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Intertwined Worlds of Insurance, Reinsurance, and the Law in the U.S. and U.K.

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In late May 2023, the Second Circuit Court of Appeals issued a detailed and complex decision that demonstrates in an unusually lucid fashion that the interconnected worlds of U.S. and U.K. insurance and reinsurance law — despite being populated by a people "divided by a common language" and separated by the proverbial "pond" — remain forever conjoined. *The Insurance Company of the State of Pennsylvania v. Equitas Insurance, Ltd.*, No. 20-3559 (2d Cir., May 23, 2023).

The interconnected U.S. and U.K. insurance/reinsurance industries are governed by two independent legal systems, yet manage to co-exist in remarkable harmony, aided by able and diligent lawyers and jurists. This decision, in the authors' view, also shows, yet again, that U.S. courts are more than capable of understanding, analyzing, and adjudicating complex insurance coverage issues and reinsurance disputes involving both U.S. and U.K. law.

Given the ubiquitous nature of arbitration clauses in reinsurance contracts (especially treaties), this type of public, reasoned, and articulate decision stands out as a significant benefit to both the U.S. and U.K. insurance and reinsurance business communities. Even were an arbitration panel qual-

ified and able to render such a complex and multi-layered case law-driven award/decision, it would almost surely remain confidential and thus be of no value to anyone beyond the parties to the dispute. Moreover, there are many federal court judges (and even some state court judges) familiar with and experienced in adjudicating complex insurance and reinsurance disputes. And, as discussed over many years at industry conferences, many of those judges have been tutored by reinsurance practitioners (including expert witnesses) and attorneys in some very high-stakes litigations, i.e., the very same professionals who populate the reinsurance arbitration community. Thus, much of the body of U.S. reinsurance case law developed over the last thirty-five years, as observed up close by these authors, has been derived from the joint efforts of astute counsel, their knowledgeable clients, expert witnesses, and able judges. It is clear that litigation remains an integral component of the insurance/reinsurance dispute resolution universe, rather than an alien process outside the industry it serves and continues to be an important complement to the arbitration process.

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The Underlying Dispute

The dispute in *Equitas* arose out of ICSOP's umbrella liability coverage of Dole Foods from 1968-71. In 2009, homeowners in Carson, California sued Dole for groundwater contamination and pollution of their soil. Dole and ICSOP settled the claims and allocated $20 million of their settlement to the ICSOP-Dole policy even though the alleged property damage continued long after the policy period. The insured and insurer/cedent applied the "all sums rule" in allocating the settlements. Under California law, the "all sums rule" "treats any insurer whose policy was in effect during any portion of the time during which the continuing harm occurred as jointly and severally liable (up to applicable policy limits) for all property damages or personal injuries caused by a pollutant." *The Ins. Co. of the State of Pennsylvania v. Equitas Ins., Ltd.*, No. 20-3559, at p. 3 (2d Cir., May 23, 2023).

Based on that allocation, ICSOP then billed its reinsurer, Equitas (successor to Lloyd's syndicates), under a facultative reinsurance policy provided via Lloyd's policy form J1 (the "Policy"). Lloyd's policy form J1 is extremely brief and rather vague, at least compared to U.S. facultative certificates and London reinsurance slip policies of more recent vintage. The face sheet of the Policy bears the Lloyd's seal with the assertion that the form is "approved by Lloyd's Underwriters Fire and Non-Marine Association" and bears the legend at the bottom "Form J1(6.8.59)". The Policy provides on its face sheet that, "[i]n

the event of any occurrence likely to result in a claim under this Policy, immediate notice should be given to: [Underwriters]." This language is the entire notice of loss provision. The only other relevant term in the Policy is what most would consider a very brief, short form "follow the settlements" clause, oddly not cited by the court until almost the very end of the lengthy decision:

> Now We the Underwriters hereby agree to reinsure against loss to the extent and in the manner hereinafter provided:
>
> > [Coverage] is "as Original" and will provide the "same gross rate, terms and conditions and to follow the settlements of the Company ….

Equitas denied the claim on the grounds that, under English law, the "all sums rule" does not apply and, further, that the six-year delay in notice of the claim barred recovery under the Policy. ICSOP disagreed on the grounds that English law would interpret the Policy as "back to back" with the reinsured policy, recognize the "all sums rule," deem the notice of loss to be timely, and hold that, absent timely notice of loss being a condition precedent to coverage under the Policy, extreme prejudice must be shown to avoid reinsurance coverage, something Equitas could not demonstrate.

