HIH Casualty & General Insurance Limited (in liquidation) v Wallace & Ors

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The Insurance Act (NSW) Applies To Reinsurance Contracts

Last year's New South Wales Supreme Court decision, *HIH Casualty & General Insurance Limited (in liquidation) v Wallace & Ors*, held that the *Insurance Act 1902* (NSW) applies to reinsurance contracts, and that as a result an arbitration clause in a reinsurance contract is not binding on the reinsured as a matter of New South Wales law.

How does this affect you?

- The application of the Insurance Act to reinsurance policies which a Court has considered in this decision for the first time radically alters[1] the law of reinsurance as it is applied in New South Wales.
- The law of New South Wales is now out of step with the law in other states of Australia, although there is a somewhat similar old legislation in Victoria which now may also be interpreted to apply to reinsurance.
- New South Wales law and New South Wales Courts provide reinsureds with a significant juridical advantage.
- The decision suggests that this Act, at least insofar as it prevents reinsurers from enforcing an arbitration clause, has to be applied to any reinsurance matter heard in a New South Wales court no matter what the governing law of the contract is expressed to be by the parties.
- Together with the Australian High Court's recent decision in *Asset Insure v New Cap Re* it may mean that 'insurance' in other acts, such as s6 of the *Law Reform Miscellaneous Provisions Act* (1946) (NSW) and similar legislation in other states and territories also includes 'reinsurance'.

Background

The decision arises from a dispute in relation to various quota share reinsurance treaties (the ***reinsurance treaties***) under which Lloyd's Syndicate 683 (***reinsurers***) reinsured HIH Casualty & General Insurance Limited (***HIH***) for professional indemnity insurance policies underwritten by HIH between 1993 and 1997.

The liquidator of HIH commenced proceedings against reinsurers in the Supreme Court of New South Wales (the ***proceedings***) when reinsurers sought to challenge the application to the reinsurance treaties of the decision of the House of Lords in *Charter Reinsurance Company Limited v Fagan* [1997] AC 313. Reinsurers have argued that their obligation to indemnify HIH under the reinsurance treaties did not arise until HIH actually paid the original insureds under the original policies. This decision did not resolve that issue.

Reinsurers sought a stay of the proceedings in reliance on an arbitration clause included in each of the reinsurance treaties. Justice Einstein refused the reinsurer's application for a stay, in part, on

the grounds that the arbitration clause in each reinsurance treaty was not binding on HIH as a matter of New South Wales law under section 19 of the Insurance Act.

1. Application of the Insurance Act to reinsurance contracts

In Australia at the federal level, the *Insurance Contracts Act 1984* (Cth)[2] varied many general principles of insurance law that were regarded as unfair to insureds. However the Insurance Contracts Act expressly does not apply to reinsurance.

Since the Insurance Contracts Act came into force there has been a tendency to overlook earlier state legislation, such as the Insurance Act, which also varied some general principles of insurance law for similar consumer protection reasons.

Prior to the Insurance Contracts Act, the Insurance Act affected all classes of insurance in New South Wales other than maritime and life in the following key ways:

- the right of an insurer to rely on a failure by an insured to comply with a term of the insurance contract;
- the right of an insurer to rely on a misrepresentation or non-disclosure by an insured;
- the right of an insurer to rely on an exclusion clause; and
- the right of an insured to commence court proceedings notwithstanding an arbitration clause.

Each of these is considered in turn.

1.1 Breach of an insurance contract by an insured

Section 18(1) provides:

> In any proceedings taken in a court in respect of a difference or dispute arising out of a contract of insurance, if it appears to the Court that a failure by the insured to observe or perform a term or condition of the contract of insurance may reasonably be excused on the ground that the insurer was not prejudiced by the failure, the Court may order that the failure be excused.

An important difference between this section and section 54 of the Insurance Contracts Act is that section 18(1) only applies where "*the insurer was not prejudiced by the failure".* There is no provision in section 18(1) to reduce the liability of an insurer to the extent that it was prejudiced. Therefore, if an insurer is prejudiced by the breach of contract, then the insured is not entitled to relief from the consequences of that breach no matter how slight that prejudice.

