI-enabled search engines outside of the region.[14] Companies operating across jurisdictions may struggle to align their usage of AI with regional mandates necessitating decentralized policy rollouts tailored to specific contexts and geographies. Furthermore, companies with one value system may struggle against competitors operating in accordance with different principles.

Companies with one value system may struggle against competitors operating in accordance with different principles.

14 Towards Data Science, Medium. (2019). Looking at AI-focused Case Studies. Retrieved October 12, 2020, https://towardsdatascience.com/looking-at-ai-focused-case-studies-139e0bb98ff5

AI GOVERNANCE

To mitigate risks and realize the potential of AI, businesses need a governance framework that is based on intent, fairness, transparency, safety, and accountability. To operationalize it effectively, they must then establish adequate safeguards, ensure active oversight arrangements, and institute an internal process for maintaining control.

TOWARDS RESPONSIBLE AI DEPLOYMENT AND USE

Growing awareness of the pitfalls and societal impacts of AI use has sparked an explosion of AI governance frameworks (see sidebar: "*A review of published AI governance frameworks*"). An assessment of more than 60 publications against the intrinsic risks and external pressures set out above suggests that businesses should base their AI governance efforts across five critical dimensions:

INTENT: By using data in a principled manner and verifying that AI design and implementation processes are ethically aligned and appropriate, businesses will be better positioned to manage risks and execute their internal review and oversight processes.

FAIRNESS: Companies need to ensure that the processes and outputs of their AI system do not unwittingly discriminate against any group or individual. By achieving this, firms can reap reputational benefits, foster greater public trust, and minimize the external risks to their business.

TRANSPARENCY: Companies should ensure that their AI processes are explainable and repeatable. Not only does this facilitate compliance reviews and stakeholder trust, it also supports continued efforts to improve AI development and deployment.

SAFETY/SECURITY: Companies that establish robust capabilities in data governance, threat protection, and user privacy are better able to detect malicious incursions, thereby mitigating adverse outcomes, minimizing their legal liability, and maximizing the utility of their data.

ACCOUNTABILITY: Companies should undertake rigorous audit and compliance assurance processes. Those that are mindful of the concerns of their various stakeholders — lawmakers, auditors, customers, business partners, and shareholders, among others — will better build confidence, fulfill regulatory requirements, and avoid complications in the future.

A review of published AI governance frameworks

A review of 60-plus published frameworks highlights how different types of author place a different value on each dimension and how they should be enforced (see Exhibit 3).

Frameworks published by companies, both Big Tech and those adopting AI, tend to focus on voluntary best-practice mechanisms rather than regulation. Additionally, they are less vocal than other types of authors with regard to Accountability and Intent — in comparison to Transparency and Safety/Security. This instinctive reticence may expose them to consumer and regulatory backlash in the event of things going wrong.

Exhibit 3: Summary of governance frameworks

Frameworks		Enforcement		Coverage				
Authorial source	# of papers	Voluntary	Regulatory	INTENT	FAIRNESS	TRANS-PARENCY	SAFETY/ SECURITY	ACCOUN-TABILITY
Big Tech	7			◑	◑	◕	◕	◔
Companies adopting AI	7			◔	◕	◕	◑	◔
Think tanks	9			◕	◕	●	◕	◑
Academia/ researchers	7			◕	◑	●	◕	◕
Policymakers/ governments	17			◕	◕	●	◕	●
Multi-stakeholder organizations	12			●	●	◕	●	◕

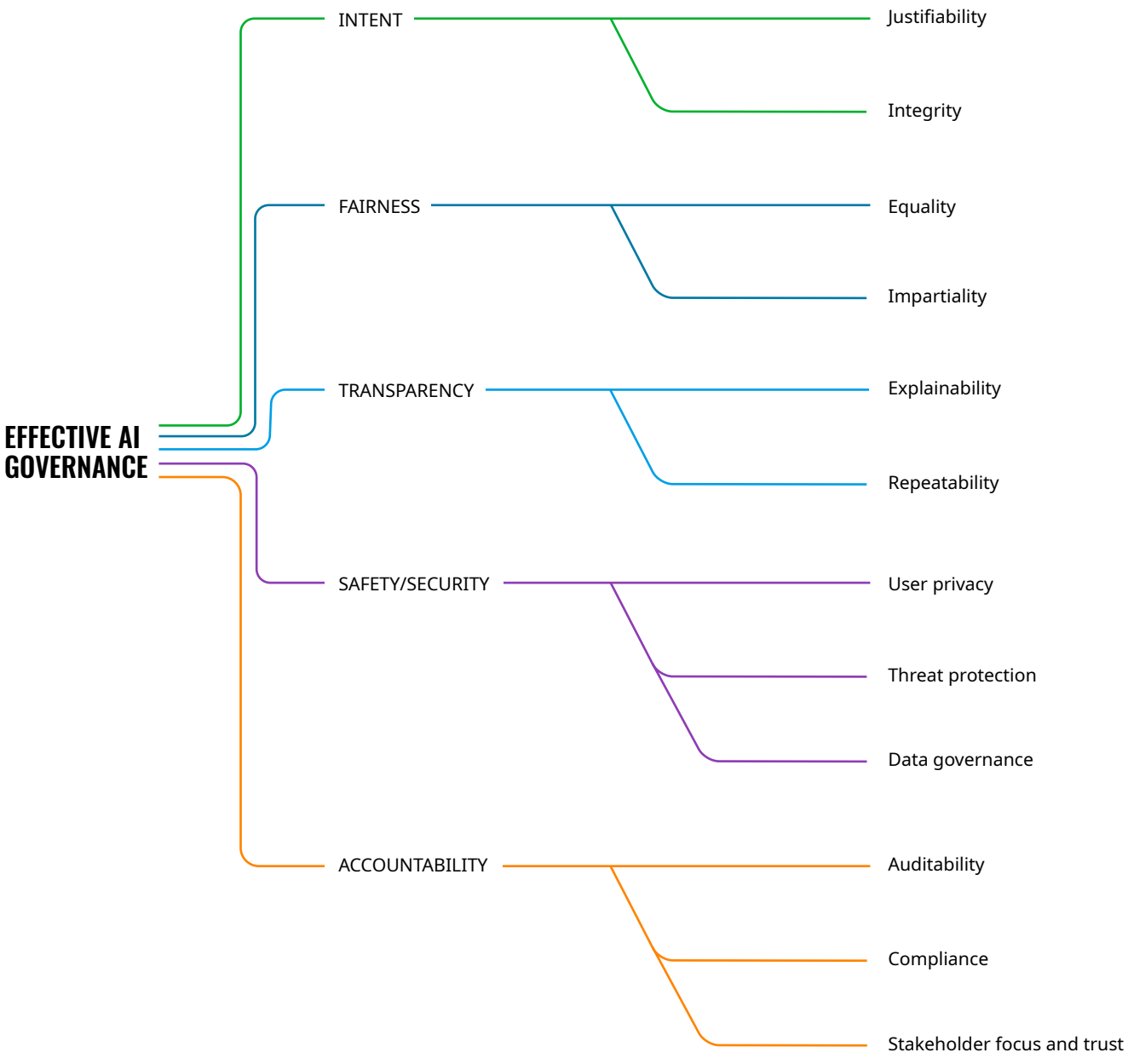
Topical focus:

● Very prevalent, frequently addressed ○ Less prevalent, occasionally considered

Source: Marsh & McLennan Advantage

The following framework expands on the five dimensions to help firms effectively oversee and assess their usage of AI technology (see Exhibit 4).

Exhibit 4: A holistic approach to effective governance



Source: Marsh & McLennan Advantage

	Imperative	Why it matters
INTENT	**Justifiability** Demonstrate that design and implementation processes, as well as the decision output, are aligned with expressed purpose	• Provides assurance that decisions adhere to intended objectives and logic • Facilitates internal review and oversight • Enhances risk management for new and existing models
	Integrity Ensure data is used in a responsible and appropriate manner	• Prevents negative social outcomes and brand implications associated with improper harvesting and selling of data
FAIRNESS	**Equality** Promote equal access and similar opportunities for all individuals and groups	• Mitigates the risk of disenfranchisement • Fosters public trust • Contributes to alleviating broader societal inequality
	Impartiality Minimize the likelihood/occurrence of biased outcomes	• Protects brand by mitigating algorithmic bias through internal and external oversight mechanisms
TRANSPARENCY	**Explainability** Produce explanatory diagnostics — inputs, intermediate factors, and outputs — that can be interpreted by developers, practitioners, and consumers; eliminate "black box" outputs	• Enables continued improvement efforts • Facilitates internal compliance reviews • Builds consumer confidence and accelerates adoption
	Repeatability Generate predictable and reproducible outputs complemented by effective supervision and maintenance processes	• Builds confidence in model output and reliability • Overcomes inherent trust issues and facilitates stakeholder acceptance
SAFETY/SECURITY	**User privacy** Protect consumer privacy and restrict AI influence to the express purpose for which it is intended	• Safeguards customer rights and builds trust and reputation • Minimizes legal liability
	Threat protection Guard AI decision engines from overt intrusion and indirect malicious inputs	• Prevents unintended algorithmic outputs • Builds user confidence in the system's ability to safely function as intended
	Data governance Manage data assets in a holistic fashion to generate value from information	• Ensures data accessibility, usability, integrity, and security • Maximizes utility of data
ACCOUNTABILITY	**Auditability** Provide traceable and verifiable model outputs that can be tested both internally and externally, with simulated or real data inputs	• Enables model assessment for bias, compliance, accuracy • Produces auditable system records — inputs, logic, outputs — to ensure adherence to auditing standards/criteria
	Compliance Adhere to relevant laws and contribute to regulatory agenda	• Fulfills ethical compliance standards • Allows the business and industry to play a role in shaping the AI regulatory agenda
	Stakeholder focus and trust Implement stakeholder-centered policies with clear enforcement mechanisms	• Prioritizes the collective benefit of all stakeholders — customers, shareholders, employees, partners, etc. • Requires a higher duty of care and disclosure to prevent improper outcomes — data expiration/use, facial recognition stipulations, etc.