The district court rejected Equitas's defenses and granted summary judgment to ICSOP. On appeal, the Second Circuit conducted its review de novo and affirmed the district court decision in a detailed and exhaustive decision that combines an analysis of the "all sums rule" under California law, with an analysis of English insurance coverage law including the "all sums rule," and an analysis of basic English reinsurance law.

The Appellate Ruling

The court first addressed U.S. tort and insurance law. After a survey of the development of mass-tort law and the related insurance coverage issues that have arisen in the U.S., the court concluded that a significant number of courts have adopted the "all sums rule," including Hawaii and California, and that the ICSOP policy was governed by Hawaii law. The court also explained that, while many courts have adopted a *pro rata* rule, many have not adopted either rule. As a court sitting in alienage jurisdiction (i.e., jurisdiction of federal courts over U.S. citizens and citizens of foreign states under 28 U.S.C. Sec. 1332), it then set out to determine how an English court would rule "in the context of reinsurance law." In doing so, the court engaged in an analysis of how English courts have approached these thorny insurance coverage issues in the context of mass-tort liability.

The court engaged in a survey of English tort law involving long-term exposure to toxic substances, such as asbestos. The court cited *Fairchild v. Glen Haven Funeral Services Ltd.*, [2003] 1 AC 32 (HL) ¶¶ 3-5 (Lord Bingham), *Barker v. Cory's UK Ltd, Barker v. Corus UK Ltd.*, [2006] 2 AC 572 (HL), and the U.K. Compensation Act 2006 c. 29 § 3 ("Compensation Act"), which reversed part of *Barker* – a case that itself had rejected a rule that apportioned tort liability among several employers on a joint and several basis. Although the Compensation Act applies only to mesothelioma, the Act set the stage for the adoption of the "all sums rule" by the U.K. courts, at least for certain types of mass torts:

> [W]hen a victim contracts mesothelioma each person who has, in breach of duty, been responsible for exposing the victim to a significant quantity of asbestos dust and thus creating a material increase in risk of the victim contracting the disease will be held to be jointly and severally liable in respect of the disease.

Following the enactment of the Compensation Act of 2006, the U.K. Supreme Court held in a subsequent case, *Trigger (Durham V. BAI (Run off) Ltd.*, [2012] UKSC 14 ¶ 78, that insurers providing coverage to employers who are liable under the Act are likewise liable under their policies for such claims against their insureds. And, in *Trigger*, the U.K. Supreme Court held that "where two contracts are linked—as in the reinsurance contract—'the law will try to read them consistently with each other.'" Then, in *Zurich Ins. PLC Branch v. International Energy Group Ltd.*, [2015] UKSC 33 ¶¶ 45-51, 54, 94-97, the U.K. Supreme Court held that insurers are jointly and severally liable on an "all sums" basis for their insured's liability when the insured is liable under the Compensation Act. The Court there held that, "once one accepts that causation equates with exposure, in tort and tort liability insurance law . . . there is no going back on this conclusion simply because there was exposure by the insured of the victim both within and outside the relevant insurance [coverage] period," despite the fundamental importance under English law of the insurance policy period as *Wasa International Insurance Co, v. Lexington Insurance Co.*, [2010] 1 AC 180 (HL) ¶ 32, had made clear. The U.K. Supreme

Court therefore held that the primary question concerned "the duty that the insurer owes to the insured - not the relative position between two insurers" and, thus, "there is . . . nothing illogical about a conclusion that each of successive insurers is potentially liable in full, with rights of contribution inter se." But the court noted, of course, that the Compensation Act did not apply in *Equitas* and, moreover, that the term or policy period of a policy is afforded fundamental respect and importance in English law.

The Second Circuit then turned to the matter at hand between the plaintiff-cedent and its reinsurer, and whether the U.K. Supreme Court would interpret the reinsurance contract as entitling ICSOP to recover from its reinsurer, even though, under English law, the "all sums" principle would not govern ICSOP's liability under its policy. The critical issue was, however, whether under U.K. law, Equitas would be liable under the Policy for the payments ICSOP made to its insured. Citing *Wasa*, the court stated that, under English law, facultative reinsurance is normally "back to back" with the reinsured insurance policy so that where the insurer is liable, the reinsurer pays its agreed proportion of the risk, and went so far as to call it a "strong presumption" in favor of coverage. Most critically, that presumption would follow even if the insured's losses were payable in a foreign jurisdiction where the law varies from English law.