Section 18(1) applies where there is a failure by the insured to observe or perform "*a term or condition of the contract of insurance"*. Before section 18A was inserted, a few cases considered whether section 18 applied to a failure by an insured to comply with its duty of disclosure. This in turn depended on whether or not the duty of utmost good faith and the corresponding duty of disclosure arose out of an implied term of the contract or were obligations independent of the contract.

This issue was resolved by the High Court in *Khoury v GIO (NSW)* (1994) 54 ALR 639, which held that the duty of disclosure was not an implied term of the contract. Mr Khoury could therefore not rely on section 18 to excuse a breach of the duty of disclosure.

Section 18 is potentially very important for reinsurance contracts governed by New South Wales law. Reinsurance contracts frequently contain conditions obliging a reinsured to give notice of claims and to co-operate with reinsurers in the handing of claims[3]. A breach of such conditions might well be excused by section 18 – see by analogy the decision of Yeldham J in *Panorama Plant Hire Pty Limited v Mercantile Mutual Insurance Company Limited* [1980] 2 NSWLR 618.

1.2 Misrepresentation and non-disclosure

Section 18A provides, in essence that a contract of insurance may not be avoided because of a misrepresentation or non-disclosure by an insured unless it was fraudulent or:

> The insured knew or a reasonable person in the insured's circumstances ought to have known that the statement was material to the insurer in relation to the contract of insurance.

The two most important consequences of this section are that:

(a) it negates the effect of "basis of contract clauses" and any scope for the doctrine of "constructive materiality"; and

(b) one looks at what a reasonable person in the insured's circumstances would regard as material, rather than what a prudent insurer would regard as material.

Basis of Contract Clauses

At common law a basis of contract clause entitles an insurer to avoid a contract for a misrepresentation or non-disclosure in a proposal form whether or not the misrepresentation or non-disclosure was material to the decision of the insurer to provide cover. Section 18A prevents an insurer from relying on such a clause to avoid a contract where the relevant misrepresentation or non-disclosure was not material.

Constructive Materiality

It has also been suggested that, at common law, there is a doctrine of "constructive materiality" which provides that a matter is deemed to be material by the very fact that a question relating to that matter is included in a proposal form. Section 18A overcomes any such doctrine.

Subjective Test of Materiality

At common law an insurer is entitled to avoid a contract for non-disclosure if an insured fails to disclose a matter which a prudent insurer would regard as material to its decision whether to not to provide cover and the terms on which cover should be provided (including the premium). Section 18A takes away this right and provides, instead, that an insurer can only avoid a contract if

> "a reasonable person in the insured's circumstances ought to have known that the statement was material to the insurer in relation to the contract of insurance".

There is an interesting comparison between this section and section 21(1)(b) of the Insurance Contracts Act. The latter provides that an insured is obliged to disclose any

matter which "*a reasonable person in the circumstances could be expected to know to be a matter so relevant"*. This section was based on draft legislation prepared by the Australian Law Reform Commission which referred to a person "*in the circumstances of the insured*". This is a subjective test requiring consideration of the circumstances of the particular insured. Before the Insurance Contracts Act came into force submissions were put to the government that the test should be an objective one – ie, an insured is obliged to disclose matters which a reasonable insured ought to know would be material to in insurer. Rather than resolve this issue, the section was drafted in an ambiguous manner, which has led to conflicting decisions as to whether and to what extent section 21(1)(b) entitles a court to look at the circumstances of the particular insured.

By contrast with the ambiguity of the Insurance Contracts Act and to the position at English law[4], section 18A clearly requires the court to consider the circumstances of the particular insured. This offers greater protection to insureds who are naive in insurance matters but arguably offers less protection to, for example, insurance lawyers.

