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UNDERLYING INSURANCE CLARIFIED

Introduction

The High Court recently considered the validity of 'other insurance' provisions in the context of section 45 of the *Insurance Contracts Act* 1984 (Cth) (**Act**).[1] The court considered the issue of whether section 45(1) of the Act applied to provisions in insurance policies which purport to limit or exclude an insurer's liability, in circumstances where an insured is indemnified under other insurance effected by or on behalf of the insured. The High Court also considered whether, in circumstances where the 'other insurance' clause applied in two different contexts, only one of which attracted the application of section 45(1), the entirety of the clause is voided, or whether that part of the clause which does not offend section 45(1) can be severed.

Summary of facts

In early 1992, Hamersley Iron Pty Limited (**Hamersley**) contracted with Speno Rail Maintenance Australia Pty Limited (**Speno**) for the provision of rail grinding services. Under the terms of the contract Speno was required to indemnify Hamersley and insure itself against all death or injury claims arising as a result of the performance of the contract.

In compliance with another provision of the contract, Speno arranged for Hamersley to be included as a named insured under a combined general liability insurance policy that Speno entered into with Zurich Australian Insurance Limited (**Zurich**) on 12 September 1995.

At the same time, Hamersley had its own contract of insurance with Metals and Minerals Insurance Pte Limited (**MMI**) (**Hamersley policy**). The Hamersley policy with MMI contained an 'other insurance' clause, the effect of which was to seek to limit the cover afforded by the MMI policy to excess insurance over the applicable limit of indemnity of any underlying insurance effected by or on behalf of Hamersley.

The clause included a provision in the following terms:

> 'In the event of the Insured being indemnified under such other Insurance effected by or on behalf of the Insured (not being an Insurance specifically effected as Insurance excess of this Policy) in respect of a Claim for which indemnity is available under this Policy, such other Insurance hereinafter referred to as Underlying Insurance, the Insurance afforded by this Policy shall be Excess Insurance over the applicable Limit of Indemnity of the Underlying Insurance but subject always to the terms and conditions of this Policy.'

Proceedings were commenced in the District Court of Western Australia by two Speno employees, injured as a result of negligence of Hamersley. One of the employees obtained a judgment against Hamersley in the sum of $1,110,186.35. The other employee settled his claim for $25,000. Zurich and Speno were ordered to indemnify Hamersley, and Zurich paid the damages under the judgment and the settlement.

Zurich commenced contribution proceedings in the Supreme Court of Western Australia, seeking contribution from MMI for the indemnified amounts paid by Zurich. Zurich argued that Hamersley was doubly insured for its liability to the Speno employees because of MMI's liability to indemnify Hamersley under the MMI policy. According to Zurich, the 'other insurance' clause was voided by the operation of section 45(1) of the Act.

In its defence, MMI relied on the 'other insurance' clause, denying that Hamersley was doubly insured and denying that section 45 had the effect contended by Zurich. MMI contended that

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[1] *Zurich Australian Insurance Limited v Metals & Minerals Insurance Pte Limited* [2009] HCA 50.

it had no co-ordinate liability with Zurich, and that, in effect, the Hamersley policy was an excess only policy.

Section 45 provides:

> '(1) Where a provision included in a contract of general insurance has the effect of limiting or excluding the liability of the insurer under the contract by reason that the insured has entered into some other contract of insurance, not being a contract required to be effected by or under a law, including the law of a State or Territory, the provision is void.
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> (2) Subsection (1) does not apply in relation to a contract that provides insurance cover in respect of some or all of so much of a loss as is not covered by a contract of insurance that is specified in the first-mentioned contract.'

At first instance

In a lengthy judgment, Johnson J held that the appropriate way to interpret section 45(1) was to give the words of the section their natural meaning when considering the effect of the underlying insurance clause. Her Honour noted two different circumstances, firstly where an insured has entered into another contract of insurance covering the same risk, and secondly where an insured has not entered into another contract but has the benefit of insurance taken out by a third party which covers the same risk.

Her Honour stated that where an insured has the benefit of insurance taken out by a third party that covers the same risk, the underlying insurance clause '*clearly has the effect of limiting or excluding the liability of the insurer because it converts the policy which indemnifies the insured for the whole of the loss to a policy which insures the insured for any excess over the applicable limit of indemnity of the underlying insurance policy'*.[2]

Her Honour held that section 45(1) makes such a provision void only in circumstances where the insured has 'entered into' the underlying insurance policy. Section 45(1) does not avoid 'other insurance' provisions where, as in this situation, the insured is merely the beneficiary of a policy taken out by a third party.

MMI submitted that the underlying insurance clause should be read in such a way as to render valid so much of it as did not offend section 45(1). Her Honour did not accept this submission, noting that the clear words of section 45(1) rendered the whole of the provision void. Noting that her reasoning produced a technical result brought about by the use of economical drafting, her Honour held that the clear words of section 45(1) operate to make the entire provision of the policy void, the provision being the underlying insurance clause in the Hamersley policy. Her Honour accordingly held that Hamersley had double insurance from both Zurich and MMI, and entered judgment in favour of Zurich against MMI.

MMI appealed.

The Court of Appeal

None of the parties to the appeal challenged the finding of the trial judge that section 45 operated to distinguish between persons who are parties to contracts of insurance and persons who are named insureds but not contracting parties, such that the section does not extend to the latter class of insured persons.

