

### The devil in the details?

The great significance of the jurisdiction and choice of law of a contract

Choosing the jurisdiction and applicable law for disputes arising out of an insurance or reinsurance contract may be secondary to sorting out the actual terms of cover, but the importance of the choice should not be under-estimated. A good lesson in the different approaches of even mainstream insurance jurisdictions can be had by looking at the experience of the insurers embroiled in the film finance saga, which has kept banks, insurers, reinsurers and the courts worldwide busy for the last seven years.

Many of the disputes which arose out of the underwriting of film finance risks related to the operation of various waiver clauses, which had been inserted in insurances by the lending banks with the aim of denying insurers their usual rights in the event of non-disclosure or misrepresentation by the banks or their brokers. Questions about the validity and scope of those waiver clauses came before the English, New York, Australian and French courts. Although not all of these gave final determinations, we discuss below how these courts did or would have approached the issue of the effect of these clauses.

#### The English approach

##### The Phoenix case

*HIH Casualty and General Insurance and Ors v Chase Manhattan Bank and Ors* [2003] 2 Lloyd's Rep 61

Chase was the leader in a lending syndicate that contracted to lend certain monies for the purposes of financing five films being produced by Phoenix Pictures. It was a condition precedent of each of the loans that the participating production companies procure an insurance policy to cover a shortfall in revenues from the relevant film. A suitable insurance policy was designed with help from the brokers, Heaths, and they, acting as Chase's agent, approached insurers. HIH in London became the lead underwriters.

The dispute arose when a shortfall in revenues occurred on each of the five films and the insurers repudiated liability on the grounds of misrepresentation and non-disclosure on the part of the brokers,

Heaths. Under section 19 of the Marine Insurance Act 1906 (which applies to all types of insurance and reinsurance, not just marine) a broker, as the insured's agent to insure, is obliged to disclose all material facts on placing. The insurer's remedy for non-disclosure (or misrepresentation) on placing is avoidance, or rescission, of the policy *ab initio*. In this case, the insurers made various allegations that the brokers had misrepresented certain aspects of the transaction and had not disclosed relevant facts.

The main issue before the courts centred around the construction of the waiver clause in the policies, which had the somewhat ironic title of "Truth of Statement". The operative parts of the clause read as follows:

"[T]he Insured will not have any duty or obligation to make any representation, warranty or disclosure of any nature, express or implied (such duty and obligation being expressly waived by the insurers) ['Phrase 6'] and shall have no liability of any nature to the insurers for any information provided by any other parties ['Phrase 7'] and any such information provided by or non-disclosure by other parties including, but not limited to, Heath North America & Special Risks Limited...shall not be a ground or grounds for avoidance of the insurers' obligations under the Policy or cancellation thereof ['Phrase 8']".

The English High Court had identified preliminary issues to be decided, namely: "[A]re insurers entitled (a) to avoid and/or rescind the contracts of insurance, and/or (b) to damages from Chase for misrepresentation". These issues were argued before the courts and appealed up to the House of Lords. At first instance, Mr. Justice



Aikens gave the clause very limited scope and found largely for the insurers. The Court of Appeal held that insurers were (i) not entitled to avoid the contracts and claim damages for negligent misrepresentation, (ii) not entitled to rescind for negligent non-disclosure and, (iii) the Truth of Statement clause excluded the right to avoid the contracts for dishonest non-disclosure.

### The House of Lords

The case was appealed to the House of Lords, the highest English appellate court. All their Lordships agreed that the intention behind the Truth of Statement clause was to distance Chase from responsibility for anything said or known by other parties involved in the policy. The clause was held to be commercially viable since it was known that Chase had no more knowledge of the special facts upon which the risk was to be assessed than the insurers themselves. Indeed, no suggestion was made by the insurers that Chase itself had made the misrepresentations and non-disclosures. What the insurers wanted to show was that Chase was liable for the misrepresentations and non-disclosures of its agent, Heaths.

Chase relied on phrase 6 of the Truth of Statement clause, submitting that it not only absolved Chase of all liability, but also indirectly waived any disclosure obligations on the part of Heaths. In the alternative, Chase argued that phrases 7 and 8 relieved it of liability for any representations by Heaths either because the language was wide enough to cover representations of any kind, or because it deprived Heaths of authority to make representations on behalf of Chase.