ACTIVATING GOVERNANCE

A framework is only useful if it can be practically and effectively implemented. In applying it, companies need to institute supporting governance infrastructure and mechanisms — an oversight committee, risk register, testing, and policy development and enforcement, among others — in a structured and rigorous manner (see Exhibit 5). With proper oversight in place, concerns can be identified and mitigation initiatives pursued.

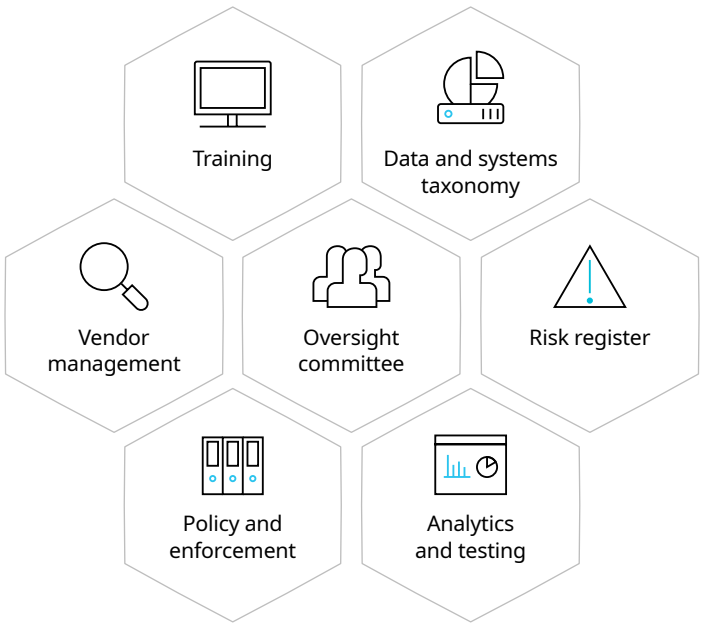
An **oversight committee**, independent of the development team and with a level of ambition endorsed by the Board of Directors, should be convened to ensure AI technologies are deployed in alignment with the firm's values and monitored to ensure adherence to control arrangements. It may be useful for this committee to comprise senior representatives from key functions such as risk management, IT, public affairs, legal, compliance, audit, and human resources to ensure a range of perspectives. The committee will also need to determine the value of, and approach to, decentralizing subsequent tiers of oversight.

To enable comprehensive coverage and oversight, a **data and systems taxonomy** should be established to serve as a guide, which details specific AI applications (including third-party solutions): This would capture data inputs and usage patterns, any associated sensitivities, required validation and testing cycles, and expected outputs.

A **risk register** should then set out the types of issues that may arise, linking this to systems and risk sources. This can be a foundation for appreciating the magnitude of the impact, the level of vulnerability, and the extent of the control regime and monitoring protocols to be applied.

Analytics and testing should be executed on a frequent and ongoing basis to monitor those risk issues that relate to system inputs, outputs, and model components. Such elements might include explainability features, bias checks, consistency monitors, intervention thresholds, back testing, and validation.

Exhibit 5: Elements of disciplined governance



Source: Marsh & McLennan Advantage

Policies and enforcement should establish norms, roles and accountabilities, approval processes, maintenance guidelines, and change control across the development lifecycle — from initiation to decommissioning. Key performance indicators, based on clear standards and tolerances, can be used to monitor compliance and measure improvement.

When using third-party solutions, it is critical to have proper **vendor management** practices and understand the robustness of vendor controls, with appropriate transparency on deviations enshrined in contracts.

Training and awareness programs for staff involved in developing, selecting, or using AI tools should be mandatory to ensure behaviors and processes are aligned with corporate expectations.

Where AI use is under particular public scrutiny, or businesses are otherwise trying to strengthen stakeholder trust, it may benefit companies to bring in independent and reputed third parties. Such parties would obviously need sufficient access and authority to effectively highlight gaps and recommend meaningful corrective actions if the business is to avoid the perception of a whitewashing.

Critically, governance mechanisms and companies must place a focus on continuous review and improvement — both at an AI application level via systems testing to mitigate potential lapses if model drift occurs and the algorithm requires recalibration and testing, and also at the process level to account for technological developments that may require revisions to wholesale testing strategies, training and awareness programs, or oversight arrangements. Businesses that elect to use external AI solutions should not assume that the vendor will bear the brunt of any mishap. The customer's first inclination is to hold the most proximal source of the overstep accountable.

AI has the potential to bring significant efficiencies and unlock new potential for business by automating processes and identifying hidden opportunities through analytical insights. However, realizing this is only possible if risks are managed. By framing the governance of their AI solutions around the five dimensions identified and instituting the governance processes outlined, businesses can ensure that they do not expose themselves to undue risk, or worse, inadvertently cause harm to broader society.

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EVERSHEDS SUTHERLAND

Testing for AI bias

Colorado Division of Insurance proposes first-of-its kind regulation requiring life insurers to test their underwriting process for racial and ethnic bias

On September 28, 2023, the Colorado Division of Insurance (**CDI**) released the first-of-its kind draft proposed regulation (**Testing Regulation**) for testing the outcomes of certain life insurance underwriting practices for racial and ethnic bias. Only underwriting processes that use external consumer data and information sources (**ECDIS**), and/or algorithms and predictive models using ECDIS (**Models**) would be the subjects of the rule.

The draft regulation would also require life insurers to immediately remediate any outcome that the testing indicates is unfairly discriminatory by taking "reasonable steps developed as a part of the insurer's risk management framework."[1] These steps include any additional testing "necessary to demonstrate the effectiveness of the remediation."

The draft Testing Regulation is one of a series of regulations implementing SB 21-169, a law that prohibits Colorado licensed insurers from using, in their "insurance practices," any ECDIS and Models that "unfairly discriminates."[2] Comments are due on the draft Testing Regulation by October 26, 2023.

Scope. All life insurers authorized to do business in the state of Colorado that employ ECDIS or Models to make or support underwriting decisions would be required to comply with the Testing Regulation. Note that under the Testing Regulation the testing requirements are limited to unfair discrimination with respect to race or ethnicity rather than all of the protected classes covered by SB 21-169. Only underwriting processes, defined as the process of evaluating an individual risk factors and determining their insurability and the premium to be charged, must be tested and only if they use ECDIS or Models.

Lookback for estimating race or ethnicity. Insurers must estimate the race or ethnicity of all proposed insureds that have applied for life insurance on or after the date the insurer initially adopted the use of ECDIS or Models in their underwriting decision-making process, including a third party acting on behalf of the life insurer that used ECDIS or Models in the underwriting process.

This provision raises many questions, including whether there should be a limitation on the lookback period, given the breadth of the definition of ECDIS, which may sweep in many older systems, and whether insurers will have retained the records required to determine when they first adopted the use of ECDIS or Models in their underwriting process. Furthermore, insurers may not have kept the records needed to determine all persons who applied for insurance during this period.

Definition of ECDIS. Under the Testing Regulation, ECDIS is defined more broadly than in SB21-169 to include "a data source or an information source that is used by a life insurer to supplement or

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1 The CDI adopted its first regulation under SB 21-169 on September 21, 2023, effective November 14, 2023, It requires Colorado's life insurers to adopt a governance and risk management (GRM) framework with respect to their use of ECDIS and Models (GRM Regulation) that supports policies and procedures to determine whether use of ECDIS and Models results in unfair discrimination with respect to race and to remediate such discrimination, if detected

2 SB 21-169 prohibits Colorado licensed insurer's use of ECDIS and Models in "insurance practices (defined in the statute as marketing, underwriting, pricing, utilization management, reimbursement methodologies and claims management) that "unfairly discriminate" based on race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression."

supplant traditional underwriting factors…" ECDIS includes, "credit scores, credit history, social media habits, purchasing habits, home ownership, educational attainment, licensures, civil judgments, court records, occupation that does not have a direct relationship to mortality, morbidity or longevity risk, consumer-generated Internet of Things data, biometric data and any insurance risk scores derived by the insurer or third-party from the above listed data or similar data and/or information source." This definition is almost identical to the definition of ECDIS in the final GRM Regulation, which includes "locations", while the draft Testing Regulation does not.

