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REINSURANCE UPDATE

Introduction

Following recent changes in the regulation of reinsurance, contracts of reinsurance for Australian insurers must be governed by Australian law. However, Australia is a federation and laws vary between States and Territories. As two recent decisions illustrate, insurers should specify which Australian jurisdiction governs the contract, and be aware of the implications that the choice of jurisdiction may have on their reinsurance arrangements.

Governing law of a reinsurance contract

Under the revised APRA Prudential Standard GPS 230 Reinsurance Management, since 31 December 2008, an insurer must ensure that its reinsurance contracts provide that the governing law of the reinsurance contract is Australian law, and that any dispute that falls to be determined by a court is to be heard in an Australian court.

The importance of specifying which Australian jurisdiction is the governing law of the reinsurance contract is illustrated by the recent decision of *AIG UK Ltd & Ors v QBE Insurance (Europe) Ltd* [2008] QSC 308 (28 November 2008). This Supreme Court of Queensland decision involved a defendant who was a primary insurer at the time of an accident in New South Wales. The proceedings concerning the accident had been settled in Victoria according to Victorian law. The plaintiffs were reinsurers of part of the liability. The reinsurance contract defined the jurisdiction as 'the Commonwealth of Australia and New Zealand only, as original'. The primary policy specified 'Australian law' as governing any dispute concerning interpretation of the contract.

The reinsurers commenced proceedings in Queensland seeking a declaration that they were not bound to indemnify the reinsured because the reinsured had failed to comply with a condition precedent to liability to advise the reinsurers of any loss that might give rise to a claim as soon as practicable and without undue delay. The reinsured sought to set aside or stay the reinsurers' proceedings for want of jurisdiction. The reinsurers argued that Rule 124 of the *UCPR* permitted service on the reinsured as the parties had agreed to submit to the jurisdiction of the Supreme Court of Queensland. At issue was whether the reinsurers' proceedings were improperly commenced in Queensland, as the reinsured argued that the proceedings should be transferred to the Victorian Supreme Court.

Mackenzie J noted that all of the parties were overseas companies and that the reinsurance contract was not made in Queensland nor probably was it breached in Queensland. The claim in respect of which indemnity was sought from the reinsurers was not made in Queensland, nor was the claim upon the reinsurance contract made in Queensland.

The litigation in connection with the accident had been conducted and settled in Victoria under Victorian law. The court file and the solicitors' files were in Melbourne. However, the reinsured's relevant decisions were not made in Victoria. It was submitted that it was relevant to speculate that the reason for choosing Queensland rather than Victoria was the absence of any equivalent in Queensland law of the *Instruments Act* 1958 (Victoria) which relieves a reinsured from the consequences that would otherwise follow from failure to comply with notice provisions in certain circumstances.

Mackenzie J found that there was a clear submission to the jurisdiction of competent Australian courts, of which the Supreme Court of Queensland is one and that there was no

basis to set aside or stay the Queensland proceeding and that it had not been established that the interests of justice required the matter to be cross-vested to Victoria.

This decision raises interesting questions for insurers and reinsurers who must submit to Australian Law as the governing law of a reinsurance contract. Insurers and reinsurers should be careful to specify which jurisdiction in Australia is the governing law of the reinsurance contract, and it is important that they become familiar with the applicable laws in each state and the impact that those laws could have on resolving a dispute under the contract of reinsurance.

Application of the *Insurance Act* 1902 (NSW) to contracts of reinsurance

The recent Supreme Court of New South Wales decision in *Westport Insurance Corporation & Ors v Gordian Runoff Limited* [2009] NSWSC 245 (8 April 2009) a decision of Einstein J, illustrates the effect of the *Insurance Act* 1902 (NSW) (***Insurance Act***) on contracts of reinsurance.[1]

Background

Gordian Runoff Limited (**Gordian**) wrote a seven year run-off Directors & Officers (**D&O**) policy for FAI Insurance Limited (**FAI**). Gordian's reinsurance with Westport and others covered original policy periods of up to three years. The former directors of FAI notified Gordian of likely D&O claims within three years of the inception of the policy. Gordian notified reinsurers who indicated that these claims would not be covered since the FAI policy was for a seven year period.

Arbitration proceedings

In July 2008 the parties agreed to resolve their dispute by going to arbitration. The arbitrators found that section 18B of the *Insurance Act* applied, with the consequence the claim was covered. Section 18B limits the application of exclusion clauses in certain circumstances. It provides that where an insurance policy excludes or limits the insurer's liability to indemnify the insured on the happening of particular events or the existence of particular circumstances, and the liability is so proscribed because the happening of those events or circumstances was likely to increase the risk of loss occurring, then if those events or circumstances did not cause or contribute to a loss, the insured is entitled to indemnity notwithstanding the exclusion, unless it is not reasonable for the insurer to indemnify the insured.

Gordian argued that section 18B applied as the seven year period of the D&O policies was a 'limitation' that did not cause or contribute to the claims made by the former FAI directors because those claims were made and notified within the first three years of the underlying policy. The arbitrators accepted this. The effect of this interpretation was that despite the reinsurers' agreement to expand the reinsurance cover to include D&O policies written for up to three years, the reinsurers were bound to provide cover to Gordian for any D&O policy of any length so long as the claim for which Gordian sought indemnity was made and notified within the first three years of the policy.

Supreme Court of New South Wales proceedings

The reinsurers appealed the decision of the arbitrators and Einstein J delivered his judgment in the proceedings on 8 April 2009. Einstein J found that while the parties had agreed to the scope of cover and had negotiated to extend the scope of cover under the treaty, by characterising this scope of cover as an exclusion or limitation, the arbitrators had incorrectly determined that section 18B applied to the reinsurance contract.

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[1] *HIH Casualty and General Insurance Limited (in liquidation) v RJ Wallace & Ors* [2006] NSWSC 1150 established that the *Insurance Act* applies to contracts of reinsurance.

Einstein J found that the arbitrators' characterisation of the parties' agreement as to the cover was a 'exclusion' or 'limitation' for the purposes of section 18B was incorrect. Einstein J noted:

> 'the grammatical, as well the natural, sense of section 18B(1), read as a whole, is that it is concerned with policy exclusions or limitations, which are triggered by a particular event or circumstance, where the loss claimed is causally unrelated to that event or circumstance. The section could not be concerned with the underlying scope of cover. That is because the scope of cover does not depend on the happening of an event or the occurrence of a circumstance ... It is qualitatively different from a policy exclusion or limitation.'

Implications for reinsurers and insurers

The decision of Einstein J makes it clear that both reinsurers and reinsureds must take the provisions of the *Insurance Act* into consideration when dealing with reinsurance contracts subject to New South Wales law. The Act not only restricts reinsurers' rights to rely on certain exclusions but also contains provisions dealing with breach of conditions, non-disclosure and the effectiveness of arbitration clauses. Reinsurers and reinsureds also need to be aware of any similar legislative provisions in other jurisdictions, such as the *Instruments Act* 1958 (Victoria) referred to above.

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POSTSCRIPT: Contracts of insurance have now been excluded from the remedial provisions of the *Insurance Act* 1902 (NSW) under the Insurance Regulation 2009. The Regulation provides that sections 18, 18A, 18B and 19 of the Act do not apply to any reinsurance contract subject to New South Wales law entered into from 1 September 2009.

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