1.3 Exclusion Clauses

Section 18B restricts the right of an insurer to rely on an exclusion clause where the circumstance excluded did not in fact contribute to the particular loss. The following points arise from the wording of this section.

(a) The section is headed "limitation on exclusion clauses" but applies where

> "the circumstances in which the insurer is bound to indemnify the insured are so defined as to exclude or limit the liability of the insurer to indemnify the insured on the happening of particular events or at least existence of particular circumstances" (Section 18B(1)(a)).

It is therefore arguable that this section applies not only to exclusion clauses, but might also have some application to clauses defining the scope of cover. The section might therefore have a broad application similar to section 54 of the Insurance Contract Act which refers to "*the effect of a contract of insurance".*

(b) Section 18B only applies where

> "the liability of the insurer has been so defined because the happening of those events or the existence of those circumstances was in the view of the insurer likely to increase the risk of loss occurring" (Section 18B(1)(b)).

This is an odd provision which denies an insured any entitlement to relief where the relevant exclusion clause was inserted for some other reason, or even for no particular reason. For example:

(i) an insured might be excused from an exclusion for claims for damage to a car while the driver is drunk, if that drunkenness did not contribute to the accident; but

(ii) an insured cannot be excused if, for example, the policy excludes claims made between an insured changing address and informing the insurer of its new address.

This provision will also deny an insured any relief for failure to notify a claim under a claims made and notified policy.

(c) Section 18B applies where "*the circumstances in which the insurer is bound to indemnify the insured are so defined…".* In this respect it is probably broader that section 54 of the Insurance Contracts Act, which in many ways covers the same ground as section 18B, but which only applies to "*some act of the insured or of some other person".*

A consequence of this difference is that section 18B, but not section 54, would apply to an exclusion for claims made while a state of war existed between the country of the insured and the country of the insurer. A further difference is that section 18B, but not section 54, would apply to latent defects, although these would generally be covered by section 46 of the Insurance Contract Act.

(d) Section 18B only applies where the relevant loss *"was not caused or contributed to by"* the relevant circumstances. There is no provision enabling the liability of an insurer to be reduced to the extent that the relevant circumstances contributed to the loss. In this respect section 18B provides less protection to an insured at section 54.

2. Insurance Act not previously applied to reinsurance

The Insurance Act applies to all contracts of insurance except those set out in s21 and the regulations made under that section. The effect of those provisions is that the parts of the Insurance Act that reform general principles of insurance law do not apply to certain insurance contracts, including most relevantly:

- contracts of insurance that are subject to the Insurance Contracts Act;
- contracts of marine insurance; and
- contracts of life insurance.

As noted earlier following the introduction of the Commonwealth Insurance Contracts Act most insurers and reinsurers gave the New South Wales Insurance Act no further thought.

Although some commentators and lawyers[5] have previously expressed the view that the Insurance Act would apply to a contract of reinsurance, because a contract of reinsurance is a type or variety of insurance contract and because contracts of reinsurance are expressly excluded from the operation of the Insurance Contracts Act, *HIH v Wallace* is the first case to ever address that issue.

Justice Einstein held that the Insurance Act does apply to reinsurance contracts. In reaching that conclusion, his Honour considered various English and Australian authorities. His Honour considered and distinguished the decision of the House of Lords in *Agnew v Lansforsakringsbolagens* [2000] Lloyd's Rep IR 317, and held that reinsurance contracts were insurance contracts.

However, it remains unclear whether the Insurance Act applies to contracts of reinsurance where the original insurance can be characterised as marine or life insurance. This issue would seem to depend on whether the subject matter of the reinsurance contract should be regarded as:

- the liability of the reinsured to pay claims under the original insurance policy; or
- the original risk.

If it is accepted that a reinsurance contract is an insurance of the original subject matter, the reinsured's liability under the original insurance merely serving to provide it with an insurable interest, then it should follow that reinsurance of original marine or life insurance policies should be similarly characterised. This may be important depending upon the type of treaty written.