With respect to phrase 6, it was submitted on behalf of Chase that section 18(3) of the Marine Insurance Act 1906 supported the contention that all liability, for both Chase and its agent, had been waived. This section states that any circumstance as to which information is waived by the insurer need not be disclosed. Since the disclosure obligation of the agent under section 19 was to be read subject to section 18, it was argued that the insurers' waiver of Chase's duty to disclose amounted to a waiver of the agent's duty as well. Their Lordships did not agree with this proposition. Lords Bingham and Hoffman both noted that a close reading of the clause revealed that its draftsman was intimately acquainted with the Marine Insurance Act 1906 and that the intention behind phrase 6 was clearly to waive Chase's obligations only and not its agents, for they were addressed in phrases 7 and 8.

In relation to phrases 7 and 8, both parties agreed that they precluded liability on the part of Heaths (and, by implication, Chase) for innocent misrepresentation and/or non-disclosure. However, the insurers argued that they did not exclude negligent and/or fraudulent misrepresentation and non-disclosure. Chase contended that the phrases denied Heaths' authority to speak for Chase and, alternatively, that they denied the insurers the remedy of avoidance anyway. Turning first to the effect on Heaths' authority, their Lordships dismissed the idea that the phrases restricted it in any way; the words simply limited the liability of Chase for Heaths' actions or omissions. It was thus left to their Lordships to determine whether, upon the true construction of phrases 7 and 8, the insurers had a right to avoid the contracts for fraudulent and/or negligent misrepresentation and non-disclosure.

Lord Bingham determined the intention of phrase 7, specifically the words "shall have no liability of any nature", to preclude the liability of Chase for damages, as well as the right of the insurers to avoid the contracts, for negligent misrepresentation. Its liability for the fraudulent misrepresentation of its agent, however, was deemed not

to be excluded by phrase 7. Although the phrase, if read literally, would preclude liability, it was deemed that fraud unravels all. Lord Bingham held that it was clear that, due to public policy, a contracting party could not exclude liability for its own fraud in inducing the making of a contract. In relation to excluding liability for an agent's fraud, if such a disclaimer was to succeed, it could only do so if the intention was expressed "in clear and unmistakable terms on the face of the contract." His attitude to phrase 8 was the same: there was no avoidance for innocent or negligent non-disclosure, but if fraudulent non-disclosure was found then the insurers could avoid.

Lord Hoffman's initial approach was to analyse the phrases with the guidelines set out by Lord Morton in the case of *Canada Steamship Lines Ltd v. The King* [1952] AC 192. He explained that, since there was no express reference to negligence in phrases 7 or 8, the actual words had to be wide enough, given their ordinary meaning, to cover negligence. Also, if the words used could be read to cover something other (and lesser) than negligence, then they would be so read and there would be no exclusion of negligence. Lord Hoffman did, however, warn against following these rules too rigidly and, instead, relied on a more purposive interpretation of the phrases. He held that, given the context of the transaction and the language used, there was nothing to suggest that either party did not intend the exclusion to cover negligence and, consequently, he considered negligence to be excluded.

Turning to fraudulent misrepresentation, Lord Hoffman agreed with the principle that "parties contract with one another in the expectation of honest dealing," and concluded that only an express reference to dishonesty would negate this contractual presumption. Since fraud was not excluded by the Truth of Statement clause, he held that phrases 7 and 8 did not bar the right of the insurers to rescind for fraudulent or dishonest non-disclosure.

In summary, it was held by the majority that although the waiver clause prevented the insurers from avoiding the contract for innocent and/or negligent misrepresentation and/or non-disclosure, the language did not cover situations in which fraud or dishonesty was involved. Fraud was held to be a thing apart which negated the basis upon which the contract was formed. Fraud could not be excluded unless express language was used and agreed to, at least in relation to an insured's agent. The conclusions reached by their Lordships were the result of a close reading of the clause itself and detailed analysis of the phrases making up the clause. This analytical approach is to be contrasted with the approach in other jurisdictions.

## The New York approach

### The George Litto case

*Chase Manhattan Bank v New Hampshire Insurance Company and Axa Reassurance S.A.* 193 Misc. 2d 580, 749 N.Y.S2d 632, 2002 N.Y. Misc. LEXIS 1297 (N.Y. Sup Ct. 2002)

The case in the US involved very similar facts. Chase was again the leader in a lending syndicate which provided a facility to a film production company (George Litto Productions). AXA RE was the lead reinsurer. The policy was brokered by Stirling Cooke Brown (SCB), who acted as agents for Chase. Again the policy included a waiver clause entitled "Truth of Statement". Similar allegations of non-disclosure and misrepresentation were advanced by the insurers in the face of overwhelming losses.



Mr Justice Gammernan, hearing the case in the Supreme Court of New York, found the Truth of Statement clause crucial in deciding what remedies might be available to AXA. It was conceded by AXA that the clause did shield Chase from liability for innocent and negligent misrepresentations, but AXA contended that this did not exclude liability for fraudulent misrepresentations and non-disclosures.