The court noted that in *Wasa*, a case upon which Equitas relied, the original policy did not contain a choice of law clause and, therefore, it was not predictable at the time of issuance of the reinsurance contract that Pennsylvania law would govern its interpretation. But the ICSOP-Dole policy contained a Hawaii choice-of-law clause and, generally speaking, Hawaii law generally follows California law, including the "all sums rule" applied to multiple years of coverage for continuous and indivisible injuries. The absence of a choice of law clause in *Wasa* was critical and distinguished it from *Equitas* where there was, indeed, a choice of law clause in the reinsured policy.

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The court further pointed out that, under English law, reinsurers must accept the risk of a change in law after formation of the contract, i.e., the development of the "all sums" principle that did not exist when the subject reinsurance contract was formed decades earlier: "[t]hus when parties fail to define in their insurance agreements a term such as 'all sums' . . . they adopt the meaning a common law court will ascribe to it, and thereby bear the rewards and risks of the common law's dynamic nature." *Equitas*, No. 20-3559 at p. 41. The court referred again to *Trigger* and *Zurich*, where the U.K. Supreme Court ruled as it did despite the relevant policies being issued prior to the relevant legal developments that formed the basis of those Courts' decisions. The court concluded that the U.K. Supreme Court would, in this instance, not rule contrary to how it had ruled in the past, mainly because the Policy expressly warranted coverage as "Original." The court stated:

> Equitas therefore cannot confine its current obligations to what those obligations would have been had the dispute arisen fifty years ago . . . This case unquestionably presents an issue that was left open in *Wasa*, and has not since been resolved by the [UK] Supreme Court. We thus cannot be certain that our prediction as to how that Court would resolve this case [in the UK] is correct. But it remains our [duty] to make our best considered judgement of how [the UK] court would decide the issue . . . and for the reasons set forth above, we conclude

> that under English law the back-to-back presumption [applied to facultative reinsurance] is strong, and we do not believe that the [UK] Supreme Court would condition that presumption on the importance of a policy term or the predictability of how a foreign court might later interpret that term. Accordingly, the back-to-back presumption [in construing a reinsurer's obligations] applies to the reinsurance policy, thus rendering the parties' obligations co-extensive.

Equitas, No. 20-3559 at pp. 41-42.

Late Notice Defense

The court easily disposed of the reinsurers' late notice defense because, under English law, unless prompt notice of loss is a condition precedent to coverage, extreme prejudice must be shown by the reinsurer. The court concluded that the reinsurers could not demonstrate "extreme prejudice" and that there was, therefore, "no reason to go where no English court has gone." *Id.* at p. 45.

Conclusion

The *Equitas* decision, while perhaps not entirely unprecedented, is nevertheless remarkable in vividly illustrating the interconnected legal and insurance/reinsurance arenas in the U.S. and the U.K. While the two legal systems have many differences, those systems and the inter-connected worlds of U.S. and U.K. insurance and reinsurance, remain closely bound and intertwined. And, despite the continued prevalence of arbitration in the reinsurance industry, this thorough and painstaking decision demonstrates the continued vitality and importance of litigation with its published reasoned and often valuable decisions.

Michael H. Goldstein, Esq. has been practicing law since 1980 in the insurance space and in reinsurance since 1985 at Mound Cotton where he worked closely with the late Gene Wollan in multiple arbitration hearings to award (and one very significant federal court trial and appeal); and then for over 20 years collaborated with Larry Greengrass as co-first chair at many hearings. Goldstein has been first chair/co-first chair in over 50 arbitration hearings to award and has argued multiple appeals in the federal circuit courts of appeal. Goldstein has represented both cedants and reinsurers and has made law in many landmark decisions in the federal and state appellate courts. Goldstein also has handled complex reinsurance disputes involving all lines of business and types of claims. In addition, Goldstein has authored multiple articles in insurance and reinsurance journals and has lectured on many insurance and reinsurance topics over the last 25 years.

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