ECDIS does not include traditional underwriting factors, which is defined for the first time in the Testing Regulation as the following factors:

1. Information provided by or on behalf of the individual to whom the information relates in response to questions on the application for insurance including medical information, family history, and disability
2. Occupational information, based on actuarially sound principles, that has a direct relationship to mortality, morbidity or longevity risk
3. Behavioral information related to a specific individual, including motor vehicle records and criminal history of non-juvenile felony conviction that has a direct relationship to mortality, morbidity or longevity risk
4. MIB data
5. Prescription drug history
6. Income tax, assets, or other elements of a specific person's financial profile provided on an application for insurance by the applicant
7. Digitalized or other electronic forms of the information listed above

Estimating Race or Ethnicity: Use of Bayesian Improved First Name Surname Geocoding (BIFSG). The Testing Regulation would require life insurers for the first time to estimate the race or ethnicity of each proposed insured using the BIFSG, which is a statistical method developed by the RAND corporation to estimate the race and ethnicity of an individual based on the individual's name and residential address. Insurers are to use the insureds' or proposed insureds' name and geolocation information included in the application for life insurance when using the BIFSG.

Insurers are to use the following categories when using the BIFSG: Hispanic, Black, Asian Pacific Islander (API) and White.

The initial test must include application data from the date the insurer first used ECDIS or Models in underwriting through December 31, 2023. Thereafter, testing must be performed annually "to include additional application data through December 31st of the previous year," suggesting that subsequent applicant data is additive onto the original data base.

While BIFSG has not, to our knowledge, been required by any state insurance regulator in the past to infer the race or ethnicity of an individual, some form of this methodology has previously been endorsed by courts in cases involving employment discrimination and Voting Rights Act cases.

However, because life insurers lack experience with using the BIFSG, it would be reasonable for the CDI to give insurers a test period to understand the issues that will arise when they use the BIFSG with their first data set of "all applicants" and to allow insurers time to discuss these issues with the CDI.

Furthermore, application data may span more than one decade. As a result, the insurer's data should be tested using the BIFSG file that aligns to the census data immediately following the date of the application.

Application Approval Decision Testing. Insurers would be required to use logical regression to assess whether there is a statistically significant difference in approval rates of Hispanic, Black and API applicants compared to White applicants, using BIFSG as a method for estimating the race and ethnicity of the insurer's applicants—information that most insurers will not have. If there is no statistical difference in approval rates (defined by the regulation to be a p-value of greater than .05) or if there is a statistical difference but that difference is less than five (5) percentage points, no further testing is required. Policy type (defined as permanent or term life insurance, and if term, the duration of the term), face amount, age, gender, and tobacco use may be used as control variables when determining if there is such a statistical difference.

Premium Rate Testing. Insurers must also determine if there is a statistically significant difference in the premium rate per $1,000 of face amount for policies issued to Hispanic, Black and API insureds relative to White insureds. As with the application approval test, linear regression must be used to determine if there is a significant difference in premium rate per $1,000 of face amount for policies issued to Hispanic, Blacks, or API applicants compared to White applicants. If there is no statistical difference (defined by the regulation to be a p-value of greater than .05) or if there is a statistical difference but that difference is less than five (5) percentage points, no further testing is required. Policy type, face amount, age, gender, and tobacco use may be included as control variables.

Variable Testing. If the difference in approval rates or premium rates under the application approval test or the premium rate test is statistically significant (defined by the regulation to be a p-value of less than .05) and five (5) percentage points or higher, then the life insurer is required to conduct additional statistical testing to identify the variables contributing to the difference and whether there is a relationship between those variables and race and ethnicity.

If any ECDIS variable or Model is deemed to have a direct relationship to a disproportionate negative outcome, it is deemed unfairly discriminatory and the life insurer must take reasonable steps, as provided for in their GRM framework, to remediate any unfair discrimination identified by the variable testing, including additional testing necessary to demonstrate the effectiveness of the remediation.

The insurer must include a description of the remediation steps taken in their report to CDI due April 1, 2024.

Note that the Testing Regulation does not discuss what steps CDI will deem adequate to remediate unfairly discriminatory outcomes and there are no limitations on the types of remediation measures that may be required under the Testing Regulation. Remediation measures are not explicitly limited to prospective measures regarding the use of ECDIS in underwriting on a going forward basis and could conceivably include measures to adjust or refund premium on policies that were underwritten in a discriminatory manner in the past.

Reporting Requirements. The proposed regulation sets out an expectation that life insurers will complete their first testing using the BIFSG for calendar year 2023 and then submit a report to CDI by April 1, 2024 and annually thereafter. The report must include the number of applicants used in the testing, as well as the number of applications received overall for the period beginning with the initial adoption of ECDIS and Models. A detailed summary of the test results from the application approval testing, premium rate testing and variable testing, including remediation steps taken, the timing of the remediation steps and subsequent testing is required.

We do not believe April 1, 2024 is a realistic deadline. Life insurers will need to gather, reformat and prepare their data in order to conduct the tests and may encounter difficulties when using the BIFSG for the first time. Insurers may therefore find it difficult to prepare the data and complete testing by April 1, 2024.

The Interplay of the draft Testing Regulation and the Final GRM Regulation. It is important to keep in mind the interplay between the draft Testing Regulation and the adopted GRM Regulation. Under the GRM Regulation, an insurer's GRM Framework must include a "documented description" of the testing required by the Testing Regulation, including "the methodology, assumptions, results and steps taken to address unfairly discriminatory outcomes."

The filing requirements of the two regulations are out of sync. By June 1, 2024, the GRM Regulation requires insurers to file with CDI a narrative report summarizing their progress in complying the regulation, including any difficulties encountered. Final compliance is required by December 1, 2024. Yet, the draft Testing Regulation would require a complete testing report, with remediation, to be filed much earlier—by April 1, 2024—and there is no provision, such as a testing period, to provide for a discussion with CDI of any difficulties insurers may have encountered in using the BIFSG or conducting the tests for the first time.

Implications for property-casualty (P&C) insurers. CDI plans to establish regulations implementing a GRM framework for P&C insurers and has suggested that the framework will not look very different from the framework for life insurers. Testing for P&C insurers have common features (such as use of BISFG) but also will vary in some respects (such as traditional underwriting factors).

We will continue to follow developments related to SB21-169 and other laws and regulations affecting insurers using algorithms, predictive models, autonomous decision making systems and artificial intelligence.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed or the Eversheds Sutherland attorney with whom you regularly work.

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Colorado Division of Insurance adopts final rule on use of big data and predictive models

September 29, 2023

The Colorado Division of Insurance (***CDI***) adopted a new regulation on September 21, 2023 (***Final Regulation***) establishing requirements governing the use of external consumer data and information sources (***ECDIS***), as well as algorithms and predictive models using ECDIS (***Models***), by Colorado-licensed life insurers in order to help ensure that life insurers who use ECDIS and Models are not engaging in unfair discrimination with respect to race. The Final Regulation will go into effect on November 14, 2023. All life insurers authorized to do business in Colorado will be required to submit a progress report regarding compliance with the Final Regulation on June 1, 2024 and must submit a report attesting that they are in full compliance with the Final Regulation on December 1, 2024 and annually thereafter.

The Final Regulation is set forth in 3 CCR 702-10 of the Colorado Code of Regulations, and requires that life insurers adopt a governance and risk management (***GRM***) framework with respect to their use of ECDIS and Models. The Final Regulation implements, in part, S.B. 21-169, which prohibits Colorado licensed insurer's use of ECDIS and Models in "insurance practices," that "unfairly discriminate" based on race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression. An initial draft of the Regulation was first proposed on February 1, 2023 (***Initial Draft Regulation***) and a revised draft (***Revised Draft Regulation***) was exposed on May 26, 2023.

The GRM framework must provide for testing to detect unfair discrimination. The CDI just released a separate proposed regulation that establishes the requirements for the quantitative testing of life insurer's ECDIS and Models.

Overview of Regulation

Scope. The Final Regulation applies to all life insurers authorized to do business in Colorado and defines ECDIS very broadly to include "a data or an information source that is used

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by a life insurer to supplement or supplant traditional underwriting factors or other insurance practices or to establish lifestyle indicators that are used in insurance practices." ECDIS includes credit scores, social media habits, purchasing habits, locations, educational or occupational background, Internet of Things data, biometric data and any insurance risk scores derived from such data. However, under the Final Regulation the GRM framework requirements are limited to unfair discrimination with respect to race rather than all of the protected classes covered by S.B. 21-169.

