Appeal No. CA-2026-000125

IN THE COURT OF APPEAL (CIVIL DIVISION)

On appeal from:
THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
LONDON CIRCUIT COMMERCIAL COURT (KBD)
CLAIM NO. LM-2024-000252
Neutral Citation: [2025] EWHC 2704 (Comm)
Before His Honour Judge Keyser KC (sitting as a Judge of the High Court)

BETWEEN:

(1) INTACT INSURANCE UK LIMITED (FORMERLY ROYAL & SUN ALLIANCE INSURANCE LIMITED)
(on its own behalf and on behalf of all members of the Royal Insurance Group (now RSA Insurance Group) reinsured under reinsurance policies 0512428/R13/81 (M43/81), M43/82, XPM0431/301 (M43/83), 871/XPM043/401 (M43/84) and M56/84, their successors and assigns)
(2) ROYAL INSURANCE (UK) LIMITED (In Liquidation)
(3) ROYAL & SUN ALLIANCE REINSURANCE LIMITED (FORMERLY ROYAL REINSURANCE COMPANY LIMITED)

Claimants / Appellants/Applicants

- and -

EQUITAS INSURANCE LIMITED

Defendant / Respondent

APPLICANTS' REPLACEMENT SKELETON ARGUMENT
25 August 2026

References to the Core and Supplementary Bundles are in the format ***[Bundle/Tab/page no.]***

A. INTRODUCTION

1. The appellants seek permission to appeal against the judgment of HHJ Keyser KC (sitting as a Judge of the High Court) in the above proceedings, which concern a reinsurance dispute: [2025] EWHC 2704 (Comm) (the "**Judgment**") [**Core/8/88-142]**.

2. This appeal raises a single issue: whether, as a matter of the proper construction of five excess of loss reinsurance contracts covering the period 1981-1985, only certain forms of exposure incurred by the reinsureds under the underlying policies are capable of eroding the excess and

limit (as the Judge found), or whether (as the appellants contend) all forms of exposure erode the excess and the limit in the same way. This issue, referred to in the Judgment as the "Defence Costs Erosion Issue", is addressed at [9]-[30] thereof [**Core/8/92-101**].

3. The key provisions of the reinsurances are as follows (Judgment, [13]-[14]) [**Core/8/95-96**], [**Core/19/233**]:

> "CLASS: General Third Party Liability including Products, Employers Liabiltiy, Motor Liability, Professional Indemnity, Financial Loss, Aviation and Marine Liability, as per original policy indemnifying B.O.C. International plc including all subsidiary and/or associated and/or affiliated companies.
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> …
>
> LIMIT: £16,000,000 any one loss or series of losses arising out of one occurrence/unlimited in all for General Third Party Liability, Motor, Aviation, Marine, Employers Liability and Professional Indemnity BUT £16,000,000 IN THE AGREGGATE for Products and Financial Loss
>
> EXCESS OF
>
> £4,000,000 any one loss or series of losses arising out of one occurrence/unlimited in all for General Third Party Liability, Motor, Aviation, Marine, Employers Liability and Professional Indemnity BUT £4,000,000 IN THE AGGREGATE for Products and Financial Loss."[1]

4. The Judge found that the sums £16 million and £4 million in the "Limit" provision were concerned only with the reinsureds' liability for "indemnity payments" (a term not used in the Reinsurances or the underlying insurances), and that while the reinsurances also covered the reinsureds' liability for the underlying insured's defence costs, they only did so once indemnity payments alone had exceeded £4 million, and thereafter for as long as reinsurers were on risk for indemnity payments (i.e., without *any* applicable financial limit).

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[1] Throughout this skeleton, where reference is made to a policy provision, it is to the policy provision from the 1981/1982 policy year [**Core/19/230-259**]. The policies for the subsequent years are on the same or materially the same terms, save where otherwise identified.

5. The consequences of this decision are stark. In spite of the reinsureds incurring significant liabilities for defence costs for which they had purchased reinsurance cover, they would be left without any cover unless the reinsurance excess of £4 million happened to be eroded by indemnity payments. Where, as occurred here, the insurers and their underlying insured acted so as to protect their and reinsurers' interests by successfully defending claims and avoiding indemnity payments, they would be left without the very reinsurance cover they paid premium to purchase.

6. By this appeal, the appellants seek to overturn this uncommercial construction: the "Limit" provision in the reinsurance contracts is in clear and simple terms. It makes no distinction between different types of reinsured liability. The specified limit (£16 million) and the specified excess (£4 million) refer simply to the reinsureds' exposure under the reinsured policies, and they apply equally to indemnity payments and defence costs. Nothing in the underlying policies affects this interpretation.

B. BACKGROUND

7. The key background is set out in the Judgment at [1]-[7] [**Core/8/90-92**] and elaborated upon below.

(1) The Reinsurances

8. The Defendant ("**Equitas**") is successor in title to Lloyd's market reinsurers who collectively underwrote (alongside company market reinsurers) total participations of between 12.5% and 44.673% ("**the Reinsurers**") under five excess of loss reinsurance contracts for the period 1981-1985 ("**the Reinsurances**"): Judgment, [4] [**Core/8/91**].[2] The Reinsurances insured the participation of the Royal Insurance Group ("**Royal**") and the Eagle Star Group ("**Eagle Star**") in a programme of worldwide general third-party liability insurance provided to BOC International plc (subsequently known as the BOC Group Plc) ("**BOC**") and its subsidiaries, a multinational manufacturing group.

9. As set out above, the Reinsurances provided cover up to a limit of £16 million in excess of a £4 million retention on materially the same terms for each annual period from 1 October 1981

[2] No claim has been brought in these proceedings against the company market reinsurers.

to 1 October 1985 (save that in the 1984/1985 year, the reinsurance was placed in two layers rather than one).[3]

10. The "Class" and "Limit" provisions of the Reinsurances, which are central to this appeal, have been set out above. Other relevant terms are:

10.1 The "REASSURED" is described as "*Royal Insurance Group and/or Eagle Star Group as may be required.*" [**Core/19/233**]

10.2 The "PERIOD" provision: "*12 months @ 1st October 1981 (losses occurring basis).*" [**Core/19/233**]

10.3 The "GEN. CONDS" provision (Judgment, [15]):

> "To follow original terms, conditions and settlements (as far as applicable to the layer).
>
> Excluding Aircraft Products.
>
> Excluding Directors and Officers Liability.
>
> Excluding Employers Liability in the U.K. and Eire.
>
> Excluding Products Recall."[4] [**Core/8/96**], [**Core/19/234**]

10.4 The "INFORMATION" provision, as originally drafted, stated: "…*Copy of original policy seen.* …" (Judgment, [15]). [**Core/8/96**], [**Core/19/234**]

10.5 The "Claims Co-operation" clause (Judgment, [17]) [**Core/8/96**], [**Core/19/237**]:

> "The primary insurers shall in the event of an occurrence or series of occurrences consequent upon one original cause which may be the subject of a claim under the policy and where the potential cost may exceed £4m, or in the event of the potential cost of such an occurrence or series of occurrences reac[h]ing £4m give notice to re-insurers as soon as practically possible and furnish all available information respecting such occurrence or occurrences if required.
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> In either such event the course to be adopted by the primary insurers shall be determined by agreement between the primary insurers and re-insurers

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[3] Specifically, the 1984/1985 year was structured as follows: £10m xs £4m and a £6m xs £14m "top up". There are, therefore, five reinsurance contracts but only four policy years.

