wotton kearney

insurance lawyers

Insurance Year in Review 2009

wotton kearney

insurance lawyers

First published in 2009
by Wotton + Kearney Insurance Lawyers

Tel +61 2 8273 9900
Fax +61 2 8273 9901

Level 5, Aurora Place
88 Phillip Street
Sydney NSW 2000
Australia

PO Box R235
Royal Exchange NSW 1225

DX 10465 SSE

Email sydney@
wottonkearney.com.au

Tel +61 3 9604 7900
Fax +61 3 9670 4699

Level 3
600 Bourke Street
Melbourne VIC 3000
Australia

DX 182 Melbourne

Email melbourne@
wottonkearney.com.au

www.wottonkearney.com.au

The Year in Review

David Kearney
Managing Partner
Tel (02) 8273 9916
david.kearney@wottonkearney.com.au

Welcome again to the annual Wotton + Kearney Insurance Law Review.

Twelve months ago insurers began to experience a decline in value across most asset classes as the Global Financial Crisis (GFC) took hold. Realised and unrealised losses resulted as the biggest single capital event in the past 30 years unfolded.

However, as we move into improving economic conditions, it appears our industry has benefited from past failings. Heavier regulation and a greater focus on price modelling, both a corollary of the collapse of HIH earlier this decade, has allowed the insurance industry to move through the GFC relatively unscathed. Certainly the industry remains well capitalised in comparison to other related industries.

Of course the impact on classes of insurance with a *longer tail* are still not clear and will put pressure on operating ratios in the future. In this publication we review for example significant developments in Directors & Officers and Financial Institutions insurance, both likely to cause insurers involved in these classes ongoing concern.

Looking internally, in 2009 we were thrilled to be recognised as a leader in the provision of legal services to the insurance market when named as the Insurance Specialist Law Firm of the Year at the ALB Australasian Law Awards. I would like to think that award reflects the consistent provision of quality legal advice across the broad areas of insurance business in which our insurance clients are involved.

Against that background, I am again very optimistic that this publication will allow those with an interest in insurance law to build or reinforce an understanding of important developments across the broad claims landscape.

4 November 2009

Services

Wotton + Kearney is a boutique insurance law firm.

Our sole focus is insurance law and we act for a diverse range of risk carriers, underwriting agents, brokers and corporate insureds providing litigious and general advisory services.

As the only Australian law firm based in more than one city focusing solely on insurance law, we have a detailed understanding of the insurance industry in Australia and of the litigation landscape relevant to the successful resolution of insurance claims. Our commitment to the insurance industry extends to overseas markets, particularly the London insurance market which continues to play a significant role in the writing of Australian risks.

Our service offering is broad. We have expertise in all forms of insurance claims litigation including claims relevant to:

+ Professional Indemnity
+ Public and Products Liability
+ ISR/Commercial Property
+ Construction/Contract Works
+ Directors & Officers Liability
+ Class Actions

Contents

wotton kearney
insurance lawyers

Wotton + Kearney
Insurance Year in Review – 2009

The year in review – an overview

Developments for insurers generally

Contents

Developments for insurers generally

Public & Product Liability

Contents

Public + Product Liability

Professional indemnity

Contents

Reinsurance

Industrial Special Risks / Construction

Contents

Foreign shores

Life Insurance + Superannuation

Insurance Year in Review 2009
Developments for insurers generally

GFC: The impact on insurance

Written by David Brady, Solicitor and Kiri-Ana Libbesson, Solicitor

Tel 02 8273 9969/ 8273 9980
david.brady@wottonkearney.com.au
klibbesson@wottonkearney.com.au

The global financial crisis (**GFC**) has impacted economies around the world causing companies to collapse and stock markets to crash and forcing governments to issue stimulus packages.

Although the insurance industry is not immune to the GFC, insurers have proven to be well placed compared to other financial institutions. In particular, Australian insurers have so far weathered the GFC well.

Despite this, it has been reported that the GFC remains the number one risk for the insurance industry because its profound consequences are likely to shape the industry for some time.[1]

Premiums

The effect of the GFC and consequent economic slowdown has seen an increase in premiums in areas such as directors & officers (**D&O**) liability insurance and certain classes of professional indemnity (**PI**) insurance. Premiums for other areas, such as property and public liability insurance, on the other hand have remained relatively stagnant due to excess capacity.

The major GFC factors contributing to increased premiums include:

+ a higher number of claims (due to people looking for ways to supplement their GFC losses);
+ a decrease in interest rates and investment returns from financial markets;
+ failing businesses (resulting in more claims on D&O and financial lines policies);
+ higher reinsurance premiums; and
+ increased levels of insurance fraud.

However, the effect of the GFC on insurance premiums in general has not been as intense as initially predicted. This is because there is currently excess capital and a healthy level of competition in the insurance market.

In addition, reinsurance premiums have not soared in all areas as initially expected. Willis Re reported in July that the reinsurance market has remained relatively stable due to *"signs of recovery in the financial markets and a lack of major underwriting losses"*.[2] On the Australian PI front, however, reinsurance prices have increased due to increased claims and reduced reinsurer capacity.[3]

D&O liability

D&O premiums have been seen to rise by an average of 10%, due to claims activity and increased exposures, caused mainly by the GFC.[4]

As more and more big businesses fail, unhappy shareholders are looking to recover their losses. The frequency and severity of D&O insurance claims are therefore rising, and with this comes an increase in premiums. →

1 Ernst & Young, Second Annual Business Risk Report – Insurance (2009) 4, 6.

2 Peter C Hearn, CEO of Willis Re in Willis, *Willis Re 1st View* (1 July 2009) 3.

3 Willis, *Willis Re 1st View (1 July 2009) 4.*

4 Marsh, *Client Briefing: Insurance Market Conditions* (June 2009).

Marsh has reported that the key pressures that have affected this market during the GFC have been:

+ a growing number of shareholder class actions;
+ increased D&O claims activity; and
+ low investment returns of insurers.[5]

Professional Indemnity

Although several PI lines have had fairly stable conditions throughout the GFC, the financial institutions sector has seen an increase in claims and premiums.

Since the onset of the GFC, more people are placing blame for their losses onto their financial advisors. Craig Claughton of Marsh has commented that:

"*Professional negligence claims are also known to increase during an economic downturn as people look to blame their professional advisors*".[6]

Claims against financial planners, auditors and stock brokers continue to rise and this is leading to increased premiums in these areas.

Auditors are facing many more claims than in the past, particularly when management personnel depart prior to a business collapse.

Examples of recent claims against auditors include:

+ Centro's cross-claim against PricewaterhouseCoopers;
+ ASIC's claim against KPMG regarding its audits of Westpoint; and
+ $746 million class action against KPMG.

Claims against financial planners are also up, with high-profile examples such as claims against planners who advised clients to invest in Great Southern.

Underwriting of financial service policies will need to be scrutinised throughout this economic time so that individual consideration is given to different services and the associated risks. Underwriters will need to consider closely the following factors:

+ the insured's product;
+ the insured's financial statements; and
+ the level of transparency and disclosure offered by the insured.

Implications for insurers

Despite the strength of the insurance industry, players in the industry will need to be mindful of both the threats and opportunities present throughout the GFC.

In these uncertain economic times the risks involved in investments are high. For this reason, insurers should focus on their core business activity of underwriting.

An Ernst & Young professional has advised that:

"*In this environment, it is essential that insurance companies gain liquidity and financial flexibility, retain earnings power and maintain agency ratings*".[7]

It has also been suggested that insurers should not focus their attention solely on one class of insurance; particularly one such as D&O.[8] Rather, one of the keys to surviving the GFC is to diversify risk.

5 Marsh, *Insurance Market Review: Australia* (March 2009).

6 Craig Claughton, NSW Manager of the FINPRO Practice at Marsh, quoted in Marsh, *Marsh News* (June 2009) 1.

7 Ernst & Young, *Second annual business risk report – insurance* (2009) 6.

8 Richard Ward, CEO of Lloyd's, quoted in insurancenews.com.au, *Insurers must spread their risks to survive* (2009) <http://www.insurancenews.com.au/analysis/insurers-must-spread-their-risks-to-survive> at 28 August 2009.

Insurers exposed: Plaintiffs getting their hands on policy documents

Written by Patrick Boardman, Special Counsel and Richard Bassingthwaighte, Solicitor

Tel 02 8273 9941 / 8273 9957
patrick.boardman@wottonkearney.com.au
richard.bassingthwaighte@wottonkearney.com.au

Details of a defendant's, or a prospective defendant's, insurance policy provides a degree of certainty about their ability to satisfy any judgment and also enables a claim to be drafted in a manner which maximises policy response.

The production of insurance documents pursuant to the discovery process has traditionally been refused on the grounds that the policy:

+ is not relevant to a fact in issue in the proceedings (and is not therefore discoverable); or
+ is protected by a confidentiality clause which is generally included in the policy wording.

This has resulted in plaintiffs, or prospective plaintiffs, seeking to challenge that 'traditional' discovery approach or utilise alternate means to obtain a copy of the relevant policy documents.

The Australian position

The 'traditional' discovery approach is set out in ***Beneficial Finance Corp Limited v PWC*** [1996] 60 SACR 19. In that case the Court considered the benefit of the tactical advantage to the plaintiff compared with the detriment to the defendant of having its confidential information in the public domain. The Court held that the insurance policy was not discoverable.

That approach has been followed in subsequent decisions and a Court usually only orders discovery of policy documents where the insurer is a party to the proceedings. However there have been exceptions to that rule (See ***Company Solutions (Aust) Pty Ltd v Kepple Cairncross Shipyard Limited*** [2004] QSC 379)[1].

In ***Style Limited in the matter of: Merim Pty Ltd v Style Limited*** [2009] FCA 314 Goldberg J of the Federal Court held that the applicant, as a shareholder of the company, was entitled to examine that company's directors and officers insurance policy as it fell within the definition of 'books' under section 247A of the **Corporations Act 2001** (**the Act**). Section 247A allows a shareholder to inspect a company's books in certain stipulated circumstances. The Court held that the shareholder was entitled to inspect the relevant insurance policy even though that may assist it in deciding whether or not to issue proceedings against the company or its directors.

An applicant took an alternate approach to accessing policy documents in the Federal Court decision of ***Lehman Brothers Australia*** →

1 Where the Court allowed the production of an insurance policy under the Queensland procedural rules on the basis that it was in the interests of justice and *"highly important to the practical issue of whether that litigation would proceed"*.

Limited v Wingecarribee Shire Council [2009] FCAFC 63. At first instance, Rares JA granted leave to the Council to review the insurance policy documents of Lehman Brothers on the basis that section 23 of the **Federal Court Act 1976 (Cth)** (**the FCA**) and the Court's inherent jurisdiction provided the Court with a discretion to make such an order so as to prevent the abuse, or frustration of, a Court process. The Council had argued that without access to the relevant policy documents it could not properly consider a proposed Deed of Company Arrangement (**DOCA**).

The Full Federal Court reversed that decision on the basis that Rares JA had erred in exercising his discretion because an understanding of the relevant DOCA did not require the disclosure of the relevant policy documents. Consequently there was no abuse of process which required Rares JA to exercise any discretion in that regard. Notably the Full Federal Court did not overturn Rares JA's decision on the basis that he did not have the requisite discretion, but merely that there was an error in the exercise of that power.

A similar application based upon the Court's discretion was heard in ***Kirby v Centro Properties Limited*** [2009] FCA 695. In that case there was an application brought under the Court's general discretion afforded by section 33ZF of the FCA and similar provisions of the Federal Court Rules on the basis that the relevant insurance documents were necessary for the parties to effectively participate in a mediation. Ryan J of the Federal Court disagreed and held that the insurance documents did not have to be produced.

The UK position

In contrast, the 'traditional' discovery position has been under attack in the UK. In ***Josh Harcourt v FEF Griffin*** [2007] EWHC 1500 QB the High Court of Justice Queen's Bench Division held that the production of documents was relevant to the proceedings notwithstanding that the insurer was not a party to proceedings and the production of the policy was not directly relevant to an issue in those proceedings.

The relevant UK procedural rules provided that the Court may order a party to give discovery to clarify a matter or give additional information at any time *"whether or not the matter is contained or referred to in a Statement of Claim"*. The Court held that the thrust of the rules was *"to avoid waste of time and cost and to ensure swift and, as far as possible, proportionate and economical litigation"*. It was held that the details of the defendant's insurance coverage was fundamental to the claimant's decision of whether, and in what way, to continue with the litigation against the defendant.

The UK trend towards putting *"all cards on the table"* was continued in ***West London Pipe Line Storage Limited v Total UK and Ors*** [2008] EWHC 1296 (Comm) in which Steel J held that the interests of the parties to the relevant proceedings (ie it provided security to the parties) was to outweigh the confidential provisions of the policy.

The UK trend is not all bad for defendants and their insurers. In ***Derrick Barr & Ors v Biffa Waste Services Limited; QBE Insurance (Europe) Limited (intervening insurers)*** [2009] EWHC 1033 (TCC) approximately 140 claimants, represented by Derrick Barr, were required to disclose the contents of their *"after the event"* insurance policy which operated in a similar manner as a litigation funding agreement. The defendant successfully argued that the presence of that cover was relevant to the progress of the proceedings and whether it was appropriate to consolidate the case with similar proceedings. The Court held that it was reasonable for the defendant to require production of the policy as the relevant information was critical to its security for costs application in the event that the proceedings were consolidated. →

Developments for insurers generally

Implications for insurers

Insurers ought to be concerned by the growing trend for Courts to grant access to insurance policies on the premise that insurance documents are relevant to determining issues beyond the strict facts in issue.

Although Australia is presently maintaining the 'traditional' discovery approach that policy documents are not relevant to a fact in issue (unless an insurer is joined as a party to the proceedings) it is clear that that approach is under threat and it must only be a matter of time before Australia adopts a position similar to that of the UK either by a broad interpretation of the relevant litigation procedural rules for discovery and/or by the Court finding that access to policy documents should be granted pursuant to its inherent discretion.

However Courts should be wary of adopting such an approach as:

+ if a party's financial standing is important it should apply to all parties, not merely those with insurance policies;
+ it is directly at odds with the confidential nature of insurance documents; and
+ it allows a case to be pleaded in such a manner as to maximise insurance coverage. This may mean that issues (which are relevant to insurance coverage principles - such as dishonesty) are not brought before the Court which is arguably against the 'interests of justice' for which the Courts seek to provide.

The decision in ***Merim Pty Ltd v Style Limited*** is the most significant decision as it will mean that any potential shareholder plaintiff will now be able to access relevant policy documents by reason of section 247A of the Act. We expect that prior to any shareholder class action there will now be an application pursuant to section 247A to access relevant policy documents.

The decisions in ***Lehman Brothers Australia Ltd v Wingecarribee Shire Council*** and ***Kirby v Centro Properties*** suggest that, at least for the present, Courts are willing to uphold the 'traditional' discovery approach regarding policy documents and that arguments of commercial necessity do not automatically justify their disclosure nor overcome the preservation of confidentiality provisions.

It is clear that plaintiffs are hungrier than ever to get insurance policies in their hands and insurers are more than ever having to justify the merit of keeping policy terms in their pocket. ■

QBE v Lumley: A restatement of contribution principles

Written by Gareth Horne, Solicitor
Tel 02 8273 9952
gareth.horne@wottonkearney.com.au

The decision of the Victorian Court of Appeal in ***QBE Insurance (Australia) Limited v Lumley General Insurance Limited*** [2009] VSCA 124 (**QBE v Lumley**) highlights that basic principles of justice and the desire of the courts to prevent unjust enrichment underlie the concept of contribution in insurance law. The decision also serves as a practical reminder that double insurance issues will often arise in the context of building and construction risks.

Background

Dabserv Pty Ltd (**Dabserv**), a tenant in commercial premises in Melbourne, contracted the fit out of its office to Probuild Constructions (Aust) Pty Ltd (**Probuild**). Commercial Interiors Australia Pty Ltd (**Commercial Interiors**) was sub-contracted by Probuild to undertake certain aspects of the fit out. During the course of the fit out an employee of Commercial Interiors accidentally dislodged and activated a flush sprinkler head in the ceiling of a meeting room causing damage to Dabserv's property and the fit out works (**the accident**).

Probuild held a Contract Works, Plant and Equipment and Third Party Liability policy with Lumley General Insurance Limited (**Lumley**) (**the Lumley Policy**). The schedule to the Lumley Policy defined "*Insured*" to include, among others, Probuild's sub-contractors. Commercial Interiors held a Commercial / Retail / Industrial policy with QBE Insurance (Australia) Limited (**QBE**) (**the QBE Policy**). The definition of "*Insured*" in the broadform liability section of the QBE Policy included Commercial Interiors and "*every principal*". Commercial Interiors did not know that it was covered under the Lumley Policy or that it was entitled to make a claim under the Lumley Policy.