3. The *International Arbitration Act 1974* (Cth) and reinsurance contracts

Australia is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the ***Convention***). Article II(3) of the Convention provides that a court of a contracting state *'when seized of an action'* which is the subject of an arbitration agreement *'shall at the request of one of the parties refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed'*.

Australia's obligations under article II(3) of the Convention are implemented under s7 of the International Arbitration Act 1974 (Cth) which requires a court to stay proceedings commenced in breach of an 'arbitration agreement', unless that agreement is 'void, inoperative or incapable of being performed'. Reinsurers sought a stay under section 7. However Justice Einstein ruled that section 19 of the Insurance Act rendered the arbitration clause in each reinsurance treaty inoperative and refused to grant the stay.

Justice Einstein also decided that s19 of the Insurance Act constituted a mandatory rule of the forum, such that it must be applied by a New South Wales court, irrespective of the court's conclusion about the law governing the contract.

4. Arbitration clauses generally

In addition to an arbitration clause, each reinsurance treaty considered in *HIH v Wallace* contained the following service of suit clause:

> The Reinsurer hereon agrees that:
>
> (i) in the event of a dispute arising under this agreement, the Reinsurer, at the request of the Company will submit to the jurisdiction of any competent court in the Commonwealth of Australia. Such dispute shall be determined in accordance with the law in practice applicable in such Court.

Justice Einstein considered a number of English authorities on contracts containing apparently inconsistent jurisdiction and arbitration clauses. His Honour found that the combined effect in this case of the service of suit clause and the arbitration clause in each reinsurance treaty was to provide HIH with an option to litigate in any court of competent jurisdiction in Australia, or to require reinsurers to submit to arbitration. Once HIH elected to commence proceedings in New South Wales, the effect of the service of suit clause was to provide that the law of New South Wales would govern the contract[6]. As a result his Honour found that the International Arbitration Act had no application, the decision to arbitrate being contractually reserved to HIH.

Further, it is a requirement of both articles II(1) and (2) of the Convention and s3(1) the International Arbitration Act that arbitration agreements be in writing. Justice Einstein considered

various international texts and authorities in relation to this requirement. He also considered evidence before him relating to the procedure for issuing insurance and reinsurance policies at Lloyd's. He found that a number of the reinsurance treaties failed to meet the requirements of article II(1) and (2) of the Convention, which were as follows:

- the arbitration agreement must be signed by both parties; or
- the arbitration agreement must be contained in an exchange of letters or telegrams.

Justice Einstein held that it was not sufficient for one party to stipulate that the contract was subject to an arbitration agreement and for both parties to continue to act on that basis. Where the arbitration agreement consisted of a clause in a treaty wording or other agreement, his Honour held that it must be signed by both parties, before article II of the Convention is enlivened. He ruled that proof by Reinsurers that the Reinsurance Treaties were processed in accordance with LPSO procedures did not discharge the burden that fell on them to establish the existence of the arbitration agreement in each case.

It will be interesting to see whether Courts in other common law jurisdictions might adopt some of the reasoning of this case in considering the law in their jurisdiction to govern policies of insurance with a jurisdiction election clause and indeed whether those clauses remain in policy wordings as the market considers the implications of this decision and English decisions on such clauses such as *Catlin v Adams*[7].

5. The Insurance Act and reinsurance contracts

Reinsurers have not appealed from the decision. The application of the Insurance Act to reinsurance policies in *HIH v Wallace* radically alters[8] the law of reinsurance as it is applied in New South Wales and has the potential to be the same in Victoria by reason of its potential application to the Victorian Instruments Act 1958.