Governance and Risk Management Framework. Section 5.A of the Final Regulation requires that insurers adopt a GRM framework that establishes procedures, systems and controls to identify any areas where the use of ECDIS and/or Models would potentially result in unfair discrimination with respect to race and remediate such discrimination. The insurer is also responsible for ensuring that any third-party vendor complies with the GRM framework requirements set forth in Section 5.A. The GRM framework requirements set forth in Section 5.A include, among other things:

1. Documented governing principles regarding the use of ECDIS and Models;

2. Board oversight of the GRM framework;

3. Senior management responsibility and accountability for monitoring the use of ECDIS and Models;

4. Establishment of a cross-functional ECDIS and AI Model governance group;

5. Documented policies and procedures regarding the use and monitoring of ECDIS and Models;

6. Protocols for addressing consumer complaints;

7. Implementation of a training program for relevant personnel on the responsible and compliant use of ECDIS and Models;

8. A documented rubric for assessing and prioritizing risk associated with the deployment of ECDIS and Models;

9. Documented up-to-date inventory, including version control, of all utilized ECDIS and Models and an explanation of any material changes in the inventory;

10. A description of testing conducted to detect unfair discrimination resulting from the use of ECDIS and Models;

11. A description of ongoing monitoring of the performance of the Models, including accounting for model drift;

12. A description of the process used for selecting third-party vendors that provide ECDIS and Models; and

13. The annual review and update of the GRM framework to ensure continued accuracy and relevance.

Reporting Requirements. Pursuant to Section 6 of the Final Regulation, insurers using ECDIS or Models are required to submit a report due June 1, 2024 summarizing progress made in complying the with the GRM framework. Insurers must then submit an annual report, due December 1, 2024 and each year thereafter, that is signed by an officer attesting to compliance with the Final Regulation, which includes the title and qualifications of the personnel responsible for ensuring compliance. If the insurer is unable to attest to compliance, the insurer must submit to CDI a corrective action plan. Insurers that do not use ECDIS and/or Models must on December 14, 2023, and on December 1 annually thereafter, submit an attestation signed by an officer of the company that the insurer does not use ECDIS or Models.

Confidentiality. Under Section 7 of the Final Regulation any documents or materials disclosed to CDI will be treated as confidential.

Enforcement. Noncompliance with the Final Regulation may result in the imposition of penalties available in the business of insurance laws or other laws under Section 9 of the Final

Regulation. Potential penalties including civil penalties, cease-and-desist orders, and license suspension or revocation.

Changes from Prior Draft

The Final Regulation contains a few material changes from the Revised Draft Regulation that are listed below:

- **Scope of GRM Framework.** Under the Final Regulation the scope of the GRM framework was expanded to identify not only instances where the use of ECDIS and Models result in unfair discrimination with respect to race but also instances that might ***potentially*** result in unfair discrimination.

- **Remediation.** Under the Final Regulation, the GRM framework now explicitly must address remediation of unfair discrimination in the use of ECDIS and Models if detected.

- **Vendors.** Insurers are only responsible for ensuring that third party vendors comply with the GRM framework in Section 5.A of the Final Regulation rather than ensuring that all regulatory requirements regarding the use of ECDIS and Models are met. Third party vendors are now explicitly permitted to provide any requested documents under the Final Regulation directly to CDI.

- **Key Personnel.** Insurers are now required not only to provide the title of each individual responsible for ensuring compliance with the Final Regulation in their annual compliance report but also their qualification. They are not required, but are permitted, to provide the names of the individuals in the report.

- **Model Drift.** Under the Final Regulation, the GRM framework's procedures for monitoring the performance of algorithms and predictive models that use ECDIS are

explicitly required to account for model drift.

- **Annual Review of GRM Framework.** The GRM framework now must be reviewed and updated as necessary annually whereas under the Revised Regulation that insurer was required to conduct a less specific "regular" review of the GRM framework.

- **Biometric Data.** The definition of "ECDIS" under the Final Regulation now explicitly includes biometric data.

What's Ahead

In order to implement the requirements under S.B.21-169 restricting the use ECDIS and Models to prevent unfair discrimination, CDI intends to issue the following separate set of regulations:

- A regulation on Models testing for life insurers for which, as described above, an initial draft of the proposed regulation was exposed by CDI on September 28, 2023. The industry previously requested that the Final Regulation and testing regulations be effective concurrently given that the two regulations are intertwined, but the implementation of the Final Regulation is not subject to the adoption of the testing regulation.

- Regulations implementing a framework for property-casualty insurers to be released by CDI. The CDI held a public meeting for stakeholders in August and has previously suggested that GRM framework for other property-casualty insurance would not look very different from the regulations for life insurers.

We will continue to follow developments related to S.B.21-169 and other laws and regulations affecting insurers using algorithms, predictive models, autonomous decision making systems and artificial intelligence.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed or the Eversheds Sutherland attorney with whom you regularly work.

EVERSHEDS SUTHERLAND

NAIC releases highly-anticipated draft model bulletin on artificial intelligence systems used by insurers

July 25, 2023

On July 17, 2023, the Innovation, Cybersecurity and Technology (H) Committee of the National Association of Insurance Commissioners (NAIC) released for comment a highly anticipated model bulletin (Model Bulletin) on regulatory expectations for the use of artificial intelligence[1] systems (AI Systems)[2] by insurers. The Model Bulletin encourages insurers to implement and maintain a board-approved written AI Systems Program (AIS Program) that addresses governance, risk management controls, internal audit functions and third-party AI systems. The goal of the AIS Program is to mitigate the risks of harm to consumers thru decisions made or supported by AI Systems, including third-party AI systems, that are arbitrary or capricious, unfairly discriminatory, or otherwise violate unfair trade practice laws or other legal standards, or that include data vulnerabilities.

The Bulletin also advises insurers of the information and documentation that insurance regulators may request during exams and investigations of the insurer's AI Systems, including third-party AI Systems.

1. Compliance with Applicable Laws and Guidance

The Model Bulletin recognizes the Principles of Artificial Intelligence (Principles) adopted by the NAIC in 2020 as an important source of guidance for insurers to use in their continuing development of an AIS Program. It also explains how the regulatory expectations outlined in the Model Bulletin are rooted in existing law, including model laws on unfair practices, corporate governance, market conduct and property and casualty ratings.

1. AIS Program Guidelines

Under the Model Bulletin, insurers are encouraged to maintain a written AIS Program that governs the use of AI Systems in order to mitigate the risk that use of such AI Systems, when making or supporting decisions that impact consumers, will

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result in decisions that are arbitrary or capricious, unfairly discriminatory, or otherwise violate unfair trade practice laws or other applicable law.

1. **Governance**

With regarding to governance, the AIS Program should:

1. be approved by the insurer's board or appropriate committee of the board;

2. vest senior management reporting to the Board or a committee of the Board with responsibility for developing, implementing, monitoring and overseeing the AI System;

3. include an assessment of the risks posed by the AI System and the nature and degree of potential harm to consumers arising from errors or unfair bias caused by the AI System;

4. be tailored and proportionate to the insurer's use and reliance on AI and AI Systems and address all phases of the AI System's life cycle;

5. address all of the insurer's AI Systems used to make decisions that impact consumers, whether developed by the insurer or a third party, and whether used by the insurer or by an authorized agent or representative of the insurer;

6. prioritize transparency, fairness and accountability in the governance framework for AI Systems;

7. at each stage in the life of an AI System, consider having a centralized or federated committee comprised of representatives from all disciplines and units within the insurer;

8. identify key personnel charged with implementing the AIS Program, including a description of such person's roles, responsibilities, qualifications and scope of authority;

9. identify escalation procedures and ongoing training and supervision of personnel;

10. document the monitoring, auditing and reporting protocols and functions within the AI Program; and

11. for predictive models, include a description of methods used to detect and address errors or unfair discrimination resulting from the model.

12. **Risk Management**

    With regard to risk management and internal controls, the AIS Program should document and address:

1. the oversight and approval process for the development, adoption and acquisition of AI Systems;

2. data practices and accountability procedures, including data lineage, quality, integrity, bias analysis and minimization, among other items;

3. management and oversight of algorithms[3] and predictive models, including:

   a. inventories

   b. detailed documentation of use

   c. measurements such as interpretability, repeatability, reproducibility and auditability of these measurements, and

   d. evaluation for drift;

4. validation, testing and auditing of data, algorithms and predictive models;

5. data and record retention policies regarding the AI Systems; and

6. protection of non-public information, including unauthorized access to the algorithms or models themselves.

