Appeal No. CA-2026-000125
Claim No: LM-2024-000252

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 COMMERICAL COURT (KBD)

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

RESPONDENT'S APPEAL SKELETON ARGUMENT

A. Introduction

1. This appeal skeleton argument is served on behalf of the Respondent ("**Equitas**").

2. The Appellants were granted permission by the Court of Appeal to appeal against the order of HHJ Keyser KC (sitting as a Judge of the High Court) of 24 November 2025 (the "**Order**") on 27 March 2026 on a limited question of construction:[1] whether the attachment point of facultative excess of loss reinsurances covering the period 1981-1985 (the "**Reinsurances**") is eroded only by payments of indemnity for claims under the original insurance, or also by payments made in respect of defence costs.

[1] {CB/11/147}. Permission to appeal had been refused by the Judge on 24 November 2025 for the reasons set out in Form N460 {CB/10/145}.

3. The underlying losses arose from products liability actions advanced against BOC International Plc and BOC Group Inc. (together "**BOC**") in the 1980s, the majority of which were paid pursuant to a settlement agreement entered into in 2001: the Toxic Tort Settlement Agreement {SB/4/114}. The issue in this appeal is worth £3,032,236.60.[2]

4. The construction issue raised by this appeal is of a narrow compass and its resolution clear and straightforward:

   a. The Reinsurances were effected on a facultative basis to provide cover for "*General Third Party Liability… as per original policy indemnifying B.O.C. International plc*" and were to "*follow original terms*".[3] The terms of the Reinsurances therefore created and reflected "back-to-back" reinsurance cover with the original insurance, the Royal Master Policies ("**RMPs**"), copies of which were seen by the Reinsurers at placement.[4]

   b. The RMPs provided indemnity cover to BOC and its subsidiaries of £20 million in respect of any claim and/or claims arising out of any one "Occurrence".[5]

   c. In addition to the obligation to indemnify, the Appellants were separately obliged to pay defence costs in addition to the limit of £20 million under the RMPs.[6]

   d. Thus, the £20 million limit under the original insurance was in respect of indemnity payments only, not defence costs.[7] Accordingly, cover for defence costs was "outside" of the limits. Importantly, this also meant that the liability to pay defence costs under the RMPs was unlimited unless and until the indemnity payments alone exceeded the £20 million limit.

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2 This is the amount claimed by the Appellants in respect of three of the four years of reinsurance cover where the £4 million excess was exceeded by defence costs and not by indemnity payments only: see § 19 of the Appellants' skeleton argument {CB/4/26}.

3 See the "Class" provision at {CB/19/233} and the "GEN.CONDS" provision at {CB/19/234}. Throughout this skeleton, where reference is made to a policy provision, it is to the policy provision from the 1981/1982 policy year. The policies for the subsequent years are on the same or materially the same terms, save where otherwise identified.

4 The "Information" provision of the Reinsurances states "*Copy of original policy seen*" {CB/19/234}.

5 {SB/1/6}. "Occurrence" is defined in Schedule A(4) as "*any loss injury or damage happening during the Period of Indemnity for which The Insured is or may become liable in contract or tort or by statute or otherwise howsoever.*"

6 Schedule D(3) of the RMPs: {SB/1/16}.

7 As the Appellants recognise and accept: see § 11 of the Appellants' skeleton argument {CB/4/23}. The Appellants also recognise and accept that the "subordinate" local policies contemplated by the RMPs as being issued on behalf of the insurers under the RMPs as evidence of the insurance provided under the RMPs also covered defence costs in addition to the limits of liability (*ibid*).

e. The Reinsurances provided cover of £16 million in excess of £4 million "*any one loss or series of losses arising out of one occurrence*".[8]

f. This reflected the £20 million limit under the RMPs and, given the facultative and "back-to-back" nature of the Reinsurances, the limit and excess thereunder were likewise concerned with indemnity payments only, and not defence costs. This also meant that, as with the Appellants' liability for defence costs under the RMPs, Equitas was liable to indemnify defence costs "outside" (i.e., in addition to) the limit of £16 million in the Reinsurances, which was limited to indemnity payments only.

g. Thus, the excess of £4 million and the limit of £16 million are eroded only by indemnity payments, not by defence costs.

5. This construction of the Reinsurances by Equitas was accepted by the Judge as correct. Equitas respectfully invites the Court of Appeal to uphold the Order for the reasons relied upon by the Judge reported at [2025] EWHC 2704 (Comm) (the "**Judgment**"). References in [] are to paragraphs in the Judgment.

B. Relevant Law

6. The principles said to be relevant to the appeal as set out in §18 of the Appellants' skeleton argument are not in dispute, subject to the following points of clarification.