As noted above, the Insurance Act's provisions go far beyond the validity of arbitration clauses. The provisions which now apply to reinsurance contracts include, in addition to s19:

- Section 18(1) which empowers the court to excuse a failure by a reinsured to comply with a term of the contract where the reinsurer did not suffer prejudice as a result.
- Section 18A which operates, in essence to prevent a reinsurer from avoiding a contract of insurance for misrepresentation or non-disclosure by a reinsured unless the misrepresentation or non-disclosure was fraudulent, the reinsured knew, or a reasonable person in the reinsured's circumstances ought to have known, that the statement or matter was material to the reinsurer. In essence, s18A would replace the 'prudent reinsurer' test in relation to materiality with one that focuses on the circumstances of the reinsured and its state of mind as to materiality. (Arguably, this may not benefit a reinsured to the same extent as a more 'naive' consumer).
- Section 18B which limits the right of a reinsurer to rely upon an exclusion clause where the 'circumstances' excluded did not contribute to the loss in question.

Whilst the Court found that s19 had a mandatory application in a New South Wales Court it did not express any view as to whether that view extended to the other provisions of the Insurance Act.
The Instruments Act 1958 (Vic)

As yet no case similar to *HIH v Wallace* has considered whether or not "insurance" includes "reinsurance" in the Victorian Insurance Act 1958. However, there seems to be no logical reason why it should not do so.

Application of The Instrument Act

The Instruments Act has a similar application, in very broad terms, to the Insurance Act. Although there do not appear to be any regulations expressly limiting its application, it would not apply to contracts of marine insurance or life insurance as Commonwealth legislation covers the field in this area. Furthermore, subject to one matter discussed below, there does not appear to be any room for the Instruments Act to operate on contracts governed by the Insurance Contracts Act.

Misrepresentation and non-disclosure

Section 25 of the Act provides:

> No contract of insurance (other than a contract of life insurance) shall be avoided by reason only of any incorrect statement made by the proponent in any proposal or other document on the faith of which such contract was entered into revived or renewed by the insurer unless the statement so made was fraudulently untrue or material in relation to the risk of the insurer under the contract.

Unlike section 18A of the Insurance Act, this section does not alter the common law rule that an insurer is entitled to avoid a contract if there is a non-disclosure of a matter which a prudent <u>insurer</u> would regard as material. The Act therefore repeats the common law test of materiality (this was confirmed by Pape J in *Babatsikos v Car Owners' Mutual Insurance Co Limited* [1970] VR 297).

Section 25 does change the common law, however, in that it prevents an insurer relying on a basis of contract clause or on any principle of “constructive materiality”. These changes are the same as those discussed in relation to section 18A of the Insurance Act.

Like section 18A of the Insurance Act, but unlike section 28 of the Insurance Contracts Act, this section does not provide that the liability of an insurer shall be reduced to the extent it has been prejudiced by a material non-disclosure. Under section 25 an insurer remains entitled to avoid a contract of insurance notwithstanding that a non-disclosure might be innocent and cause no prejudice to the insurer.

Failure to give notice or make a claim

Section 27 protects an insured against a failure “*to give any notice or make any claim in the manner and within the time required by the contract of insurance”* where:

(a) the failure was due to an “*accident mistake or other reasonable cause”;* and

(b) the reinsurer has not “*been so prejudiced by such failure that it would be inequitable if such failure were not a bar to the maintenance of such proceedings”.*

This section provides a fair amount of discretion to a court in determining what constitutes a “reasonable cause” in failing to comply with the insurance contract and determining the circumstances in which an insurer has been “so prejudiced” that it would be “inequitable” to allow the insured’s claim to proceed.

Section 27 is rather awkwardly worded. It states that the relevant failure by the insured "*shall not be a bar to the maintenance of any proceedings…upon the contract by the insured".* It was argued in *GRE Insurance Limited v QBE Insurance Limited* [1985] VR 83 that the section could not be relied on to establish the liability of an insurer where the proceedings were brought by another insurer for contribution (rather than being brought by an insured for indemnity). The majority of the Full Court of the Supreme Court of Victoria rejected this argument on the basis that it would frustrate the clear intention of this section.

It was also argued in that case that the section did not operate where there was a failure by the insured to comply with a condition precedent to the insurance being "effected". It was argued that, as no insurance had been "effected", there was no "contract of insurance" on which the section could operate. This argument was supported by Anderson J but was rejected by the majority of the Full Court.