7. **Third-Party AI Systems**

   Each AIS Program should address the insurer's standards for acquiring, use and reliance on AI Systems developed or deployed by a third- party, including:

1. the extent and scope of the insurer's reliance on third-party data;

2. appropriate due diligence to assess the third party, its AI Systems, and its AI governance and risk management protocols in order to make sure that the third-party AI Systems that are used to make or support decisions impacting consumers meet legal standards;

3. terms in the contract with third parties that:

   a. require third-party data and model vendors and AI System developers to have and maintain an AI Systems program commensurate with the standards expected of the insurer;

   b. entitle the insurer to audit the third-party vendor;

   c. entitle the insurer to receive audit reports by qualified auditors confirming the third-party's compliance with standards; and

   d. require the third-party to cooperate with regulatory inquiries and investigations by state insurance departments; and

4. performance of audits to permit the insurer to appropriately monitor any third-party vendors for compliance with applicable law.

5. **Regulatory Oversight and Requests for Information**

Under the Model Bulletin, the applicable state regulator has the authority to request from the insurer information and documentation relating to the insurer's AI Systems (as well as information and documentation developed by third parties that are relied upon by the insurer or its agent) as part of their market conduct examinations and as otherwise necessary to monitor the insurer's compliance with the law. Such information and documentation include:

- the AIS Program and related documentation, including policies and procedures related to the management and oversight of algorithms and predictive models;
- inventories and descriptions of algorithms, predictive models, and AI Systems;
- information and documentation related to validation, testing and auditing of AI Systems;
- information and documentation related to the protection of non-public information, including unauthorized access to the algorithms or models;
- due diligence materials relating to the third-party AI Systems;
- contracts with third-party AI System vendors; and
- audits and confirmation processes of third-party compliance with contractual and regulatory obligations.

Issues related to the draft Model Bulletin include the definitions of AI Systems and algorithms; the extent of the governance and risk management controls expected; and the expectation that third-party vendors of AI Systems will agree to be subject to inspection and inquiry by 50 state insurance departments, including market conduct exams.

1. **Comment Period**

Comments on the Model Bulletin are due to the NAIC's (H) Committee by September 5, 2023 and should be submitted to

Miguel Romero (maromero@naic.org). The (H) Committee will hear comments from in-person attendees at the NAIC's Summer National Meeting on Sunday, August 13, 2023 at 2:00 p.m.

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1 "Artificial Intelligence" is defined as "machine-based systems designed to simulate human intelligence to perform tasks, such as analysis and decision-making, given a set of human-defined objectives. This definition treats machine learning as a subset of artificial intelligence."
2 "AI Systems" are defined as "an umbrella term describing artificial intelligence and big data related resources utilized by insurers."
3 "Algorithm" is defined as a computation or machine learning process that augments or replaces human decision-making in insurance operations that impact customers.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed or the Eversheds Sutherland attorney with whom you regularly work.

Friday General Session Course Materials

ARIAS U.S.

Fall Conference

November 9-10, 2023

New York, NY

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THE VIEWS EXPRESSED IN THESE SLIDES ARE NOT ATTRIBUTABLE TO INDIVIDUAL SPEAKERS, BUT ARE INTENDED TO SERVE AS A SPRINGBOARD FOR PANEL DISCUSSION

ARIAS U.S.

Pet Peeves: What Are The Biggest Complaints/Dislikes About Arbitration And What To Do About Them

November 10, 2023

Mark Gurevitz
Sylvia Kaminsky
David Raim
Susan Aldridge
Amy Kline, Moderator

The Process

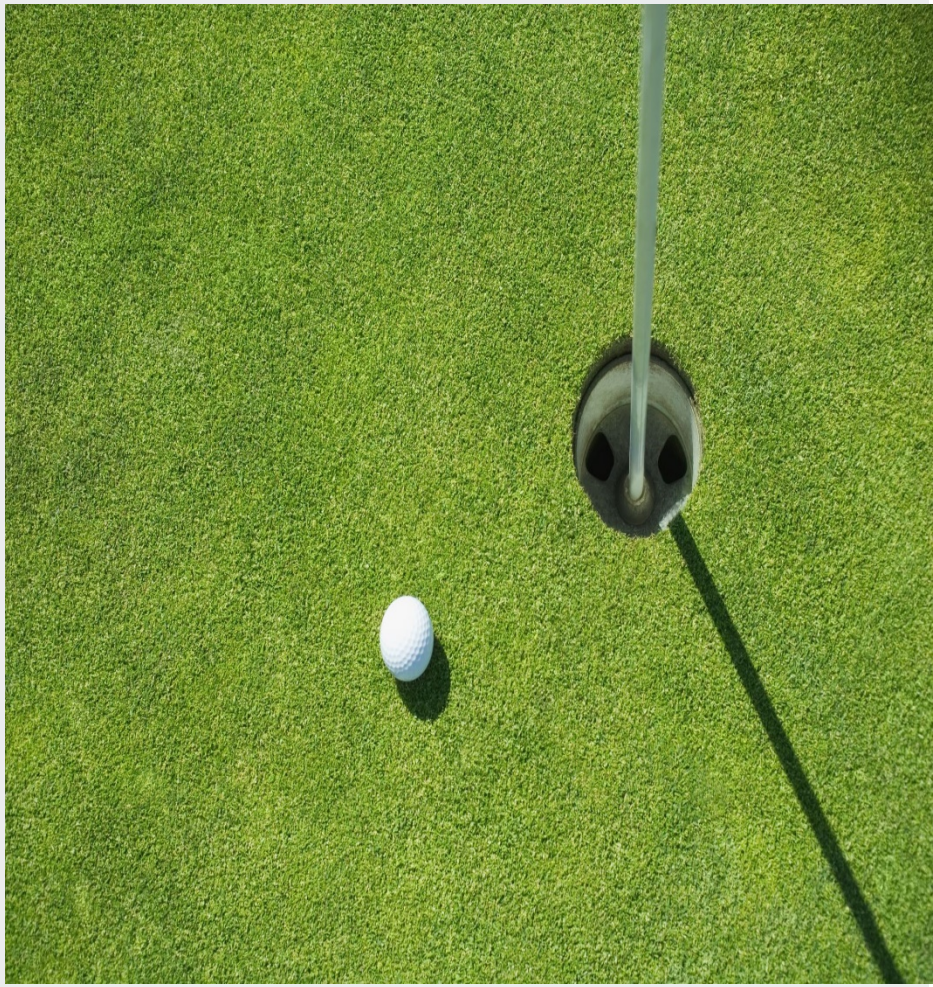
- Solicited feedback from company representatives and outside counsel
- Presented results to arbitrators to consider

What We Will Address Today

- What companies and their attorneys dislike about the arbitration process (and potential solutions they propose)
- Arbitrators' responses to these criticisms
- Potential solutions that may improve the process

What We Will NOT Address Today

- Things arbitrators can't control—e.g., umpire selection process, desire for all neutral panels
- Any arbitrator "pet peeves"



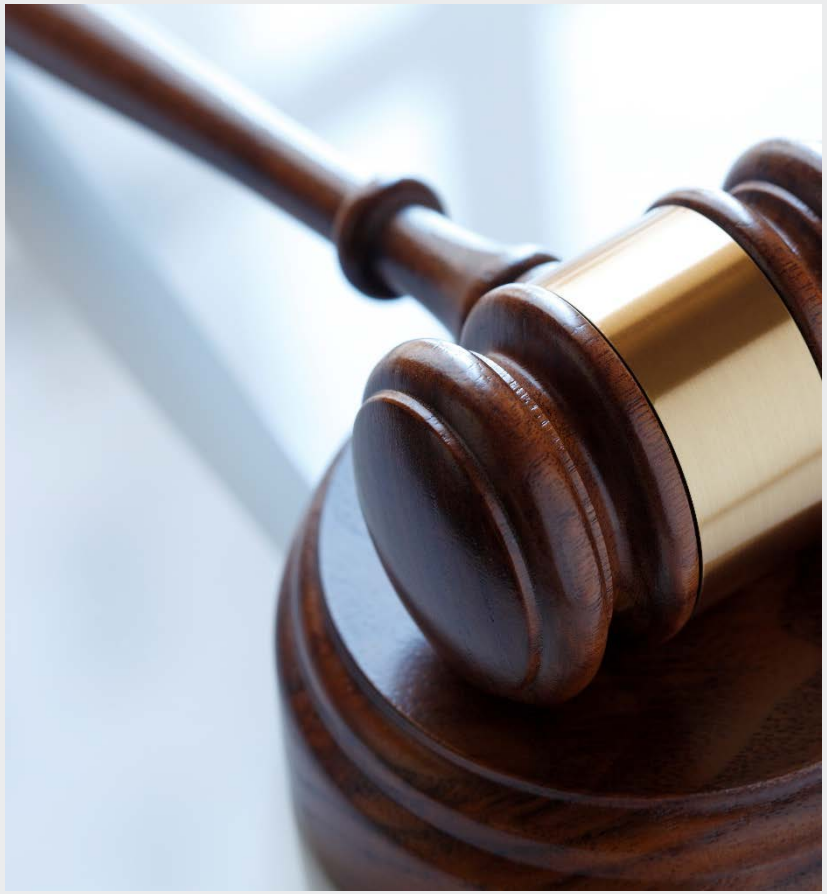
Pet Peeve 1:
Panels, Please Help Us Because We Lawyers Can't Help Ourselves

- Parties given too much latitude because panel is worried about challenges
- Overzealous counsel engage in "scorched earth" discovery
- Arbitrations are too expensive and take too long

Pet Peeve 1
What Can Panels Do?