### Disclaimers

Gammernan J's approach to interpreting the detail of the Truth of Statement clause was set out in the "Disclaimers" section of his judgment. AXA had argued that there was an established New York legal principle that disclaimers could not apply to facts within the peculiar knowledge of the party making the misrepresentation (citing *Tahini Investments Ltd. v Bobrowsky* 99 AD2d 489 (2d Dept 1984)). Gammernan J's response to this was simply to hold it inapplicable to the facts at hand.

Gammernan J. went on to state that he would only be giving the words of the clause their plain and ordinary meaning and would not go beyond this. Any subjective or creative interpretation of the words would be dismissed. In particular, the interpretation tendered by AXA (that the Truth of Statement clause did not cover either misrepresentations made by SCB as Chase's agent or disclosures required by law) was not given any credence. He therefore concluded that the clause was a complete bar to any claim of misrepresentation or non-disclosure, even if the alleged conduct was fraudulent.

This black letter approach to interpretation lies in stark contrast with that of the majority in the House of Lords, who were willing to take into account the circumstances and intentions of the respective parties when negotiating the contract. The English purposive approach gives effect to the commercial realities of a transaction such as this and provides a more detailed consideration of the construction of each phrase. For example, they may have held that the clause was drafted widely enough to cover fraud, but their Lordships acknowledged that commercial parties could not be expected to honour contracts based on a fundamental dishonesty, thus reflecting business conduct and public policy. Gammernan J's approach was simply to condemn AXA for making a bad bargain, without any further consideration.

The judge went on to cite two cases in which plaintiffs appeared to have forgone full disclosure of material facts, as was the case here, and were deemed to have acceded to the risks this could entail. In *Rodas v Manitar* 159 AD2d 341 (1st Dept 1990) it was held that where a party had been put on notice that not all material facts had been disclosed, but then it proceeded with the transaction regardless, the party was taken to have assumed the business risk and thus "will not be heard to complain that he has been defrauded when it is his own evident lack of due care which is responsible for his predicament." The case of *Meltzer v G.B.G Inc.* 176 AD2d 687 (1st Dept 1991) was also found to be analogous. In that case, the plaintiffs accepted a contract in redacted form and, again, were held to have accepted the business risk involved. Applying these findings to AXA's predicament, Gammernan J. found that AXA had similarly acceded to the exclusion of any obligations on Chase's part, to non-avoidance even in the event of misrepresentations and non-disclosures by SCB, and accepted that there might be misrepresentations or omissions of information. This behaviour was analogous to accepting a redacted contract, in the judge's opinion. By this, he meant that AXA had agreed to very limited disclosure and, as a result, they were not in a position to complain *ex post facto* with regard to Chase's responsibility for representations and non-

disclosures. Therefore, Chase was free of all liability, even for fraudulent misrepresentation and non-disclosure. Interestingly, Gammernan J. also held that, because there was no express reference to shielding SCB in the Truth of Statement clause, SCB were not protected by it and thus AXA could pursue SCB for its fraudulent misrepresentations and non-disclosures independently.

This ruling was subsequently upheld by the Supreme Court of New York, Appellate Division, First Department on 17 April 2003. Leave to appeal was then denied on 2 September 2003 by the New York Court Of Appeals.

## The Australian approach

### The ReAC case

*Reinsurance Australia Corp Ltd v HIH Casualty and General Insurance* [2003] FCA 56

In the Australian decision, the proceedings were at an earlier stage to those heard in the US and UK. Here the respondents (the insurers, bank and its broker) were seeking one of the following; a strike out of the reinsurers' claim, a grant of a permanent or temporary stay of the proceedings, or that the service of proceedings be set aside. These proceedings concerned reinsurances of HIH relating to the Phoenix transactions which had formed the basis of the English case described above. Again the relevant judgment concerned the operation of a "Truth of Statement" clause.

The application was heard in the Federal Court of Australia, New South Wales District Registry, by Mr. Justice Jacobson. HIH was the "fronting" insurer, Chase was the lead bank, and Heaths was the broker. ReAC and Monde Re were the reinsurers and applicants.

Jacobson J. explained that the purpose of the Truth of Statement clause was to "limit, or perhaps exclude entirely, any liability which Chase may have to the insurers for misrepresentation or non-disclosure." Refusing to rule on the clause itself, he noted the respective positions of the English and US courts (as described above), but said that the clause would not preclude a claim under the Trade Practices Act 1974, if the agreement was induced by misleading or deceptive behaviour, both within and outside of Australia. The ability to bring a claim under section 52 of that Act was well established in Jacobson J.'s opinion and he cited a case to support this: *Leda Holding Pty v Oraka Pty Ltd* (1998) ATPR 41-601. The advantage for the reinsurers, if allowed to proceed with the Trade Practices claim, was that it provided a means of bypassing the relatively comprehensive disclaimers contained within the Truth of Statement clause without using the common law and, if successful, this claim could result in damages being awarded (s.82), or other discretionary relief (under s.87).