7. *First*, as to the purpose of reinsurance and, specifically, in the context of an excess of loss reinsurance, the reinsurance cover will be subject to all the terms of the reinsurance and not just the limits and excesses. Moreover, the limits and excesses must be construed with the other terms of the reinsurance to determine when the transfer of financial risk to the reinsurer commences and when it ceases – and the extent of the risk transferred. The final sentence of §18.1 of the Appellants' skeleton argument fails to recognise the nuances of this transfer of financial risk which is the very issue in dispute in this appeal, *viz* whether the financial risk transferred to Equitas under the Reinsurances when £4 million has been eroded only by indemnity payments, or by indemnity payments and defence costs. As Foxton LJ observed in the order granting permission to appeal, "*[n]either is an inherently more likely or commercial outcome than the other… Ultimately, all depends on the construction of the contract in issue*" {CB/11/147}. Put simply, where one is concerned

[8] The "Limits" provision at {CB/19/233}.

with third-party legal liability policies, it is common for cover to extend to defence costs. However, whether such cover is "inside" the limit of indemnity or "outside" (i.e., in addition to the stated limit of indemnity) depends upon the terms of the policy in question. Equally, any reinsurance on a "back-to-back" basis will reflect that position at the reinsurance level.

8. *Secondly*, Equitas does not accept the Appellants' construction of the Reinsurances in the final sentence of §18.4 of their skeleton argument (which is asserted in the context of the test for the incorporation of terms):

    a. The "GEN. CONDS" provision of the Reinsurances provides "*To follow original terms, conditions and settlements (as far as applicable to the layer)*" {CB/19/234}.

    b. The Appellants assert that the language "*as far as applicable to the layer*" reflects the test for the incorporation of terms set out in HIH v New Hampshire Insurance Co [2001] Lloyd's Rep IR 224 per David Steel J.

    c. This provision in the "GEN, CONDS" section of the Reinsurances is a combination of (i) a term to incorporate original terms and (ii) a "follow the settlements" provision.[9]

    d. Equitas contends that, properly construed, the reference to "*as far as applicable to the layer*" applies only to the follow the settlements provision i.e. the Reinsurers are only required to follow settlements as far as they are applicable to the layer. Certainly, it does not operate to alter the nature of cover provided by the Reinsurances on a "back-to-back" basis, i.e., if defence costs are "outside" of limits on the RMPs, coverage under the Reinsurances for such defence costs is likewise in addition to the limits of indemnity.

9. In addition to the clarifications above, the following principles are also relevant to this appeal:

    a. Facultative reinsurance involves the reinsurance of one sole risk or a series of related original policies. The essential characteristic of facultative reinsurance is that the reinsurer is free to choose whether to accept any particular risk and the reinsured is free to choose whether to cede any particular risk: MacGillivray on

[9] Unlike a full reinsurance clause, this provision does not contain a retention stipulation: see MacGillivray on Insurance Law (16th Ed.) para 33-057.

Insurance Law (16th Ed.) para 33-017. In this case, the Appellants ceded their liabilities under the RMPs, copies of which were seen by Reinsurers prior to subscription to the Reinsurances.

b. In the context of facultative reinsurance, there is a presumption, aided by general words of incorporation, that the parties intend at least the scope of the cover to be back-to-back with the underlying insurance: HIH v New Hampshire Insurance Co [2001] Lloyd's Rep IR 596 at [166] per Rix LJ.

c. "Back-to-back" reinsurance with the insurance means that the reinsurer agrees that if the insurer is liable under the inwards policy, the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure: Vesta v Butcher (No 1) [1989] AC 852 at 895 per Lord Griffiths.

C. The Judgment

10. In the Judgment, the issue on appeal is referred to as the "Defence Costs Erosion Issue" and is addressed by the Judge at [9] to [30] {CB/8/92-101}.

11. The Judge began by correctly recognising that this issue concerned the proper construction of the Reinsurances and referred to the well-established basic principles of construction: [9] {CB/8/92}.[10]

12. The Judge then identified the nature of the Reinsurances as facultative, excess of loss policies which were back-to-back with the RMPs: [10] {CB/8/92-93}. This was (and remains) common ground between the parties.

13. Having regard to the dictum of Lord Griffiths in Vesta v Butcher at 895 on what is meant by "back-to-back" reinsurance referred to above, the Judge first set out the provisions of the RMPs at [11] to [12] {CB/8/93-95} and then set out the provisions of the Reinsurances at [13] to 18] {CB/8/95-96}.

14. The Judge regarded the interpretation of the provisions as "*fairly clear and the construction contended for by Equitas to be correct*" [19] {CB/8/96}. The Judge gave eleven reasons for this conclusion. In summary:

[10] As the order of Foxton LJ granting permission to appeal observes: "*Ultimately, all depends on the construction of the contract in issue.*": {CB/11/147}.

a. The Reinsurances are facultative back-to-back policies which "*follow original terms*" and the Reinsurers had seen a copy of the "*original policy*" at placement (which was agreed by the parties to be the RMPs): [20] {CB/8/97}.

b. The financial limit of indemnity cover in the RMPs is £20 million with cover for defence costs sitting alongside and in addition to the indemnity cover, i.e., "outside" of the limits. Thus, cover for defence costs was *prima facie* without financial limit, save that such cover existed for so long as the indemnity for liability was not exhausted. Therefore, in view of the nature of the Reinsurances, the natural understanding of the "Limit" provision in the Reinsurances would be that the £16 million for cover and the £4 million for excess reflect the £20 million in the RMPs and thus relate to indemnity cover and not defence costs: [21] {CB/8/97}.