On the day after the accident Probuild, through its broker, notified Lumley of the accident. Soon after, Commercial Interiors notified QBE of a claim arising from the accident. Some time later the adjustor appointed by QBE wrote to Lumley seeking clarification of whether the Lumley Policy would cover Commercial Interiors' liability to Dabserv. Lumley responded to that letter by confirming that the Lumley Policy would cover Commercial Interiors' liability, however, Lumley would be seeking contribution under the QBE Policy.

Probuild undertook the rectification works itself and was indemnified by Lumley for the costs of rectification after application of the deductible. QBE agreed that the costs of rectification were fair and reasonable. Lumley sought contribution from QBE in respect of the sum paid to Probuild for the costs of rectification, however, QBE refused to make a contribution. Lumley subsequently commenced proceedings against QBE seeking 50% of the sum paid to Probuild for rectification costs.

The decision at first instance

In his judgment at first instance Justice Pagone restated the principle in ***Albion Insurance Co Ltd v Government Insurance Office of New South Wales*** (1969) 121 CLR 342 that the issue of contribution involves an inquiry as to whether →

the payment of an insured's claim for indemnity by one insurer will provide the other insurer with a defence to a like claim.

His Honour also cited with approval the decision of Sackville J in ***Drayton v Martin*** (1996) 9 ANZ Ins Cas 61-32 where it was held that an insurer seeking contribution from a co-insurer under an indemnity policy must establish that:

+ it is liable to indemnify the insured under its own policy;
+ it has made payment in respect of that liability;
+ the co-insurer is liable to indemnify the insured under its policy; and
+ the co-insurer has not made payment in respect of its liability to the insured.

In applying the principles in ***Drayton v Martin*** His Honour held that QBE was liable to make contribution to Lumley in respect of Lumley's payment to Probuild.

Decision on appeal

QBE appealed the decision of Pagone J on 12 grounds. The principal issues in dispute included:

+ whether a claim for indemnity by Probuild under the Lumley Policy also amounted to a claim for indemnity by Commercial Interiors under the Lumley Policy;
+ whether Commercial Interiors was required to authorise or ratify cover being conferred on it under the Lumley Policy before double insurance could exist; and
+ whether the NSW Court of Appeal decision in ***AMP Workers Compensation Services (NSW) Ltd v QBE Insurance Ltd*** (2001) 53 NSWLR 35, that the time for determining whether there is double insurance is the time of the casualty, should not be followed in Victoria because that case involved issues of statutory law in New South Wales that do not apply in Victoria.

In its judgment the Court of Appeal also considered on whose behalf the rectification costs were paid by Lumley. The Court of Appeal upheld the decision at first instance and determined, on the facts, that Lumley's payment of the rectification costs was made on behalf of Commercial Interiors to discharge its liability in tort to Dabserv.

Implied notification

In their joint judgment Neave JJA, Dodds-Streeton JJA and Kyrou AJA agreed with the finding at first instance that the claim for indemnity made by Probuild under the Lumley Policy also constituted a claim for indemnity by Commercial Interiors under the Lumley Policy. In particular, their Honours agreed with the reasoning of Pagone J that Probuild notified 'the incident' as a whole and, in circumstances where QBE was aware that Commercial Interiors' liability to Dabserv was being treated as an insured risk under the Lumley Policy, it could be inferred that QBE acquiesced to Commercial Interiors having provided notification under the Lumley Policy.

The joint judgment noted that section 54 of the **Insurance Contracts Act 1984 (Cth)** (**the ICA**) would apply if it was ultimately held that Commercial Interiors was obliged to, but had not, notified Lumley of its claim for indemnity under the Lumley Policy. The effect would be that Lumley could reduce the amount payable under the policy in respect of the claim for any prejudice suffered. Their Honours held, on the facts of the case, that it was difficult to see what (if any) prejudice had been suffered by Lumley.

Ratification of cover

During the appeal QBE submitted that Pagone J erred in finding that Commercial Interiors did not have to authorise or ratify cover being conferred on it under the Lumley Policy. In particular, it was submitted that section 48 of the ICA and the decision in ***Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*** (1988) 165 CLR 107 had the effect that Commercial Interiors had to take positive steps to "*engage*" the Lumley Policy. →

The joint judgment rejected QBE's submission and held that neither the language nor the underlying purpose of sections 48 or 76 of the ICA required Commercial Interiors to ratify its inclusion as an insured as a pre-condition to enforcing its rights under the Lumley Policy.

Timing of double insurance

In ***AMP v QBE*** the NSW Court of Appeal held that the payment of a joint liability by one co-insurer cannot defeat the right of contribution, and therefore the right of contribution does not depend on the state of affairs that exist after a payment has been made. That led the court to the conclusion that the question of double insurance should be determined at the time of the casualty, in accordance with the principle outlined by the High Court of Australia in ***Albion***.

The court in ***AMP v QBE*** also held that a co-insurer should not be allowed to be unjustly enriched simply because the insured decides to make a claim under the other co-insurer's policy.

QBE submitted that the decision in ***AMP v QBE*** should not be followed for a number of reasons including that it involved law specific to New South Wales.

The joint judgment in ***QBE v Lumley*** disagreed with that submission and held that the question of double insurance should be determined at the time of the casualty giving rise to the insured's loss or liability. In reaching that conclusion their Honours added that the approach adopted in ***AMP v QBE*** is consistent with the underlying rationale and purpose of principles of contribution because it:

+ prevents unjust enrichment of a co-insurer in circumstances where the insured fortuitously makes a claim for indemnity under a policy with the other co-insurer; and
+ removes the potential incentive to reject or delay payment of claims in the hope of avoiding contribution.

Comment

While the judgment of the Victorian Court of Appeal in ***QBE v Lumley*** does not change the law on double insurance, it clarifies that double insurance should be determined at the time of the casualty. The joint judgment also provides an effective and thorough restatement of the issue of contribution and its underlying equitable principles.

The dispute in ***QBE v Lumley*** arose in the context of building works being performed by a head contractor and its sub-contractor. While the judgments at first instance and appeal address very specific principles of contribution, the case provides a practical reminder to claims personnel that issues of double insurance will often arise in the context of building and construction risks. Insureds in the building and construction industries should also be alive to the possibility that they might be covered by a third party's policy in the event of a claim. ■

ACE v Moose: Enforcing the jurisdictional bargain

Written by Adam Chylek, Partner
Tel 02 8273 9940
adam.chylek@wottonkearney.com.au

The interpretation of choice of law and jurisdiction clauses in commercial contracts represents an area of growing significance as contractual relationships increasingly transcend jurisdictional boundaries. The issue is of particular relevance to insurers extending cover for claims that might arise in foreign jurisdictions. The recent decision of the Supreme Court of New South Wales in ***ACE Insurance Limited v Moose Enterprise Pty Ltd*** [2009] NSWSC 724 (**ACE v Moose**) provides important guidance on the interpretation and application of choice of law and jurisdiction clauses, and the application of equitable principles to determine when the institution of foreign proceedings will be deemed unconscionable, vexatious and oppressive.

Background

Wotton + Kearney acts for ACE Insurance Limited (**ACE**), the insurer of Moose Enterprise Pty Ltd (**Moose**) pursuant to a public and products liability policy (**the Policy**) issued by ACE's Perth office. ACE and Moose are Australian entities.

Moose develops toys for sale to Australian retailers and foreign distributors. In 2007 Moose announced a voluntary recall of its *Bindeez Beads* product after batches were allegedly found to have contained a toxic substance. Following the voluntary recall of the *Bindeez Beads* product, known as *Aqua Dots* in North America, various class actions were commenced in several United States jurisdictions against Moose and others. Moose made a claim for indemnity under the Policy. There is a relevant issue as to whether the various class actions in the United States trigger the Policy.

In December 2008 Moose, without notice, commenced declaratory proceedings against ACE in the San Francisco Superior Court (**Californian Proceedings**). The Californian Proceedings alleged, among other things, that ACE had a "*duty to defend*" Moose under Californian municipal law so long as there was a *possibility* that its claim for indemnity might be covered under the Policy. ACE sought and obtained an ex parte injunction from the Supreme Court of New South Wales shortly after being informed of the Californian Proceedings. The temporary injunction restrained Moose from taking further steps in the Californian Proceedings until ACE's application for a permanent anti-suit injunction was determined.

Policy

Clause 4.11 of the Policy provided that:

"Should any dispute arise concerning this policy, the dispute will be determined in accordance with the law of Australia and the States and Territories thereof. In relation to any such dispute the parties agree to submit to the jurisdiction of any competent court in a State or Territory of Australia."

The Expona Endorsement to the Policy contained the following proviso:

"Provided that all claims which fall under the terms of this endorsement, it is agreed:

+ *the limits of liability are inclusive of costs as provided under supplementary payment in this policy.*
+ *that should any dispute arise between the insured and ACE over the application of* →

this policy, such dispute shall be determined in accordance with the law and practice of the Commonwealth of Australia."

Jurisdiction

In ***CSR Limited v Cigna Insurance Australia Limited*** (1997) 189 CLR 345 (**CSR v Cigna**) the High Court of Australia held that an injunction may be granted in aid of a contractual promise not to sue in a foreign jurisdiction, for example, where the parties agree to submit to the exclusive jurisdiction of the courts of the forum.

ACE submitted that Clause 4.11 of the Policy constituted an exclusive jurisdiction clause and that the Expona Endorsement aided in that construction. Justice Brereton considered that the Expona Endorsement did not aid the construction of Clause 4.11 because the Expona Endorsement was a choice of law clause not a choice of jurisdiction clause and the term "*practice*" meant insurance practice not court practice.

In terms of Clause 4.11 itself, His Honour reviewed a long line of authorities where jurisdiction clauses have been interpreted and held that Clause 4.11 did amount to an exclusive jurisdiction clause. In reaching that conclusion His Honour cited with approval the judgment of Giles J in ***FAI General Insurance Co Ltd v Ocean Marine Mutual Protection & Indemnity Association Ltd*** (1997) 41 NSWLR 117 and concluded that:

- while the absence of the word "*exclusive*" in not determinative, it will weigh against the clause being held to be an exclusive jurisdiction clause;
- where the courts of the forum selected by the jurisdiction clause will have jurisdiction, that will weigh in favour of a clause being an exclusive jurisdiction clause;
- jurisdiction clauses in insurance contracts are treated the same as jurisdiction clauses in other contracts except in the case of ambiguity where the clause will ordinarily be construed against the insurer; and
- the use of mandatory words such as "*shall*" in a jurisdiction clause weigh in favour of the clause being held to be exclusive in nature.

His Honour added that there was a *"particularly strong case"* for Clause 4.11 to be interpreted as intending more than providing for the non-exclusive jurisdiction that existed in circumstances where ACE and Moose are Australian entities, the Policy was issued in Australia, the Policy is governed by Australian law, and Australia is the "*natural forum*" for disputes under the Policy.

Breach of implied negative stipulation in the Policy

ACE also submitted that, by instituting the Californian Proceedings in an attempt to apply Californian law to the Policy, Moose was in breach of an implied contractual obligation not to invoke the jurisdiction of a court which would apply a law other than the law referred to in the choice of law clause. Justice Brereton rejected that submission on the basis that the choice of law clause in the Policy was declaratory not promissory in nature. However, His Honour added that, with the use of very clear language, a choice of law clause could be made promissory rather than declaratory so that there could arise an implied contractual obligation not to sue in a jurisdiction that would apply a different law.

Vexation and oppression

One of Moose's central submissions was that the San Francisco Superior Court would apply Californian law to the Policy and, in particular, impose on ACE a "*duty to defend*" which does not arise under Australian law. That would, in effect, provide Moose with a benefit not available in local proceedings.

In ***CSR v Cigna*** the High Court observed that foreign proceedings will only be vexatious, oppressive or unconscionable if there is nothing to be gained by them over and above what could be gained in local proceedings. In ***ACE v Moose***, Justice Brereton referred to the →

decision of Goff LJ in ***Bank of Tokyo Ltd v Karoon*** [1987] AC 45 (**Bank of Tokyo**) where it was noted that the criteria for establishing that foreign proceedings are vexatious, oppressive or unconscionable *"was very rarely fulfilled"*.

Justice Brereton held that, notwithstanding the comments of Goff LJ in ***Bank of Tokyo***, the decision by Moose to commence the Californian Proceedings was vexatious, oppressive and unconscionable and California was a clearly inappropriate forum for the declaratory proceedings. His Honour reached that conclusion with reference to the choice of law, the jurisdiction clause, the location of ACE and Moose, the fact that the Policy was issued in Perth, and the very faint connection with California.

Comment

The judgment of Justice Brereton in ***ACE v Moose*** has significance in the areas of private international law, contract law and insurance law. Insurers will take some comfort from the fact that remedies such as anti-suit injunctions are both available and attainable where insureds seek to flout the jurisdiction and choice of law clauses in an insurance contract. Insurers should be mindful, however, that the absence of the word "*exclusive*" in a jurisdiction clause will tend against the clause being deemed an exclusive jurisdiction clause leaving the insurer vulnerable to being sued in foreign jurisdictions. ■

wotton kearney
insurance lawyers

Australian court gives effect to the term 'retroactive date'

Written by Charles Simon, Partner and Clare Branch, Senior Associate

Tel 02 8273 9911/ 8273 9938
charles.simon@wottonkearney.com.au
clare.branch@wottonkearney.com.au

On 19 December 2008, Justice McDougall delivered judgment in the Supreme Court of NSW in ***Towry Law v Chubb Insurance & Ors*** [2008] NSWSC 1352**.** The decision concerned the construction of a composite policy of insurance written under a Jumbo line slip and underwritten by twenty seven insurance companies and Lloyd's Syndicates (**the Underwriters**) in separate proportions for the period 31 December 1999 to 31 December 2002.

Background to dispute

The plaintiffs, Towry Law plc and UKFP (Asia) HK Limited (collectively the **Towry Law Parties**) became subsidiaries of AMP during the currency of the policy.

Towry Law sought indemnity pursuant to the professional indemnity section of the subject policy relevant to damages paid to investors under a Hong Kong compensation scheme as a result of alleged mis-selling by the Towry Law Parties of a number of funds to its clients. The claims arose from matters which occurred before the Towry Law Parties became subsidiaries of AMP. Underwriters denied indemnity to the Towry Law Parties on the basis of a retroactive date which applied under the policy to subsidiaries acquired during the policy period (the retroactive date being the date of the acquisition as set out in General Condition 12(B) of the policy).

The question of indemnity hinged on three fundamental issues:

+ whether, on the proper construction of the policy, General Condition 12(B) operates to impose a retroactive date exclusion or limitation on any cover provided under the professional indemnity section of the policy to a subsidiary acquired after 31 December 1999;
+ if the policy were to be constructed in a manner contended for by the Towry Law Parties, whether Underwriters were entitled to rectification of the policy such that it would provide that a company acquired by AMP during the period of insurance was not entitled to be indemnified in respect of claims arising out of events that occurred before the date of acquisition unless Underwriters expressly agreed otherwise (**the rectification argument**); and
+ whether, as an alternative to the rectification argument, Underwriters conducted themselves on the basis that the policy, regardless of its proper construction, had the effect of excluding claims arising out of events that occurred before the date of acquisition so that a conventional estoppel arose (t**he estoppel argument**). Underwriters asserted that they would suffer detriment if the Towry Law Parties were permitted to assert rights inconsistent with →

the terms of the conventional assumption on which Underwriters and AMP had conducted their affairs.

General Condition 12(B) was a term of the policy whereby, on certain conditions, "*acquisitions made by [AMP] will be automatically covered…*". Debate turned on a sentence in General Condition 12(B) which provided that "*The Retroactive Date in respect of the acquisition to be the date of the acquisition or to be agreed by Underwriters*".

Judgment

There was common ground between the parties that, so far as questions of subjective intention or understanding of the Underwriters were relevant, the intention or understanding of the following market was to be ascertained by reference to the intention or understanding of the leading underwriters who made the declarations. This obviated the need to call evidence from all 27 underwriters relevant to the rectification argument.

It was also common ground between the parties that the Court was concerned to ascertain the "*objective intention"* of the parties insofar as that intention appeared from the terms in which the parties agreed their contract and other matters to which the Court may have had regard. Those matters included the purpose and object of the transaction, namely, what, in a commercial sense, the parties were seeking to achieve by it.