[4] A further condition was subsequently added stating "*Re P.I. including claims made in the Period in respect of losses occurring prior to inception.*" (Judgment, [16]) [**Core/8/96**], [**Core/19/239**]

> and the primary insurers shall not without the consent of re-insurers litigate with regard to such loss but such consent shall not be unreasonably withheld.
>
> In the event of a difference of opinion between the primary insurers and re-insurers in respect of an opportunity whereby settlement of a loss can be obtained by the acceptance of a standing judgment or transaction agreed by the claimant re-insurers retain the right to pay to the primary insurers the amount the equivalent to their liability under this policy according to such standing judgment or transaction and shall thereafter be under no further liability under this policy in respect of the loss."

(2) The underlying insurance programme

11. The structure of the worldwide general third-party liability insurance programme reinsured by the Reinsurances was as follows:

11.1 **Royal Master Policies** ("**RMPs**"): **£0 - £20 million [Supp/1/3-26].** By the RMPs, Royal and Eagle Star (together "**the Insurers**"), in equal shares, provided worldwide liability cover to BOC and each of its subsidiary and/or associated companies arising from any occurrence during the period of indemnity with a limit of liability of £20 million (which applied in the aggregate for the policy period for product losses): Judgment, [2], [11]-[12] [**Core/8/90, 93-95**]. The RMPs contemplated that "subordinate" local policies would be issued on behalf of the Insurers as evidence of the insurance provided under the RMPs (*ibid.*). The RMPs would only apply to the extent that coverage was not provided under such subordinate policies by virtue of any limitation of cover: Schedule I(7) [**Supp/1/24**]. In other words, the intention was that locally-issued policies would be the first port of call for claims.

11.2 Pursuant to Schedule D(3) [**Supp/1/16**], defence costs incurred by BOC with the consent of the Insurers were payable *in addition* to the limits stated in the RMPs (but without the application of any excess): Judgment, [11]-[12] [**Core/8/93-95**]. This Schedule formed a key part of the Judge's analysis and is addressed in detail below.

11.3 **The Newark Subordinate Policies** ("**NSPs**"): **$0 – $40 million [Supp/2/27-36].**[5] US "subordinate" policies were issued to BOC's US subsidiary, Airco Inc[6] ("**BOC US**") by Newark Insurance Company ("**Newark**"), then a Royal entity: Judgment, [2]

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5 Revised to $30 million in the 1984/1985 year as the pound weakened against the dollar.

6 Subsequently the BOC Group Inc.

[**Core/8/90**]. The cover under the NSPs was for, *inter alia*, BOC US's personal injury liability caused by an occurrence taking place during the policy period anywhere in the world (*ibid.*). The limits mirrored the RMPs (allowing for USD:GBP conversion) (*ibid.*). Cover applied in excess of either (a) the amount recoverable under an underlying insurance (*see below*), or (b) a retained limit of $25,000, each occurrence. Defence costs were payable in addition to the limits of liability and without the application of any excess (*ibid.*).

11.4 UK entities of Royal and Eagle Star provided 100% reinsurance to Newark, split 50% each: Judgment, [2] [**Core/8/90**]. This gave effect to the split of liability in the RMPs and ensured that US liabilities under these US subordinate policies were fully reinsured with any liability being borne in the UK by the Insurers. It is Royal's share of the losses borne pursuant to this intra-group reinsurance that are claimed in these proceedings.

11.5 **Liberty Mutual Policies: $0 - $2/3 million [Supp/3/37-113].** The primary layer underlying insurances provided to BOC US (and sitting below the NSPs) were issued by Liberty Mutual Insurance Company ("**Liberty**"): Judgment, [3] [**Core/8/90-91]**. They covered, *inter alia*, bodily injury liability. The aggregate liability thereunder was $2 million, revised to $3 million for the 1983/1984 and 1984/1985 years. Defence costs were payable in addition to the limits of liability and without the application of any excess.

12. Cover under all the above policies was provided (by re-issuance and/or extension) for four annual periods from 1 October 1981 to 1 October 1985. These policy periods dovetail exactly with those under the Reinsurances.

(3) <u>Payments under the insurances and claimed under the Reinsurances</u>

13. From the mid-1980s, BOC US was subject to third party bodily injury claims in respect of, primarily, allegedly defective welding and asbestos-producing products that it sold. BOC US claimed against its insurers under the NSPs in respect of: (i) indemnity payments made by BOC to underlying claimants pursuant to settlements and judgments; and (ii) BOC US's costs in defending suits by underlying claimants. Both were covered under the NSPs and indemnified by the Insurers. Once these liabilities exceeded £4 million in a given year, the Insurers sought to recover against their Reinsurers under the above Reinsurances. The Defendant, however, refused to make payment.

14. The sum claimed in this action was £3,760,574.83 (without interest), the vast bulk of which was paid by the Insurers pursuant to a settlement agreement entered into in 2001: the "**Toxic Torts Settlement Agreement**" or "**TTSA**": Judgment, [5(1)] [**Core/8/91**], [**Supp/4/114-228**]. The parties to the TTSA were: BOC and BOC US, Liberty, Newark, the Second Claimant, two Eagle Star entities and three other US insurance companies which provided cover to BOC between 1948 and 1988 (*ibid.*). Detailed background to the TTSA is also set out in the Judgment at [44]-[60] [**Core/8/107-115**] in the context of the proper and businesslike steps issue (decided in favour of the Claimants).

15. The TTSA provided for the allocation between BOC US's insurers of: (a) "*defence costs*" incurred in connection with the defence of BOC US, and (b) "*indemnity costs*" paid in reasonable settlement or in satisfaction of judgments. In both cases, the costs were in respect of "Toxic Tort Bodily Injury Claims". They were allocated between BOC's insurers between 1948 and 1988 on the basis of New Jersey case law, according to which indivisible losses such as those caused by asbestos and welding fumes exposure are allocated by reference to the limits of cover purchased in a given year.[7]

16. Under the TTSA, Newark was rendered liable for 47% in respect of both past and future (defence and indemnity) costs under the NSPs (equating to a $7,285,000 payment in respect of past costs): *see* Judgment, [5(1)] [**Core/8/91**], see also [**Supp/4/140**].