c. This understanding of the "Limit" provision is confirmed by the structure of the RMPs: [22] {CB/8/97}.

d. The Reinsurances follow the terms of the RMPs. The wording of the "Limit" provision in the Reinsurances mirrors the structure of the RMPs and therefore relates to the duty to indemnify only, not the additional duty to pay defence costs: [23] {CB/8/97}. As such, back-to-back with the RMPs, the Reinsurances provide cover for defence costs in addition to (i.e., "outside of") the limits of indemnity.

e. In the "Limit" provision, the £16 million relates only to indemnity costs and it would be surprising if the £4 million related differently: [24] {CB/8/98}.

f. Further support for the natural interpretation of "loss or series of losses" in the "Limit" provision of the Reinsurances, namely as relating to the duty to indemnify rather than the duty to pay defence costs, is provided by other provisions of the Reinsurances: [25] {CB/8/98}.

g. The agreed fact that the Reinsurances cover the Appellants' liability for both indemnity and defence costs does not mean that both indemnity and defence costs must be capable of eroding the £4 million reinsurance excess: [28] {CB/8/100}.

h. The alternative construction advanced by the Appellants that no limit or excess applied to the Reinsurers' liability for defence costs is not the only conceivable alternative. Whilst such a construction might be logically available, it would divorce the liability to pay defence costs from the exposure to indemnity liability on which it was parasitic: [29] {CB/8/100-101}.

i. There is nothing uncommercial in Equitas's construction: [30] {CB/8/101}.

D. The so-called "critical errors"

15. The Appellants assert that the Judge made five "critical errors" in reaching the conclusion that the construction of the Reinsurances contended for by Equitas is correct. These so-called "critical errors" are misconceived. The Judge's construction was correct, and the Order should be upheld.

(i) So-called critical error 1: The assertion that the Judge inadequately focused on the Reinsurances and their terms is wrong.

16. The Judge carefully considered the provisions of the Reinsurances in [10] and [13]-[30].

1. The "Class" provision

17. In the "Class" provision of the Reinsurances as set out by the Judge at [13], the Reinsurers agreed to reinsure "*General Third Party Liability including Products, Employers Liability, Motor Liability, Professional Indemnity, Financial Loss, Aviation and Marine Liability, as per original policy indemnifying BOC International plc including all subsidiary and/or associated and/or affiliated companies.*" (emphasis added) {CB/19/233}.

18. The liability of the Appellants under the original policy, i.e. the RMPs, was twofold: first, a limit of liability of £20 million for indemnity payments; and, secondly and in addition, an unlimited liability for defence costs, until such time as the £20 million limit for indemnity payments had been exhausted.[11] To that extent, the notionally unlimited cover for defence costs was parasitic upon the obligation to indemnify liability payments. Once that indemnity limit had been exhausted, the separate obligation to pay defence costs would cease.

19. The separately identified types of "*Liability*" in the "Class" provision of the Reinsurances thereby reflected the "*Liability*" under the RMPs which was subject to a policy limit of £20 million, with liability for defence costs in addition, i.e., "outside" that limit of £20 million.

[11] Schedule D(1) provides the limit of £20 million for indemnity payments i.e. "*any claim or number of claims arising out of any one Occurrence*" {SB/1/16} and Schedule D(3) provides the indemnity for defence costs i.e. "*any costs and expenses*" {SB/1/16}. Schedule D(5) sets out the parasitic nature of the liability for defence costs on the liability for indemnity payments {SB/1/17}.

20. The "Class" provision emphasises the back-to-back nature of the Reinsurances: "*as per original policy indemnifying BOC…*". This was the first tenet of the Judge's reasoning. The "Class" provision therefore clearly formed part of the Judge's analysis.

21. Further, the Appellants suggest in §26 of their skeleton argument that the Judge did not have sufficient regard to the "Class" provision because he ignored the fact that it does not distinguish between defence costs and indemnity payments. This complaint proceeds on a false premise. The "Class" provision refers expressly to the class of cover being "*as per original policy*". The original policy (i.e. each of the RMPs) does expressly distinguish between defence costs and indemnity payments, as is common ground. This division reflects the distinction between the duty to indemnify and the duty to defend (and pay defence costs). Thus, the "Class" provision, by virtue of its reference to the original policy, necessarily distinguishes between indemnity payments and defence costs.

22. As to the Appellants' reliance on the basic function of reinsurance, Equitas' construction of the Reinsurances is entirely consistent with this. The liability under the original policy was for indemnity payments up to a limit of £20 million, plus defence costs in addition to that limit. By virtue of the back-to-back nature of the Reinsurances, it was this same liability on the same terms which was reinsured on an excess of loss basis, namely an indemnity up to a certain amount (£16 million excess £4 million) with defence costs in addition.