Require good cause or leave of panel to:

- Take depositions beyond a certain number
- Present experts
- Submit dispositive motions



Pet Peeve 1
What Else Can Panels Do?

- Shut down unnecessary witness testimony once they “get it”
- Preclude testimony completely if believe it is unnecessary or duplicative
- Fact testimony introduced through written witness statements, followed by cross

Pet Peeve 2: Horses For Courses

- Small dollar cases must be tried cost effectively
- Use proportionality in allowing discovery and determining hearing time

Pet Peeve 3: Arbitrators Are Too Partisan

- Enough with the biased party arbitrator questions
- Umpires need to control aggressive party arbitrator behaviour
- Ex parte communication should cease after organizational meeting

Pet Peeve 4: Too Much Opportunity For Abuse Of Process

- Panels don't do enough to lock parties into their claims and defenses by conclusion of discovery
- Late produced evidence should not be permitted

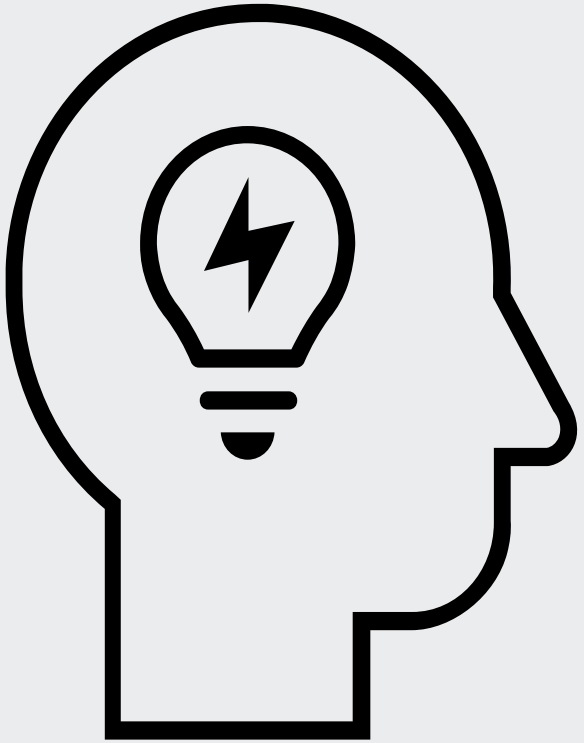
Pet Peeve 4: Other Ways To Limit Abuse Of Process

- Limit pleadings to avoid late-identified issues
- Consider imposing sanctions for abuse of process

Pet Peeve 5: Do As We Ask And Not As You Think

- Don’t bring up issues in deliberations that were not raised by the parties
- Don’t render awards based on a rationale the parties did not have an opportunity to brief

Pet Peeve 5
Possible Solutions



- Before close (or perhaps commencement) of hearing, panels should convene to discuss whether there are any issues the parties have not raised that the panel wishes for the parties to address

- Panels should consider establishing internal rules so that one arbitrator may not raise a new issue or procedural suggestion without first running it by the other panel members

Pet Peeve 6: Groundhog Day

- Awards should be clear and precise
- Awards should fully address all issues raised to prevent parties from seeking relief on the same issue(s)

Pet Peeve 6
Declaratory Relief

- Consider options for resolving disputes on the same issue(s) that may arise in the future

Where Do We Go From Here?

- Present ideas that most arbitrators and counsel agree would lead to positive change to ARIAS committee as action items

QUESTIONS???

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New York, NY

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Do Cheaters Never Prosper?

Suggestions for Curbing Abuses in Arbitration

Daniel L. FitzMaurice, Day Pitney LLP
Steven C. Schwartz, Chaffetz Lindsey LLP

Some caveats

1. "**Alleged**": many of the cases we reference concern *alleged* facts. What actually happened and why were disputed and likely remain so.

2. "**Cheating**": even on undisputed facts, reasonable minds can often differ as to where aggressive advocacy ends and cheating begins.

3. "**Academic freedom/non-attribution**": we are not acting in any official capacities or on behalf of any client, our firms, or even ourselves. The purpose of this program is to provoke thought and debate in hopes of moving toward constructive solutions.

ARIAS U.S.

Tactic: Fabricate an Agreement to Arbitrate and then wait for the other side to default

To cheat in arbitration, do you need an agreement to arbitrate?

Bey v. Fid. Inv. LLC, No. 23-920, 2023 WL 2504754 (E.D. Pa. Mar. 14, 2023)

- Bey claimed Fidelity essentially took his bonds
- He demanded that Fidelity arbitrate before the American Arbitration Management Services ("AAMS")
- He relied on an altered customer services agreement that he alone had signed
- Fidelity ignored the arbitration demand
- The arbitrator found that Fidelity agreed to arbitrate through "**passive acquiescence**"
- The arbitrator issued an award in Bey's favor worth approximately **$100 Billion**.

Bey v. Fid. Inv. LLC, No. 23-920, 2023 WL 2504754 (E.D. Pa. Mar. 14, 2023)

- Bey filed a motion to confirm the award in the Pennsylvania Court of Common Pleas
- Fidelity removed the case to federal court
- The judge noted that Bey and AAMS were part of the "American Morish and Sovereign Citizen" movement
- The judge found that there was no arbitral agreement and that the AAMS conspired with Bey to commit fraud
- The Court denied the motion to confirm

Could there ever be a reinsurance arbitration without an arbitral agreement?

Olsen v. U.S. ex rel. U.S. Dep't of Agric., 546 F. Supp. 2d 1122 (E.D. Wash. 2008), *aff'd sub nom., Olsen v. U.S. ex rel. Fed. Crop Ins. Corp.*, 334 F. App'x 834 (9th Cir. 2009)

- Lynn Olsen and Carr Farms bought crop insurance from American Growers Insurance Company (AGIC)
- They suffered crop losses 2 years in a row and made a claim; AGIC resisted
- The Nebraska Insurance Department liquidated AGIC
- The insureds demanded that AGIC's reinsurer, the Federal Crop Insurance Corporation (FCIC), arbitrate
- The policy had an arbitration clause (AAA), but the reinsurance treaty did not

Could there ever be a reinsurance arbitration without an arbitral agreement?

Olsen v. U.S. ex rel. U.S. Dep't of Agriculture

- FCIC wrote advising it would not participate because it had not: (a) agreed to arbitrate, or (b) waived sovereign immunity
- The arbitrator issued two awards in favor of the insureds for over $3 million
- The insureds sued to confirm the awards; the FCIC moved to vacate
- The Court vacated the awards, finding that:
  - (a) the policy's arbitration clause bound only AGIC/insureds, and
  - (b) FCIC never agreed to arbitrate.

How do the ARIAS•U.S. Rules treat this issue?

Rule 2.1 of the ARIAS •U.S. Rules for the Resolution of Insurance and Reinsurance Disputes ("Rules"):

> 2.1 **Arbitration Agreement** — an agreement to submit present or future disputes to arbitration, whether contained in a reinsurance contract or other written document reflecting the agreement of the Parties.

Rule 1.5:

> 1.5 The Panel shall have all powers and authority not inconsistent with these Rules, the **agreement of the Parties**, or applicable law.

ARIAS • U.S. RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

How do the ARIAS•U.S. Rules treat this issue?

Rule 15.3:

15.3 The Panel is authorized to award any remedy permitted by the **Arbitration Agreement** or subsequent written agreement of the Parties. In the absence of explicit written agreement to the contrary, it is within the Panel's power to award any remedy allowed by applicable law, including, but not limited to: monetary damages; equitable relief; pre- or post- award interest; costs of arbitration; attorney fees; and other final or interim relief.

ARIAS • U.S. RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

How can the ARIAS•U.S. Rules be improved?

- *Change Rule 4.1 to require that the arbitration demand identify all applicable arbitral agreement(s)*

- *Change the prehearing procedure in Rule 10 to*:

  - *Require the petitioner to supply a copy of any arbitral agreement(s) and allow a response from the respondent, including by identifying any other arbitral agreements*;

  - *Identify as a topic for the organizational meeting any disputes over the existence and terms of any arbitral agreement(s).*

ARIAS • U.S. RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

Tactic: Stack the umpire deck with ringers and unqualified candidates

The perfect umpire is someone who has already concluded that my side is right!

Nat'l Cas. Co. v. OneBeacon Am. Ins. Co., No. 12-CV-11874, 2013 WL 3335022 (D. Mass. July 1, 2013), *aff'd sub nom., Emps Ins. Co. of Wausau v. OneBeacon Am. Ins. Co.*, 744 F.3d 25 (1st Cir. 2014)

- OneBeacon arbitrated against one reinsurer and lost
- A federal court confirmed the award in favor of reinsurer #1
- OneBeacon demanded that Wausau and National Casualty (collectively, Wausau) arbitrate over the same issues
- The parties agreed to a consolidated arbitration and to choose the umpire by the name three/strike two/DJIA method
- Wausau's nominees included:
  (a) the umpire in the first arbitration; and
  (b) the party-appointed arbitrator for reinsurer #1.