17. In addition, defence costs and indemnity payments were also incurred by the Insurers in relation to individual bodily injury claims relating to the use of BOC products other than asbestos and welding related products, and pursuant to a later settlement (referred to as the Linde Settlement Agreement) which supplemented the TTSA: *see* Judgment, [5(2)-(3)] [**Core/8/91**].

C. RELEVANT LAW

18. The principles relevant to this appeal can be stated shortly, the question being principally one of contractual interpretation.

    18.1 The purpose of reinsurance is to indemnify the reinsured against any liability that may arise under the original policy: South British Fire and Marine Insurance Company of

[7] As to the content of New Jersey law on allocation, see Judgment, [62]-[70] [**Core/8/115-124**].

New Zealand v Da Costa and others [1906] 1 KB 456 at 460 per Bigham J.[8] Plainly, as regards excess of loss insurance, this will be subject to the limits and excesses stated which determine when the transfer of financial risk to the reinsurer from the reinsured commences and when it ceases.

18.2 Reinsurance contracts are contracts like any other and, as such, are subject to the ordinary principles of contractual construction: *see* Unipolsai Assicurazioni SpA v Covea Insurance Plc [2024] 2 All ER (Comm) 687 at [36]. The relevant authorities on contractual interpretation are also set out in the Judgment at [9] [**Core/8/92**].

18.3 Where a court is construing linked contracts, the starting point must be the provisions of the contract before it: *see* Temple Legal Protection Limited v QBE Insurance (Europe) Limited [2008] Lloyd's Rep IR 643 at [57] (Beatson J) (aff'd [2009] Lloyd's Rep IR 544).

18.4 The test for the incorporation of terms is set out in HIH v New Hampshire Insurance Co [2001] Lloyd's Rep IR 224 at [39]-[40] per David Steel J.[9] Incorporation will only be achieved if (i) the term is germane to the reinsurance; (ii) the term makes sense, subject to permissible manipulation, in the context of the reinsurance; (iii) the term is consistent with the express terms of the reinsurance; and (iv) the term is apposite for inclusion in the reinsurance. As the Reinsurances provide, they are to "*follow original terms, conditions and settlements*" but only "*as far as applicable to the layer"* [**Core/19/234**].

D. THE DECISION

19. After lengthy agreed standstills, the case came to trial in 2025. The Defendant relied on three principal grounds for having refused to make payment. Two of those grounds were rejected. The third is the subject of this appeal, namely whether, as a matter of interpretation of the Reinsurances, the Reinsurers were liable once combined indemnity payments and defence

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8 This conception of reinsurance as concerned with indemnifying reinsureds for the liability that they have assumed is of great antiquity: *see, e.g.,* Delver v Barnes (1807) 1 Taunt. 48 at 51 per Lord Mansfield CJ ("…*a reassurance, which consists of a new assurance, effected by a new policy, on the same risk which was before insured, in order to indemnify the underwriters from their previous subscription*…"). *See also* MacGillivray on Insurance Law (16th Ed.) paras. 33-001-33-005; and Wasa v Lexington [2010] AC 180 at [33].

9 Approved by the Court of Appeal in the same case: [2001] Lloyd's Rep IR 596 at [162].

costs exceeded £4 million in a given year (as the Claimants argued) or whether (as Equitas argued) the Reinsurers were only on risk once indemnity payments alone exceeded £4 million. £3,032,236.60 turned on the point, the reinsureds' liability in three of the four years having only exceeded £4 million by virtue of defence costs.

20. It was, consistently with the law cited above, common ground at trial that the Reinsurances incorporated the terms and conditions of the RMPs, but only insofar as germane.[10] It was also common ground that the "*original*" policies referred to in the Reinsurances were the RMPs (Judgment, [15] [**Core/8/96**]), and that the RMPs, and therefore the Reinsurances (by virtue of the "Class" provision), covered *both* indemnity payments *and* defence costs.[11]

21. The debate on this issue was accordingly limited to whether both defence costs and indemnity payments eroded the excess or whether only indemnity payments were capable of doing so. For the avoidance of doubt, it was and is the appellants' position that *all* Royal's and Eagle Star's liabilities under the underlying policies, which liabilities were uncontroversially the subject of coverage under the Reinsurances, eroded the £4 million excess *and* were subject to the £20 million limit (inclusive of the retention).

22. The relevant section of the Judgment on this issue is at [9]-[30] [**Core/8/92-101**]. The Judge's reasoning begins at [19] [**Core/8/96**]. It can be reduced to the following core points:

    22.1 The Reinsurances were "back-to-back" with the RMPs, followed the terms of the RMPs, and the limits in both (£20 million) were the same.

    22.2 Defence costs cover under the RMPs, pursuant to Schedule D(3), was in addition to the £20 million limit, and was without financial limit albeit it was temporally limited by the subsistence of cover for indemnity payments.

    22.3 The same was accordingly likely to be true of the Reinsurances.

    22.4 It would be surprising if the excesses operated differently from the limits in the Reinsurances.

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[10] *See* Re-Re-Amended Particulars of Claim, ¶14.1, as admitted at Re-Re-Re-Amended Defence, ¶14.2 [**Core/17/171**], [**Core/18/208**].

[11] *See* Re-Re-Re-Amended Defence, ¶41.1.9; Re-Re-Re-Amended Reply, ¶16.1 [**Core/18/221**], [**Supp/7/297**].

22.5 References to "losses" in the Reinsurances supported the view that they were principally concerned with indemnity payments and not defence costs.

22.6 The claims cooperation clause does not alter the analysis.

22.7 There is nothing uncommercial about Equitas's construction.

E. APPELLANTS' SUBMISSIONS

23. The appellants submit that the Judge was wrong and that this appeal should be allowed. At a minimum, the test for granting permission to appeal (i.e., that the appeal has real prospects of success: CPR 52.6) is met.

24. In reaching the conclusions that he did, the Judge made five critical errors which are developed and addressed in stages below.[12] They are as follows:

24.1 **Critical error 1**: the Judge failed to give due weight or consideration to the fact that the Reinsurances, including in the "Limit" provision, make no distinction between particular forms of liability borne by the reinsureds, and provide no basis whatsoever for distinguishing between defence costs and indemnity payments.

24.2 **Critical error 2**: the Judge failed to consider whether the "*follow original terms, conditions and settlements (as far as applicable to the layer)*" clause in the Reinsurances was effective to incorporate Schedule D(3) from the RMPs, and if so the effect (if any) of the incorporation of such clause in the Reinsurances. He was instead overly focussed on the superficial symmetry between the £20 million limit in the RMPs and the £20 million of cover provided by the Reinsurances.