2. The "Limit" provision

23. The "Limit" provision in the Reinsurances (with the exception of the 1984/1985 Reinsurances which were split into two layers of cover for £16 million in excess of £4 million) provides {CB/19/233}:

> "*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 AGGREGATE 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 £4,000,00 IN THE AGGREGATE for Products and Financial Loss.*"

24. The Appellants seek to construe this provision in isolation without regard to: (i) the back-to-back nature of the cover provided under the Reinsurances, as emphasised in the "Class"

provision addressed above ("*as per original policy indemnifying BOC…*") and accepted by the Appellants; (ii) the fact that the Reinsurances are "*To follow original terms, conditions…*"; and (iii) the wording of the "Limit" provision itself.

25. The Appellants assert that the "Limit" provision is necessarily *sui generis* and peculiar to the Reinsurances because the RMPs do not contain an excess. This is advanced in an attempt to drive a wedge between the RMPs and the Reinsurances to avoid the consequences which would otherwise follow from their back-to-back nature. But this does not work. If the Appellants were correct, there could never be back-to-back cover under an excess of loss reinsurance unless the underlying insurance also contained an excess. This is obviously incorrect. Put another way, one can always reinsure a tranche of one's liability (i.e., excess of loss) on a back-to-back basis, rather than reinsuring 100%. The *amount* reinsured does not alter the back-to-back nature of the relationship between the RMPs and the Reinsurances.

26. Further, the RMPs were primary policies in the sense that the indemnity provided applied "ground up." In those circumstances, they obviously do not have any excess. However, the obligation to pay defence costs under the RMPs nevertheless existed in tandem with the obligation to indemnify. The Reinsurances were reinsuring the Appellants in respect of their liabilities under the RMPs and those liabilities were in respect of the twofold obligation in the RMPs, namely: (a) to indemnify up to a limit of £20 million; and (b) until that limit had been exhausted, to pay defence costs in addition.

27. By the terms of the "Limit" provision in the Reinsurances, the Appellants retained £4 million of their obligations under the RMPs and reinsured their obligations above £4 million.[12] The £4 million retained by the Appellants was the obligation to indemnify, and with it the associated obligation to pay defence costs. However, that latter and separate obligation to pay defence costs was in addition to the £4 million of risk retained by the Appellants. Thus, as the Judge correctly concluded in [23] and [24], the £4 million retention under the Reinsurance Policies is concerned with indemnity payments only.

28. The Appellants' assertion in §27 of their skeleton argument that the "Limit" provision defines the floor and ceiling of the cover under the Reinsurances is just that: mere assertion.

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[12] The Appellants in fact bore less risk than the £4 million excess from 1 October 1983 since they arranged certain sub-excess protections within their retention of £4 million.

It is an incorrect assertion when, for the reasons set out above, defence costs are covered in addition to the limit under the Reinsurances.

29. Further, and contrary to §28 of the Appellants' skeleton argument {CB/4/30}, the Judge correctly concluded that the wording of the "Limit" provision supports this construction:

    a. The limit of each of the Reinsurances is defined by reference to "*any one loss or series of losses*".

    b. "*Loss*" or "*Losses*" in the Reinsurances can mean only indemnity payments, not defence costs:

        i. The Reinsurances follow the terms of the RMPs.

        ii. The structure of the RMPs is to indemnify BOC "*against Liability arising from any Occurrence*" during the relevant period {SB/1/12}. The natural interpretation of this indemnity cover, having regard to the definition of "Occurrence" in Schedule A(4), is that it refers to BOC's liability for damages or compensation to third-party claimants. The additional and parasitic duty to pay defence costs in the cover under the RMPs is achieved by Schedule D(3) and the temporal limitation in Schedule D(5).

        iii. Accordingly, the phrase "*loss or series of losses arising out of one occurrence*" in the "Limit" provision is concerned with the reinsured's, i.e. the Appellants', duty to indemnify, not the additional obligation to defend, pursuant to which defence costs were payable *in addition* to the Limit payable for the underlying loss. Therefore, "*loss or series of losses"* must refer to indemnity payments only in respect of the £4 million excess.

        iv. For consistency, and also by reason of the facultative back-to-back nature of the Reinsurances, "*loss or series of losses arising out of one occurrence*" in the "Limit" provision must also refer to indemnity payments only in respect of the £16 million limit. It necessarily follows, on this basis, that defence costs are covered under the Reinsurances *in addition* to the limit of £16 million (albeit limited to those defence costs

incurred during the period of time when the Reinsurers are on risk, i.e., after the £4 million retention has been exhausted by indemnity payments and until £16 million in indemnity payments is exhausted).

v. This is also consistent with the references to "*loss*" elsewhere in the Reinsurances which are addressed below.

3. Other provisions in the Reinsurances

30. The construction of "*losses*" in the "Limit" provision as referring to indemnity payments only is consistent with and supported by other provisions in the Reinsurances.

