COVINGTON

UK Supreme Court Restricts Scope Of "All Sums" Principle In Mesothelioma Employers' Liability Insurance Cases To Defence Costs

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Insurance

Introduction

On May 20, 2015, the UK Supreme Court handed down judgment in the case of *Zurich Insurance Plc UK branch v. International Energy Group Limited,* reversing in part the decision of the Court of Appeal of February 6, 2013.

The Supreme Court confirmed that under English law a policyholder is entitled to recover from any one of its insurers on risk during the period of the claimant's alleged exposure to asbestos the full amount of defence costs incurred in defending a claim by an employee with mesothelioma alleging that the policyholder negligently exposed him/her to asbestos. It also confirmed that the policyholder can recover from any one insurer the full amount of any compensation that it has to pay, but the insurer is entitled to claw back from the policyholder a proportion of the compensation payment where there were uninsured years during the period of exposure, as well as recovering contributions from any other insurer that had been on risk during the period of exposure. The claw back right applies to indemnity costs but not to defence costs.

Background

The policyholder, International Energy Group Limited ("IEG"), a solvent company previously known as Guernsey Gas, settled a mesothelioma claim by a former employee whom it had employed for a period of 27 years (from 1961 to 1988) for the sum of about £278,000. It then sought to recover the full amount of compensation from its Employers' Liability ("EL") insurer, Zurich, whose predecessor company had only insured IEG for the last 6 out of the 27 years of employment. Excess, which is in run off, had insured a further 2 years, but the remaining 19 years were uninsured. Zurich claimed that it was only liable to the policyholder for a proportion of the victim's compensation equivalent to the portion of the claimant's employment for which it had been on the risk. The trial Judge, Mr Justice Cooke, found in favour of Zurich on the basis of what he held to be the applicable Guernsey law, although some of his comments provided "*obiter*" support for the existence of the "All Sums" principle under English Law.

The Court of Appeal overturned the decision of the trial judge and held that there was sufficient causal link between the employee's exposure to asbestos during the years when the policyholder was insured by Zurich and his contraction of mesothelioma for the policyholder to have a contractual right to indemnity against Zurich for the full amount. The Court of Appeal rejected arguments by Zurich that it was entitled to contribution from the

policyholder in respect of uninsured periods on the basis of principles of unjust enrichment and natural justice.

Zurich appealed to the Supreme Court, and both the Association of British Insurers and the Asbestos Victim Support Group Forum UK intervened. The Supreme Court fielded a seven member panel due to the significance of the issues, and the panel was split 4-3 on the grounds for the decision.

The Supreme Court Decision

The Supreme Court's *ratio decidendi* was that the old English common law rule of proportionate recovery laid down by the House of Lords in the case of *Barker* [2006] UK HL 20 remained good law in Guernsey, notwithstanding the later decision of the Supreme Court in the *Employer's Liability Policy Trigger Litigation* [2012] UK SC 14, which applied the exposure principle to EL policies, and which IEG had argued undermined the effect of *Barker*. On this basis, under the applicable Guernsey law, IEG was not entitled to recover from Zurich more than a proportionate part of the full compensation that IEG had paid, equivalent to the duration of Zurich's cover as a percentage of the entire exposure period. However, Zurich was required under common law to indemnify IEG for its full defence costs, since these would have been the same, whatever the period of exposure or insured cover, and insurers had consented to the incurring of the costs. The Supreme Court relied on the reasoning of the Privy Council in *New Zealand Forest Products Limited v. New Zealand Insurance Company Limited* [1997] 1 WLR 1237, in which an insurer was held liable to pay all defence costs that reasonably related to the policyholder's defence, even though another defendant who was not a policyholder also benefited.

The finding as to Guernsey law and the English common law was decisive in enabling Zurich's Appeal to succeed but, in view of the importance of the issues under English law, the Court also considered the current English law position, thus taking into account the existence of the UK Compensation Act 2006, which superseded the *Barker* case.