24.3 **Critical error 3**: the Judge failed to give due consideration to the fact that the RMPs contained no excess akin to that in the Reinsurances and therefore the issue of whether the bespoke £4 million excess in the Reinsurances could be eroded by defence costs and indemnity payments or only by indemnity payments was not an issue to which the RMPs could provide any answer.

24.4 **Critical error 4**: the Judge failed to recognise that the purpose and effect of the "*follow original terms, conditions and settlements*" clause in the Reinsurances was to ensure that

[12] All references to paragraph numbers in this section are to the Judgment, unless otherwise stated.

Reinsurers bore liability for the same exposure as the reinsureds, *not* to define the operation of the limits and excess of the Reinsurances (which are *sui generis* the Reinsurances).

24.5 **Critical error 5:** the Judge failed to give due weight or consideration to the commercial consequences of his interpretation, including but not limited to the implausibility of (i) the Reinsurers assuming unlimited liability for defence costs as long as indemnity payments exceeded £4 million but did not exceed £20 million, and (ii) the reinsureds retaining unlimited liability for defence costs as long as indemnity payments did not exceed £4 million.

Critical error 1 (paragraph 24.1 above): inadequate focus on the Reinsurances and their terms

25. **[1] The "Class" provision defines what is covered under the Reinsurances; that indisputably includes Insurers' liabilities for *both* indemnity payments *and* defence costs**. This ought to have been the starting point and yet it forms no part of the Judge's analysis at [20]-[30] [**Core/8/97-101**]. The scope of cover under the Reinsurances is defined by the "Class" provision [**Core/19/233**]. The "Class" provision is not restricted to any particular types of exposure and makes no distinction between defence costs and indemnity payments. In referring to "*General Third Party Liability including Products … as per original policy indemnifying B.O.C. International…*", the "Class" provision is most naturally read as including within its scope *all* exposure and liabilities that reinsureds may incur under the original policy (which it is common ground is the RMP) and the insurance arrangements which give effect thereto. This is consistent with the basic function of reinsurance: *see* South British Fire and other cases referenced above.

26. None of this was disputed by Equitas at trial, but it is nonetheless significant. In circumstances where it is common ground that the "Class" provision in the Reinsurances – the key provision defining cover – does not distinguish between defence costs and indemnity payments, the starting point in an excess of loss reinsurance must be that the limit of £20 million and the excess of £4 million apply to both *without distinction*, barring express words to the contrary. Put simply, all indemnifiable loss under the Reinsurances would be expected to erode the excess and limits. This is a fundamental point, and one nowhere addressed in the Judgment: in the context of reinsurance which is concerned with reducing a reinsured's exposure to liabilities under the original insurance, there can, in principle, be no reason to distinguish between one form of exposure and another.

27. **[2] The "Limit" provision defines the floor and ceiling of the cover provided by the Reinsurances, and no more.** The "Limit" provision [**Core/19/233**] is necessarily *sui generis* the Reinsurances.[13] This is not least because neither the RMPs nor the NSPs contain an excess akin to that in the Reinsurances. It is in clear and simple terms, and serves two purposes. It sets (i) the floor and ceiling of the exposure defined in the "Class" provision, and (ii) (relatedly) the basis for aggregation. The floor and ceiling take the form of the two financial figures (£16 million and £4 million),[14] with the wording that follows them concerned only with the basis for aggregation (with different bases for aggregation applicable to different classes of liabilities). The function of the "Limit" provision is thus not to draw any distinction between particular types of exposure or underlying liabilities, let alone to dictate that only certain types of exposure/liabilities (i.e., indemnity payments) could erode the excess and the limit, but not others (i.e., defence costs). The purpose of the provision is instead to specify, in clear terms, the point at which the financial risk under the underlying policies is transferred from the reinsureds to the Reinsurers (and when such transfer ceases).

28. The Judge nevertheless thought that the *wording* of the "Limit" provision supported his construction, and relied on two points.

    28.1 At [23] [**Core/8/97**], he pointed to the fact that the "Limit" provision "*refers to cover or excess in respect of* ***losses****, arising out of* ***occurrences****, for listed types of liability*" (Judge's emphasis). He said that this "*mirrors the structure of the Royal Master Policies and must in my view relate to the duty to indemnify, not the additional duty to pay defence costs.*"

    28.2 At [24] [**Core/8/98**], the Judge referred to "*the simple point that in the Limit provisions the £16 million relates only to indemnity costs; it does not include defence costs, which are additional*".

29. These are repetitions of the same point, and, significantly, they appear to assume what is in issue, without analysis or reasoning as to *why* that must be so. As analysed above, there is nothing in the "Limit" provision itself which even hints at an interpretation that the limit or excess relates only to indemnity payments. Certainly, the words "*loss or series of losses arising out of one occurrence*" are not suggestive of such a restriction (*see* further, the next point).

30. **[3] There is nothing in the Reinsurances which states that the excesses and limits are concerned with anything other than the total sums for which reinsureds were liable**

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13 (and therefore not "back-to-back" with the underlying policies)

14 Save as regards 1984/1985 – *see* footnote 3 above.

under the underlying policies. At [25] [**Core/8/98**], the Judge held that support for his construction was to be found in "*other provisions*" of the Reinsurances. He identified: (i) the reference in the General Conditions to cover for professional indemnity ("**PI**") claims which were to extend to "*claims made in the Period in respect of losses occurring prior to inception*", and (ii) the use of the word "*loss*" in the claims cooperation clause.

31. The appellants' position is that the use of the word "*loss*" in the Reinsurances, whether in the "Limit" provision ("*loss or series of losses*") or the two provisions identified by the Judge, and referenced above, does not demonstrate any distinction between the treatment of defence costs and indemnity payments and provides no support for the Judge's interpretation:

    31.1 The word "*loss*" is broad and unrestricted; it can mean different things in different contexts, even within a single insurance or reinsurance policy. In the insurance or reinsurance context, it is most frequently used to refer to financial losses (i.e., quantified liabilities) or the injury or damage giving rise to such financial losses. On any view, it is plainly an apt term in the present Reinsurances to encompass *all* liabilities to which the reinsureds are subject, and which fall within the "Class" provision, without distinction between defence costs and indemnity payments.

    31.2 As used in the "Limit" provision, "*loss*" can be given its natural meaning, *viz.* "*[d]iminution of one's possessions or advantages*".[15] Defence costs (like indemnity payments) fit that description (amounting as they do to a diminution in the reinsureds' financial position as a result of the incurring of reinsured liabilities), and may "*aris[e] out of one occurrence*" (e.g., the sale of a defective product leading to bodily injury), which leads to a claim by a third party.[16]

    31.3 Even assuming (*arguendo*) that the word "*loss*" in the "Limit" provision in fact means or is intended to refer to the injury or damage giving rise to the claim against the insured and the consequent third-party liability, this would not in any way undermine the appellants' analysis. Such injury or damage, which prompted the claim against the insured, would cause the insured to incur costs in defending the claim, and, if the claim leads to legal liability by judgment or settlement, indemnity payments. Therefore, "*loss*", understood in this alternative way, could nonetheless plainly give rise to, and encompass, the reinsureds' liabilities in the form of both indemnity payments and

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15 OED, "*loss* (n.)".

