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## LIMITS ON ALLEGING STATE SPONSORED FRAUD: WHAT ARE THEY AND SHOULD REINSURERS WORRY?

By Wendy Allen-Rodney and Carlos Fane

The decision by London market reinsurers to end their legal battle with state-owned Korea National Insurance Corporation (KNIC)<sup>1</sup> raised some eyebrows within the industry when it was reported at the end of last year (see *Reinsurance* 9 December 2008 and 14 January 2009): the reinsurers not only agreed to pay 95% of the 44 million euro reinsurance claim but also to withdraw all allegations of fraud and impropriety against KNIC.

As has been widely reported, KNIC's claim concerned a helicopter crash, which, allegedly, destroyed a warehouse in North Korea and large amounts of disaster-relief supplies stored there. The helicopter involved in the crash was owned by the North Korean Airline, Air Koryo, insured by KNIC, under an aviation hull and liability policy. The reinsurance of this risk was placed in London, with both London and non-London market reinsurers. The reinsurers suspected fraud and, for this reason, among others, refused to pay KNIC's claim. Their suspicions were aroused when KNIC presented meticulously detailed evidence in support of the claim just days after the disaster. Their suspicions were aroused further by expert evidence casting doubt on claims that high volumes of supplies were stored at the warehouse before the incident.

KNIC took the reinsurers to court – in North Korea, as the contract contained a Korean law and jurisdiction clause, meaning that any

dispute between KNIC and the reinsurers fell to be decided by the North Korean court in accordance with North Korean law. The North Korean court upheld KNIC's claim. The reinsurers refused to comply and KNIC sought to enforce the North Korean judgment through the Commercial Court in London. Ultimately, the reinsurers agreed to settle before a final decision was reached.

However, one issue dealt with by the Court before the proceedings were settled, which has received less press attention, is whether, when faced with claims like KNIC's, involving state-owned entities in totalitarian regimes, reinsurers may be prevented from raising allegations of state-sponsored fraud and corruption.

Among the allegations raised by the reinsurers were that the underlying claim was fraudulent. The reinsurers alleged that there had been no crash and that senior officials of the North Korean state, the ruling Korean Workers Party, the warehouse and KNIC had been complicit in the fraud. In support of this, the reinsurers pointed to what they alleged was the North Korean state's history of criminality, of which they gave various examples, including narco-trafficking and producing counterfeit currency and goods. They also argued that due to the high degree of overlap between the North Korean judiciary and the corrupt North Korean state implicated in the fraud, the North Korean Court's judgment should not, on public policy grounds, be enforced.



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The Commercial Court considered as a preliminary issue, before the full trial could go head, whether these allegations were likely to damage the UK's diplomatic relations with North Korea and, if so, whether they raised issues that the Commercial Court was prevented, by the so-called the doctrine of "non-justiciability", from adjudicating upon. To the surprise of many, the Commercial Court concluded that they did, and ordered the allegations to be struck out. The reinsurers appealed.

The Court of Appeal decided that causing embarrassment to a foreign state did not necessarily damage diplomatic relations. It had not been demonstrated that this would be the effect of the reinsurers' allegations and therefore they were ones that the Court could consider.

Despite this favourable judgment, the reinsurers did not fight on, instead settling soon after the judgment was handed down.

For the reinsurance market, the Court of Appeal's judgment is good news, particularly for those operating in regions of the world in which corruption is widespread and there is no clear separation of powers between the executive and the judiciary: it strongly suggests that if a foreign state or state owned entity is the reinsured under a reinsurance contract,

the reinsurers cannot be precluded from alleging fraud simply because doing so may embarrass that state. However, it is not quite clear from the Court of Appeal's judgment how far this principle extends beyond the particular facts of this case: the Court delivered its judgment at speed (to allow the trial to continue as quickly as possible), without detailed submissions on the doctrine of "non-justiciability", and even stated in its judgment that it "*would not attempt an in-depth exposition of that law and [its judgment] should be regarded as ... limited to this case*". This means there is scope for the Court to take a different view on another occasion. Were it to do so, with the result that allegations of fraud and corrupt state-interference with the functioning of a foreign court could not be raised, the implications for reinsurers could be serious, particularly in today's world, in which, in the wake of the credit crunch and for ideological reasons, more and more companies face the threat of being taken into state control. So, any sighs of relief, with which the Court of Appeal decision may have been greeted, could be premature.

### Endnotes

- <sup>1</sup> *Korea National Insurance Corporation ("KNIC") v. Allianz*