Nat'l Cas. Co. v. OneBeacon

- The umpire from arbitration #1 declined to complete a questionnaire in arbitration #2
- Reinsurer #1's party-appointed arbitrator withdrew
- To replace the former umpire, Wausau nominated: the in-house lawyer/company rep for reinsurer #1 in arbitration #1
- Wausau then sued seeking a judgment declaring that collateral estoppel barred OneBeacon's claim; OneBeacon cross-petitioned to disqualify Wausau's latest nominee
- The Court dismissed the complaint and denied OneBeacon's cross-petition

Does the finger problem require changes to the ARIAS•U.S. Rules or Code of Conduct?

- ARIAS•U.S. Rule 6.7 provides that, if the party-appointed arbitrators cannot agree on an umpire, then each will nominate 5 candidates.
- The ARIAS•U.S. Neutral Selection Process provides for ARIAS•U.S. to randomly select nominees from the Certified Umpire or Certified Arbitrator list. ***Should the Rules adopt this random-selection procedure?***
- Canon 1 of the ARIAS•U.S. Code allows for a party to nominate an individual who is currently serving as a party-appointed arbitrator. ***Should the Code prohibit an individual currently serving as a party-arbitrator in one matter from acting as umpire in another arbitration involving that same party?***

ARIAS • U.S. RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

ARIAS•U.S. Code of Conduct

Tactic: Make sure the umpire knows whom to thank for the appointment

We thought you should know . . .

Affiliation bias (or effect): “[T]he implicit bias of the arbitrator to favor the appointing party.”

Sergio Puig, Anton Strezhnev, *Affiliation Bias in Arbitration: An Experimental Approach*, 46 J. Legal Stud. 371, 373 (2017)

Experiment to Test for Affiliation Bias in Arbitration

- 257 solo mock arbitrators: volunteers drawn from among experienced arbitrators and counsel
- Four groups: members of each group were given a fictional source of their appointment: (a) the claimant; (b) the respondent; (c) as a joint effort; or (d) a tribunal.
- Hypothetical: the claimant has prevailed; the remaining issue is how to allocate costs and fees. Options are to award costs/fees: to the claimant, to the respondent, or for each party to bear its own.

Experiment to Test for Affiliation Bias in Arbitration

Results:

- Those told either they were appointed jointly by the parties or by a tribunal generally ruled in the same proportion among the options.
- On average, arbitrators who were informed the claimant appointed them were **18% more likely** to award the claimant costs/fees than those told they were appointed by the respondent.

CONCLUSION: The experiment confirms that affiliation bias may influence some arbitrators, even volunteers engaged in a mock arbitration.

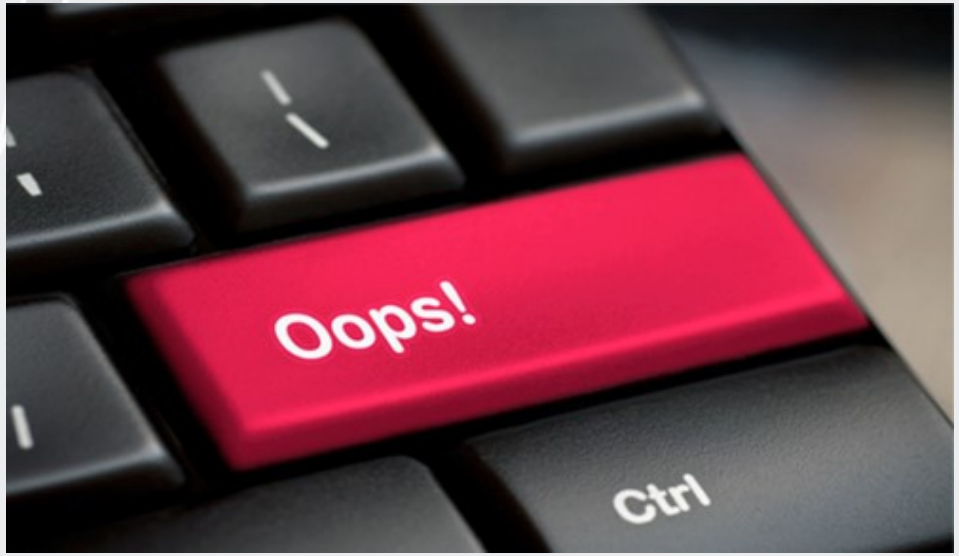
What happens when a party inadvertently or intentionally advises the umpire of the source of the nomination?

Allstate Ins. Co. v. OneBeacon Am. Ins. Co., 989 F. Supp. 2d 143, 147 (D. Mass. 2013):

- OneBeacon submitted a position statement that included as an exhibit a supplemental arbitration demand from which the umpire could determine that OneBeacon was the source of the nomination – i.e., **inadvertent disclosure**;

- Allstate sued seeking to disqualify the umpire and to enjoin the arbitration;

- The Court found that OneBeacon had not violated any contractual obligation to Allstate and denied the requested relief.



What happens when a party inadvertently or intentionally advised the umpire of the source of the nomination?

Allstate Ins. Co. v. OneBeacon :

• The Court also concluded Allstate's request was procedurally improper, because there is no mechanism to disqualify an umpire in a pending arbitration.

• Lastly, the Court concluded further that Allstate failed to establish it was irreparably harmed by having to arbitrate before an umpire who knew the source of the appointment, rejecting the contention that it was futile for Allstate to proceed before this umpire.

What happens when a party inadvertently or intentionally advised the umpire of the source of the nomination?

*IRB-Brasil Resseguros S.A. v. Nat'l Indem. Co., No. 11 CIV. 1965 NRB, 2011 WL 5980661, at *5–7 (S.D.N.Y. Nov. 29, 2011))*:

- IRB's party-appointed arbitrator submitted an affidavit during court proceedings in which he disclosed that, before nominating two umpire candidates, he contacted each to "confirm their interest, ability, and willingness to serve as IRB's Umpire Candidate." Thus, there was an intentional disclosure of the source (plus ex parte contacts).
- NICO moved to disqualify one of these nominees (the other nomination had become moot). NICO argued the nominee was "under the control" of IRB and, thus, ineligible under the parties' agreement.

What happens when a party inadvertently or intentionally advised the umpire of the source of the nomination?

IRB-Brasil Resseguros S.A. v. NICO:

- The Court denied the motion to disqualify: "It is well established in this Circuit that parties are precluded from attacking the partiality of an arbitration panel until after an award has been issued."
- "While NICO is free to challenge the "evident partiality" of the panel under Section 10(a)(2) of the FAA after an award is rendered, it may not challenge the partiality of the arbitrators at this stage of the proceedings."

TAKEAWAY: Whether a party intentionally or unintentionally discloses the source of the appointment, a court will not intervene before the final award.

How do the ARIAS•U.S. Neutral Panel Rules and Insurance Panel Rules treat selection and the source of nominations?

Rules 6.4-6.10 of the ARIAS •U.S. Neutral Panel Rules and of the ARIAS •U.S. Insurance Panel Rules provide:

- Neutral Rules: each party nominates 6 neutral arbitrator candidates; Insurance Panel Rules: each party nominates 3 umpire candidates.
- ARIAS-U.S. distributes questionnaires and, upon selection, will notify the Parties and Panel.
- "**Under no circumstances will the Parties or ARIAS-U.S. disclose to the Panel who nominated the arbitrators/umpire for service or what ranking the Parties gave the arbitrators.**"
- Unilateral contacts and ex parte communications with a candidate are prohibited.

ARIAS • U.S. NEUTRAL PANEL RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

ARIAS • U.S. PANEL RULES FOR THE RESOLUTION OF INSURANCE AND CONTRACT DISPUTES

How do the ARIAS•U.S. Rules treat this issue?

Rules 6.5 and 6.7 of the ARIAS •U.S. Rules provide:

- Absent an agreement between the party-appointed arbitrators, each party nominates 5 candidates; the party-appointed arbitrators send umpire questionnaires; each party strikes 4 of the other party's nominees; and then the umpire is chosen by lot from among the remaining candidates;
- "**Unilateral contact with a nominee by a party, party-appointed arbitrator, or its representative is not permitted unless and until the Panel, after being duly constitutes, so permits.**"

Should the Rules add an express prohibition on advising nominees of the source, as the Neutral and Insurance Panel Rules do?

ARIAS • U.S. RULES FOR THE RESOLUTION OF U.S. INSURANCE AND REINSURANCE DISPUTES

How does the ARIAS•U.S. Code treat this issue?

Canon I: Integrity:

• 1. The foundation for broad industry support of arbitration is confidence in the fairness and competence of the arbitrators.