The entire Court agreed that Zurich was bound to indemnify IEG for its entire defence costs under the current English law that includes the Compensation Act 2006, just as it was under the common law, on the basis of the arguments already mentioned above. However, the Court reached a decision in relation to the compensation element of the claim that meant that IEG was unable to recover full compensation from Zurich. The majority, led by Lord Mance, held that Zurich was liable to pay the full amount of the compensation to IEG, but was then in turn entitled to recover an equitable contribution from IEG in relation to the part of the exposure period when IEG had no insurance, as well as from any other insurers on risk to the period of exposure in relation to the period when the latter were on risk. The minority, led by Lord Sumption, expressed the view that the position in relation to the compensation was the same under current English law as it was under the common law, so that Zurich was only liable to IEG for a proportion of the compensation equivalent to its participation in the entire insurance coverage.

Finally, Lord Mance considered, again *obiter*, what the position would have been if IEG had been insolvent and the employee had therefore had a direct claim against Zurich under the **Third Parties (Rights against Insurers) Act 1930**. He concluded that it was probable in that case that the employee would have been able to recover 100% of the compensation from Zurich, which would in turn have contribution rights against the insolvent policyholder (which may have no value) and any other insurers.

The Reasoning Behind the Decision

This decision represents a return to a more conservative approach to insurance coverage analysis by the Supreme Court, following its more liberal and creative decision in the *Employer's Liability Policy Trigger Litigation.* The difference of opinion as to the reasoning behind the decision between the two groups within the Supreme Court (each led by a distinguished commercial lawyer with extensive experience of insurance) was grounded in the respective approaches of the leading judges. While Lord Mance (for the majority) preferred to characterise his approach as a search for a pragmatic and commercial solution to problems caused by prior judicial development of the law, based on loose principles of co-insurance and self-insurance, Lord Sumption (for the dissent) and the two members of the Court who agreed with him chose to base their approach more strictly on judicial precedent, and expressed concern in particular that developing the law in the way in which Lord Mance sought to do so created more "violence" to establish legal principle, as well as a potential risk of affecting the law going beyond that relating to the recovery of mesothelioma claims under employers' liability policies.

Implications for EL policyholders defending claims by employees

Indemnity (Compensation Costs)

1. For policyholders with gaps in coverage (such as missing policies or uninsured periods), the *IEG v Zurich* judgment has removed the possibility that solvent EL policyholders can use the "all sums" principle, as it has been applied in practice in the USA, to avoid such gaps in coverage and they must now bear ultimate liability in respect of uninsured periods of cover, although they retain the flexibility of selecting one insurer to sue.

2. For policyholders with no gaps in coverage, the judgment preserves thethe ability of the policyholder to allocate on an all sums basis. The insurer that it chooses to sue must pay the policyholder the entire amount of the asbestos compensation that the policyholder paid to the claimant. While the insurer can sue other insurers for contribution, this does not lessen the "all sums" recovery for the policyholder.

Defence Costs

In both situations above, under the *IEG v Zurich ruling,* EL policyholders will still be able to recover the full amount of their defence costs from any insurer on risk, notwithstanding uninsured periods of cover and will not be subject to any claw back by insurers.

Cases not involving mesothelioma

Strictly speaking, the effect of *IEG v Zurich* is confined to mesothelioma cases, but it is possible that insurers may try to extend the reasoning of the minority in the case relating to the current English law position to other kinds of long tail personal injury claims.

Implication for PL policyholders defending claims by non-employees

The judgment does not apply to Public Liability ("PL") policies, and PL insurers will likely continue to refuse to indemnify policyholders on an exposure basis in respect of claims by non-employees, on the authority of the Court of Appeal's decision in *Bolton v. Municipal Mutual,* [2006] EWCA (Civ) 50, which applied the injury in fact principle to PL policies. The

Supreme Court's support in *IEG v Zurich* for a less literal interpretation of commercial insurance policies in the Employer's Liability Policy Trigger Litigation and other aspects of its approach to the interpretation of the EL policies in that case arguably provided a basis for re-consideration of the *Bolton* decision in a PL context in the near future: however, the more conservative approach of the Supreme Court in *IEG v Zurich* bodes less well for policyholders in this context.

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