MMI challenged the finding of the trial judge that the offending part of the underlying insurance clause could not be severed so as to enable the clause to operate as intended in respect of the insurance effected by Speno on behalf of Hamersley.

The Court of Appeal[3] noted that a literal reading of section 45(1) might indicate that severance is not permitted, as the section refers to 'the provision' as void, rather than void 'to that extent'. In the leading judgment, Beech J stated that the literal reading could be avoided in either of two ways,[4] firstly to construe the word 'provision' as a reference to the substance and

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[2] *Zurich Australian Insurance Limited v Metals & Minerals Insurance Pte Limited* [2007] WASC 62 at 140.

[3] *Speno Rail Maintenance Australia Limited v Metals and Minerals Insurance Pte Ltd* [2009] WASCA 31.

[4] Ibid at 97 ff.

effect of the clause of the contract, rather than to the clause itself, and secondly, to give the section an interpretation that the provision is void only to the extent that it has the stipulated effect. His Honour held that the consequences of the literal meaning would lead to some strange outcomes if, for example, another insurance clause also dealt with matters unrelated to section 45. His Honour did not accept that the wording of section 45 showed an intention to exclude severance, and accepted MMI's submissions that the underlying insurance clause permissibly could be severed. He noted that severance will not always be possible, but held that the underlying insurance clause in the Hamersley policy could be severed such that there was no double insurance.

The High Court

On appeal to the High Court, Zurich re-agitated the issue of whether section 45(1) operated such that it applied to a situation where a person is a named beneficiary to a contract of insurance even though not a party to that contract of insurance. Zurich also appealed on the basis that the Court of Appeal was in error in failing to find that section 45(1) of the Act renders void the whole of the relevant provision of Hamersley's policy with MMI and not just the offending part of it.

French CJ, Gummow and Crennan JJ considered the construction of section 45 and, in line with the reasoning of the trial judge, pondered the ordinary relevant meaning of 'enter into'.[5] Their Honours contrasted section 48 of the Act, which provides that a person who is named in the insurance contract as a beneficiary is entitled to recover the amount of his or her loss from the insurer, notwithstanding that the person is not a party to the contract. Their Honours noted that section 48 does not convert the position of a non-party insured to that of a person who has 'entered into' a contract of insurance within the meaning of section 45(1), as contended by Zurich.

Zurich argued that section 45(1) should be construed as if the text read:

> 'Where a provision... has the effect of limiting or excluding the liability of the insurer under the contract by reason that the insured [*including a person entitled under section 48*] has entered into [*an arrangement giving it cover under*] some other contract of insurance... the provision is void'.

The court rejected that submission and confirmed that the reference to 'entered into' in section 45 does not include a non-party insured.

Their Honours did not labour over the severance issue. They examined the meaning of the word 'provision' in section 45(1) and the definition of the word in the Oxford English Dictionary. The dictionary definition contained reference to a provision 'providing for some particular matter' and their Honours noted that the inclusion of more than one provision for a particular matter in one clause of the contract may be an accident of drafting. There was no necessity to interpret section 45(1) so that its operation could vary depending upon accidents in paragraphing and numbering in insurance contracts. Their Honours noted that the Hamersley policy contained two statements, each describing circumstances where the policy would be converted to an excess insurance policy. Each statement is a provision of the contract, and section 45(1) operates only to render void that part of the underlying insurance clause which relates to instances where the insured is party to double insurance, and not merely a named beneficiary.

The statements to which their Honours refer are contained in the wording of the underlying insurance clause in the Hamersley policy, namely '...such other Insurance effected by or on behalf of the Insured...'. Their Honours held that 'effected by' and 'effected ... on behalf of' constitute two statements, each of which is a 'provision' of the contract, and accordingly capable of being separately regarded for the purposes of section 45(1).

Hayne and Heydon JJ concurred. Their Honours noted that Hamersley had not entered into any contract of insurance with Zurich and that there was no basis upon which the relevant expression in section 45(1) – 'the insured has entered into some other contract of insurance' - has anything other than its ordinary meaning.

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[5] *Zurich Australian Insurance Limited v Metals and Minerals Insurance Pte Limited* [2009] HCA 50 at 23 ff

Their Honours held that the question of severance did not arise, because section 45(1) made void a provision included in a contract of general insurance which had a particular effect described in section 45(1). The operation of the avoidance is not reliant upon the manner in which any particular insurance contract is drafted.

Observations

It should be noted that the High Court decision does not impact upon genuine policies of excess layer insurance. At first instance and on appeal, it was held that the Hamersley policy with MMI was not saved by the exception in section 45(2) because that policy did not sufficiently specify the underlying insurance contract, and the excess policy must specify the underlying policy to fall within the exception in section 45(2). The High Court's decision does not affect the operation of the exception in section 45(2). Those insurers who can identify with precision the primary layer of insurance will continue to be protected by section 45(2) against any claims for double insurance.

The decision impacts upon the effect of clauses that are now almost universally incorporated in construction contracts and contracts involving the use of subcontract labour, which require the subcontractor to effect insurance in the names of the subcontractor and the head contractor. That insurance, in respect of the head contractor, and depending upon the terms of the insurance contract, may not operate to ground a claim for double insurance by the insurer against the insurer of the head contractor.

The decision makes it clear that an insurer can successfully include in a contract of general insurance a term that converts the insurance into an excess only policy in circumstances where the insured is a beneficiary of, but not a party to, another contract of insurance.

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