It is trite law that the term in question was to be given the meaning which a reasonable person, having the background knowledge of the parties at the time of the agreement, would understand it to have from the language used by the parties: ***Pacific Carriers Limited v BNP Paribas*** (2004) 218 CLR 461-462. In undertaking the construction of the term, the Court determined that it should take into account the purpose that reasonable persons in the position of the parties would have. To do this, the Court should have regard to the genesis of the transaction, the background to it, its context and the market in which it was made: ***Zhu v Treasurer of the State of NSW*** (2004) 218 CLR 530 at 559.

In essence, the Court found in favour of the Underwriters on the questions of construction, rectification and estoppel.

"Retroactive Date"

The Court analysed the inter-relationship between an "*Assured*" and General Condition 12(B) of the policy. The Court held that the effect of the proviso to the definition of Assured in the policy was that an after-acquired subsidiary must meet the conditions spelled out in General Condition 12(B) before it could fall within the class of "*Assured*" so as to become entitled to the benefit of indemnity under the relevant insuring clause. General Condition 12(B) extended to after-acquired subsidiaries meeting the criteria expressed in the clause.

In General Condition 12(B) the words *"Retroactive Date"* were held to be related to *"the acquisition"*. In such a context, the phrase *"the acquisition"* referred back to the introductory words of the clause *"…acquisitions made by the Assured"*. Such usage suggested that the automatic cover provided to such acquisitions was qualified by a retroactive date for each acquisition: the date of acquisition unless otherwise agreed.

The Court recognised however that the problem was not able to be solved merely by the application of linguistic analysis. Ultimately, it was necessary to look to the intention of the parties in order to determine the proper interpretation of the policy.

The Court acknowledged that the information provided to Underwriters in respect of AMP and Underwriters' ability to request more information, and analyse the information given, underpinned Underwriters' decision to accept the risk, subject only to the protection offered by the "*Discovery Limitation Clauses*" in the policy. The Court recognised that Underwriters would not be given equivalent information in respect of subsidiaries acquired by AMP during the period of insurance. Thus, at the moment upon which cover attached →

to an acquisition, the Court acknowledged that one would not expect Underwriters to be in possession of any information at all, let alone information sufficient to allow them to assess the risk of offering cover on a retroactive basis.

The Court recognised that Underwriters would be prepared to offer automatic cover in respect of acquisitions from the date of acquisition. The Court recognised, however, that it did not follow that Underwriters would have been prepared to take on, as well, the risk that any due diligence undertaken by AMP was sufficient to remove the risk of claims arising out of the activities of acquired companies prior to acquisition.

The Court opined that the intention of the parties, objectively ascertained, was to ensure that the automatic coverage extended to acquisitions by General Condition 12(B) did not of itself oblige Underwriters to accept an obligation to indemnify the acquired entity for claims arising from matters that occurred before the date of acquisition. The Court opined that such a finding might explain why, in General Condition 12(B), the concept of any *"Retroactive Date"* was linked to *"the acquisition"* rather than to *"loss"* (as was the case elsewhere in the policy).

Ultimately, the Court found that an acquired entity's inclusion in the class of an *"Assured"* was expressly made *"subject to"* the retroactive date, unless Underwriters agreed otherwise.

Rectification

Given the Court's findings on the question of construction, it was not necessary for the Court to consider Underwriters' arguments for rectification. Nevertheless, the Court made certain findings in the event that an appeal is pursued by the Towry Law Parties. The Court found that were it necessary to express a concluded view on rectification, it would have concluded that General Condition 12(B) should be rectified so as to impose a retroactive date exclusion or limitation on any cover provided under the professional indemnity section of the policy to a subsidiary acquired after 31 December 1999.

Estoppel

Similarly, given the Court's conclusions on the question of construction, it was not necessary to deal with the issue of estoppel. Again, the Court found that if it were necessary to deal with the question of estoppel, it would have found in favour of the Underwriters. The Court found that Underwriters would suffer prejudice if the Towry Law Parties or AMP were permitted to depart from the assumption that General Condition 12(B) operated such that automatic coverage extended to a relevant acquisition (during the currency of the policy) would not provide indemnity for claims arising out of events that occurred before the date of acquisition unless Underwriters expressly agreed to this.

Implications

Although the findings are based on facts specific to the case, the judgment represents a sound and careful analysis of a wide range of issues relating to the interpretation of policies of insurance. It also provides an insight into the manner in which an Australian court was prepared to adopt the industry meaning of the term "*retroactive date*" and the manner in which the Court accepted the commercial purpose of a clause inserted by Underwriters to limit their exposure in circumstances where they did not have any relevant underwriting information for their consideration in making a decision or assessing a risk of a new subsidiary.

Justice McDougall's decision was closely reasoned and examined in some detail, with particular focus on the issues of policy construction, rectification and estoppel.

Nino v MLC Ltd [2009] NSWSC 400:

Interest under the Insurance Contracts Act

Written by Matthew Foglia, Special Counsel

Tel 02 8273 9905
matthew.foglia@wottonkearney.com.au

This case concerned a plaintiff's claim for interest pursuant to section 57 of the **Insurance Contracts Act 1984 (Cth)** (**the ICA**).

Facts

The plaintiff in ***Nino v MLC Ltd*** [2009] NSWSC 400 held a policy covering permanent total disablement.

The plaintiff made a claim on the policy on 23 February 2003, which the insurer declined in May 2003 on the basis that the plaintiff, a teacher, was still able to continue to work as a teacher on a casual basis.

After several years of further examinations by a number of doctors, with conflicting results, the insurer finally accepted and paid the claim on 25 July 2008.

The plaintiff claimed interest pursuant to s 57(2) of the ICA for the period of time commencing on the day on which it was unreasonable for the insurer to have withheld payment of the claim.

It is apparent that the plaintiff suffered a back injury from lifting children and ceased her employment with the Department of Education in 2001. She thereafter engaged in casual teaching work for between 6-8 hours per week.

The decision

White J relied on the comments of Cole J in ***Bankstown Football Club Ltd v CIC Insurance Ltd*** as the applicable principles for applying section 57(2) of the ICA:

"A reasonable period is to be given to the insurer to investigate and determine its position. But if it adopts an incorrect position in relation to its obligations to pay under the policy, that, in my view, does not mean that simply because that incorrect position is adopted on a bona fide basis, it becomes reasonable for the insurer to decline to pay the sums otherwise due. That seems to be the correct interpretation of s 57(2), particularly in circumstances of s 57(1) of the Act, where an insurer is liable to pay a person an amount under a contract of insurance."

White J considered significant the fact that the insurer ultimately accepted liability for the claim:

"*I proceed on the basis that the defendant does accept that it was liable to pay the amount which it ultimately paid. This is relevant because the basis on which the defendant at least initially rejected the claim was one which it could bona fide have adopted as to the proper construction of the policy, but to which it ultimately did not adhere. Had it adhered to that construction, and had it been correct, then the plaintiff would not have been entitled to the benefit sought.*" →

The insurance policy defined the expression 'Total and Permanent Disability Benefit' to mean: "*the Sum Insured payable to the Policy Owner in the event of the Life Insured's total inability – resulting from injury, sickness or disease – to carry out the normal duties of his or her usual occupation for a period of six (6) consecutive months, and NAFM is of the opinion that the Life Insured is unable ever to perform any gainful occupation for which the Life Insured is reasonably fitted by training, knowledge or experience.*"

While the policy did not define the term "*gainful occupation*", it did define the term "*Gainfully Employed*" (which was relevant to other clauses in the policy) to mean "*the continued employment of the Life Insured for a minimum of 30 hours per week*".

It appears that the insurer initially declined the claim because the plaintiff was able to perform a gainful occupation (that is, 6-8 hours a week of casual teaching). As the insurer did not adhere to this construction of the policy (particularly the undefined term gainful occupation), White J concluded that "*in considering the reasonableness of the time for the defendant to consider the claim, I proceed on the basis that the policy responded if the plaintiff could not be gainfully employed for at least 30 hours per week.*"

In the circumstances, White J concluded that a period of three months from the making of the claim on 15 February 2003 was a reasonable period for the insurer to have conducted an investigation. His Honour therefore awarded interest for the period from 15 May 2003 to the date the claim was paid on 25 July 2008.

Implications

There are a number of reasons why an insurer may pay a claim in circumstances where there may be bona fide reasons to dispute indemnity for the claim. Where this occurs, the insurer would be well served to avoid admitting liability for the claim and to instead structure the payment in such a way so as to minimize the possibility of an exposure for interest. If appropriate, given the duty of utmost good faith, an insurer would benefit from negotiating a release as part of the settlement or offering to pay the claim on a no admission of liability basis. ■

Tidswell Financial Services Ltd v Sovereign Capital Ltd [2009] FCA 582

Written by Matthew Foglia, Special Counsel

Tel 02 8273 9905
matthew.foglia@wottonkearney.com.au

In this matter before the Federal Court in South Australia, the plaintiff settled its claim against the defendants. The defendants, however, had a third party claim against their insurer for indemnity in relation to the plaintiff's claim against them. While both the defendants and the third party agreed that the proceedings should be transferred from the South Australia registry of the Federal Court, a dispute arose between them as to the Registry to which the proceedings should properly be transferred.

By notice of motion seeking a change of venue pursuant to section 48 of the **Federal Court of Australia Act 1976 (Cth)** (**the Act**), the third party (ie the insurer) argued that the proceedings should be transferred to the Sydney Registry, while the defendants (ie the insured) argued in favour of a transfer to the Brisbane Registry.

In the primary proceedings, the plaintiff's claim against the defendants related to an investment undertaken by the first defendant on behalf of various investors, including the plaintiff. The relevant investment was the provision of mortgage funds by the first defendant to Diamond Bay Construction Pty Ltd for the purchase and development of properties in Vaucluse, Sydney.

In the third party action, the insurer defended against the claim for indemnity on the basis of alleged misrepresentations by the defendants in relation to the Diamond Bay development.

The insurer argued that Sydney was the more appropriate venue because:

+ the development at issue was based in Sydney;
+ the directors of Diamond Bay Construction Pty Ltd were all based in Sydney;
+ the solicitors retained to act in the purchase of the property and the finance broker were all based in Sydney; and
+ the builder involved in the construction of the development at issue was based in Sydney.

In contrast, the defendants argued that Brisbane was a more suitable venue because the first defendant was a company based in the Gold Coast and the second, third and fourth defendants were all persons based in the Gold Coast.

Besanko J relied on ***National Mutual Holdings Pty Ltd v Sentry Corporation*** (1988) 19 FCR 155 for the well known test applied under section 48 of the Act: →

"*The factors which the Court is entitled to take into account in considering whether one city is more appropriate than another … are numerous. The Court must weigh those factors in each case. Residence of parties and of witnesses, expense to parties, the place where the cause of action arose and the convenience of the Court itself are some of the factors that may be relevant in particular circumstances. Ultimately, the test is: where can the case be conducted or continued most suitably bearing in mind the interests of all the parties, the ends of justice in the determination of the issues between them, and the most efficient administration of the Court. It cannot and should not, in our opinion, be defined more closely or precisely*."

His Honour concluded that, although the case was finely balanced, the fact that the proceedings raised issues concerning a transaction and development in Sydney meant that the New South Wales Registry rather than the Queensland Registry was a more convenient place for the proceeding to be conducted and continued.

Implications

It is important to remember that the most appropriate venue for an indemnity dispute is not necessarily the same as the venue for the underlying claim. ■

When is circumstantial evidence sufficient to prove fraud?

Written by Hannah Keane, Solicitor
Tel 02 8273 9983
hannah.keane@wottonkearney.com.au

The recent decision of Justice Rolfe in ***West End Aeronautical Plc v QBE Insurance (Australia) Limited*** [2009] NSWDC 18 provides a useful illustration for insurers seeking to rely on the defence of fraud when only circumstantial evidence is available.

Facts

Network Welding Pty Ltd (**Network Welding**) was a steel fabricator for the building industry. QBE insured Network Welding's contents and stock for $700,000.

The directors of Network Welding were Mr and Mrs Paulo. Network Welding owed money to the plaintiff, West End Aeronautical Plc (**West End**), which was owned and controlled by Mrs Paulo's brother-in-law, Mr Lopez (**Lopez**).

During the policy period, a fire occurred at Network Welding's premises causing damage to its stock and contents. Network Welding was thereafter placed into administration. West End, as a secured creditor, brought proceedings against QBE asserting its rights to monies payable under the QBE policy to Network Welding.

The fire inspector concluded (and neither party disputed) that the fire was deliberately lit to destroy Network Welding's premises and its contents because:

+ the fire and burn damage patterns indicated that there were 2 seats of fire in different areas of the premises;
+ flammable liquid had been used to enhance the spread of fire in both seats;
+ both deadlocks on the rear door of the premises were unlocked and a steel cross-bar used for securing the door had been removed and was lying against the wall on the ground;
+ a steel bar frame in a toilet window had been cut with an oxy-acetylene torch but the bars had been pulled inward and the window was shut; and
+ the CCTV security recorder had been removed.

Decision

QBE argued that it was not liable to indemnify Network Welding under the policy because of Network Welding's fraud, non-disclosure and/or breach of policy conditions. Justice Rolfe confined his decision to the defence of fraud.

Justice Rolfe held that QBE had the burden of proving fraud and that the standard of proof is the balance of probability, *"but the degree of probability must be commensurate with the occasion and be proportionate to the subject matter"* (i.e. the burden of proof is high for fraud). In doing so His Honour followed well established precedent (see ***Briginshaw v Briginshaw*** (1938) 60 CLR 336, ***Rejfek v McElroy*** (1965) 112 CLR 517 and ***Neat Holdings Pty Ltd v Karagan Holdings Pty Ltd*** (1992) 110 ALR 449). →

As there was no direct evidence linking Paulo or his family to the fire, QBE was forced to rely on circumstantial evidence to make out its case. QBE argued, and Justice Rolfe accepted, that relevant factors to be taken into account included motive and opportunity.

Justice Rolfe considered the following circumstantial evidence to be relevant in finding for QBE on the basis that the claim was fraudulent:

+ Network Welding was in serious financial difficulty at the time of the fire and was in fact insolvent with no capital to fund operations.
+ Paulo had a *"real motive"* for burning down the premises because a successful claim under the policy would enable Paulo to trade the company out of its difficulties and allow it to repay West End.
+ Paulo had the opportunity to start the fire.
+ Paulo was a critical witness but West End failed to call Paulo, preventing cross-examination.
+ Paulo had made an earlier workers compensation claim following a car accident, alleging that he was disabled and totally incapacitated for work, when the evidence indicated that he was actively involved in the running of the business. The Court found a pattern of dishonesty on Paulo's part.

Implications

Courts are understandably very reluctant to find fraud especially when there is no direct evidence linking an insured to the incident which triggers the policy. That is so even when insurers might feel that common sense would dictate that a claim is fraudulent. There is accordingly a high evidentiary onus placed on insurers which can be notoriously difficult to overcome.

The West End decision illustrates:

+ that Courts are prepared to refuse a claim on the basis of fraud established by circumstantial evidence;
+ the importance of proving motive and opportunity; and
+ the value of a proper and thorough investigation by the insurer of the claim and all surrounding circumstances.

Chief Commissioner of State Revenue v Qantas Airways Ltd [2009] NSWCA 163

Written by Catherine Osborne, Partner and Matthew Foglia, Special Counsel

Tel 02 8273 9930/ 8273 9905
catherine.osborne@wottonkearney.com.au
matthew.foglia@wottonekearney.com.au

This case involved the interpretation of the **Duties Act 1997 (NSW)** (**the Duties Act**) and in particular whether, on the basis of the Duties Act as it existed between August 2001 and March 2006, duty was properly chargeable to insureds who paid premiums to general insurers who were not registered insurers under the **Insurance Act 1973 (Cth)** (**the Insurance Act**).

Facts

Between August 2001 and March 2006, Qantas was assessed with more than $5 million in duty on premiums that it paid on global insurance policies to insurers who were not registered under the Insurance Act.

Qantas objected to the assessment and the objections were disallowed. This case arose as an appeal by Qantas of the Chief Commissioner's decision to disallow the objections.

At first instance, Handley AJ of the Supreme Court ruled in favour of Qantas. In a unanimous decision, the Court of Appeal upheld that finding in favour of Qantas.

