HELP! THE FORUM SELECTION TRAP IN AUSTRALIAN INSURANCE CONTRACTS

Akai Pty Ltd v *The People's Insurance Co Ltd*

As the cross-border exchange of goods and services in the region becomes more liberalised, it is increasingly common for ASEAN insurers to extend policies to businesses outside their home jurisdiction. The insurance contracts usually either provide for disputed claims to be adjudicated by the courts of the home country of the insurance company or the parties agree to refer disputes to third "neutral" countries, such as Singapore or England. Seldom, if ever, does an insurer agree to refer claims to courts in the insured's home jurisdiction.

ASEAN insurers considering extending their operations to Australia may therefore be surprised to learn that, in the recent case of *Akai Pty Ltd* v *The People's Insurance Co Ltd*[1], the Australian High Court effectively held that ASEAN and other foreign insurance companies who issue insurance policies to Australian businesses are compelled by Australian law to refer disputes to adjudication in Australia.

Background

In mid 1991, The People's Insurance Co Ltd ("PIC"), a Singapore insurance company, entered into a credit insurance policy with Akai Pty Limited ("Akai"), a company incorporated in New South Wales, Australia. Akai is the local subsidiary of a large. Japanese electronics manufacturer.

In negotiating the policy, PIC had initially required the insurance contract to be governed by the law of Singapore and disputes to be resolved by the courts of Singapore. Akai rejected this, but the parties were able to agree on England as a "reliable and impartial" third country alternative[2]. Accordingly, the contract provided for the law of England to be the governing law, and for all disputes to be referred to the courts of England.

Some time after entering into the insurance contract, Akai claimed indemnity under the policy for loss suffered by it as a result of the liquidation of one of its creditors. PIC denied liability on the basis of several breaches of the insurance policy by Akai. Under the law of England, these breaches may have been sufficient for PIC to refuse to indemnify Akai. However, under section 54 of the Australian *Insurance Contracts Act 1984* ("Act"), PIC could only avoid liability to the extent to which Akai's defaults caused or contributed to the relevant loss.

1 (1997) 141 ALR 374.
2 Ibid at 376.

Akai brought its claim against PIC in the Supreme Court of New South Wales, Australia. PIC applied for a stay of these proceedings on the basis of the English forum selection provision in the insurance contract. Akai argued that the Act invalidated the forum selection provision. The High Court of Australia, by a majority of three to two[3], upheld Akai's argument and refused to stay the Australian proceedings.

Application of Act

The reasoning of the High Court majority followed a two step process. The majority first considered whether or not the Act applied to the Akai insurance contract. If the insurance contract was governed by English law, as specified in the contractual choice of law provision, then the Act (as a provision of Australian law) could have no application.

The scope of the Act is set out in section 8, which provides as follows:

> (1) Subject to section 9, the application of this Act extends to contracts of insurance, the proper law of which is or would be the law of a State or the law of a Territory in which this Act applies or to which this Act extends.
>
> (2) For the purposes of subsection (1), where the proper law of a contract or proposed contract would, but for an express provision to the contrary included or to be included in the contract or come other contract, be the law of a State or Territory in which this Act applies or to which this Act extends, then, notwithstanding that provision, the proper law of the contract is the law of that State or Territory.

The English choice of law clause in the insurance contract clearly constituted an "express provision to the contrary", and therefore had to be disregarded by the High Court.

The question for the High Court to decide was therefore whether or not the objective proper law of the insurance contract would otherwise have been Australian (or, in this case, New South Wales) law. If so, then the Act would apply to the contract.

The majority held that, in the absence of a choice of law clause, the objective proper law of the contract would be the law of New South Wales.

Following the approach in *Commonwealth* v *Bonython*[4], the majority determined that the law of New South Wales was the law with which the contract had its "closest and most real connection".

3 The majority consisted of Toohey, Gaudron and Gummow JJ. The minority consisted of Dawson and McHugh JJ.

4 (1950) 81 CLR 486.