31. The reference to "*losses*" in the General Conditions provides: "*Re P.I. including claims made in the Period in respect of losses occurring prior to inception*".[13] This cannot refer to defence costs since defence costs cannot be incurred prior to inception. The Appellants' response to this in §31.5 of their skeleton argument does not properly engage with this point. Instead, it inaccurately reformulates the point and ignores the fact that the Judge relied upon this provision as "*further support*" for his interpretation and as indicating that the Reinsurances are consistent in their usage and coherent when so interpreted, rather than relying on it as a provision which "*precludes a different meaning of "loss" in the "Limits" provisions*": [25] {CB/8/98}.

32. Similarly, the Judge relied upon the use of "*loss*" in the Claims Cooperation Clause in support of his interpretation of "*loss or series of losses*" in the "Limitation" provision: [25] {CB/8/98}. Again, the Appellants' criticism of this in §31.6 of their skeleton argument does not properly engage with the point made by the Judge or recognise the Judge's appropriate regard to the interpretation of the Reinsurances as a whole to avoid incoherence or internal inconsistency.

33. As to the Judge's reliance in [24] on the endorsement to the Reinsurances recording "*Limit of Indemnity £16,000,000 in excess of £4,000,000*" (emphasis added), the Appellants' criticism of this is, again, unfounded. The Appellants assert in §33.1 of their skeleton that the reference 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)*

[13] {CB/19/239}

and indemnified by the reinsureds…"; however, the basis for that assertion is not articulated. Indeed, it appears to proceed on an assumption of the very matter that is in issue: whether the limit of £16 million in excess of a £4 million retention is concerned with the (whole of) the cover to be provided under the Reinsurances, or whether it is concerned only with the cover for indemnity payments, with cover for defence costs being provided in addition under the Reinsurances.

4. The Claims Cooperation Clause

34. The Appellants are critical of the Judge's interpretation of the Claims Cooperation Clause in the Reinsurances in [26]: see §§34-35 of the Appellants' skeleton argument {CB/4/33-35}. However, the analysis and interpretation of the Reinsurances in [20]-[24] are sufficiently compelling that there is no need to refer to the Claims Cooperation Clause, as the Judge himself recognised at the consequentials hearing.[14] Accordingly, it is simply wrong for the Appellants to assert that the Judge's interpretation relied on a rendering of the Claims Cooperation Clause at all, irrespective of the Appellants' view of its plausibility.

(ii) So-called critical errors 2 and 3: The Judge did not mistakenly rely on the RMPs as supplying the answer

35. The Judge's reliance on the RMPs was entirely appropriate in circumstances where it was common ground that the Reinsurances were placed on a facultative and back-to-back basis to provide cover for "*General Third Party Liability… as per original policy indemnifying B.O.C. International plc*" and were to "*follow original terms*" which had been seen by Reinsurers at placement.[15]

5. The £20 million limit

36. The limit of £16 million excess £4 million in each of the Reinsurances mirrors the £20 million limit in each of the RMPs. This was admitted by the Appellants in their pleaded case.[16] The Appellants also state expressly in §36.1 of their skeleton argument that the limit under the Reinsurances was chosen because it is the same as the limit under the RMPs (at

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14 {SB/8/305}.

15 The Information section provides "*Copy of original policy seen*": {CB/19/234}.

16 See the admission in paragraph 16F of the Re-Re-Re-Amended Reply at {SB/7/299} of paragraph 41.1.6 of the Re-Re-Amended Defence at {CB/18/221}.

least as regards three of the four policy years). That, of course, is a limit for indemnity payments only, with defence costs in addition.

37. This fact is certainly a significant element of the Judge's analysis and interpretation of the Reinsurances. Indeed, it is the obvious starting point given the admitted nature of the Reinsurances. Contrary to the suggestion by the Appellants in §24.2 of their skeleton, there is nothing "superficial" about this symmetry between the £20 million limit in the RMPs and the £20 million limit under the Reinsurances: it reflects the back-to-back nature of the reinsurance cover. However, it does the Judge a disservice to suggest that his interpretation was based upon the fact that the RMPs and Reinsurances both adopt a £20 million limit alone. Even a cursory reading of [19] to [30] shows the fallacy of this argument.

38. Similarly, the suggestion that the Judge did not analyse the words used by the parties in the contracts is also belied by the Judgment. The support for the distinction between the treatment of defence costs and indemnity payments in respect of the excess or the limit can be found in the express words of the Reinsurances as considered and analysed by the Judge, *viz* "*as per original policy*" in the "Class" provision and "*To follow original terms, conditions…*" in the "GEN. CONDS" provision.

39. Even if the Judge had engaged at the level of intention without reference to the actual words of the contract at issue (which he did not), the allegedly "*equally plausible*" reasons that £20 million was chosen in the Reinsurances as encompassing both indemnity payments and defence costs asserted by the Appellants in §36.3 of their skeleton are far from plausible at all; they are certainly not equally plausible to the £20 million limit being chosen to reflect the limit under the RMPs (which the Appellants have expressly accepted was the case in §36.1 of their skeleton argument). Indeed, if the Appellants were correct, they faced the real risk of incurring liability under the RMPs where the defence costs far exceeded the limit of liability for indemnity payments, with the consequence that any reinsurance was grossly inadequate.