By way of background, the Duties Act as it existed prior to 2006 contained the following sections in Part 1 of Chapter 8:

+ Section 229 charges *"duty on the amount of the premium paid in relation to a contract of insurance that effects general insurance…"*.
+ Section 231 provides that "*Premium, in relation to general insurance, means the total consideration given to an insurer…*".
+ Section 235 places liability for payment of the duty upon the general insurer, subject to section 236 which requires "*a person who obtains, effects or renews any general insurance as an insured person with a person who is not a registered insurer*" to lodge a return with, and to pay the relevant duty to, the Chief Commissioner.

Part 3 of Chapter 8 of the Duties Act which relates to "*How is duty paid by an Insurer?*" contains section 247(2) which defines a general insurer as a person:

+ who writes general insurance, and
+ who does so otherwise than as an insurance intermediary, and
+ who is authorised as a general insurer under the **Commonwealth Insurance Act 1973**.

The Dictionary to the Duties Act defines the term "*Insurer*" as having the meaning given by section 247. →

Significantly, section 6 of the Duties Act provides that "*words and expressions used in this Act (or any particular provision of this Act) that are defined in the Dictionary at the end of this Act have the meanings set out in the Dictionary*".

The issue in dispute and the rationale for the Court's decision

The only issue that was in dispute was whether Part 1 of Chapter 8 of the Duties Act (that is, the charging of duty on premiums) operates in respect of all general insurers or only those insurers within the definition of "*insurer*" as that term is defined in section 247 (that is, insurers registered under the Insurance Act).

McFarlan JA, with whom Ipp JA and Campbell JA agreed, concluded that the Dictionary definition of Insurer applied with the result that duty could only be charged on premiums paid to insurers registered under the Act:

"The definition of 'Insurer' in the Dictionary and the applicability by s 6 of that definition to the whole of the Act including Pt 1 of Ch 8 is stated plainly and unambiguously. As the words in the Act itself when read literally are not capable of bearing the meaning that [the Chief Commissioner] wishes to attribute to them, it would be necessary for the Chief Commissioner to show that application of the ordinary meaning would produce absurdity or at least departure from clear legislative intent. This he has not done."

Implications

While the issue raised in this case will no longer arise under the current form of the Duties Act (as that Act has since 2006 been clear that insureds are responsible for paying duty on the premiums paid to insurers who are not registered under the Insurance Act), this decision will likely have insureds reviewing their pre-2006 arrangements with unregistered insurers to determine whether they are entitled to significant tax refunds.

Terms of an insurance policy: Where does the onus of proof lie?

Written by Olympia Samolis, Senior Associate

Tel 02 8273 9935
olympia.samolis@wottonkearney.com.au

The decision of the NSW Court of Appeal in ***QBE Insurance (Australia) Ltd v Stewart*** [2009] NSWCA 66 provides guidance on which party bears the onus of proving the limit of indemnity under an insurance policy where the policy documents are no longer in existence.

Background

Mr Stewart (**Stewart**) commenced proceedings against QBE Insurance (Australia) Limited (**QBE**), the workers' compensation insurer of Pilkington Bros (Australia) Limited (**Pilkington**) by whom Stewart was employed from 1964 to about 1967, and Wallaby Grip Limited (**Wallaby Grip**) as the supplier of asbestos products.

During the course of his employment with Pilkington, Stewart was exposed to asbestos fibre which resulted in his development of the deadly lung condition, mesothelioma. Stewart's widow was appointed the legal personal representative of his estate and was substituted as the plaintiff in the proceedings.

The matter was heard at first instance in the Dust Diseases Tribunal of NSW (**the DDT**). It was clear that there was a policy of insurance in place, and this was admitted by QBE. What was in dispute, however, was the extent of the liability under the policy.

At the relevant time, s18(1) of the **Workers Compensation Act 1926 (NSW)** provided that every employer was required to obtain a policy of insurance for an amount of at least $40,000 in respect of its liability for any injury to its workers.

Decision at first instance

In the DDT proceedings, it was inferred that the policy issued by QBE to Pilkington provided cover for at least $40,000. This was admitted and no evidence was led of any variation to this.

Stewart argued that the onus was on QBE to prove the terms of the policy and there having been no evidence led regarding the limit of the policy, it was argued that cover was unlimited.

The DDT held that the onus of proving the limit of the policy lay with the party asserting the limit. In the absence of evidence from QBE, the DDT held that the onus was on QBE to prove that the policy was not unlimited.

The DDT applied ***Di Cecco v Mercantile Mutual Insurance (Workers' Compensation) Limited*** (2002) 23 NSWCCR 143 where like this case there was no evidence of a policy, there was no further evidence led and Curtis J held in clear terms that the insurer bore the onus of establishing the policy was limited in its cover. The DDT was of the view that the insurer should be able to produce evidence to show the limit of a policy even if the primary documents were no longer available. →

Decision on appeal

QBE appealed on two aspects. Firstly it appealed the finding that Pilkington was negligent in the absence of evidence demonstrating that an alternative system of work obviating the risk of injury was available. More relevantly, however, QBE appealed the extent of its liability to Stewart under the policy.

The Court of Appeal held unanimously that the evidence supported a finding of negligence against Pilkington. In relation to the extent of liability point, by majority, the Court of Appeal found in favour of QBE, setting aside the DDT's decision.

QBE submitted that the trial judge erred in law in imposing an onus upon it to prove an element of the plaintiff's case. In its defence, QBE "*did not admit*" this critical term of the policy. It was submitted that the onus was then on Stewart to prove that aspect of his case.

The Court of Appeal cited with approval ***BI (Contracting) Pty Ltd v Strikwerda*** [2005] NSWCA 288 where Mason cited the following statement from McCormak on Evidence, 5th Ed at 388: "*Very often one must plead and prove matters as to which his adversary has superior access to the proof*". He went on to say:

"*But the point remains that a party bearing the persuasive burden who seeks to cast the evidentiary burden on the other party must point to something out of the ordinary or to compelling precedent. None exists in the present case.*"

The Court of Appeal was of the opinion that the same could be said of this case. It held that the trial judge fell into error in following ***Di Cecco*** and in holding that the onus lay with QBE to prove against unlimited cover. It held that cover was limited to $40,000 and that the ultimate onus lay with Stewart and that no evidentiary onus arose to alter the situation.

Implications

The decision of the Court of Appeal reinforces the principle that the onus of proof lies with the party making an assertion. Given that the existence of insurance and the terms of the insurance policy were elements of Stewart's case, the onus of proving these elements therefore lay with him.

It is a significant decision for insurers which carry liabilities under old insurance policies for which documents may no longer be in existence. It remains to be seen how the Courts will deal with a similar case where there is no prescribed statutory minimum level of cover to which regard can be had.

Stewart and Wallaby Grip have obtained special leave to appeal to the High Court on the insurance point. Wallaby Grip's interest is significant in that the outcome affects its proportion of damages owed to Stewart, it being jointly and severally liable with QBE.

Given the Court of Appeal's decision contained a strong dissenting judgment on the issue the High Court may be interested in granting special leave.

Section 6 actions against insurers: A low bar for claimants

Written by Anthony Bagnette, Solicitor
Tel 02 8273 9960
anthony.bagnette@wottonkearney.com.au

On 10 December 2008 in **La Trobe Capital and Mortgage Corporation Ltd v ACE Insurance Ltd** (2008) NSWSC 1303 Justice Hislop of the New South Wales Supreme Court granted leave to an injured party to commence proceedings against an insurer where the insured company was in liquidation and had been deregistered. In light of the current economy, this case serves as a reminder to insurers that the court will extend such leave to injured parties where there is the existence of an *arguable* case that the insurer is obliged to provide indemnity.

In June 2002 United Valuers Pty Limited (**United**[1]), on behalf of REA Australasia Pty Limited (**REA**), valued a property in Illawong, NSW (**the property**) at $1.8M for La Trobe Capital and Mortgage Corporation Limited (**La Trobe**). In August 2002 La Trobe granted a $1.26M home loan secured by a first mortgage over the property (**mortgage**) based on that valuation.

In January 2003 the property mortgagor defaulted. In August 2003 United again prepared a pre-auction valuation for La Trobe and valued the property at $1.8M. La Trobe exercised its right to resell the property and held an auction in October 2003. At the auction the property had a high bid of $1.24M and wasn't sold. The next day, 17 October 2003, United received a letter from La Trobe alleging that the valuer negligently prepared the $1.8M pre-mortgage valuation. Two retrospective valuations were subsequently obtained valuing the property at $1.1M and $1.05M. In April 2004 the property was sold for $1.12M – a loss by La Trobe of $446,570.

During its operation REA was insured under a standard professional indemnity policy (the **policy**) issued by ACE Insurance Limited (**ACE**) effective from 14 December 2002 to 14 December 2003. The policy was a claims made policy indemnifying REA against civil liability for *"breach of duty owed in a professional capacity"* in connection with REA's professional business. On 25 September 2007 La Trobe's solicitors made a claim to REA (reinstated in 2007 for the limited purpose of allowing La Trobe to make its claim) which REA forwarded as a claim to ACE on 2 October 2007. ACE disputed that the 17 October 2003 letter was a "*circumstance*" from which the claim arose.

The proceedings

In 2008 La Trobe sought to bring an action directly against REA's insurer, ACE, alleging that REA acted negligently, engaged in conduct that was misleading or deceptive or likely to mislead or deceive in contravention of Section 52 of the **Trade Practices Act 1976 (Cth)** and was in breach of contract causing the loss of $446,570.

Section 6 of the **Law Reform (Miscellaneous Provisions) Act 1946 (NSW)** (**LRMPA**) allows for direct recourse against an insurer for enforcement of a charge against insurance moneys. →

1 On 4 October 2002 United wrote to La Trobe and informed it that REA was replaced by United as a trading entity and, other than the change of name, the change would be transparent. In March 2003 REA went into voluntary liquidation and it was deregistered on 1 November 2003.

It permits a court to grant leave to a plaintiff to proceed directly against an insurer if the plaintiff can establish:

+ an arguable case against the insured; and
+ an arguable case that the insurer is obliged to provide indemnity to the insured.

The judgement

ACE conceded during the trial that there was an arguable case of breach of duty by REA. Nevertheless ACE contended that the cause of action accrued (and therefore the charge was created) prior to the commencement of the policy by asserting that the 2 August 2002 valuation was clearly and objectively incorrect at that time. The court rejected this contention on the basis that it was reasonably arguable that the plaintiff was unaware that there would be a loss until the property was passed in at auction in October 2003, which was during the policy period.

Further, ACE contended that the 17 October 2003 letter to United was not a claim made to REA or a "*circumstance*" (which may give rise to a claim) that was reported to ACE during the policy period so as to trigger the policy for the claim which was subsequently made in 2007. The court rejected this contention on the basis that it was arguable that the 17 October 2003 letter was a circumstance that was notified to ACE during the policy period. In this regard, the Court noted that there was some evidence that ACE arguably had received the letter during the period of insurance.

As a result, the Court permitted the plaintiff to proceed directly against ACE.

Implications

This case is another example of the relatively low threshold required to join an insurer under Section 6 of the LRMPA. ■

Amendments to pleadings: Costs no longer an all-healing panacea

Written by Dian Turner, Solicitor
Tel 03 9604 7911
dian.turner@wottonkearney.com.au

In its recent decision of ***Aon Risk Services Australia Limited v Australian National University*** [2009] HCA 27, the High Court shifted from the principles set out in the 1997 decision of ***Queensland v JL Holdings Pty Limited*** (1997) 189 CLR 146 with respect to the weight case management should play in the exercise of a discretion to allow amendment to pleadings.

Background

In December 2004, the Australian National University (**ANU**) issued proceedings in the Supreme Court of the Australian Capital Territory against its insurers and its insurance broker, Aon Risk Services Australia Ltd (**Aon**). ANU claimed indemnity for losses it had suffered by reason of fire damage to buildings and contents at its Mount Stromlo Complex.

In November 2006, at the commencement of the four week trial, ANU settled with the insurers. ANU subsequently applied to adjourn the trial and make significant amendments to its pleadings against Aon.

The trial judge allowed the application, relying on ***JL Holdings*** as authority for the proposition that "*justice is the paramount consideration*" in determining an application to amend a pleading. The trial judge held that while the explanations given by ANU for the delay in seeking the amendment were not entirely satisfactory, it was important that the allegations "*raised real triable issues"* between the parties.

The High Court's decision

The majority of Gummow, Hayne, Brennan, Kiefel and Bell JJ (with French CJ and Hayden J writing separate, but concurring, judgments) overturned the trial judge's decision and ordered that ANU's application be dismissed with costs.

The majority rejected the approach taken in ***JL Holdings*** which essentially considered that costs could remedy any prejudice as the starting point for the question of whether an amendment should be allowed. The Court also rejected the proposition that a party had anything approaching a right to make amendments subject to the payment of costs. The Court held that the objectives of case management, which are expressly stated in the civil procedure rules of all Australian jurisdictions, must be given proper consideration.

The Court was concerned with two provisions of the **Court Procedure Rules 2006 (ACT)**. The first is Rule 21, which is contained in Chapter 2 "*Civil proceedings generally*". It states:

"*(1) The purpose of this chapter, and the other provisions of these rules in their application to civil proceedings, is to facilitate the just resolution of the real issues in civil proceedings with minimum delay and expense.*" →

The second is Rule 502(1), which gives the Court discretion to grant leave for a party to amend a pleading.

The majority made it clear that the purpose stated in Rule 21 could not be ignored when exercising a discretion under Rule 502(1). The majority held that the words "*just resolution*" must be understood in light of the purposes and objectives of the rules, which include speed and efficiency. While stating that the focus on speed and efficiency should not detract from a proper opportunity being given to the parties to plead their case, the majority held that limits must be placed on the ability of a party to replead, particularly when delay and costs are taken into account.

In addition to consideration of the factors considered most important to the trial judge, namely:

+ any prejudice faced by Aon, and whether this could be remedied by costs; and
+ whether ANU had an arguable claim to put forward,

the majority considered that the following factors required specific consideration:

+ the impact of the adjournment on other litigants who would face delay in the determination of their matters due to the lost trial date and need to substantially recommence the litigation;
+ the position of Aon in defending a new claim; and
+ the reason for ANU's delay in seeking the amendment.

It was clear that the Court considered as material the late stage at which the application was brought, which resulted in the loss of the four week trial. It was also relevant that ANU's reasons for requesting the amendment were purely tactical. The High Court did not accept that the application was brought about by the emergence of new facts or information, but by a shift in strategy by ANU following resolution of the claim against the insurers.

Application of the principle

While the present case concerned specific provisions of the ACT Rules, it has wide-reaching application in all Australian jurisdictions. The decision, which was handed down on 5 August 2009, has already been cited in a number of WA Supreme Court and Federal Court decisions. The principles were applied by the Queensland Supreme Court in ***Hartnett v Hynes*** [2009] QSC 225 in its consideration of Rule 5 of the **Uniform Civil Procedure Rules 1999 (QLD)**, which is similar to Rule 21 of the ACT Rules. Similar provisions exist in both Victoria and New South Wales.

In the future, litigants must strive to get the pleadings correct and prepare for trial properly, or face the consequences. ■

GST on legal costs may be unrecoverable

Written by Juliet Eckford, Solicitor
Tel 02 8273 9934
juliet.eckford@wottonkearney.com.au

GST on legal costs was recently dealt with by the NSW Court of Appeal in ***Boyce v McIntyre*** (2009). It was held that a costs assessor was not empowered to make a determination in relation to GST payable on legal costs.

Facts

McIntyre was liable to pay the legal costs of Boyce. Legal costs of $3,000 and GST of $300 were in dispute. Disbursements of $202 were not disputed.

The costs assessor determined that a fair and reasonable amount for legal costs was $2,050 and that the total costs payable amounted to $2,252. This figure was affirmed on review, and on appeal by Harrison AJ.

Boyce then appealed a number of issues to the Court of Appeal, including his entitlement to GST. Ipp JA (with whom Macfarlane and Hoeben JJA agreed) found that pursuant to the **Legal Profession Act (NSW) 2004**:

"…a costs assessor is empowered to assess costs that are defined by s302(1) as including "fees, charges, disbursements, expenses and remuneration". GST does not fall under any of these categories and does not come within the ambit of legal costs. GST is an issue in respect of taxation, not legal costs."

Implications for insurers

It seems that as a costs assessor does not have the power to make a determination on the GST payable on costs, a successful party is not entitled to the GST component of an enforceable judgement.

Previously, GST was payable on legal costs of a party not entitled to recover an input tax credit from the Australian Taxation Office. This decision therefore impacts those parties, including injured persons. It seems to prevent, a successful litigant from recovering, on a costs assessment, payment of the GST component of its legal costs.