Unlike section 54 of the Insurance Contracts Act, section 27 of the Instruments Act does not provide for the liability of an insurer to be reduced to the extent it was prejudiced by any such failure by an insured. This would generally work in favour of an insurer. If, however, a court held that the prejudice suffered by an insurer did not make it "inequitable" for the failure to be excused, then an insured might believe it could do better relying on section 27 of the Instruments Act (which entitles the insured to full recovery) rather than section 54 of the Insurance Contracts Act (which reduces the insured's recovery to the extent of any prejudice). This option is not open to an insured, however, as section 54 would prevail over section 27 to the extent that there is a direct conflict. As section 54(1) provides that, in the relevant circumstances, an insurer "may not" refuse to pay a claim but that its liability "is reduced" to the extent of the prejudice, one must assume that section 54 "by necessary intendment" (see section 7 of the Insurance Contracts Act) overrides section 27 of the Instruments Act.

Arbitration

Section 28(2) entitles an insured to bring court proceedings notwithstanding any arbitration clause in the insurance contract.

6. Section 6 of the Law Reform Miscellaneous Provisions Act (NSW) (1946) (the *Act*)

The decision in *HIH v Wallace* together with the High Court's decision in *Asset Insure v New Cap Re* also increases the likelihood that Courts will interpret the term "insurance" when it is used in other legislation as including "reinsurance". One such piece of legislation is s6 of the Act.

Relevantly, s6 of the Act provides as follows:

(1) If any person (hereinafter in this Part referred to as the insured) has, whether before or after the commence of this Act, entered into a contract of insurance by which the person is indemnified against liability to pay any damages or compensation, the amount of the person's liability shall on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding that the amount of such liability may not then have been determined, be a charge on all insurance moneys that are or may become payable in respect of that liability.

(4) Every such charge as aforesaid shall be enforceable by way of an action against the insurer in the same way and in the same court as if the action were an action to recover damages or compensation from the insured…

If section 6 applied to reinsurance it would operate in this way:

- the direct insurer and the reinsured under a contract of reinsurance (the ***Insurer***)
- has entered into a contract of insurance (its contracts of reinsurance);
- by which the Insurer is indemnified by its reinsurer (the ***Reinsurer***) against liability to pay compensation (it is indemnified against its liability to indemnify those insured by it under the contracts of direct insurance) (the ***Direct Insureds***);

therefore, pursuant to section 6:

- on the happening of the event giving rise to the claim for compensation (the notifications by the Direct Insureds under its contracts of insurance with the Insurer);
- a charge on all insurance moneys that are or may become payable in respect of that liability (the reinsurance proceeds due to the Insurer from the Reinsurer);
- is created in favour of the Direct Insureds and – subject to the Court granting leave - can be enforced pursuant to s6(4).

7. A liability to pay damages or compensation?

It might be argued that a contract of reinsurance does not indemnify the reinsured against its liability to "*pay any damages or compensation*" on the basis that arguably a payment pursuant to a contract of insurance does not meet the description of either "*damages*" or "*compensation*".

Damages

Whilst there is academic debate over whether an insurer's liability under a contract of insurance is a liability to pay damages[9], the better view is that absent a breach of contract by the insurer this is not the case. Windeyer J in the Supreme Court case of *Odyssey Re (Bermuda) Ltd v Reinsurance Australia Corp Ltd* (unreported 12/4/01) seems to have confirmed the position in New South Wales:

> But the plaintiff's cause of action was for unliquidated damages for breach of contract: see *Luckie v Bushby* (1853) 13 CB 864; 138 ER 1443; *E Pellas & Co v Neptune Marine Insurance Co* (1879) 5 CPD 34; *William Pickersgill & Sons Ltd v London and Provincial Marine and General Assurance Co Ltd* [1912] 3 KB 614 at 622; *Chandris v Argo Insurance Co Ltd* [1963] 2 Lloyd's Rep 65 at 74 and *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440 at 462. It had to establish a contract (the policy) by the which the defendant promised to do something (indemnify it against Mitora's claim), and breach of that contract (failure to indemnify it against Mitora's claim). It could then recover the loss suffered as a consequence of that breach. The plaintiff's cause of action accrued upon breach. Thus it must be asked what the defendant was required to do in performance of its promise, and when it failed to do what was required of it. Only when the defendant failed to do what was required of it could a cause of action for damages for breach of contract accrue to the plaintiff. There was no cause of action simply because Mitora made its claim or the claim

was notified to the defendant – the defendant could have thereafter fully performed its promise.

On this basis, in New South Wales an insurer's liability is not technically a liability for damages unless the insurer breaks its promise to indemnify the insured against its loss by refusing to pay the claim as required pursuant to policy terms and conditions.[10]

However, whilst it may be true that reinsurers do not reinsure their reinsured for damages claims but rather for claims on insurance policies, the reality is that reinsurers in practical terms do not refuse to pay claims simply because their reinsured (by failing to pay within its contractual obligations) has converted a claim on an insurance policy into a claim for breach of contract.

Compensation

The better view appears to be that an obligation to indemnify against a liability is an obligation to pay compensation. "To indemnify" and "to compensate" have a similar if not identical meaning:

(a) the Macquarie Dictionary defines compensation as "something given or received as an equivalent for services, debt, loss, suffering etc; indemnity";

(b) the Macquarie Dictionary defines an indemnity as "*compensation for*" *damages or loss sustained*";

(c) the Lexis Nexis Australian Encyclopaedic Legal Dictionary defines an indemnity as "a sum of money paid to compensate a person for liability, loss or expense incurred by the person".

(d) The Oxford Companion to Law defines an indemnity as "*an undertaking to compensate for loss, damage, or expense*".

Whilst there does not appear to be any Australian case law directly on point, Stoughton LJ in *Total Transport v Arcadia Petroleum (The Eurus)* [1998] 1 Lloyd's Rep 351 at 358 (CA) when referring to an indemnity clause in a bill of lading commented that: "*there the word 'indemnify' is used in what might be regarded as its primary meaning, to compensate one person in respect of his liability to another.*"

The Act speaks of liability to pay "compensation" only, not liability to make payment in "compensation for a wrong". On this basis, it appears that an obligation to compensate does include an obligation to indemnify within s6 of the Act.

Whilst in light of the decisions in *HIH v Wallace* and *Asset Insure v New Cap Re* there seems to be a solid argument for s6 of the Act extending to reinsurance we will need to await a judicial determination to clarify the question.

Comment

Many aspects of the decision in *HIH v Wallace* will be troubling for reinsurers. The decision means that so far as reinsurance contracts are concerned, the law of New South Wales is out of step with the law in other states (though the courts in Victoria may take the same approach in relation to similar legislation enacted in that state) and comparable jurisdictions outside Australia. New South Wales law now provides reinsureds with a significant juridical advantage.

Equally troubling from a policy perspective is the main issue to be heard, ie the contention advanced by reinsurers regarding their liability for claims as yet unpaid by the cedent. When that issue is heard, consideration will need to be given to its prudential implications. If reinsurers' contention prevails, no doubt regulators will focus on the issue in future in the context of capital regulation. This will in all likelihood operate to the detriment of both insurers and reinsurers.

The courts have decided within the space of 12 months, that 'insurance' includes 'reinsurance' for the purposes of both the *Corporations Act 2001* (Cth) (the ***Corporations Act***)[11], and the Insurance Act, leaving unanswered for the time being the question of whether the same result will be obtained in relation to the Instruments Act 1958 (Victoria) in relation to section 6 of the *Law Reform Miscellaneous Provisions Act 1946* (NSW) (both of which are discussed above) and to legislation similar to section 6 in other states and territories.