Although a number of considerations were mentioned, the majority's determination was largely based on the fact that the risk insured by the relevant contract was located in Australia[5]:

> it is proper to have regard to a number of matters including the places of residence or business of the parties, the place of contracting, the place of performance, and the nature and subject matter of the contract...The policy was the product of negotiations conducted by communications between Sydney and Singapore. But the policy had no practical connection with Singapore except that the insurer happened to be a Singaporean company. The policy had no factual connection at all with England. On the other hand, the risk was very substantially situated in New South Wales...the only countries covered under the policy were identified as Australia and New Zealand. The maximum liability was stated in Australian currency...In our view, the State of New South Wales contained the system of law with which the contract of insurance comprised in the policy had its closest and most real connection[6].

The High Court majority discounted the intention of the parties in favour of English law as expressed in the forum selection clause. Normally, a forum selection clause, such as the clause referring disputes to the courts of England, would (in the absence of a choice of law clause) supply an inference that the parties intended as the proper law the system of law of the country chosen by them as their forum[7]. However, the majority considered that section 8 of the Act also required the implied expression of intention evidenced by the forum selection clause to be disregarded for the purposes of determining the proper law. It was said:

> there is an extreme artificiality in first, as required by the statute, disregarding that express choice, and then proceeding by analysis of the other provisions in the contract to infer the making by the parties of a choice of governing law.[8]

In other words, the High Court majority considered that the Australian legislators must have intended the words "express provision to the contrary" in section 8(2) of the Act to extend to implications in the insurance contract, such as are usually read into a forum selection clause, that the contract be governed by foreign law.

5 Greene, Janey "Party Autonomy in Choice of Law in Contract: Through the Lens of Akai Pty Ltd v The People's Insurance Company", (1997) 25(5) *Australian Business Law Review* 330 at 336.

6 Op cit note 2 at 387–388.

7 *Cie Tunisienne* v *Cie d'Armement* [1971] AC 572 at 590, 604.

8 Op cit note 2 at 389.

The High Court majority decision effectively means that, no matter what the agreement or even the intention of the parties with regard to the governing law of an insurance contract, if the insured risk is located in Australia, then the Australian courts will apply Australian law to determine any disputes arising under the contract.

Stay of Proceedings

Section 52 of the Act provides as follows:

> Where a provision of a contract of insurance purports to exclude, restrict or modify, or would, but for this subsection, have the effect of excluding, restricting or modifying, to the prejudice of a person other than the insurer, the operation of this Act, the provision is void.

The High Court majority held that section 52 would apply to the English forum selection clause, because the courts of England would be unlikely to apply the Act, but would instead give effect to the contractual choice of law clause of the insurance policy and would apply English law[9]. This would effectively constitute an exclusion of, or restriction on, the operation of the Act. Therefore, under section 52, according to the High Court majority, the forum selection clause was void.

The High Court majority also said that, apart from section 52 of the Act, a stay of proceedings, which is a discretionary matter, would be contrary to the policy of the law (that is, the Act) and therefore discretion should be exercised against granting the stay. The majority said that the policy of the Act was "against the use of private engagements to circumvent its remedial provisions"[10].

Accordingly, if the risk insured by an insurance contract is located in Australia, the Australian courts will refuse to acknowledge the agreement of the parties for disputes to be adjudicated outside Australia.

Minority decision

In their dissent from the decision of the majority, the High Court minority noted that the Act does not expressly prevent parties from selecting a forum outside Australia. If the parties do select a forum outside Australia,

9 No evidence was actually produced by either party as to the state of English law in this regard. The High Court applied the usual assumption that the unproved foreign law accords with the common law of the forum: *Standard Bank of Canada* v *Wildey* (1919) 19 SR(NSW) 384.