40. As to the Appellants' assertion in §36.4 of their skeleton argument that the analysis of the RMPs and Reinsurances as both adopting a £20 million limit ignores the structure of the reinsurance cover in the fourth 1984/1985 year, this is a classic example of failing to see the wood for the trees. Although the Reinsurance for 1984/1985 was split into two layers, specifically a £10 million xs £4 million layer and a £6 million xs £14 million "top up" layer, nothing turns on this. The overall structure of cover for that year was substantively the same

as the cover in the other years, and the overall reinsurance cover obtained for 1984/1985 reflected the £20 million limit in the RMP for that year. Again, this total £20 million limit covered indemnity payments, with cover for defence costs in addition. The "Limit" provision in the Reinsurance for 1984/1985 was rightly interpreted by Equitas and the Judge accordingly.

6. Incorporation of Schedule D(3)

41. 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.*"

42. Contrary to the Appellants' assertions, it was and is legally permissible (and appropriate) to incorporate Schedule D(3) of the RMPs in the Reinsurances. This incorporation is consistent with the presumption in the context of facultative and back-to-back reinsurance cover and the words of incorporation in the Reinsurances, specifically in the "Class" provision and the "GEN. CONDS" provision: per Rix LJ in HIH v New Hampshire (referred to above).

43. The alleged difficulties with such incorporation of Schedule D(3) as identified by the Appellants in §§37 to 40 of their skeleton argument are illusory.

44. First, Schedule D(3) does not trespass on, nor is it inconsistent with, the "Limit" provision in the Reinsurances.

    a. As addressed above, the "Limit" provision refers to indemnity payments only. Incorporating a provision from the RMPs that provides cover for defence costs in addition to the £16 million limit in excess of £4 million in respect of indemnity payments in the Reinsurances does not involve any contradiction of that "Limit" provision.[17]

    b. Moreover, even if the reference to "(*as far as applicable to the layer)*" in the incorporating term in the "GEN. CONDS" provision applies to the original terms and not just to settlements (as to which Equitas's position is set out above), Schedule D(3) must be applicable to the Reinsurances. Schedule D(3) is a

[17] The Appellants' reliance on the dicta of Hobhouse LJ in Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd [1998] Lloyd's Rep IR 421 is therefore entirely misplaced.

necessary term defining the risk ceded by the Appellants to the facultative Reinsurances, *viz* liability for indemnity payments with defence costs in addition.

45. Secondly, the express provision made in the Claims Cooperation Clause of the Reinsurances does not preclude the incorporation of Schedule D(3) or, if appropriate, Schedule D more generally.

    a. As the Appellants acknowledge in §39.2 of their skeleton argument, Schedule D(5) is only "*similar*" to the third paragraph of the Claims Cooperation Clause. The differences indicate that the parties deliberately agreed the specific (and different) terms of the Claims Cooperation Clause in the Reinsurances. The Appellants' assertion that this means that, where the Reinsurers wish to make <u>similar</u> provision in the Reinsurances to that in Schedule D of the RMPs, they did so expressly, is a *non sequitur*.

    b. Further, in circumstances where the Reinsurances were placed on a facultative basis to provide cover for "*General Third Party Liability… as per original policy indemnifying B.O.C. International plc*" and were to "*follow original terms*" which had been seen by the Reinsurers on placement, the provision in Schedule D(3) that defence costs are covered in addition to the limits did not require any further specific or express provision in the Reinsurances.

46. Thirdly, there is a simple and straightforward manipulation of Schedule D(3) of the RMPs to allow meaningful incorporation of it in the Reinsurances which reflects the fact that the Appellants *qua* reinsureds have a duty to defend the underlying insured, and therefore will have incurred defence costs in addition to indemnity payments. In those circumstances, one merely has to swap "*The Insurers*" for "*the Reinsurers,*" "*The Insured*" is swapped for "*the reinsured*" and "*claimant*" is swapped for "*insured*".

47. As so manipulated, Schedule D(3) reads:

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

48. Thus, if BOC *qua* the Insured has paid costs and expenses to any claimant, or if BOC has incurred defence costs with the consent of the Appellants *qua* insurers / reinsureds, the

Appellants will have been liable to indemnify those sums in addition to any indemnity payments for BOC's liability. In those circumstances, the Appellants will likewise seek recovery from Equitas *qua* reinsurer.

49. Indeed, an appropriate manipulation may be simpler still, namely one which focusses upon the fact that the defence costs incurred under the RMPs by the Appellants *qua* insurers are being claimed by them *qua* reinsureds under the Reinsurances. In other words, the amounts identified in Schedule D(3)(a) and (b) are sums which, *ex hypothesi*, the Appellants have paid out under the RMPs and are now claiming under the Reinsurances. This addresses the supposed difficulties in §39.5(b) and (c) of the Appellants' skeleton argument.

50. Such a limited manipulation of Schedule D(3) reads as follows:

> "*The Reinsurers will in addition indemnify the reinsured 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.*"

51. This also resolves the apparent problem of consent raised in §39.5(d) of the Appellants' skeleton argument: the manipulation is seeking to deal with the defence costs incurred with the Appellants' consent *qua* insureds / reinsureds. As such, it remains their consent which is relevant.