This is surely not the intention of the legislation, however it remains to be seen whether legislative amendments will correct this anomaly. In the meantime, insurers might refuse to pay GST on an individual's or non-GST registered party's costs. ■

Drafting your way out of section 45 of the Insurance Contracts Act

Written by Judy Truong, Solicitor
Tel 02 8273 9965
judy.truong@wottonkearney.com.au

In February 2009, the Court of Appeal of Western Australia considered section 45 of the **Insurance Contracts Act 1984** (**ICA**) in ***Speno Rail Maintenance v Metals and Minerals Insurance*** [2009] WASCA 31. The decision concerns the equitable right of contribution between co-insurers. The decision addresses a dual insurance scenario in which an insurer indemnifies an insured and another insurer (who has paid a contribution to the first insurer) then seeks to exercise a right of subrogation.

Facts

Speno Rail Maintenance Australia Pty Ltd (**Speno**) was subcontracted to Hamersley Iron Pty Ltd (**Hamersley**) to carry out certain rail works on Hamersley's railway. During the works, two Speno employees sustained injuries and claimed damages against Hamersley.

Hamersley admitted liability for the employees' injuries and sought a contractual indemnity from Speno. Speno held an insurance policy with Zurich Australia Insurance Ltd (**Zurich**) which covered Hamersley as a principal. Hamersley also held liability insurance with Metals & Minerals Insurance Pte Ltd (**MMI**). Zurich indemnified Hamersley for its liability to both employees and then sought contribution from MMI on the basis of dual insurance.

MMI denied Zurich's claim relying on an *"underlying insurance"* clause arguing that the MMI policy operated as an excess policy over the Zurich limit of indemnity. Zurich relied on section 45 of the ICA arguing that the underlying insurance clause was void.

Trial

At trial, the District Court of Western Australia found in favour of Zurich to the effect that section 45(1) of the ICA applied to an insurance policy that had been entered into by the insured itself and not one under which it was merely a beneficiary. It held that an underlying insurance provision must *specifically* refer to the *"other insurance"* in order to fall within the scope of section 45. MMI was ordered to contribute to Zurich.

MMI sought a declaration that any contribution for which it was liable could be satisfied by way of an entitlement to subrogate to Hamersley's rights against Speno directly (thereby reducing its net exposure to nil). The Court agreed and declared that MMI was entitled to exercise its subrogation rights.

Appeal

When does s45 apply?

The Full Court confirmed that section 45(1) should be read strictly so that it applied only when a policy of insurance had been effected by an insured rather than for it. Beech AJA stated it was of no relevance when the *"other"* insurance had been entered into, as long as it was in place. →

Can you sever an underlying insurance clause?

At trial, the District Court held that the underlying insurance clause relied upon operated in two parts. Firstly, where Hamersley had effected the MMI policy in its own name and secondly, where a policy had been effected covering the same risk in respect of which Hamersley was also entitled to indemnity. The Court also found that section 45(1) did not apply to the second half of the underlying clause where the Zurich policy had been effected *on behalf of* Hamersley. However, as it was found to apply to the first half of the underlying clause, the entire provision was rendered void.

On appeal MMI and Speno argued that the *"other insurance"* clause should have been severed at trial so that the second half of the underlying clause was able to operate. The Full Court agreed. In particular, Beech AJA held that:

+ the purpose of section 45 was to render an "*other insurance*" provision void only to the extent that such provision triggered section 45(1);
+ the language of section 45 did not reveal an intention to exclude severance. Section 45(1) only applied to insurance contracts entered into by the insured and not to those to which it was a beneficiary. As such section 45 did not operate to prevent an underlying clause from being severed - to do so would not advance the general purpose of section 45; and
+ severance of a contractual term that is void by reason of public policy or statute is permissible if the elimination of the invalid promise changes the extent but not the kind of contract.

What about MMI's entitlement to subrogation?

Speno argued that MMI should not have been entitled to bring an action of subrogation against Speno because MMI would not fully indemnify Hamersley for the claims.

The Full Court agreed. Beech AJA reasoned that the general subrogation rights of an insurer should also apply between co-insurers. That is, an insurer could exercise its right of subrogation of the insured only when that insurer had paid out the full extent of the liability owed under its own policy.

Implications

The judgment of the Full Court will be revisited by the High Court in October 2009. The High Court will determine whether section 45 should continue to be interpreted strictly or whether a more liberal approach is warranted.

For the moment, section 45 will render an "*other insurance*" provision void only to the extent that it, on strict interpretation, offends section 45(1). However, it is possible to sever any offending part of a clause thus allowing the remaining part to operate. This decision means that it is arguably open to an insurer to carefully draft an "*other insurance*" clause that escapes section 45 and a raft of dual insurance claims.

Furthermore, an insurer does not have a right of subrogation if it is called on only to contribute to, rather than wholly indemnify, a claim. An insurer who is aware of a possible claim for dual insurance should decide at the earliest possible stage if it intends indemnifying an insured for a claim so it can exercise its subrogation rights at a later stage. ■

The broker's duty of care

Written by Matthew Foglia, Special Counsel
Tel 02 8273 9905
matthew.foglia@wottonkearney.com.au

BMW Australia Finance Ltd v Miller & Associates Insurance Broking Pty Ltd [2009] VSCA 117 involved a premium funding loan of nearly $4 million by BMW Australia Finance Ltd (**BMW**) to Consolidated Timber Holdings Ltd (**CTHL**) in relation to a cost of production insurance policy issued by HIH which insured insolvency risks (**the Policy**).

Miller & Associates Insurance Broking Pty Ltd (**Miller**) was an insurance broker engaged by Plantation Management Corporation Ltd (**PMCL**) (which became CTHL) to obtain a premium loan in respect of the Policy.

Miller approached BMW in October 2000 in relation to obtaining premium funding for the Policy. In this regard, Miller provided a copy of an HIH certificate that suggested that the insurance was property insurance which was cancellable.

In December 2000, Miller provided a bundle of further documents to BMW without any cover letter or other explanation of the contents of the bundle. The bundle included, among other things, a copy of the cost of production policy which was clearly not a property policy, as it covered the risk to PMCL of investors not meeting their obligation to maintain plantations because of their insolvency.

BMW approved and granted the loan, which was to be paid back in ten repayments. After three payments, CTHL defaulted on the loan. BMW sought damages from Miller in the amount of $2,797,691 on the basis that Miller engaged in misleading or deceptive conduct and also was negligent.

Misleading or deceptive conduct claim

At first instance, the trial judge found in favour of Miller, concluding that BMW's mistaken belief that the Policy was property insurance was caused by its own failure to read the documents. In a 2-1 decision, the Victoria Court of Appeal granted BMW's appeal.

Miller knew that cancellability of the Policy was the most important thing to a premium lender. BMW was under the misconception that the Policy was a property policy and was cancellable. Robson AJA, with whom Neave JA agreed, found that Miller created this misconception by providing to BMW, in response to a request for a document that disclosed the nature of the insurance, a certificate that referred to "*properties insured and limits*". The subsequent provision of the Policy did not correct that false impression.

The negligence claim

Typically, an insurance broker only owes duties to its own client. In the circumstances of this case, however, the majority held that Miller owed (and breached) a duty to BMW to provide accurate information about the policy to be funded. The Court relied on expert evidence that "*to the broker's knowledge the premium funder relies on the broker to provide accurate details of the insurance to be funded in making the decision to fund the premium and the broker intends the funder to so rely.*"

Apportionment

The majority allowed the appeal and entered judgment for BMW, however, it reduced the judgment by 40% for BMW's own negligence in failing to examine the policy.

Implications

Ordinarily an insurance broker only owes a duty of care to its client. This case represents an expansion of the duty of care to premium funders because of the relationship between brokers and premium funders. ■

Fraudulent non-disclosure: A heavy burden for insurers

Written by Lisa Feltz, Solicitor
Tel 02 8273 9937
lisa.feltz@wottonkearney.com.au

The principles relevance to fraudulent non-disclosure were considered in ***Dawes Underwriting Australia Pty Ltd v Roth*** [2009] NSW CA 152.

In June 2006, Mr Roth purchased a 2004 Ferrari F360 motor vehicle (**the vehicle**) for $350,000. He then sought insurance for the vehicle over the phone through Dawes Underwriting Australia Pty Limited (**Dawes**). Mr Roth disclosed the following information when asked about his driving and claims record:

+ in the last 5 years he had 2 claims for damage to his car whilst it was parked;
+ in the last 5 years he had a ticket for using his phone and a speeding fine for less than 15kms over the limit;
+ that he lost his licence once 8 years ago when he was on his "*P*" plates.

On or around 21 June 2006 the insurance policy commenced and Mr Roth received an email from Dawes enclosing a new policy memorandum of insurance which stated:

"To ensure cover continues, we must receive the fully completed and signed proposal form, payment of the premium and written proof of your entitlement to any no claim bonus, before the expiry of the end term. Payment required within 14 days".

Mr Roth completed the proposal form and returned it to Dawes on 29 June 2006. Dawes returned it to him on 10 July 2006 with a request that he provide further information on the damage to his car while it was parked. Mr Roth returned the proposal in its final form to Dawes on 14 July 2006. Mr Roth presented the following information on his proposal form:

+ in the last 10 years he had never had his licence refused, cancelled, suspended or special conditions imposed;
+ he disclosed an accident in January 2006 when a third party reversed into his vehicle whilst he was parked but that the third party had paid the repair costs;
+ he disclosed a fine for use of his mobile phone whilst driving in November 2003.

On 10 September 2006 Mr Roth was involved in a collision causing extensive damage to his vehicle. He submitted a claim form to Dawes, in which he supplied information on his driving record which conflicted with his two previous disclosures.

The true position as to Mr Roth's driving record during the preceding 10 years included several accidents although not all his fault, numerous fines for speeding, use of a mobile phone while driving, disobeying traffic lights and a licence suspension.

Through its solicitors Dawes indicated an intent to avoid the policy on the basis of non-disclosure.

Mr Roth commenced proceedings against Dawes in the District Court seeking recovery of the cost of the repair for the vehicle. Dawes pleaded a non-disclosure defence arguing:

+ that it would not have issued the policy if proper disclosure had been made; and
+ alternatively, that it could avoid the policy for fraudulent non-disclosure. →

Underwriting guidelines

Dawes' Underwriting Guidelines at the relevant time included the following:

"Drivers with poor traffic records or loss of licence may be insured under the second chance scheme. Second chance rates may only be applied when writing the risk. We are not able to use the second chance rates to underwrite a risk after a claim".

Insurance Contracts Act

Section 28 of the **Insurance Contracts Act** (**ICA**) states:

"(1) This section applies where the person who became the insured under contract of general insurance upon the contract being entered into:

(a) failed to comply with the duty of disclosure; or

(b) made a misrepresentation to the insurer before the contract was entered into;

but does not apply where the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation before the contract was entered into.

(2) If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.

(3) If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection 2 or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insured in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made".

Primary Judge's decision

The District Court in the first instance was confronted with two issues:

+ Was the failure of Mr Roth to disclose his true driving and claims record fraudulent so as to permit the insurer to avoid the contract under s28(2) of the ICA?
+ Would the supply of correct information by Mr Roth have made any difference to Dawes' attitude in the sense contemplated by s28(1) of the ICA?

The Primary Judge held that there was no doubt that Mr Roth was reckless when providing information to Dawes, however, he was not satisfied that Dawes had established the degree of recklessness required to satisfy fraud under section 28 of the ICA as he did not consider that Mr Roth had no honest belief in the truth of the representations. Instead, His Honour was of the view that Mr Roth had been careless.

On the question of whether the policy would have been issued on relatively identical terms and conditions if there had been no misrepresentation or non-disclosure, the Primary Judge found that Dawes would have issued the policy in any event. The Primary Judge was of the view that it was clear that the granting of insurance under the Second Chance Scheme was a matter of discretion. The Primary Judge concluded that Dawes was far more interested in obtaining the premium than it was in the rigorous review of information provided by Mr Roth or the risk.

Court of Appeal

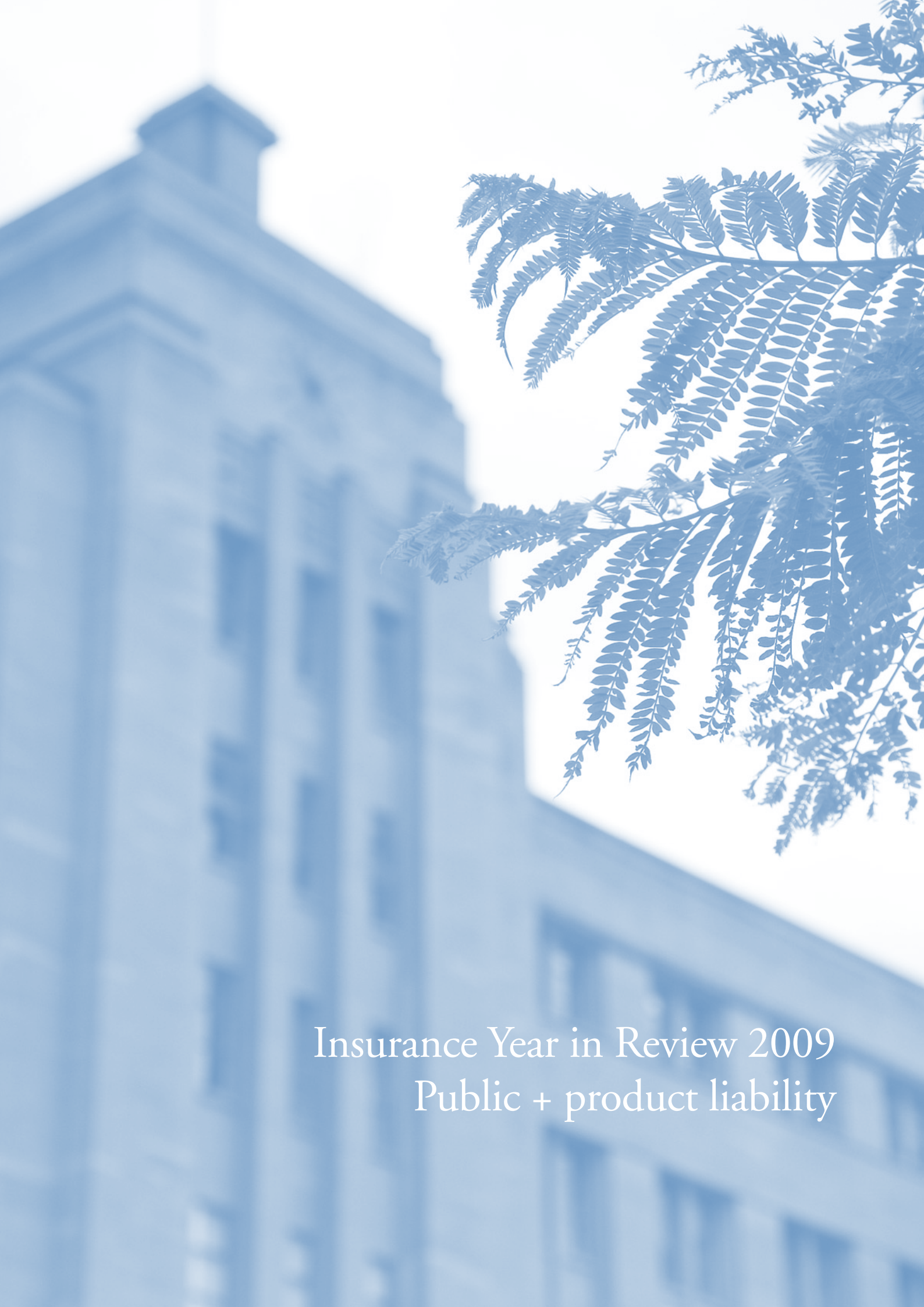
The Court of Appeal held in relation to the question of fraud that the Primary Judge had applied the test correctly in the first instance. MacFarlan JA, with whom Hodgson JA and Young JA agreed, stated the test for fraud under s28(2) of the ICA represents a *"high hurdle"* but that the test was necessary due to the nature of an allegation of fraud which involves a mental element. MacFarlan JA held that it was open to the Primary Judge to accept the evidence of Mr Roth as indicative of carelessness and not fraud.

In relation to the second question, MacFarlan JA held that the Primary Judge's finding that →

Dawes would have issued the policy of insurance despite Mr Roth's driving and past claims record was based on the Primary Judge's view of the credibility of the Dawes underwriter. The Primary Judge attached significance to the fact that the underwriter and his staff did not see it as important that there were discrepancies between the answers Mr Roth gave during the initial telephone conversation and those which he gave later on the proposal form. Dawes did not undertake any further investigations as to why the information provided differed. It was therefore open to the Primary Judge to consider that the absence of inquiry by Dawes tended to indicate that Dawes was not paying much regard to disclosure.