10 Op cit note 2 at 396.

according to the minority, that selection means that the Act cannot apply, because the Act applies only to disputes which are to be adjudicated in Australia:

> The Act is directed to Australian courts, not the courts of another country. It does not seek to prevent the parties to a contract submitting their disputes exclusively to the courts of another country and it is therefore within the contemplation of the Act that those disputes will be determined otherwise than by the application of its provisions.[11]

Citing *The Eleftheria*[12], the minority observed that the authorities require strong reasons to displace a contractual forum selection by the parties. The minority could find no such strong reasons in the instant case.

In particular, according to the minority, the policy of the Act did not seek to displace agreements between the parties for disputes to be referred to a non-Australian court.

The minority would have granted the stay of proceedings sought by PIC to hold Akai to its agreement to litigate in England.

Commentary

Australian commentators have generally supported the majority decision in *Akai*. The High Court majority decision has been justified in terms of "the propriety of sacrificing the parties' subjective intentions to the protectionist policies driving the legislation"[13] and has been described as the victory of substantive policy over conflict of laws policies of uniformity, predictability, respect for the sovereignty of other states and comity[14]. *Akai* appears to have been as much about a conflict of policies, between the domestic and the international, as a conflict of laws.

The result in the *Akai* case may be compared to the result in the recent case *CSR Ltd* v *Cigna Insurance Australia Ltd*[15], where the High Court granted a stay of proceedings which allowed an Australian insured party to seek higher damages against the local subsidiary of a foreign insurer in the United States. These two cases, at least, would seem to indicate that the application of the discretionary stay before the High Court tends to favour the insured party.

11 Ibid at 381.
12 [1970] P 94.
13 Op cit note 6 at 340.
14 Bell, Belinda, "Proper Law — Ignoring the Contract? A Note on *Akai Pty Ltd* v *The People's Insurance Co Ltd* (1997) 19(3) *Sydney Law Review* 400 at 410.
15 (1997) 146 ALR 402.

The question is, whether the preference for the insured party as a matter of policy, did not cause the High Court majority in *Akai* to unduly compromise certain principles of law.

Choice of Law

The key element in the majority decision was the determination that the objective governing law of the contract for the purposes of the Act was Australian (New South Wales) law.

First, the High Court majority had to exclude the implication arising out of the forum selection clause in favour of English law. The Act only permits exclusion of "express provisions" and does not refer to implications of agreed intention by the parties such as are usually inferred from a forum selection clause.

In a manner contrary both to previous judicial[16] and academic[17] opinion, the High Court majority effectively interpreted "express provisions" to include implied intentions. The majority justified its departure from the natural meaning of the provision on the basis that "such a reading would cause the section, and therefore the Act itself, to misfire by falling short of addressing the mischiefs which the legislation is designed to remedy"[18].

As one commentator has noted, the court effectively concluded that "the drafters of the Act had a fairly weak grasp of choice of law principles"[19]. The drafter should have been aware that the objective proper law could be influenced by indications of agreed intention in the contract, and drafted legislation covering both express and implied provisions. Since the drafting was deficient, the High Court majority decided to interpret the Act in a way that would overcome the deficiency, in order to ensure that what the majority considered to be the policy objectives of the Act were met.

After deciding it was entitled to ignore implied provisions of the insurance contract, the High Court majority proceeded to determine the objective proper law of the contract almost solely by reference to the location of the insured risk. Since there is no judicial authority which compels the attachment of special weight to the location of the insured risk in insurance contracts, it might be asked why the location of the insured risk is a more legitimate nexus than, say, the location of the liability, a factor which the majority apparently did not even acknowledge. The

16 *John Kaldor Fabricmakers Pty Ltd* v *Mitchell Cotts Freight (Australia) Pty Ltd* (1989) 90 ALR 244. This case was not referred to in the judgement of the High Court majority.
17 Nygh, P, *Conflict of Laws in Australia* (1991), Fifth Edition at 276.
18 Op cit note 2 at 389.
19 Op cit note 6 at 335.

location of any liability owed by PIC to Akai, under conflict of laws principles, would be considered to be in Singapore[20]. Certainly, there is authority in favour of the location of a contractual liability having a role in determining choice of law[21]. Given that, on one interpretation, the entire purpose of the insurance contract was to create a liability to the insured in certain circumstances, the jurisdiction in which that liability was created would appear worth a mention.