16 *See, e.g.,* Forney v Dominion Insurance Co [1969] 1 WLR 928 at 935G.

defence costs. The "Limit" provision would apply to and aggregate all such liabilities in accordance with its terms.

31.4 Indeed, in light of this analysis, and the obvious, ordinary, natural meaning of the word "loss", it is difficult to understand on what basis the Judge concluded that the "*natural interpretation of "loss or series of losses" in the "Limit" provisions of the Reinsurance Policy*" related to "*the duty to indemnify rather than the duty to pay defence costs*" ([25] [**Core/8/98**]).

31.5 The General Conditions provision to which the Judge refers at [16] and [25] [**Core/8/96, 98**] makes clear that PI cover under the Reinsurances includes, unlike for other classes of liabilities, claims-made cover such that PI losses need not necessarily have occurred within the policy period if the claim is made in that period. True it is that losses occurring prior to inception where a claim is yet to be made are unlikely to be concerned with the incurring defence costs, but that plainly does not mean that the word "*loss*" as used by the parties throughout the Reinsurances is so restricted; simply that it will in this context capture a particular subset of loss. The Judge himself appeared to recognise this in the final sentence of [25] [**Core/8/98**].

31.6 In the claims cooperation clause [**Core/19/237**], "*loss*" is used in the second paragraph in the phrase "*the primary insurers shall not without the consent of re-insurers litigate with regard to <u>such loss</u> but such consent shall not be unreasonably withheld*" (emphasis added). The word "*such*" indicates a reference back to what has already been said in the clause, and can only plausibly refer to "*an occurrence or series of occurrences… which may be the subject of a claim under the policy*" in the first paragraph. Construed in that manner, "*loss*" appears to refer to the injury or damage which could give rise to liability on the part of the Insurers. The same usage appears in the third paragraph of the clause. When viewed in this way, it is plain that there is no basis for the Judge's conclusion that "*the meaning of "loss" in the Claims Co-Operation Clause is clearly the loss in respect of which the duty to indemnify arises, not a loss consisting of the costs of defending a claim in respect of such loss*" ([25] [**Core/8/98**]) or "*"such loss" can only relate to the claimants' loss—that is, the loss that would be asserted against BOC and that would engage or potentially engage a liability to indemnify…*" ([26(6)] [**Core/8/99**]). "*loss*" in the form of the injury or damage giving rise to third-party liability can give rise to and encompass *all* consequent liabilities, whether they are in the form of indemnity payments or defence costs. In any event, given the wide, mutable meaning of the word "*loss*", its meaning in the claims cooperation clause cannot dictate its meaning in the "Limit" provision.

32. In short, the use of the word "*loss*" in the Reinsurances does not support the Judge's reasoning. Whatever that word might mean in particular clauses, on no analysis does it support a distinction between the treatment of defence and indemnity costs, including in the "Limit" provision. Indeed, if the intention was to draw such a distinction, the broad, context-specific, word "*loss*" would be a most inapt vehicle for communicating the parties' intentions.

33. The Judge also suggested at [24] [**Core/8/98**] that his construction of the "Limit" provision as relating to indemnity payments only was consistent with endorsements to the Reinsurances recording "Limit of Indemnity £16,000,000 excess of £4,000,000 (see [**Core/19/252-257**])."[17] This simply does not work:

    33.1 The reference there to "Indemnity" is plainly to the indemnity to be *provided by Reinsurers under the Reinsurances* (which is subject to a limit of £16 million in excess of a £4 million retention) rather than to the indemnity payments incurred by the underlying insured (BOC) and indemnified by the reinsureds (Royal and Eagle Star).

    33.2 Further, the reimbursement of a defence costs liability is a form of indemnity,[18] and therefore the phrase "Limit of Indemnity" does not suggest that the limit or excess in the Reinsurances is eroded only by indemnity payments but not defence costs. The suggestion to the contrary shows how far wrong the Judge has gone in his analysis.

    33.3 If anything, simple descriptions of the Reinsurances in these terms tend to reinforce the correctness of the appellants' construction, namely that the limit of Reinsurers' obligation to indemnify the reinsureds (whether for "indemnity payments" or "defence costs") truly is £20 million (and no more).

34. **[4] The Judge's interpretation relies on an implausible rendering of the claims cooperation clause in the Reinsurances.** The appellants argued at trial that, while they did not place significant emphasis on the claims cooperation clause, it supported their interpretation of the reinsurance excess. This is because the first and second paragraphs of the clause (*see* paragraph 10.5 above and [**Core/19/237**]) required that Reinsurers be notified and consulted (in certain respects) in the event that the "*potential cost*" of "*an occurrence or series of occurrences consequent upon one original cause which may be the subject of a claim under the policy*" may

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17 *See also* Judgment, [18] [**Core/8/96**].

18 *See* Schedule D(3) itself in the RMPS itself, *viz.* "*The Insurers will in addition indemnify*…" [**Supp/1/16**].

exceed £4 million or in fact reaches £4 million. The reference to "*potential **cost***" (emphasis added) exceeding £4 million reflected that what Reinsurers were concerned with and what they wanted to control was the risk of *combined* defence costs and indemnity payment liability exceeding £4 million, not merely the risk of indemnity payment liability reaching that threshold. Certainly, if the intention was to refer to indemnity payments to the *exclusion* of defence costs, "*cost*" was not an apposite term.[19]

35. In seeking to shoehorn the claims cooperation clause into consistency with his interpretation notwithstanding this point, the Judge adopted an extraordinary and obviously wrong interpretation of that clause which had not even been argued for by Equitas.[20] The Judge held at [26(3)-(8)] [**Core/8/99-100**] that the £4 million sum in the clause was *not* concerned with the excess at all, but was merely a threshold for large claims. The fact that both it and the excess were £4 million was merely coincidental. That cannot conceivably be correct (as the Judge all but acknowledged when refusing permission to appeal[21]).