Given the findings of Gammernan J. in the US, the Australian judge found that the reinsurers were effectively barred in the US from claiming that the Truth of Statements clause failed to exclude fraudulent misrepresentations and non-disclosure. He considered that the same claims were essentially being made concurrently in England and Australia and whilst they had a possibility of success, they could lead to inconsistent findings of fact. As there were proceedings in England at this stage, continuing with the Australian proceedings would be oppressive and vexatious if solely based on pursuing the common law arguments. He thus deferred that issue to the English courts. However he would allow the proceedings in Australia based on the Trade Practices Act.



In discussion about the differences between English common law and the Australian Trade Practices Act, the judge said, at paragraph 322, "[T]he principal differences for present purposes are that, under the Trade Practices Act, a representation may be as to a future matter, innocent misrepresentation may sound in damages, there is a reversal of onus with respect to future matters and it is not possible to contract out of liability. Accordingly, under English law the remedies which would be open to ReAC and Monde Re are more restricted than in a claim under the Trade Practices Act.. The protection afforded to the recipient of misleading and deceptive information in Australia (here, the reinsurers) was clearly greater than in either of the other two jurisdictions. Jacobson J. found at paragraph 326 that, in principle, the "co-existence of local and foreign proceedings is not vexatious or oppressive where relief is available in one forum which is not available in the other." Since there was a significant risk that the relief offered by the Act would not be available to the applicant reinsurers outside of an Australian court, Jacobson J. refused to grant a stay. In other words, Jacobson J. had ruled that it was at least possible for the reinsurers, both an Australian company (ReAC) and a foreign one (Monde Re), to benefit from relief under the Trade Practices Act for misleading and deceptive conduct on the part of the respondents.

Whilst, frustratingly, the Australian proceedings did not rule on the Truth of Statement clause, the judgment of Jacobson J. does provide some useful insight into how an Australian approach might be formulated. If the reinsurers failed under the common law, a Trade Practices claim would have provided a useful alternative. The statute provides greater scope for relief to the victim of misrepresentations and deceptive behaviour than the English common law. Under the Act, courts could award not only damages and other relief, such as an indemnity to cover the representee's losses, but also avoidance of the contract ab initio. Unfortunately, the parties settled this case before a final hearing could determine the issue so the true position under Australian law was not decided.

## French law

The film finance cases also hit the French courts. Reinsurers issued proceedings in Paris seeking negative declaratory relief in circumstances where the underlying insurances were the subject of litigation in England or elsewhere. Although these proceedings did not reach the stage where a decision had to be made, proceedings before the Tribunal de Commerce de Paris are conducted with the benefit of minimal disclosure by the parties and on the basis of witness statements, where the witnesses are usually not subjected to cross-examination.

Accordingly, even if the French courts were to reach conclusions about the scope and effect of a waiver clause similar to those of England, New York or Australia, this less adversarial and less document heavy approach might well have yielded a vastly different result when the waiver clause was then applied to the facts of the case.

## Conclusion

The contrast between the different approaches taken by the different jurisdictions to what were similar waiver clauses is marked. Although England, New York and Australia might be said to have a similar common law approach to insurance issues generally (clearly not true of the civil law approach in France), and particularly the specific issue here, statutory differences come into play (the Trade Practices Act in Australia and the Misrepresentation Act 1967 in England as examples). In addition and irrespective of their legal approach to non-disclosure and misrepresentation, the approach to construction varies, perhaps most markedly demonstrated by comparing the in-depth analysis of the five Law Lords in Phoenix with Gammerman J.'s rather dismissive approach in the George Litto case. On top of that, there are the differences in the way in which evidence is dealt with, whether by juries or judge, on the basis of minimal or full disclosure and then with or without cross-examination of witnesses.

It is against this background, that the importance of the choice of law and jurisdiction for any dispute under a contract can be seen. Underwriters might spend a long time in negotiation over the terms of cover. Indeed, the unfortunate underwriters in these cases may have spent many an hour in discussion over the "Truth of Statement" clause. In the end, what may have been the most determinative factors in these cases (and what might have the greatest effect on the outcome of any dispute on an insurance contract generally) were the choice of law governing the contract and the jurisdiction in which the dispute was litigated.



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