• 2. Arbitrators owe a duty to the parties, to the industry, and to themselves to be honest; to act in good faith; to be fair, diligent, and objective in dealing with the parties and counsel and in rendering their decisions . . . .

• 3. . . . There are certain circumstances where a candidate for appointment as an arbitrator **must refuse to serve**:

e) where the candidate is nominated for the role of umpire and the candidate was contacted prior to nomination by a party, its counsel or the party's appointed arbitrator with respect to the matter for which the candidate is nominated as umpire

CODE OF CONDUCT

How does the ARIAS•U.S. Code treat this issue?

Canon VIII: Just Decisions:

• Arbitrators should make decisions justly, exercise independent judgment and not permit outside pressure to affect decisions.

• 2. Arbitrators should, after careful review, analysis and deliberation with the other members of the panel, fairly and justly decide all issues submitted for determination.. . . .

CODE OF CONDUCT

Should the Code offer direction about what an umpire or neutral arbitrator should do if, after being chosen, he or she learns of the source of the nomination?

As a practical matter, are nominees often aware of the source without necessarily being told?

Tactic: Obtain access to Panel deliberations.

Wouldn't you like to be in the room where it happens?

What happens if a party or its counsel receive access to Panel deliberations?

Nat'l Indem. Co. v. IRB Brasil Resseguros S.A., 164 F. Supp. 3d 457, (S.D.N.Y. 2016), amended, No. 15 CIV. 1165 (NRB), 2016 WL 3144057 (S.D.N.Y. Apr. 14, 2016), and aff'd sub nom. Nat'l Indem. Co. v. IRB Brasil Reseguros S.A., 675 F. App'x 89 (2d Cir. 2017)):

- Jan. 15, 2015: FINAL DECISION by majority that the cedent, IRB, failed to demonstrate its allocation was objectively reasonable
- April 15, 2015: Second decision by a majority: NICO is entitled to keep the premium under the 2008 treaty
- April 16, 2015: IRB's party-arbitrator issues a 6-page, single-spaced dissent to both rulings
- April 17, 2015: The umpire responds: "comparing the clearly written . . . dissent with the manner in which [the arbitrator] has communicated within the panel over the past three years, [I] can only surmise that he was not the (sole) author."

What happens if a party or its counsel receive access to Panel deliberations?

Nat'l Indem. Co. v. IRB Brasil Resseguros S.A.:

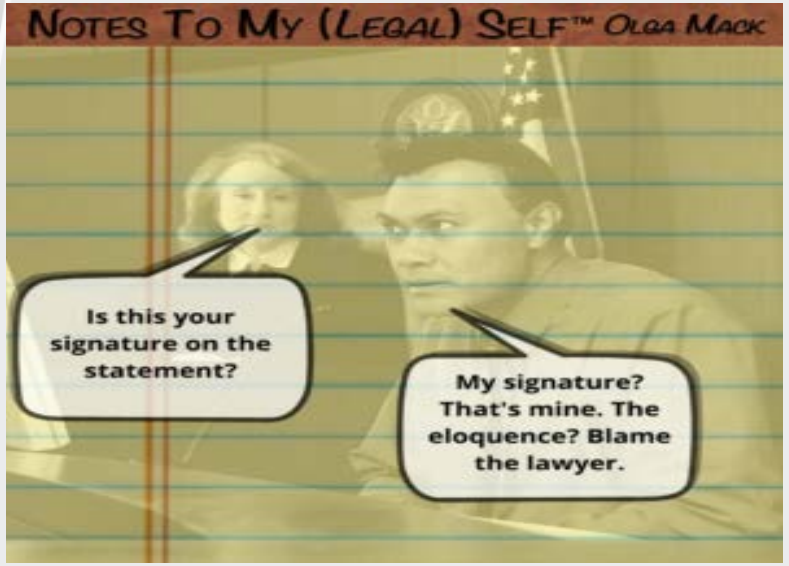
- IRB's counsel later admitted that:

(a) IRB's party-arbitrator, unsolicited, contacted IRB's counsel on an ex parte basis during Panel deliberations – supposedly to express his concern that the umpire was "biased in favor of NICO";

(b) IRB's counsel "provided [the arbitrator] with a template draft dissent for his consideration"; and

(c) IRB's arbitrator adopted the dissent that counsel had drafted.

- IRB's new counsel withdrew the dissent as one of the bases to show evident partiality, and IRB lost its petition to vacate.



Was that wrong? Should the arbitrator/counsel have not done that?

What happens if a party or its counsel receive access to Panel deliberations?

Nw. Nat. Ins. Co. v. Insco, Ltd., No. 11 CIV. 1124 SAS, 2011 WL 4552997 (S.D.N.Y. Oct. 3, 2011):

- Fall 2010: Insco's arbitrator tells its counsel that he was concerned about the relationship between NNIC's arbitrator and its counsel
- Feb. 11, 2011: Insco's arbitrator shares with counsel private email communications among panel members
- Feb. 15, 2011: Insco demands that the Panel resign; Insco's arbitrator alone resigns
- After resigning, Insco's former arbitrator provides to its counsel 182 pages of intra-panel emails
- A U.S. District Judge later found these emails included panel deliberations and discussions of pending issues

Panel Deliberations

What happens if a party or its counsel receive access to Panel deliberations?

Nw. Nat. Ins. Co. v. Insco, Ltd.:

- NNIC sued seeking to disqualify Insco's counsel
- In the arbitration, Insco appointed a replacement arbitrator
- The panel (including Insco's new arbitrator) issued a statement that the disclosures by Insco's former arbitrator "struck at the heart of the arbitral process . . . ."
- The Court disqualified Insco's counsel and said:

> Allowing parties to obtain confidential panel deliberations would provide an unfair advantage in the legal proceedings and have a chilling effect on the ability of arbitrators to communicate freely.

What happens if a party or its counsel receive access to Panel deliberations?

Nw. Nat. Ins. Co. v. Insco, Ltd.:

- The Court quoted Comment Three to the ARIAS Code of Conduct, Canon IV:

  It is not proper at any time for arbitrators to . . . inform anyone concerning the contents of the deliberations of the arbitrators.

- The Court also cited ARIAS Ethics Guidelines:

  An arbitrator should not reveal the deliberations of the Panel. To the extent an arbitrator predicts or speculates as to how an issue might be viewed by the Panel, the arbitrator **should at no time repeat statements made by any member of the Panel in deliberations** or even his or her own.

CODE OF CONDUCT

What happens if a party or its counsel receive access to Panel deliberations?

Nw. Nat. Ins. Co. v. Insco, Ltd.:

- The Court also quoted the American Bar Association's Code of Ethics for Arbitrators in Commercial Disputes:

> In a proceeding in which there is more than one arbitrator, it is **not proper at any time for an arbitrator to inform anyone about the substance of the deliberations** of the arbitrators.

- Lastly, the Court quoted NY Rules of Professional Conduct, Rule 8.4(c) and (d):

> **A lawyer or law firm shall not**: . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation; . . . engage in conduct that is prejudicial to the administration of justice.

AMERICAN BAR ASSOCIATION

Code of Ethics for Arbitrators in Commercial Disputes

New York State Unified Court System

PART 1200
RULES OF PROFESSIONAL CONDUCT

Whatever ethical rules apply to cheating in arbitration, who will enforce them?

Courts generally do not oversee ethical conduct in arbitration

- The Federal Arbitration Act generally allows courts to act only after an award and, even then, upon strong evidence and with limited recourse. *E.g., Certain Underwriting Members of Lloyds of London v. Fla. Dep't of Fin. Servs.*, 892 F.3d 501, 505 (2d Cir. 2018) (requiring proof of evident partiality by "clear and convincing evidence").

- As Judge Jacobs observed in *Lloyds v. Florida*:

  > We acknowledge the value of disclosure, transparency, and ethical conduct on the part of arbitrators. . . . Mainstream arbitral guidelines such as ARIAS . . . require comprehensive disclosure. . . . It would appear that [the cedent's arbitrator] violated these ethical codes . . . . However, it is well-established that such ethical violations do not compel vacatur of an otherwise-valid arbitration award.

Should arbitrators oversee and enforce ethical conduct in arbitration?

- "[A]rbitrators can and should be the first line of defense in dealing with participant misconduct."

- "Given the lack of institutional controls over the arbitral forum, the arbitrators appear to be the first and last resort to protect participants and ensure a fair forum."

- Suggested reforms include: "expanding the criminal laws dealing with crimes against the administration of justice to the arbitral forum or ever so slighting loosening the standards of vacatur in the event of unethical conduct or both."

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Lying, Stealing, and Cheating: The Role of Arbitrators as Ethics Enforcers, 52 Univ. of Louisville L. Rev. 443 (2014)

Should ARIAS•U.S. adopt an enforcement regime to ensure ethical conduct and address cheating in insurance and reinsurance arbitrations?


ARIAS
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