By ignoring the location of the liability, and focusing on the location of the risk, (which is invariably the place where the insured party is located) the High Court majority was able to find a way to protect the local insured against the foreign insurer. The risk in the majority's approach is that the High Court is perceived as engaging in law-making, effectively re-writing the "mistakes" in legislation, and selectively discarding inconvenient common law principles, to achieve what it believes to be the intent of the Parliament, and thereby undermining the separation of powers between the legislature and the judiciary which is crucial to the operation of the Australian Constitution.

Choice of Forum

The key difference between the majority and the dissenting minority was that the minority considered that the Act did not seek to regulate insurance contracts which provided for dispute resolution in a neutral forum outside Australia. This appears to have been on the basis that the choice of a neutral forum was considered "a common and legitimate purpose of choice of forum clause"[22]. On the other hand, the majority placed great emphasis in its reasoning on the legislative purpose of sections 8 and 52 of the Act being to avoid circumvention[23]. The majority clearly considered that the forum selection clause in the Akai insurance contract constituted an attempted circumvention of the Act.

With respect, the minority's view is to be preferred in this regard. "Circumvent" in this context surely does not merely mean an avoidance by chance, but rather an evasion by craft. For instance, where two Australian parties to a contract providing for insurance of an Australian business seek to nominate an English proper law and an English forum, it could generally be inferred that the parties are seeking to circumvent the operation of the Act. In the context of an international insurance contract, where the selection of a neutral governing law and forum is common practice, such an inference would generally be unreasonable.

20 The place of residence of PIC (see *Jabbour* v *Custodian of Isreali Absentee Property* [1954] 1 All ER 145 at 146; *Re Helbert Wagg & Co* [1956] Ch 323).

21 *Tomkinson* v *First Pennsylvania Banking & Trust Co* [1961] AC 1007.

22 Op cit note 6 at 335.

23 Australian Law Reform Commission, Report No 20, *Insurance Contracts* (1982) cited in op cit note 2 at 385.

In the context of choice of law, the authorities have established that a selection will be invalid where it is made to evade the application of a law which would otherwise have applied[24]. This has meant in practice that, in order to hold a contractual choice to be invalid, courts have had to determine as a matter of fact that the attempted selection was for no other purpose than to avoid the operation of the relevant law[25]. Such an approach gives effect to the common law's traditional respect for freedom of contract.

In the *Akai* case, there was no evidence of any intentional circumvention of the Act by the parties in the above sense. The forum selection clause was based upon the common international practice of selecting a neutral venue for dispute resolution, not upon any specific arrangement to exclude the impact of the Act or any other provision of Australian law. Accordingly, the majority's attempt to rely on the Parliament's purported proscription of circumvention of the Act as a justification for a decision which is otherwise questionable in principle appears unconvincing.

Consequences

The consequences of the decision for Australian business have already been recognised in Australia: "there are very few providers of credit insurance in Australia... the majority's holding is going to discourage the availability of affordable credit insurance"[26]. Indeed, any ASEAN or other foreign insurance company which does not wish to be subject to the Act or to the Australian court system would be well advised to refuse to extend insurance to businesses located in Australia.

If Australia wishes to exclude itself from the cross-border exchange of insurance services with the region, decisions like that of the High Court majority in *Akai* will prove to be of great assistance. However, if Australian businesses need insurance which can only be obtained, or obtained more cheaply, overseas, then it seems they cannot expect any Help from the Australian High Court.

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24 *Vita Food Products* v *Units Shipping Co* [1939] AC 277.
25 *Golden Acres Ltd* v *Queensland Estates Pty Ltd* [1969] Qd R 378.
26 Op cit note 6 at 336.
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