Critical errors 2 and 3 (paragraphs 24.2 and 24.3 above): the Judge's mistaken reliance on the RMPs as supplying the answer

36. **[5] The Judgment focuses, almost myopically, on the fact that the RMPs and Reinsurances both adopt a £20 million limit**. As the Judge put it at [23] [**Core/8/97**]: "*[t]he "Limit" provisions of the Reinsurance Policy are, on the most obvious reading, reflective of the £20 million of cover in the Royal Master Policies*" and "*the £16 million and the £4 million correlate to the £20 million in the Royal Master Policies*". Indeed, this identity of limits between the two contracts was the rootstock from which all other tendrils of the Judge's reasoning sprouted. As to it:

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19 For the avoidance of doubt, the appellants do not contend (and did not contend before the Judge) that the words "*potential cost*" would not encompass indemnity payments (cf. Judgment, [26(1)] [**Core/8/98**]). The point is that the phrase is wide enough to capture both such payments *and* defence costs, which the Judge himself appeared to acknowledge at [26(6)] [**Core/8/99-100**].

20 Equitas accepted in its pleading that the claims co-operation clause "*refers to the excess of £4 million*" (Re-Re-Re-Amended Defence, ¶41.1.8 [**Core/18/221**]).

21 The Claimants' solicitors' note of the consequentials hearing records the Judge stating as follows: "*It may be that some of the reasons I gave e.g. incorporation of comments about the claims cooperation clause, may be controversial but I think looking at the basic way the insurance works, which I tried to set out in the first 5 reasons for reaching my conclusion, are compelling to my mind.*" [**Supp/8/305**]

36.1 It is obviously true that, for three of the four policy years (1981-1984), the "Limit" defined in the Reinsurances (£20 million as calculated by £16 million excess £4 million) is the same as the limit under the RMPs, and it is not disputed that that limit was chosen because it is the same.

36.2 It does not, however, follow that the Reinsurances can be interpreted from this fact to mean that defence costs operate outside that £20 million limit just because defence costs under the RMPs were payable in addition to limits. It does not follow because interpretation requires analysis of the words used by the parties in the contracts, and does not rest on the imputation of intentions based on broad similarities between two contracts. As set out above (and further developed below), the words used in the Reinsurances do not support any distinction between the treatment of defence costs and indemnity payments in respect of the excess or the £20 million limit, and nothing can be incorporated from the RMPs to create or justify such a distinction.

36.3 It also does not follow because, even engaging at the level of imputation of intention without reference to the words of the contracts at issue, it is at least equally plausible (as compared with the intention apparently imputed by the Judge) that £20 million was chosen in the Reinsurances because (i) it *roughly* mirrors likely exposure under the RMPs, and/or (ii) any other figure would have been arbitrary in circumstances where actual total liability under the RMPs is unknowable, and/or (iii) the parties to the Reinsurances simply did not turn their minds to the fact that reinsureds might incur liability exceeding £20 million under the RMPs/subordinate policies by reason of the structure of those policies, and/or (iv) £20 million was simply the maximum liability that Reinsurers were prepared to accept with the reinsureds left to purchase additional layers of excess of loss reinsurance if desired.

36.4 This analysis also ignores the structure of reinsurance cover in the fourth 1984/1985 year. As the Judge noted at [13] [**Core/8/95**], the Reinsurance for 1984/1985 was split into two layers of cover: specifically, a £10m xs £4m layer and a £6m xs £14m "top up" layer. The Reinsurers for each were different, including in relation to the Lloyd's market reinsurers: see Schedule 1 to the Re-Re-Amended Particulars of Claim. While the overall structure of cover for the 1984/1985 year was similar to the other years, with reinsureds retaining £4 million of the liabilities incurred pursuant to the underlying policies and ceding the rest up to a limit of £20 million, it cannot be said that, as between the parties to each layer of cover for the 1984/1985 year, that it was

"*reflective*" of or "*correlated*" with the numerical limit under the RMPs. This underlines the danger in focussing overly on the superficial symmetry in the numbers and failing to give due weight and consideration to the contractual terms.

37. **[6] The Judge's approach amounted to incorporating Schedule D(3) of the RMPs without considering whether it was legally permissible to do so (which it was not).** The Judge's central reliance on the RMPs described in [5] above was also dependent upon treating Schedule D(3) of the RMPs – which provides for defence costs to be payable "*in addition*" to policy limits – as incorporated into the Reinsurances: see [20]-[23] [**Core/8/97**]. The Judge does not, however, appear to have confronted the difficulties with this analysis.

38. Schedule D(3) of the RMPs provides:

> "The Insurers will in addition indemnify The Insured against any costs and expenses:
>
> (a) recoverable by any claimant from The Insured and/or
>
> (b) incurred by The Insured with the consent of The Insurers." [**Supp/1/16**]

39. Had the Judge properly analysed whether Schedule D(3) could be incorporated into the Reinsurances on the law set out in HIH v New Hampshire (see paragraph 18.4 above), he would have found that it could not be so incorporated:

39.1 The Judge would have begun by considering Schedule D ("Indemnity Limits") as a whole and considering whether it was *prima facie* apt for incorporation. He would immediately have recognised that it was not, because it trespassed on, and was inconsistent with, territory expressly covered in *different* terms on the face of the Reinsurances, namely the limits and excesses thereof. It makes no sense to incorporate into the Reinsurances terms defining the limits of the RMPs in circumstances where the Reinsurances make their own bespoke provision for limits and excesses. Having noted the *sui generis* nature of the "Limit" provision in the Reinsurances, the Judge ought accordingly to have concluded that Schedule D of the RMPs fell outside the terms of the incorporating clause because it is paradigmatically not "*applicable to [the] layer*".[22]

[22] See Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd [1998] Lloyd's Rep IR 421 at 435 per Hobhouse LJ ("*It is wrong in principle to distort or disregard the terms of the reinsurance contracts*

39.2 Had the Judge engaged in the required analysis in relation to incorporation, not only would he have noted that Schedule D trespassed on the same or similar ground as the Reinsurances, he would also have noted that where the Reinsurers wished to make similar provision in the Reinsurances to that in Schedule D of the RMPs, they did so expressly. For example, while Schedule D(5) [**Supp/1/17**] is similar to the third paragraph of the claims cooperation clause, Reinsurers did not simply rely on the "*follow original terms*" wording to incorporate that latter provision but instead wrote it out expressly and adapted it appropriately. This reflects the fundamental nature of limits provisions to reinsurance contracts; and the fact that they must be given effect on their own terms absent a very clear indication to the contrary.

39.3 Having identified these points, the Judge would then have considered whether, despite the fact that Schedule D as a whole was not apt for incorporation, Schedule D(3) might be capable of being carved out from the rest of the Schedule and incorporated. Had he posed that question, the Judge would have observed that Schedule D(3) concerns indemnification by "the Insurers" to "The Insured".

39.4 The Judge would then have needed to consider whether manipulation of the clause was possible to allow meaningful incorporation notwithstanding. No proposal for manipulation was made by Equitas in this regard, presumably because no sensible manipulation is possible (and because unmanipulated incorporation does not assist it): if "*The Insurers*" is swapped for "*Reinsurers*" and "*The Insured*" is swapped for "*reinsured*", the clause reads as follows:

> "The Reinsurers will in addition indemnify the reinsureds against any costs and expenses:
>
> (a) recoverable by any claimant from the reinsured and/or
>
> (b) incurred by the reinsured with the consent of the Reinsurers."

