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

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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* (6^{th} 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.