Implications

This case demonstrates the difficulties facing insurers in establishing a non-disclosure defence. Insurers have the burden of proof and in relation to fraudulent non-disclosure it is indeed, as Mcfarlan JA stated, "*a high hurdle*". ■



Insurance Year in Review 2009
Public + product liability

Product Liability: What is the 'occurrence'?

Written by Robin Shute, Partner
Tel 03 9604 7905
robin.shute@wottonkearney.com.au

Product liability and the insurance coverage for the risk is rarely in the judicial news. Perhaps this is a reflection of the fact that the principles are by and large settled and the policy wordings issued by Underwriters are well understood. The case of ***Selected Seeds Pty Ltd v QBEMM P/L*** (2009) QSC70 has reinforced our understanding of existing principles of how coverage operates. It has also highlighted a potential area not so well known of the relationship between damages recoverable under a policy and expectation losses.

The facts

The facts were relatively straightforward. The plaintiff purchased, so it thought, Jarra Grass seed but in fact it was supplied with the wrong product, which turned out to be Summer Grass seed, which was of a lower grade and unsuitable for the particular purpose of the plaintiff. The damages sought fell into the following trends:

- the costs of eradicating Summer Grass from the property;
- the loss of use of that land during the eradication process;
- the loss of profit which would have been derived from the sale of Jarra fodder and Jarra seed; and
- a diminution in the value of land, resulting in a lower contractual sale price than if the property had been seeded with Jarra grass.

The plaintiff resolved the claim and sought indemnity from its insurer.

The meaning of 'Occurrence'

Product liability policies, that is to say insurance which gives coverage for legal liability caused by Products resulting in personal injury or property damage, are usually written on an Occurrence basis. The Occurrence must happen in the policy period. In this case the Occurrence was defined to mean:

"*An event which results in Personal Injury or Property Damage neither expected nor intended from Your standpoint*."

Tracing the "*event*" which results in Property Damage can be problematical and cause practical difficulty particularly where a product was inherently unsuitable at the date of its supply. Lord Mustill in ***Axa Reinsurance (UK) PLC v Field*** (1996) 1 WR 1026 gives some guidance. He emphasised that "*an event*" is "*something which happens at a particular time, at a particular place, and in a particular way*". In the judgment he emphasised that an occurrence must "*cause*" the personal injury or property damage. In ***The Distillers Company v Ajax Insurance Company Ltd*** (1974) 8 CA 3 Stephen J said:

"*I would not regard the word 'occurrence' in this context as out to refer to the death of a victim or to his illness or injury but rather to the mishap causing such death, illness or injury.*"

Analysing mishap as being the occurrence therefore leads to an inquiry into causation and the facts themselves in ***Selected Seeds***. →

Purchase of the seeds was held not to be the occurrence, just as in the ***Distillers*** case the purchase of the relevant drug (which caused disability) was not the occurrence. Something more causally relevant is required. In ***Distillers*** the Court said the ingestion of the drug by a pregnant woman, the accumulation within her body of harmful constituents and the effect of all these upon the foetus all constituted the occurrence. Thus consistent with established authority, the event causing damage ("*the mishap*") in ***Selected Seeds*** was held to be the planting of the seed. The seed at that point damaged the land by introducing unwanted elements. The land needed to be decontaminated and other loss and damage thereafter followed.

The efficacy exclusion

Underwriters in defence raised the argument that one of the exclusions to the policy – the so called Efficacy Clause - applied to exclude the loss. As in most product liability policies, there was an exclusion in respect of:

"The failure of any Product to correctly fulfil its intended use or function and/or meet the level of performance, quality, fitness or durability warranted or represented by the insured."

The *"Efficacy Clause"* has been the subject of litigation over the years but not to a significant degree. I suspect this is because its purpose is largely self-explanatory. Product liability insurance is designed to indemnify the Insured for loss or damage to third party property and personal injury caused by a Product. Such coverage is to be distinguished from Product Guarantee. The purpose of the cover, it has been said on occasions, is to indemnify an insured for perils external to the product. Product liability policies accordingly incorporate various exclusions which expressly make it clear that the "*Product supplied*" is outside the scope of the indemnity. The *"Efficacy"* Exclusion is related to the Product and fitness for purpose.

Typically it is aimed at situations where the product does not work as represented or required.

In the New Zealand case of ***Independent Wool Dumpers Pty Ltd v AIU (NZ) Ltd*** (1992) 7 ANZ Ins Cas 61-152 the Court was concerned to consider whether a press which continually broke down and failed to meet performance specifications could be indemnified for the costs of repairing the defective press and for the subsequent loss of production under a product liability policy. The Court held that a product liability policy could not be used to recover losses to rectify products which had been manufactured defectively. If one views therefore the Efficacy Clause from this perspective, it had a limited operation in ***Selected Seeds***.

The Court held that there had been relevant property damage, that is to say damage to the land of the plaintiff caused by the seeds, which in turn opened the door both to a claim for the clean up costs of the land and for the economic loss (loss of profits) which had been suffered because the crops had not been grown. The loss flowed from the damage to land.

The Efficacy Clause would have been applicable, for example, if the correct seeds had been purchased but they had not grown as represented. In the ***Independent Wool Dumpers*** case, the Court also held that once failure or breakdown of the press had been excluded, there was no event resulting in any property damage for the purposes of the policy. A claim for loss of use, i.e. loss of profits, did not arise.

Caution thus must be maintained because there are authorities where these two strands of reasoning have produced a mixed result. The ability to recover loss of profits under a product liability policy was restricted in ***Rexodan International Ltd v Commercial Union Assurance*** (1999) Lloyd's Rep IR 495. In that case Rexodan's product, soap powder, →

broke down and damaged its cardboard packaging. The third party claimed against Rexodan for:

+ the value of the damaged soap powder and expenses incurred in extra handling;
+ the cost of cartons which had been manufactured in anticipation of further deliveries of powder which were then not ordered by another party; and
+ loss of future sales from that other party because of non supply.

In the leading judgment Hobhouse LJ emphasised the distinction between a defective article causing damage to third party property and a more general claim for damages for breach of contractual liabilities. He held on the facts that the claims for manufactured cartons and future sales were not within a product liability policy. He drew the distinction between loss or damage caused by the product and claims for expectation loss pursuant to a claim for breach of contract. The ramifications of this case have not been explored in Australian decisions.

One can see readily how the argument on efficacy had been mounted in ***Selected Seeds***. The critical finding of fact by the Trial Judge was that the occurrence was damage to land and as a result the Court was prepared to hold that the loss of profit on the crops which had not been grown was a legal liability for loss consequent upon the happening of an occurrence rather than an expectation loss.

Addendum

Since preparing this article, the Court of Appeal in Queensland has overturned the first instance judgment in reasons delivered on 22 September 2009. It upheld the finding that the relevant "*Occurrence*" was the planting of the seed and hence the damage to land.

However the Court of Appeal overturned the Trial Judge on his findings in respect of the Efficacy Clause. It departed from the Judge's factual findings and distinguished the authorities upon which he relied to find that the Clause was operative on its true construction. The reasoning was based upon the fact that the seeds as sold had in fact grown on as they should have done and, as such, did not cause damage which should be viewed as accidental. On the construction of the clause the liability was therefore "*plainly*" excluded. The Court rejected the arguments that coverage should operate and that a broad interpretation as given defeated the nature and purpose of a product liability cover. The reasoning of the Court of Appeal, going forward, needs to be understood by practitioners because it introduces a narrowing of the scope of coverage. It is bound to be the subject of considerable comment. To some degree the reasoning is the product of the specific facts of the case. Where a product works as it should but the wrong product has been supplied, product liability coverage will not operate. ■

A shot across the bows of private statutory causes of action for personal injury

Written by Charles Thornley, Special Counsel
Tel 02 8273 9910
charles.thornley@wottonkearney.com.au

In ***Wynn Tresidder Management Pty Ltd v Barkho*** [2009] NSWCA 149 the NSW Court of Appeal considered whether a breach of Regulations under the **Occupational Health and Safety Act 2000 (NSW)** (**OHSA**) conferred a private cause of action on a member of the public. Insurers will be relieved to hear what the Appeal Court had to say.

Facts

Fiona Barkho was visiting the Neeta City Shopping Centre (**Centre**). Heavy rain had caused a leak onto a temporary carpeted ramp. Pedestrians had carried water from the ramp onto a tiled section of the Centre's floor. Barkho slipped and fell as she stepped onto the tiled floor, injuring herself.

Judgment at first instance

Barkho sued, amongst others, the Centre manager Wynn Tresidder Management Pty Ltd (**WTM**) for breach of its occupier's duty of care and for breach of Clauses 34 and 36 of the OHSA Regulations (**Regulations**). Clause 34(1) requires a "*controller*" of work premises to take reasonable steps to prevent a foreseeable risk of harm while Clause 36 requires the elimination or control of such a risk.

Hungerford J found that WTM had breached its duty of care. His Honour also found that the Regulations afforded Barkho a private cause of action for damages in the event of breach (following the line of authority in ***O'Connor v S P Bray Ltd*** [1937] HCA 18). His Honour found that WTM had breached the Regulations and was also liable on that basis. WTM appealed against both findings.

Court of Appeal

WTM's appeal against the finding that it had breached its common law duty of care was rejected. The Court of Appeal therefore did not need to consider the statutory cause of action, but in the leading judgment McColl JA provided a strong indication that the Court would have overturned Hungerford J's decision on that issue for the following reasons:

+ Before Hungerford J considered whether the Regulations provided a private cause of action, he should first have considered whether they extended to cover persons in the relationship of occupier and member of the public.
+ It seems improbable that legislation whose long title and stated object is to secure the health, safety and welfare of persons "*at work*" would extend to provide a private cause of action to members of the public.
+ Nothing in the Second Reading Speech to the Bill suggests that the legislature intended to extend the Bill's provisions to protect →

members of the public entering shopping centres, but rather suggests an intention that the legislation address the elimination of risk in the workplace.

+ The definition of "*place of work*" in the OHSA is capable of extending to areas in a shopping centre to which the public and workers have access. However. despite the Regulations appearing to protect members of the public accessing places of work, there are substantial policy reasons for concluding that the legislature did not intend the OHSA and its Regulations to extend to protect a member of the public in the circumstances in which Barkho was injured.
+ To the contrary, the **Civil Liability Act 2000 NSW** (**CLA**) evidences a determination on the part of the legislature to limit the circumstances in which damages can be recovered for negligence outside of the workplace.
+ The absolute or strict duties imposed by Clause 34 and 36 are in contrast to the enquiries required to determine the existence of a duty of care and its breach under the CLA.
+ If the Regulations confer a private cause of action to members of the public injured in premises where people also work (such as shopping centres) that would result in the inequitable situation where those persons would be in a substantially better position than those injured in places where people do not also work.
+ Even if the Regulations did provide a private cause of action, to the extent that the Regulations are inconsistent with the CLA they should arguably be excluded from operation.

Conclusion

Despite being obiter dictum this aspect of the judgment should be welcomed by insurers for the following reasons:

+ It is a timely shot across the bows of any attempt to circumvent the reforms introduced under the CLA by the use of statutory causes of action under the OHSA.
+ It indicates that the Court of Appeal will likely restrict the application of the OHSA and its Regulations to the workplace – the area where the legislature intended the legislation to apply.
+ It reaffirms the importance and overriding role of the CLA in governing the recovery of damages for physical injury suffered outside of the workplace. ■

So, is it 'advice' or not?

Written by Claire Tingey, Senior Associate
Tel 02 8273 9915
claire.tingey@wottonkearney.com.au

In ***Transfield Services (Aust) Pty Limited v Hall; Hall v QBE Insurance (Aust) Pty Limited*** [2009] NSWCA 294 the NSW Court of Appeal considered the doctrine of the non delegable duty of care, reinforcing the High Court decision of ***Stevens v Brodribb Sawmilling Co. Pty Limited (1986)*** 160 CLR 16, and the terms of a public and product liability policy.

The facts

Norman Hall was employed as a navy reserve with the Royal Australian Navy. On 29 January 2002, Hall fell 10 metres while abseiling on a high ropes course at HMAS Stirling, a navy base in Western Australia. The rope course had been built or installed in 1993 by Rope Tech Australia Pty Limited (**Rope Tech**) in conjunction with Merrybrook Pty Limited. Rope Tech was the predecessor of Adventure Training Systems Pty Limited (**ATS**).

Hall commenced proceedings against ATS, whose business involved the fabrication, installation, maintenance and repair of rope courses and their component parts, Transfield Services (Aust) Pty Limited (**Transfield**), who contracted with the Commonwealth of Australia in respect of Defence establishments including HMAS Stirling, and QBE Insurance (Australia) Pty Limited (**QBE**) as the public and product liability insurer of ATS (ATS took no part in the trial or the appeal and did not hold professional indemnity insurance).

On 17 December 2001, ATS inspected the rope course pursuant to a contract with Transfield. The rope course had been closed due to safety concerns. Following the inspection, ATS provided Transfield with a report at a cost of $7,198 which identified and recommended work which needed to be carried out within six months. The corroded safety strop which caused Hall's accident was not identified as a risk/defect in the report. On receipt of, and in reliance on the report, the rope course was re-opened for use.

Decision at first instance

The Trial Judge found ATS negligent on the basis that it should have removed the shrink wrap covering the safety strop during its inspection on 17 December 2002, at which time ATS would have seen the corrosion. The shrink wrap had not been removed since first applied when the rope course was installed by Rope Tech.

Transfield was found liable for the negligence of ATS (despite ATS being an independent contractor) on the basis that it owed users of the rope course a non-delegable duty of care as the activity was considered to be sufficiently dangerous to attract such a duty.

The Trial Judge also held QBE was not liable to indemnify ATS, as QBE's liability under the policy arose only in relation to the *"business"* of ATS, and ATS' liability did not arise out of its *"business"*. In addition, ATS' liability was excluded under the policy as it was caused by or arose out of advice which had been given for a fee. →

The Appeal

Non delegable duty of care
Transfield successfully appealed against the finding of a non delegable duty of care.

The leading judgment of Campbell JA (with whom McClellan CJ in Common Law and Beazley JA agreed) reviewed the nature of non-delegable duties, focussing on the decision of ***Stevens*** where 4 of the 5 members of the High Court rejected the assertion that a person has a non delegable duty of care to ensure that reasonable care is taken by independent contractors engaged in extra-hazardous activities. Campbell JA held that although the activity was extra-hazardous, this was not enough to impose liability on Transfield. Following a thorough review of decisions since ***Stevens***, he concluded that this aspect of the law had not altered.

QBE policy interpretation
Hall successfully cross appealed against the Trial Judge's findings on policy interpretation, submitting the QBE policy responded to indemnify ATS.

ATS' public and product liability policy incepted in 1993. The Court of Appeal considered the history between ATS' broker and the underwriter to determine the nature of ATS' *"business"* relevant to the policy and the meaning of "*occupation*" listed in the Renewal Certificate, in circumstances where the Schedule was not attached to the Policy.

In 1993, ATS' business was identified in the Proposal as "*fabrication, installation, sale and training of outdoor equipment*". *"Occupation"* was described as the *"sale of adventure equipment (retail) ie packs, sleeping bags, rock climbing gear & sale installation & training of ropes confidence courses*". On 14 June 2001, ATS' occupation was changed to "*retail sale of adventure equipment (packs, sleeping bags, rock climbing gear) and sale, installation & training of ropes confidence courses".*

On 17 December 2001, ATS' broker sought reinstatement of the policy (which had lapsed due to non-payment of premium), identifying the "*business"'* as "*fabrication, installation, sale and training for outdoor equipment*". The Renewal Certificate issued on 2 January 2002 noted that Underwriters required a full update on ATS' current activities (which was never provided). The Renewal Certificate identified ATS' "*occupation*" but did not explicitly identify any "*business*".

The operative clause in the Product Liability section of the policy provided that:

"*The Insured is indemnified by this Section in accordance with Clause 1 of the General Operative Clause against claims arising out of or in connection with any Product in respect of injury and/or Damage first happening during the Period of Insurance as the result of an Occurrence*".

The Court accepted that the "*business*" and "*occupation*" of ATS were the same, and included "*other*" activities undertaken by ATS which were incidental to, but part of carrying out that business such as maintenance of the ropes course. Any liability that ATS incurred to Hall was therefore one arising out of its "*business*".