39.5 The clause so manipulated does not make sense in the context of the Reinsurances.

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in order to make them fit in with what may be a different position under the original cover. The words "conditions as underlying" cannot contradict either the period or limit provisions of the individual reinsurance contracts.")

(a) First, the clause is directly tied to what precedes it: "…*will* ***in addition indemnify***". In circumstances where Schedules D(1) and D(2) [**Supp/1/16**] are not incorporated it is not linguistically coherent to incorporate D(3).

(b) Second, "claimant" appears to refer to an underlying claimant, and an underlying claimant would not be recovering costs and expenses from a reinsured, but rather from BOC.

(c) Third, the above manipulation would suggest that the costs and expenses indemnifiable by the Reinsurers pursuant to the incorporation of Schedule D(3)(b) are those incurred by the reinsured, rather than those incurred by BOC in defending the underlying claims. That is inconsistent with the Reinsurances which provide cover for the reinsureds' liability to BOC, including in respect of the costs and expenses incurred *by BOC* in defence of underlying claims, and not for the reinsureds' own costs and expenses.

(d) Fourth, even ignoring that point, the only mechanism in the Reinsurances for the giving of consent by Reinsurers to the incurring of costs in respect of the underlying claims is under the claims cooperation clause. There, consent is only required in relation to decisions to litigate and not to settle (see [35] [**Core/8/103**]), and only where the potential cost of occurrences may exceed or in fact exceeds £4 million. Incorporation of Schedule D(3) would accordingly have the effect that only certain costs and expenses incurred in specific circumstances and in respect of very large claims would be recoverable. That makes no commercial sense and is not a result contended for by Equitas.

(e) Ultimately, the above points reflect the fact that a provision from the RMPs manifestly concerned with the relationship between BOC and its Insurers is inapposite for inclusion in the Reinsurances. While there are good reasons for the Insurers agreeing, under the underlying insurances, to bear defence costs in addition to limits (and without financial cap), most significantly because they control the incurring of such costs, the same logic and rationale do not apply to the Reinsurance position.

40. Had the Judge found that Schedule D(3) could not be incorporated, he would not have reached the conclusion he did because there would have been no basis at all for drawing a distinction between defence costs and indemnity payments under the Reinsurances.

41. **[7] Even if Schedule D(3) *were* incorporated (*quod non*), it would not have the effect contended for.** There are two possible interpretations of the Reinsurances if Schedule D(3) is incorporated therein, neither of which results in defence costs not eroding the excesses.

41.1 The first possible interpretation is that Schedule D(3) is incorporated in unmanipulated form and merely records the fact that the reinsureds are liable in respect of defence costs. The appeal would succeed on this interpretation.

41.2 The second possible interpretation is that Schedule D(3) is incorporated in manipulated form (with the resulting incoherence of the sub-provisions somehow resolved), with the consequence that Reinsurers agree to bear defence costs *in addition to* the £20 million *limit* stated in the Reinsurances. This, however, still does not assist Equitas; it does not tell the reasonable reader anything about the erosion of the reinsurance *excess*. On this interpretation, Reinsurers' defence costs liability would either sit entirely outside the "Limit" clause (with the specified limit and excess being relevant only to indemnity payments) such that Reinsurers would be liable for defence costs *from the ground up*, or it would attach once the £4 million excess was eroded by all forms of reinsured liability. Again, therefore, the appeal would succeed.

42. What is not possible is the interpretation proposed by Equitas and accepted by the Judge. That interpretation is impossible because it involves not only incorporation, but also impermissible modification of the Reinsurances so that they state what is otherwise unsaid: namely, that defence costs will not be counted in the excess and will not be indemnifiable under the Reinsurances until the excess has been eroded by indemnity payments only. The RMPs do not say this: unsurprising, as their limits are structured entirely differently. Nor do the Reinsurances assist: they draw no distinction between defence costs and indemnity payments for the purposes of eroding the £4 million excess (or indeed for any other purpose).

43. In an attempt to resolve this problem, the Judge adopted a further leap to permit the conclusion that defence costs would not erode the excess under the Reinsurances and would only be payable when indemnity payments had eroded the excess up to £4 million. He said at [29] of the Judgment [**Core/8/101**]: "*RSA's liability to pay defence costs was dependent on its liability for indemnity costs—it arose when the prior level of BOC's insurance cover, which was provided by Liberty, was exhausted and ended when the limit of RSA's liability for indemnity costs was reached. So too, in my judgment, the Reinsurers' exposure to liability for defence costs arose when the £4 million excess for indemnity costs had been exhausted and would end when the £16 million limit for indemnity costs was reached.*"

44. That leap relies on a process of mental gymnastics according to which, because Insurers' liability to indemnify for defence costs (under the RMPs or the NSPs) was only activated once the underlying insurance (provided by Liberty) was exhausted, the Reinsurers – *implicitly* – also did not become liable to pay defence costs until the excess was exhausted by indemnity payments. There are at least four fundamental problems with this reasoning:

44.1 There is no textual support for this interpretation. Neither the Reinsurances *nor* the RMPs provide that Reinsurers' liability for defence costs is contingent, and only arises, upon Reinsurers being liable to make indemnity payments.

44.2 It views the question of the erosion of the Reinsurance excesses exclusively and impermissibly through the lens of the present dispute. As envisaged by Schedule D(2) [**Supp/1/16**], there may be claims where there is no underlying insurance, and therefore Insurers' liability for defence costs (via the RMPs or subordinate policies) would be from the ground up. The foundational premise for the mental gymnastics therefore falls away.

44.3 It in any event compares apples with pears. An excess is not the same thing as an underlying policy, and an excess of loss reinsurance does not operate in the same way as insurance policies sitting in a tower of a global liability insurance programme. The Reinsurances do not insure BOC in respect of third-party liability; they provide reinsurance protection for the Insurers' exposure under the liability programme to *both* indemnity payments *and* defence costs. The way in which cover under the RMPs or NSPs triggers by reference to an underlying policy is thus utterly irrelevant to the interpretation of the Reinsurances which serve an entirely different purpose. In those circumstances, there is no justification for construing the Reinsurances to come on and off risk (for defence costs) in a manner analogous to the direct insurance policies.

44.4 In any event, even if the effect of incorporating Schedule D(3) into the RMPs is not only that defence costs are payable in addition to the £20 million limit, but also that such liability only arises upon Reinsurers being liable for indemnity payments, this *still* does not assist Equitas or support the Judge's interpretation. This is because it does not follow that the bespoke excess in the Reinsurances can only be eroded by indemnity payments and not by defence costs. Simply put, the incorporation of Schedule D(3) does not tell the reasonable reader anything about the operation of the £4 million excess in the Reinsurances.