52. This modest and rudimentary manipulation makes sense in the context of the Reinsurances. The reference to "*will in addition indemnify*" is coherent with the "Limit" provision of the Reinsurances since that provides for cover for indemnity payments of £16 million in excess of £4 million and Schedule D(3) as incorporated provides cover for defence costs in addition to this.

7. The Effect of the Incorporation of Schedule D(3)

53. The effect of the incorporation of Schedule D(3) on the interpretation of the Reinsurances is simple: defence costs are covered in addition to the cover provided under the "Limit" provision. Thus, defence costs are outside the excess and the limit of the Reinsurances and cannot erode either the £4 million excess or the £16 million limit.

54. The possible interpretations asserted by the Appellants in §41 of their skeleton argument are irrelevant: the first concerns an unmanipulated form of Schedule D(3); and the second ignores the parasitic nature of the liability to pay defence costs on the indemnity liability.

55. As to the Appellants' second interpretation, this was rightly rejected by the Judge at [29] {CB/8/100}. Contrary to the Appellants' assertion in §§43 and 44 of their skeleton argument, this did not involve a process of "*mental gymnastics*". Rather, it is the Appellants who engage in such mental gymnastics in their desire to avoid the "*most obvious*" and "*natural reading*" of the "Limits" provision: [23] {CB/8/97}.

56. There are no fundamental problems with the Judge's reasoning underlying the conclusion that the £4 million retention can be eroded by indemnity payments only. The Judge addressed the way in which the limits under both the RMPs and Reinsurances work with cover for defence costs in addition, i.e., "outside" of the limits:

    a. The indemnity provided by the Appellants under the RMPs was for indemnity up to a certain limit (£20 million), plus defence costs in addition to that limit. This was what was reinsured under the facultative Reinsurances on an excess of loss and back-to-back basis, namely an indemnity up to a certain amount with defence costs in addition once the £4 million excess point had been reached.

    b. The obligation to pay defence costs in addition, both under the RMPs and under the Reinsurances is not without *any* limit. There is no monetary limit; instead, that obligation to pay defence costs subsists only as long as the monetary limit of the duty to indemnify has not been exhausted. Once that duty to indemnify has been exhausted, the obligation to pay defence costs ceases. There is, therefore, a temporal limit on the obligation to pay defence costs. To be clear, this is not unusual: it is the default position, for example, in domestic US policies which have a duty to defend which is separate and distinct from the duty to indemnify.

    c. By the terms of the Reinsurances, the Appellants retained £4 million of their obligations under the RMPs and reinsured their obligations above £4 million. As already addressed above, the £4 million retained by the Appellants is the Appellants' obligation to indemnify, and with it the associated obligation to pay defence costs which was in addition to the £4 million of risk retained by the Appellants. Thus, the £4 million retention under the Reinsurances is concerned with and can be eroded by indemnity payments only.

d. This is clear from both the structure of the Reinsurances and the underlying policies, and the express term of the Reinsurances that they are: "*To follow original terms, conditions and settlements (as far as applicable to the layer)*" {CB/19/234}. Further, and as was and remains common ground, the Information section of the Reinsurances states that a copy of the original policy, *i.e.* the RMP, had been seen by Reinsurers {CB/19/233}. Thus, Reinsurers had seen that there was an obligation to indemnify with defence costs payable *in addition*.

(iii) So-called critical errors 4 and 5: The Judge's construction is entirely plausible and commercial

57. There is nothing implausible or lacking in commercial common sense in the Judge's construction. In the lukewarm order granting permission to appeal, Foxton LJ noted that neither a construction that deductibles and attachment points in primary and reinsurance policies are to be eroded only by payments or settlement of claims, nor a construction where such erosion is by indemnity payments and defence costs, is an inherently more likely or commercial outcome than the other: {CB/11/147}. The Appellants' so-called critical errors 4 and 5 simply beg the question of the proper construction of the Reinsurances.

8. The purpose of "follow original terms" and "back-to-back" cover

58. As set out above, the first tenet of the Judge's reasoning was the back-to-back nature of the reinsurance cover which "*follow original terms*", of which Reinsurers had seen a copy. The Appellants' contention that the Judge's interpretation subverts the purpose of "back-to-back" cover and generates a mismatch or dissonance between the Reinsurances and the RMPs is simply wrong.

a. No mismatch or dissonance is generated by the excesses and limits being concerned with indemnity payments only. On the Judge's interpretation of the Reinsurances, the cover thereunder with defence costs covered in addition to the £16 million limit (and not eroding the £4 million excess) is "back-to-back" with the cover under the RMPs where defence costs are covered in addition to the limit of £20 million.

b. It is the Appellants' construction that results in a mismatch since, pursuant to the RMPs, the Appellants would be covering indemnity payments up to £20 million with defence costs in addition, the latter of which were unlimited with the potential to exceed the indemnity limit. On the Appellants' case, the reinsurance cover that

they obtained was confined in monetary terms to £16 million which could be eroded by both indemnity payments and/or defence costs. This would mean that, contrary to the facultative and "back-to-back" reinsurance obtained, the Appellants' liability for defence costs in addition (and, indeed, any amount of indemnity costs which is not covered by the £16 million because that had been eroded by indemnity payments and/or defence costs), would not be reinsured at all.