The Court held that the operative clause of the policy responded to this loss. The Court differed in their interpretation of the clause excluding cover for liability caused or arising out of advice given for a fee. McClellan CJ and Beazley JA found that the policy responded and the exclusion did not apply. Campbell JA disagreed, agreeing with the Trial Judge that ATS' conduct (the provision of a report following its inspection) was "*advice*" within the meaning of the policy.

McClellan CJ held that the task which ATS was requested to carry out was not properly described as "*advice… for a fee*". It was asked to assess the "*course and certify*" and replace "*all strand vices to the high ropes course with new and hard eyes"*. He considered in detail ATS' response to Transfield's request for a →

quote, and concluded that ATS was offering no more than a general maintenance check in the course of its ordinary business while noting further maintenance work which was required. Excluding such "*advice*" would "*strike fundamentally at the commercial purpose of the policy*".

He concluded that the description of work carried out by ATS was within the normal business of ATS insured by QBE, and was not excluded under the terms of the policy.

Implications

The decision reinforces the doctrine of non-delegable duties since ***Stevens*** and highlights the importance of carefully considering the activities of independent contractors who are carrying out "*extra-hazardous activities*".

Importantly for insurers, the decision highlights the difficulties associated with distinguishing if "*advice*" provided by an insured, when combined with other tasks such as inspection and maintenance, is incidental to its "*business*" and covered under a product and public liability policy, or if such *"advice"* is subject to a professional indemnity policy.

The decision is a timely reminder to insurers and insureds of the importance of ensuring that the insured's details contained in the Policy Schedule are accurately described and complete to assist with policy interpretation. ■

Limitations, labour hire and occupiers' liability: A review of common public liability issues

Written by Belinda Henningham, Partner

Tel 02 8273 9913
belinda.henningham@wottonkearney.com.au

Bostik Australia Pty Ltd v Liddiard [2009] NSWCA 167 is a useful authority for public liability insurers insofar as it revisits issues which commonly arise in the public liability arena, being the operation of the NSW statutory limitation provisions for personal injury claims and the principles governing an occupier's duty of care to a labour hire employee.

Background

Mr Liddiard injured his back lifting a 44 gallon drum on Bostik Australia Pty Ltd's (**Bostik**) premises. Bostik operated a business of packaging industrial sealants. Mr Liddiard's employer, Brolton Industries Pty Ltd (**Brolton**), operated a maintenance engineering business from a small part of the premises which it occupied under agreement with Bostik. In the course of this business, Brolton supplied Mr Liddiard's labour to Bostik, essentially to work as a general hand.

Raw materials for Bostik's business arrived on site in 44 gallon drums. Empty drums were used as rubbish bins around the premises. In the course of his general hand duties, Mr Liddiard lifted one such drum in order to empty it and injured his back when the drum was heavier than anticipated. He had until then performed this task twice weekly for 6 months without incident.

Mr Liddiard brought common law proceedings in negligence against Brolton as his employer and Bostik as occupier. The case ran to appeal on the issues of:

+ whether the claim was statute barred by the **Limitation Act 1969 (NSW)**;
+ whether Bostik owed Mr Liddiard a duty of care; and
+ if a duty was owed, whether Bostik breached that duty.

Limitation period

Mr Liddiard was injured on 30 January 2003. He commenced proceedings on 13 June 2007, some 4.5 years later. Bostik argued that his claim was statute barred by section 50C(1)(a) of the **Limitation Act** which imposes a 3 year limitation period for personal injury claims in NSW with time commencing to run from the date when "*the cause of action is discoverable by the plaintiff*".

Since proceedings were commenced on 13 June 2007, the critical question was whether the cause of action was discoverable by Mr Liddiard before 13 June 2004 (3 years earlier). The Court of Appeal determined this with reference to the criteria stipulated in section 50D which, in essence, specifies that a cause of action is "*discoverable*" when a person first "*knows or ought to know of each of the following facts*":

+ that the injury occurred (s.50D(1)(a));
+ that the injury was caused by the defendant's fault (s.50D(1)(b)); and
+ that the injury was sufficiently serious to justify the bringing of an action (s.50D(1)(c)).

Ultimately, Mr Liddiard's action was not statute barred. →

The occurrence of the injury

The parties agreed that the relevant date for the purpose of s.50D(1)(a) was the date of the injury.

The defendant's fault

Bostik argued that Mr Liddiard knew before 1 June 2004 that his injury was caused by Bostik's fault as required by s.50D(1)(b) on the basis that he knew facts including that Brolton occupied part of Bostik's premises, that he was employed by Brolton but that his labour was partly used for Bostik's benefit, and that the 44 gallon drum was left over from Bostik's business activities.

However, the trial and appellate Courts rejected this argument on the basis that Mr Liddiard did not know the nature of the arrangements between Brolton and Bostik for the provision of his labour and thought his work was carried out purely for Brolton's benefit. The Court accepted that this was all Mr Liddiard knew until 31 October 2006 when his solicitor obtained a statement given by his employer to WorkCover which outlined Brolton's labour hire arrangement with Bostik.

The Court confirmed that what must be known for the purpose of s.50D(1)(b) are the key factors necessary to establish legal liability, but it is not necessary that the plaintiff be able to articulate a cause of action. In this case, Mr Liddiard could not know the causal relationship between his injury and Bostik's fault until he had the employer's statement.

Serious nature of the injury

The trial and appellate Courts also agreed that Mr Liddiard did not know that he suffered an injury sufficiently serious to justify the bringing of an action (s.50D(1)(c)) until after his first round of neck surgery in November 2004. When that surgery did not provide significant relief, the serious nature of his injury would have been apparent.

Bostik's duty of care

By a 2:1 majority, the Court of Appeal found that Bostik owed Mr Liddiard no duty of care. The majority judges were persuaded by the fact that Bostik had contracted Brolton to provide services, including emptying the drums, and Brolton was responsible for the manner in which that work was conducted.

Bostik gave no instructions to Mr Liddiard as to how to carry out his work nor was it involved in the coordination of its contractor's activities. The Court made this finding despite evidence from Bostik's site manager that he was responsible for ensuring proper safety measures for emptying of the drums. The Court found that the site manager's control over Mr Liddiard was "*theoretical rather than actual, and insignificant*" since he did not train, supervise or instruct Mr Liddiard. In these circumstances, the majority were not prepared to find that Bostik had assumed responsibilities akin to those which arise in a labour hire scenario.

Even if a duty was owed, the majority found it had not been breached, particularly as there was no evidence as to why the bin was heavier than usual on the subject occasion. Ipp JA said:

"the possibility that some person would put some heavy object in a bin, or that the bin might be heavier than ordinarily would be the case, was a possibility that was obvious and should have been foreseen. It does not follow, however, that a reasonable response to the risk would require a change in the kind of bins that were in use."

Comment

Bostik breaks no new ground, but it does provide further insight into the difficulties which an insurer will face in seeking to prove a NSW personal injury claim statute barred given the broad discretion afforded to the Court by s 50D of the **Limitation Act** in terms of determining the date on which time commences to run.

The case further reinforces the importance of establishing an occupier's control over a contractor's work practices and procedures before a duty of care can be said to arise. If an occupier takes no part in training, supervising or instructing a contract worker, then the worker will be hard pressed to prove a duty of care owed by the occupier. ■

Insurance payment no 'set off' to damages

Written by Karen Jones, Senior Associate
Tel 02 8273 9908
karen.jones@wottonkearney.com.au

In ***Papadopoulos v MC Labour & Anor (Ruling No 2)*** [2009] VSC 176 the plaintiff sought damages for a lower back injury sustained whilst working for a labour hire company, MC Labour Hire Services Pty Ltd (**MC**), and performing work for Concept Hire Ltd (**Concept**). The plaintiff sued MC and Concept for negligence and breach of statutory duty.

The Court was asked to determine whether the plaintiff's receipt of $150,000 for permanent and total disablement under a policy of insurance should be taken into account in any assessment of damages. MC submitted that the plaintiff's damages should be reduced as it, not the plaintiff, had paid premiums for the policy under a workplace agreement.

Purpose of the payment

Beach J relied on ***Redding v Lee*** (1983) 151 CLR 117 in noting that the question of whether the payment should be taken into account would turn upon the *"character and purpose of the payment"* and whether it was intended that the plaintiff should enjoy the payment in addition to whatever damages he might recover. Further, if the receipt of the payment was not dependent upon or intended to replace any loss of wages or earning capacity, then a conclusion that the payment was not intended to reduce the damages could be more easily drawn.

Finding

Beach J ruled that MC had paid premiums pursuant to its contractual obligation to do so and that the plaintiff, having performed work for MC, was entitled to receive the payment. Beach J considered that the payment was in place to assist the plaintiff and not to relieve MC of its tortious liability. The $150,000 was therefore not to be taken into account in assessment of the plaintiff's damages against MC and Concept.

After a jury trial lasting 19 days, the plaintiff was awarded damages of $677,825 after reduction of 11.5% for contributory negligence (see ***Papadopoulos v MC Labour Hire Services Pty Ltd & Anor*** **(No 4)** [2009] VSC 193).

Beach J's decision clarifies the circumstances under which a plaintiff's receipt of separate benefits can be successfully argued as a *"set off"* to a claim for damages.

wotton kearney
insurance lawyers

Loss of chance: Will the High Court revolutionise the law of recovery for personal injury?

Written by Charles Simon, Partner and Cassandra Wright

Tel 02 8273 9911
charles.simon@wottonkearney.com.au

As the law presently stands there is no right of recovery of damages to a plaintiff, in a medical negligence claim, who establishes that a breach of duty of care deprived him/her of the chance of a better outcome.

This decision of ***Gett v Tabet*** [2009] NSWCA 76 has seen the Court of Appeal depart from an earlier authority (see ***Rufo v Hosking*** (2004) 61 NSWLR 678) which required a patient to prove, on the balance of probabilities, that there did exist a chance of a better outcome had the negligence not occurred and this was a chance which would have been taken. Rather, the Court of Appeal has now determined that damages will only be awarded against a tortfeasor where the Court is satisfied on the balance of probabilities that the breach of duty of care caused, or materially contributed to, harm to the plaintiff. This approach would seem consistent with the underlying principles of causation, namely that the harm suffered was caused or contributed to by the negligence of the defendant.

Facts

Reema Tabet, the plaintiff, aged 6, came under the care of Dr Gett, specialist paediatrician, suffering headaches, vomiting and a subsequent neurological episode. A CT scan revealed a brain tumour.

At issue before the Court was whether an earlier referral for a CT scan would have led to the diagnosis of a tumour and treatment such that the plaintiff would have had the chance of a better outcome.

Decision

At first instance, Studdert J found that Dr Gett breached his duty of care in failing to promptly order a CT scan but was unconvinced that the discovery of the tumour would have avoided a seizure if made earlier. His Honour found that Tabet lost a chance of better medical outcome and determined that Tabet was entitled to damages for loss of that chance. He assessed the loss of chance of a better outcome at 40%.

Dr Gett appealed the finding that he was liable to Tabet in the absence of any establishment on the balance of probabilities that harm was suffered as a result of his breach of duty.

The Court of Appeal agreed that Dr Gett breached his duty of care but opined that the causal connection between the tortious conduct and Tabet's injuries must be considered on the balance of probability.

The Court of Appeal held that Tabet did not prove on the balance of probabilities that her brain damage was caused by Dr Gett's failure to perform an earlier CT scan. The Court →

found it should depart from its own earlier authority in ***Rufo*** because it was inconsistent with the **Civil Liability Act** (**CLA**) relevant to the nature of harm to justify a finding of negligence.

The Court noted that it was the role of the High Court to reformulate *"the law of tort to permit recovery for physical injury not shown to be caused or contributed to by a negligent party, but which negligence has deprived the victim of the possibility (but not the probability) of a better outcome".* The Court intimated that the approach would not necessarily be limited to medical negligence cases, but would potentially revolutionise the law of recovery for personal injury. The Court considered its limits, unless expanded by the High Court, fell short of a proposition which revolutionises the proof of causation of injury in personal injury cases.

Implications

In choosing not to follow earlier authorities the Court of Appeal held it was *"plainly wrong"* to depart from conventional principles. As a result the Court determined that the question of the causal effects of clinical negligence should be assessed on the balance of probabilities, not on the basis of loss of a chance.

Special leave to appeal to the High Court has been sought. However it is noteworthy that the principles enunciated in this decision are consistent with section 5 of the CLA which specifically imposes on the plaintiff the onus of proof on the balance of probabilities and does not include *"risk"* of physical or mental harm.

Hoteliers' liability: Adeels Palace Pty Ltd v Moubarak (2009) NSWCA 29

Written by Robin Shute, Partner
Tel 03 9604 7905
robin.shute@wottonkearney.com.au

The duty of care owed by a proprietor to patrons injured by criminal behaviour in a nightclub: the law consolidated and explained by the NSW Court of Appeal.

The liability of the licensee of a nightclub and restaurant to persons injured in a shooting was upheld by the Court of Appeal which found that there was no appealable error in the primary judge's award to 2 patrons shot by another visitor on New Years Eve on 31 December 2002/1 January 2003.
The responsibility of occupiers for injuries to patrons is a vexed question. We are seeing more and more the commencement of actions by patrons injured late at night in fights which have occurred often as a consequence of alcohol. The extent of the obligations of the occupier to foresee and to prevent worse behaviour by the provision of appropriate security has been examined in a careful and illuminating leading judgment given by Giles JA.

Admittedly the facts were extreme. The restaurant premises themselves had a licensed seating capacity of close to 300 persons. The evidence was that the premises were *"packed out"* with possibly as many as 400 people present. At about 2.30am a dispute erupted on the dance floor following which a male of Lebanese appearance appears to have picked a fight which then carried on in the kitchen. He left the premises in order, it was found, to collect a gun. Gun shots were then heard. It emerged that the assailant had shot one patron in the leg and then a second patron was shot and badly injured.

The allegations of negligence were that the patrons were owed a general duty of care by the restaurant to take care to avoid injuries caused by the unlawful actions of patrons on the premises. It was said that the duty was breached because the security arrangements of the function were "*far short of what reasonable care and skill required in all the circumstances*".

At first instance the injured parties were successful in recovering damages collectively of approximately $1.2 million. The Trial Judge held that the inadequacy of the security materially contributed to, and so caused, the injuries.

At the heart of the case was whether a duty of care arose. In the decision of ***Modbury Triangle Shopping Centre Pty Ltd v Anzil*** (2000) HCA 61, the occupier of a supermarket car park was held not to owe a duty of care in relation to the criminal conduct of third parties. An attack in the car park had occurred involving violent and criminal behaviour. So in this case it was argued that the occupier of premises did not owe a duty of care in relation to the shooting as it involved disassociated serious criminal activity. It was submitted that the cases in which occupiers of licensed premises were held to have had a →

duty of care in relation to the prevention of violent criminal acts were inconsistent with ***Modbury***. The Court had no real difficulty in distinguishing ***Modbury*** as has in fact occurred in a number of other cases. The duty of care, the Court said, involved more complex factors including the degree of foreseeability and predictability of events involving criminal conduct arising. Specifically the basis of the duty:

"…must be found in the level of control exercised by the occupier over those on the premises and the occupier's knowledge, or ability to know about, the condition of persons on the premises where liquor is being sold…".

The Court took particular note of a Victorian decision called ***Club Italia (Geelong) Inc v Ritchie***. In that case the Court focused upon the issue of harm *"arising from a state of affairs created by the Club"*. The question of duty also arose from the capacity of the occupier to control the conduct of persons within the Club.

This ability was ordinarily exercised by the presence of security staff. The Court at first instance made a number of findings that the security staff were inadequate in number. It appears that there were only 2 security staff and for an unknown reason only one was on duty at the time of the shooting. Evidence was given by experts that the guard on duty could not conceivably have carried out all the necessary preventive and security intervention measures which ought to be necessary. Proper security should have prevented the person doing the shooting from gaining entry to the premises with the gun. He should have been properly searched – particularly as it seems he left the venue in order to get the gun from his car. More security might well have prevented the turn of events.

The Court had no difficulty in finding that the conclusions of the Trial Judge ought to be upheld on the question of the existence of a duty of care.

Not all injuries in pubs or restaurants will succeed. The case is thus of interest for showing how, in the future, potential plaintiffs can establish foreseeability of injury and that the owner had the capacity to influence events. In laying down the test of foreseeability the Court recognised that there may very well be circumstances where the injury which occurred was genuinely "*unexpected*" and something which could not have reasonably been foreseen by the occupier.