If the result of the decision is that a significant number of HIH's reinsurance contracts are subject to New South Wales law and jurisdiction, and that as a result judgments can be obtained by the liquidator in New South Wales (such that any judgment debt becomes payable in New south Wales), it may result in a significant benefit to HIH's insureds if the judgment can be enforced against the reinsurer (eg if the reinsurer has assets in New South Wales). It may increase reinsurance proceeds available to the Australian liquidator for distribution in accordance with section 562A of the Corporations Act (or section 6 of the Law Reform Miscellaneous Provisions Act if it applies) rather than under less favourable English law[12].

We await the judicial, legislative, regulatory and industry response.

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[1] or confirms the views of some commentators as to the correct operation of the *Insurance Act* (see 3 below).

[2] References to the *Insurance Contract Act* in this paper are to the form of that Act as it applies as at the date of this seminar. This paper does not take the possible reforms of that Act which are presently under consideration into account.

[3] A claims co-operation clause of that type was consider in *Gan Insurance Company Ltd v The Tai Ping Insurance Company Limited* [2002] EWCA Civ 248.

[4] where according to *Pan Atlantic Insurance Co Ltd & Anor v Pine Top Insurance Limited* [1995] 1 AC 501 the test under section 18 of the Marine Insurance Act 1906 is whether the relevant non-disclosure was one that would have an effect on the mind of the prudent insurer in estimating the risk.

[5] Including Allens Arthur Robinson Senior Associate, Malcolm Stephens, in his prescient paper 'State Legislation Affecting General Insurance Law" which was presented on 13 June 2002 and from which parts of this paper is substantially sourced.

[6] It is interesting to contrast this case with the recent English decision in *425 Catlin Syndicate Ltd & Ors v Adam Land & Cattle Co* [2006] EWHC 2065 (Com) which considered the same clause and concluded that the insurance was governed by English law but the insured had a contractual right to elect for the jurisdiction of a Court in Nebraska. The judge concluded that the insurers plainly took the risk that the Nebraskan Court might not apply English law as the English Court might do. He stayed English proceedings so that the matter could proceed in Nebraska.

[7] [2007] EWHC 2065 (see discussion above).

[8] or confirms the view of some commentators as to the correct operation of the *Insurance Act (see 3 above).*

[9] For example, it is has been argued that a promise to indemnify is a promise to keep a party from harm, which when infringed would give rise to a right to damages: on this basis when an insured suffers loss the insurer would have breached its promise to indemnify giving rise to a liability in damages. See for example Rafal Zakrzewski, *"The Nature of a Claim on an Indemnity"* (2006) 22 JCL 54; Robert Cameron, *"Reinsurance and the Australian Context: A two part discussion of aspects of the interaction of federal, NSW and common law in the context of reinsurance" (2001) 12 ILJ 199;* cases referred to in *Re Motor Group Australia Pty Ltd (administrators appointed) (ACN 101 051 101):Marsden & Anor (as voluntary administrators of Motor Group Australia Pty Ltd (administrators appointed)* (2005) 54 ACSR 389).

[10] The common law position in England was considered by the House of Lords in The Fanti (*Firma C-Trade SA v Newcastle Protection and Indemnity Association; The Fanti; Socony Mobil Oil Co Inc and ors v West of England Ship Owners Mutual Insurance Association (London) Ltd; The Padre Island* [1990 2 All ER 705) in which Lord Goff of Chieveley accepted that: "*...at common law, a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage, for example, by having to pay a third party. I also accept that, at common law, the cause of action does not (unless the contract*

provides otherwise) arise until the indemnified person can show actual loss: see *Collinge v Heywood* (1839) 9 Ad & El 633, 112 ER 1352"

[11] *AssetInsure Pty Ltd v New Cap Reinsurance Corporation Ltd* [2006] HCA 13, see case analysis at http://www.aar.com.au/pubs/insol/foinsolapr06.htm.

[12] See the Court of Appeal's decision in *HIH Casualty & General Insurance Limited* [2006] EWCA Civ 732 see case analysis at http://www.aar.com.au/pubs/insol/foinsoljun06.htm.