Critical errors 4 and 5 (paragraphs 24.4 and 24.5 above): the implausibility of the Judge's construction and the absence of commercial common sense

45. **[8] The Judge's interpretation is inconsistent with the purpose of a "*follow original terms*" provision and misunderstands "back-to-back" cover.**[23] The purpose of a "*follow*" provision and "*back-to-back*" cover created thereby is to ensure that where the insurer is liable under the underlying policy, the reinsurer will likewise be liable (subject to the percentage risk ceded in cases of proportional reinsurance, or the application of an excess and limit in excess of loss reinsurance): *see* citation from Forsikringsaktieselskapet Vesta v Butcher [1989] AC 852, 895 at [10] of the Judgment [**Core/8/93**]. The Judge's interpretation however subverts this purpose and generates a mismatch or dissonance between the two contracts. It has the effect that, counterintuitively, the Reinsurances do not necessarily respond to liabilities payable by the Insurers under the insurance policy in excess of £4 million. Instead, the Reinsurances respond only to certain categories of such loss (indemnity payments), and/or only respond to other categories in certain circumstances (*viz.* if indemnity payments exceed £4 million). That is heterodox and ought to have been recognised as a further pointer against the Judge's interpretation. Very clear words would have been needed to justify such a conclusion, and none can be found in the Reinsurances or the RMPs.

46. **[9] The Judge's interpretation ignores the commercial and practical reality of the writing of reinsurance.** The Reinsurances are short, simple contracts designed to transfer exposure from reinsureds to reinsurers on terms that are easily identifiable for those that purchase the reinsurance *and* those that scratch the slip presented. As the points above demonstrate, even understanding Equitas' approach requires a process of mental abstraction that is entirely at odds with the simple nature of those contracts. The view more consistent with the simplicity of such contracts is that the Reinsurances cover reinsureds' exposure from the floor identified up to the limit identified; nothing more, nothing less. Reinsureds' exposure includes defence costs liability, with the result that defence costs liability is covered within the limits once the excess has been exhausted by all forms of reinsured liability.

47. **[10] The Judge's interpretation would generate commercial absurdity.** The flipside of point [9] is that the Judge ignored the commercial complexities that his interpretation would generate (*cf.* [30] [**Core/8/101**]). On the appellants' interpretation, both parties know that the reinsureds retain a maximum exposure of £4 million and that the cover provided by Reinsurers

[23] Cf. [20]-[21], [23], [30] [**Core/8/97, 101**].

will end at exposure of £20 million (inclusive of the retention). The Insurers can therefore make appropriate reserves for their losses up to £4 million and, if they consider it necessary, enter the excess of loss reinsurance market and seek a further layer of cover, excess £20 million, to protect themselves against exposures exceeding that amount. Their various exposures to liabilities under the underlying policies are treated consistently and coherently.

48. On Equitas' interpretation and that adopted by the Judge, defence costs and indemnity payments are treated differently, without reason or explanation, and without considering why a reinsured would want to purchase different reinsurance protection for its different reinsured exposures. Further, neither party would have any such certainty or protection as neither would be able to predict its likely exposure and make reserves accordingly (and/or, in the case of Reinsurers, price risks appropriately). If there were high-volume, low-success litigation which generated significant cost but not liability (a possibility invoked by counsel for Equitas),[24] the reinsureds would have unlimited, unreinsured defence costs exposure, within the layer to which the Reinsurances ostensibly applied, unless indemnity payments crept over £4 million (a possibility which might never occur). If indemnity payments did happen to cross £4 million, Reinsurers would then have unlimited defence costs exposure unless and until indemnity payments reached £20 million (which they might never do). Neither would be able to reinsure or retrocede that unlimited liability because they would be unable to define it in any certain terms. That is an extraordinary and implausible bargain for the parties to strike without express wording in the Reinsurances to that effect, particularly in circumstances where the amount of the reinsured's retention "*is always a matter of prime importance when writing reinsurance.*"[25]

49. The Judge's answer to these submissions was, in effect, 'tough': see [30] [**Core/8/101**]. The commercial consequences are, as he put it, "*simply a consequence of the combination of (i) The Insurers' obligation to pay defence costs in addition to the indemnity and (ii) the back-to-back nature of the reinsurance*" (*ibid.*). For the reasons set out above, the appellants do not accept that these two matters justify the interpretation adopted. Significantly, this is not a case where the clear words of the contract or the natural meaning of the language used necessitates the adoption of a commercially

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[24] Counsel for Equitas gave at trial the example of opioids litigation, where costs might run into hundreds of millions without significant indemnity payments: "*Your lordship may have seen in the press… the opioid litigation in the US that's been fighting for over a decade, and only recently got to settlements. And that's meant that a primary insurer who maybe only gave 2 or 5 million of cover is on the hook for 0.5 billion worth of legal costs, because there has been no indemnity*…". Day 1, {49:3-11}. [**Supp/6/246**]

[25] Charter Re v Fagan [1997] 1 AC 313 at 390 per Lord Mustill.

absurd interpretation: see, e.g., Arnold v Britton and others [2015] AC 1619 at [20]. Here, the language of the Reinsurances fully support the appellants' position and the language of the RMPs is irrelevant when considering the operation of the (different) limits and excesses in the Reinsurances. In these circumstances, the commercial absurdity of Equitas's proposed interpretation ought to have weighed heavily and led the Judge to conclude that that indemnity payments *and* defence costs were capable of eroding the reinsurance excesses. The proposition that Equitas' construction is not uncommercial because the reinsureds have themselves chosen under the RMPs to accept potentially unlimited liability in respect of defence costs also misses the point (see [30] [**Core/8/101**]). The function of the Reinsurances is precisely to protect reinsureds against exposure that they cannot handle, i.e., to *resolve* this problem up to the limit these Reinsurers were willing to accept (£20 million). Equitas' construction denudes the Reinsurances of that protective function.

50. At the very least, the appellants' construction is one which is, as the Judge put it, "*logically available*" ([29] [**Core/8/101**]). The Judge ought, in those circumstances, and in accordance with established authority, to have preferred the appellants' far more commercial construction: Rainy Sky SA v Kookmin Bank [2011] 1 WLR 2900 at [29]-[30] (Lord Clarke).

F. CONCLUSION

51. For the reasons set out above, the appellants submit that the Judge's decision on the construction of the "Limit" provision in the Reinsurances was wrong and that the appeal should be allowed; at a minimum, the test for permission to appeal is met. The excess under the Reinsurances of £4 million is eroded by *all* reinsured liabilities, including defence costs, and the limit similarly applies to cap Reinsurers' total exposure to defence costs and indemnity payments at £20 million (inclusive of the retention).

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25 August 2026