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NO REINSURER SPIKING ALLOWED - NOW SETTLED ENGLISH LAW: EQUITAS AND MMI SUPREME COURT CASE IS DISCONTINUED

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The case between Equitas and Municipal Mutual Insurance (MMI) has been discontinued, bringing to an end a dispute that was due to be heard by the UK Supreme Court this week. Last year's ruling by the Court of Appeal therefore stands as settled law. This is an important victory for reinsurers with similar inwards exposures.

The conclusion of this long-running saga means that the reinsurance industry finally has judicial guidance as to how employers' liability (EL) mesothelioma claims (arising out of exposure to asbestos spanning a number of policy years) should be presented to reinsurers and, specifically, that insurers cannot present 100% of a mesothelioma claim to any applicable year of reinsurance cover of its own choosing (an allocation method known as "spiking").

Mesothelioma Claims: summary of the law to date

In brief, the dispute concerned the treatment of mesothelioma claims in certain contracts of employers' excess of loss liability reinsurance. This is a hotly debated issue in the reinsurance market and, until today, there has been no authority on it.

However, in order to understand the background to the settlement, the Court of Appeal's decision and its relevance to the reinsurance market as a whole, it is important to understand the English cases that went before it.

"Fairchild"

The House of Lords held that any one of many employers who had exposed a victim to asbestos was liable for the total loss caused by the mesothelioma of the employee.

"Barker"

The Court held that liability could be apportioned between employers according to the extent to which they had contributed to that risk.

The Compensation Act 2006 reversed *Barker* and provided that an employee who has contracted mesothelioma from any of a number of employments can claim compensation in full from any one employer. That employer can then claim a contribution from other liable employers (if they can be identified/located).

The Supreme Court in *Zurich v International Energy* commented that insurers on one year would be liable for the whole claim even when they were on risk for only part of the relevant exposure period and the insurer would then have the right to claim contributions from other insurers on risk/the employer itself.

Equitas v MMI

The arbitral proceedings and permission to appeal

Lord Justice Flaux ("Flaux") was appointed to hear a dispute between Municipal Mutual Insurance (MMI) and Equitas, as a judge-arbitrator under a special procedure in a confidential arbitration related to MMI's attempts to "spike" Equitas with its mesothelioma claims i.e. to choose which reinsurance year to allocate losses. Lord Justice Flaux is currently presiding over the FCA test case concerning non-damage BI claims in the context of Covid-19.

Flaux's award allowed MMI (the reinsured) to "spike" each reinsurance claim to any applicable year of reinsurance cover of its own choosing.

Equitas sought leave to appeal to the Court of Appeal which leave was granted under Section 69 of the Arbitration Act (on a point of law).

The Court there held (whilst specifically stating that it was NOT making a decision on those issues at that stage) that leave to appeal should be granted because it was arguable that Flaux's decision was open to serious doubt for the following reasons:

1. **Implied Allocation Issue**

As set out above, Flaux had held that a reinsurer could be held liable for the whole loss even though it was only on risk for part of the period in the same way as insurers were (under *Zurich*).

The Court of Appeal was persuaded when considering the application for leave to appeal, that there was a *"seriously arguable case for treating the insurance and reinsurance positions differently".*

2. **Good Faith Issue**

Flaux held that the reinsured's duty of good faith (in this context) was limited only to a duty not to act dishonestly in making the claim and did not affect the reinsured's ability to "spike" its reinsurers.

The Court of Appeal was persuaded that, if Flaux LJ's decision is right in that the reinsured has a choice as to how it allocates its losses to reinsurers, there was "force in the submission" that this

restrains the reinsured's duty of good faith.

3. **Recoupment and Contribution Issue**

In terms of Equitas' (the reinsurer's) right to claim a contribution from other reinsurers and against MMI for any "self-reinsurance", Flaux held that contributions should be apportioned in accordance with the "independent liability" method i.e. in proportion to: (a) the amounts that would have been borne by each layer/retention if the whole claim had been presented to each relevant year; and (b) the relative amount of exposure which occurred in each relevant year.

The Court of Appeal identified three "potential problems" with Flaux LJ's determination of this issue:

1. There is nothing in the existing authorities which assists with the determination made on retentions;

2. There is a "strong argument" that the issue of contribution/recoupment in insurance/reinsurance is different from the *Fairchild* case of not needing to prove who caused the injury; and

3. The Court could see "considerable force" in the argument that the higher layers of reinsurance in subsequent years should be made good first in any contribution and recoupment process on the basis that they should always be furthest from the risk.

The Court concluded that it was just and proper for the Court to determine this appeal despite the decision of the parties to resolve the matter by way of arbitration on the basis that the parties had not excluded the right of Appeal under s 69 Arbitration Act.

The Court of Appeal also considered the issue to be important for the insurance/reinsurance industry and recognised that the same issues were likely to come up in subsequent arbitrations and that therefore it was desirable for the Court of Appeal to make a determination of the issue.

The Court of Appeal's decision on 17 April 2019

The Court of Appeal had to address three questions of law.

In the event of an insured employee being 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:

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

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

3. 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 Court of Appeal answered these questions as follows:

1. No;

2. Yes, unless there is some other rational basis for ascertaining the contribution to the risk in each triggered policy year;

3. This question did not arise unless the answer to question 2 (if appealed to the Supreme Court) is held to be wrong, in which case the Equitas (the reinsurer's) method should be applied.

Comment

The Court of Appeal's decision was appealed and was scheduled to be heard by the Supreme Court this week (8 - 9 July 2020). Both insurers and reinsurers with mesothelioma claims had been awaiting the outcome of the Supreme Court hearing with interest. However, the late abandonment by MMI of their final chance of appeal draws the case to a close without the three questions referred to above being determined by the highest Court in England and Wales. The Court of Appeal's judgment stands and is an important clarification for the market concerning mesothelioma exposures. The law is now clear: no spiking is allowed.

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MEET THE TEAM

Jonathan Sacher

London

jonathan.sacher@bclplaw.com
+44 (0) 20 3400 2307

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