9. Commercial and practical reality

59. The assertions as to the commercial and practical reality of the writing of reinsurance in §46 of the Appellants' skeleton argument do not advance the Appellants' case. The Reinsurances are on terms that create and reflect "back-to-back" cover with the RMPs and expressly follow the terms of that underlying insurance. That cover and those terms of the RMPs provide for cover of defence costs *in addition* to the limit. The Reinsurers saw the RMPs at placement and there is nothing uncommercial or impractical with Reinsurers providing cover under the Reinsurances on those terms. There is no process of mental abstraction required as the Appellants suggest. Rather, the Reinsurers simply had to read the copy of the original policy which is expressly recorded in the Reinsurances as having been seen.

10. No commercial absurdity

60. There is no commercial absurdity in Equitas's interpretation of the Reinsurances, as adopted by the Judge. Indeed, the order granting permission to appeal recognises that the Judgment offers "*a sensible and coherent interpretation of the Reinsurances as facultative excess of loss contracts*" {CB/11/147}.

61. The reason and explanation for defence costs and indemnity payments being treated differently are set out clearly in the Judgment, contrary to the assertion in §48 of the Appellants' skeleton argument. Namely, that the Reinsurances provide facultative "back-to-back" cover with the RMPs which in turn provide cover for indemnity payments with defence costs in addition. That cover is then merely reflected in the Reinsurances. The Judgment rightly recognises the distinction between the duty to indemnify and the duty to defend (and pay defence costs).

62. Further, there are advantages and disadvantages to this cover for defence costs in addition for both parties.[18] As the Judge put it in [30]: "*Things could turn out disadvantageously for either party*" {CB/8/101}. The Appellants focus on the disadvantages to each party without acknowledging the advantages on the flipside of each scenario posited in §48 of their skeleton argument.

63. As to the Appellants' suggestion that the Judge's interpretation means that neither party could reinsure or retrocede their liability, this is manifestly incorrect in circumstances where the Appellants have done exactly that under the Reinsurances. In any event, it is the Appellants who assumed the real risk that their total liability under the inwards policies would not be reinsured. Had the Appellants intended there to be reinsurance cover once indemnity payments and/or defence costs had exceeded £4 million, express terms to this effect should have been included in the Reinsurances.

64. The Appellants' reliance on Arnold v Britton and others [2015] AC 1619 at [20] is inapposite where the interpretation of the Reinsurances is not commercially absurd. If relevant at all, that point of interpretation lies against the Appellants where they seek to advance an interpretation of the Reinsurances which ignores (i) the facultative and "back-to-back" nature of the Reinsurances as created and reflected in the "Class" provision, (ii) the "*To follow original terms*" provision and (iii) the limit of £16 million excess £4 million chosen to reflect the £20 million limit of the RMPs with cover for defence costs in addition.

65. Finally, as to the suggestion that the Judge ought to have preferred the Appellants' construction as the "*far more commercial construction*", that is simply wrong. The Appellants' construction is not more commercial than Equitas'. In any event, the Appellants misquote the Judge in [29]. The Judge did not say the Appellants' construction is one which is logically available. Rather, the Judge was responding to the submission that the only conceivable alternative to the Appellants' construction was that no limit or excess applied to the Reinsurers' liability for defence costs. The Judge said that this alternative construction "*might be logically available*" (emphasis added), but that it would divorce the liability to pay defence costs from the exposure to indemnity liability on which it was parasitic.

66. The interpretation of the Reinsurances by Equitas and accepted by the Judge reflects this parasitic liability. Pursuant to the Reinsurances, the Appellants retain £4 million of

[18] As recognised by Foxton LJ in the order granting permission to appeal: {CB/11/147}.

indemnity payments plus defence costs. Once the £4 million is eroded by indemnity payments, the Appellants' liability for indemnity payments and defence costs in addition ends and the Reinsurers are liable under the Reinsurances for indemnity payments up to the limit of £16 million plus defence costs. Once the £16 million limit is exhausted by indemnity payments, the Reinsurers' liability for defence costs also ends. The parasitic right to defence costs is outside of the limits under both the RMPs and the Reinsurances. Thus, this parasitic right ends once the indemnity has been paid. This interpretation is entirely logical, internally consistent and commercial

E. Conclusion

67. For the reasons given by the Judge and set out above, the Judge's decision on the construction of the "Limit" provision in the Reinsurances was correct and the appeal should be dismissed. The excess under the Reinsurances of £4 million is eroded by indemnity payments only. Once the £4 million excess is eroded by indemnity payments, the Reinsurances provide cover for indemnity payments up to the limit of £16 million with defence costs covered in addition until the £16 million obligation to indemnify has been exhausted.

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