In this particular case the Court at first instance seems to have been taken to both the history of the locality in which the restaurant was situated and to the actual police records by way of showing previous incidents over a lengthy period of time. The injured parties were thus able to build a picture of the restaurant being one in which, from the standpoint of the objective observer, one could conclude that there was a probability of incidents happening, thus making it desirable for effective security to be available.

The Court also looked closely at the nature of the restaurant and that it was "*deliberately calculated*" to attract patrons to the premises. '*The type of activities carried on there involved numerous people gathering in close proximity to each other, at least predominantly for the purpose of social interaction, over many hours, in circumstances where alcohol was readily available*." Alcohol therefore was another reason why the duty of care should exist even though it did not play a prominent part in this case, other than, as background, that patrons might be potentially troublesome and violent.

The question of effective security is at the heart of the duty of the occupier having the requisite capacity to control conduct. Adequate security is a function of expert evidence and what is reasonable in all the circumstances. In this case, the Court found a breach. The security guards did not give evidence, allowing the Judge to draw adverse inferences. Furthermore, self-evidently, one or two security guards were →

not enough to control a venue of 300 people in the event that trouble broke out. The Court did not make any conclusion of what the correct number of guards may be because adequacy of security is a question of fact in all the relevant circumstances.

Even so, it was also argued at the appeal that any absence of security guards was not causative of the loss since security guards could not have done anything to stop a shooting. The Trial Judge made findings of fact which the Court of Appeal held were open to the Judge on the evidence he heard. Thus the Court of Appeal declined to interfere with the finding of causation, believing that security may well have a made a difference.

Most cases which come forward involve fights or injuries in nightclubs and restaurants rather than shootings. A shooting is at the extreme end of criminal conduct, but it will be seen that the Court of Appeal was prepared to uphold such extreme conduct as being both foreseeable and conduct over which there was capacity to control. The case reflects society's increasing intolerance of public displays of improper behaviour. The case underlines the way in which the Courts will make every effort to ensure that providers of recreational facilities control behaviour so as to ensure safety for all patrons. ■

Condos v Clycut: Speculation or conjecture does not establish negligence

Written by Charles Simon, Partner
Tel 02 8273 9911
charles.simon@wottonkearney.com.au

In ***Condos v Clycut Pty Ltd*** [2009] NSWCA 200 the NSW Court of Appeal reaffirmed that the burden of evidentiary proof requires a plaintiff to adduce evidence supporting a positive inference implying negligence on the part of the defendant; an inference which arises as an affirmative conclusion from the evidence, rises above a level of conjecture and is established as a matter of probability.

Facts

James Condos (**the claimant**) sued Clycut Pty Ltd (**Clycut**), the owner of a shopping centre, and Reflection Security Pty Ltd (**Reflections**), a firm which Clycut engaged to provide security services at the centre, arising from an injury he sustained on 23 March 2005. The claimant alleged that while walking through the shopping centre a barricade fell over and struck him.

At first instance

There was a substantial issue at trial as to what caused the accident. The claimant was unable to lead direct evidence as to how the incident occurred. He gave evidence that he was taken by a security guard to a medical centre where he overheard the security guard tell a person that the claimant was struck by a barricade. The security guard was not called to give evidence but completed an incident report which noted that *"the barricade fell over and hit the customer"*. The incident report contained a notation that the weather was *"very wet and windy"*.

Given the lack of evidence verifying the cause of the accident, Goldring DCJ found that the claimant had failed to show that either Clycut or Reflections owed him a duty of care in the circumstances or that there was a breach of that duty. He found for each defendant.

On appeal

The critical issue on appeal was whether the primary judge was correct in finding that the claimant had failed to establish that Clycut and Reflections breached their respective duty of care.

The imposition of a duty on Clycut and Reflections was not challenged on appeal. However, Clycut maintained that it discharged its duty by the appointment of Jones Lang La Salle to manage the Centre. It contended that there was no evidence the latter had failed to act reasonably in relation to a foreseeable risk.

The claimant invited the Court to draw an inference of negligence on the part of Clycut and/or Reflections from the fact that the barricade had been in place for a lengthy period and that it was windy on the day in question.

Even if the claimant fell because he was struck by a barricade, the Court stated that the claimant *"never"* established the nature of the barricade which struck him, the position of the barricade prior to it allegedly hitting him, evidence as to how the barricade was secured or evidence of the →

likely direction and speed of the wind relative to the position of the barricade.

Given the absence of critical information, the Court said it was not possible to draw an inference that either Clycut or Reflections failed to take reasonable care to avoid a foreseeable risk of injury. In particular, the claimant failed to establish that either Clycut or Reflections "*did, or did not do, something in relation to a barricade on the day in question which would support a finding that they failed to respond to a foreseeable risk*."

McColl JA highlighted that in order for the claimant to succeed against one or both entities, it was necessary to adduce evidence supporting a positive inference implying negligence on their part, "*an inference which arose as an affirmative conclusion from the evidence and one established to the reasonable satisfaction of a judicial mind. The evidence had to rise above the level of conjecture, could not be based on possibilities but had to be established as a matter of probability, and had to do more than give rise to conflicting inferences of equal degrees of probability.*"

While the Court acknowledged that it is entitled to draw inferences from "*slim circumstantial facts that exist so long as that goes beyond speculation*" it affirmed that the inference must be available and be considered to be more probable than other possibilities.

The Court was also critical of the claimant's failure to raise the issue of whether or not Jones Lang La Salle had effectively discharged its duties under its agreement with Clycut. The Court said it was incumbent upon the claimant to demonstrate that Jones Lang La Salle had, for some reason, failed to discharge its duties in relation to the safety of the premises before a conclusion could be drawn that Clycut had some residual obligations to the claimant which it had breached.

Implications

The NSW Court of Appeal has affirmed that claims for breach of any tortious duty will not be successful unless a claimant can adduce evidence supporting a positive inference implying negligence on a defendant's part which extends beyond a level of conjecture or speculation. The evidence has to be established as a matter of probability and has to do more than give rise to conflicting inferences of equal degrees of probability. ■

Contributory negligence reduces the workers compensation payback

Written by Jason Buttigieg, Senior Associate

Tel 02 8273 9933
jason.buttigieg@wottonkearney.com.au

The law in New South Wales provides that a worker who first receives workers' compensation payments and then damages for the same injury must repay the workers' compensation to his or her employer. It also provides that if the amount of damages received by the worker has been reduced to take account of the worker's contributory negligence, then the amount repayable to the employer should be reduced to the same extent that any damages are reduced.

In ***Hickson v Goodman Fielder Ltd*** [2009] HCA 11 the High Court was asked to determine whether workers' compensation payments to be repaid to an employer can be reduced when a damages claim is settled and there is no Court determination about contributory negligence or the calculation of damages.

The High Court was also required to consider whether a Court can hear evidence on the extent to which a settlement amount recovered by a worker was reduced because of contributory negligence, the degree of contributory negligence and the calculation of damages the worker would have been likely to recover if there had been no contributory negligence.

The decision at first instance

Glen Hickson (**the claimant**) was injured in a motor vehicle accident whilst driving to work on 12 March 2003.

He initially brought a workers' compensation claim against his employer and then commenced District Court proceedings for personal injuries (**the tortfeasor action**). The tortfeasor action was settled in favour of the claimant for $2.8 million plus costs.

Exercising its rights under section 151Z(1)(b) of the **Workers Compensation Act 1987 (NSW)** (**WCA**), the employer commenced proceedings against the driver of the second vehicle seeking repayment of workers' compensation payments made to the claimant (**the recovery action**).

Section 151Z(1)(b) states:

"If the worker recovers firstly compensation and secondly damages, the worker is liable to repay out of those damages the amount of compensation which a person has paid in respect of the worker's injury under this Act, and the worker is not entitled to any further compensation."

It was common ground between the claimant and his employer that contributory negligence had been a live issue in the claim against the driver of the second vehicle.

Pursuant to section 9(1)(a) of the **Law Reform (Miscellaneous Provisions) Act 1965 (NSW)** (**LRMPA**), the damages recoverable in the tortfeasor action were subject to a reduction for contributory negligence. Section 10(2) of the LRMPA provides for the reduction in the liability of a claimant to repay workers' compensation in a case in which the damages recoverable at common law are reduced on account of contributory negligence. →

In the recovery action, the claimant pleaded that his actions contributed to his injuries and that his liabilities to repay compensation to the employer were to be reduced to the same extent that the damages recoverable by him against the driver of the second vehicle were reduced.

The trial judge held that section 10(2) of the LRMPA operated to reduce the amount of workers' compensation benefits repayable to the employer from damages recovered in the tortfeasor action without the requirement of a determination by a Court concerning contributory negligence.

The trial judge also held that, subject to the rules of evidence, evidence was admissible in the recovery action to establish the extent to which damages recovered by the claimant in the tortfeasor action were in fact reduced on account of the claimant's contributory negligence.

On appeal

The employer challenged the trial judge's application of section 10(2) of the LRMPA. By a 2:1 majority, the Court of Appeal held that in the absence of a judicial determination of contributory negligence in the tortfeasor action (and in the absence of a tripartite agreement between the claimant, the driver of the second vehicle and the employer), Part 3 of the LRMPA has no application and the total amount of workers' compensation paid by the employer was repayable by the claimant pursuant to section 151Z(1)(b) of the WCA.

The High Court

The claimant appealed. The High Court unanimously upheld the trial judge's decision.

The High Court noted that the effect of the Court of Appeal decision was that section 10(2) of the LRMPA did not operate on the amount of compensation repayable by the claimant to reflect the common ground between the employer and the claimant that contributory negligence had been a live issue in the settled tortfeasor action. It was accepted that this would not have been the case had the tortfeasor action proceeded to trial with a determination.

The High Court held that in the circumstances of the recovery action the Court may be required to determine the damages recoverable by the claimant and the extent of the reduction in respect of contributory negligence. This was a reflection of the fact that the parties in the recovery action were not the same as in the tortfeasor action.

The High Court also found that the desirability of finality did not justify reading section 10(2) of the LRMPA as confined to those cases in which the tortfeasor action proceeded to judgment with a Court determination of the extent of the claimant's contributory negligence under section 9(1)(b) of the LRMPA as:

+ the fact that this may lead to a *"trial within a trial"* was an incident of the working out of the respective liabilities under the statutory scheme and the common law; and
+ the reduction for which section 9(1)(b) of the LRMPA provided involved an exercise in apportionment. The reduction in liability to repay compensation for which section 10(2) of the LRMPA provided was proportionate to the reduction in the damages recoverable on account of the claimant's contributory negligence.

Implications

The High Court decision in ***Hickson*** confirms that in a claim in which a liability is created in a non employer tortfeasor, the extent of the claimant's contributory negligence does not have to be determined by a judgment in the tortfeasor claim in order to trigger the operation of section 10(2) of the LRMPA.

Accordingly, insurers confronted with a recovery claim under section 151Z are entitled to argue for a reduced payback dependant on the basis of the worker's contributory negligence. ■

Imprecise contractual terms result in the 'cleaning up' of an occupier

Written by Paul Spezza, Special Counsel
Tel 02 8273 9909
paul.spezza@wottonkearney.com.au

The NSW Court of Appeal has found the public liability insurer of a cleaning contractor now in liquidation not liable for a damages bill for a woman who slipped on a squashed orange at a shopping centre in Sydney. The Court's unanimous judgment in ***Bevillesta Pty Limited t/as Top Ryde Shopping Centre v Liberty International Insurance Company t/as Liberty International Underwriters*** [2009] NSWCA 16 is a timely reminder for occupiers, cleaning contractors and their insurers to ensure that in claims for breach of contract against third parties, the precise terms of the relevant contract are established. Failing to do so will likely render a claim for breach of contract futile.

Wotton + Kearney acted on behalf of Liberty International Underwriters (**LIU**).

Facts

At about 5.30pm on 23 July 2001, supermarket employee, Sharifeh Reshad, was using a walkway outside a fruit shop at the Top Ryde Shopping Centre (**the shopping centre**) when she allegedly slipped on an orange and sustained various injuries. Her route took her along a walkway within the shopping centre between a fruit shop and a garden bed. At 5pm a witness had seen two oranges on that walkway, one of which was squashed and the witness saw the same squashed orange still in situ after Mrs Reshad's fall between 5.40pm and 5.45pm.

As a result of her injuries Mrs Reshad issued proceedings in the District Court of NSW against the owners of the shopping centre, Bevillesta Pty Limited (**Bevillesta**). Two entities thought to be the cleaners of the shopping centre at the time, Kidds Services Pty Limited and Kidds Executive Pty Limited (**Executive**), were also sued. Bevillesta issued a cross claim against Executive but as that entity was in liquidation Bevillesta successfully joined Executive's public liability insurer, LIU, to the proceedings pursuant to section 6 of the **Law Reform (Miscellaneous Provisions) Act (NSW) 1946**.

Trial

At trial, His Honour Hughes DCJ held Bevillesta liable for the plaintiff's injuries on the basis that it had halved the number of cleaners required under its contract with the cleaning contractor from 4 to 2 prior to the incident. The trial judge, who found that there had not been any inspections between 5pm and 5.40pm on the day of the incident, held that the reduction in cleaning staff exposed customers to a greater risk of injury and that risk materialised. The trial judge found that a reasonable inspection schedule was every 15 minutes. The trial judge dismissed Bevillesta's cross claim against LIU on the basis that there was insufficient manpower to eliminate the risk of food stuffs falling and remaining on the floor for longer periods. →

The decision on appeal

Bevillesta appealed in relation to its cross claim against LIU. The Court of Appeal confirmed that, in general, Bevillesta's duty of care could be passed onto a cleaning contractor.

The Court of Appeal found that, after the change to the cleaning contract, the cleaning contractor was still required to exercise reasonable care and skill even though there was no particular requirement regarding the frequency of inspections. The absence of this requirement proved fatal to Bevillesta's case. The Court of Appeal held that, because there was no evidence regarding the frequency of the cleaning contractor's obligation to make inspections, Bevillesta had not done enough to transfer its duty of care to the cleaning contractor.

Consequently, Bevillesta failed to establish that the cleaning contractor had breached its duty of care or its contractual obligation to exercise reasonable care and skill. This meant that the cleaning contractor was not liable and the owner's appeal was dismissed.

Implications

The shopping centre owner or centre manager may be tempted to cut back on cleaning services in order to save expense. This decision serves as an important reminder that in order to effectively delegate the owner's duty of care to a cleaning contractor, the owner must ensure that the cleaning contract specifies an appropriate frequency level for cleaning inspections. ■

Civil Liability Act (NSW): Reasonable care requirements

Written by Jason Buttigieg, Senior Associate

Tel 02 8273 9933
jason.buttigieg@wottonkearney.com.au

The NSW Court of Appeal considered the application of section 5B of the **Civil Liability Act 2002 (NSW)** (**CLA**) in ***Penrith Rugby Leagues Club Ltd t/as Cardiff Panthers v Elliot*** and affirmed that it does not itself impose an obligation on a person to exercise reasonable care to avoid harm to another.

The facts

Yvonne Elliot (**the claimant**) was injured as a result of a fall at Cardiff Panthers (**the premises**) on 4 September 2004. The incident occurred at approximately 6.30pm.

The claimant was leaving the premises when she stepped on twigs or sticks in the car park, causing her to fall and fracture both wrists. She alleged that the premises were inadequately lit and that the defendant's system of cleaning and maintenance was inadequate to remove accumulations of the twigs or sticks.

It was conceded by the defendant that the lighting in the car park was controlled by a photo-electronic sensor, so that the lights automatically switched on at sunset. The sensor failed to illuminate the lights at the time of the accident.

The decision at first instance

The trial judge found that the absence of lighting on the day of the incident caused a foreseeable risk of harm to patrons.

Accordingly, the defendant was in breach of its duty of care to the claimant in failing to provide adequate lighting. The trial judge found that a reasonable response to the foreseeable risk of harm would have been:

"To provide a system of ensuring that the external lights that operated by means of an automatic system were in fact functioning by the time it was dark."

The trial judge also found that if the lights had been functioning at the time the claimant fell, she would not have regarded the presence of twigs or sticks on the surface of the car park as a significant hazard which the defendant was required to take further steps to mitigate. In this respect the trial judge found that it was sufficient that the car park was cleaned daily.

On appeal

The defendant challenged the trial judge's interpretation of section 5B and the test applied as to the duty owed in the circumstances of the incident.

The Court of Appeal unanimously upheld the appeal and entered a verdict in favour of the defendant.

Section 5B provides that a person has not failed to exercise reasonable care and skill in failing to take precautions against a risk of harm unless:

+ it was a risk of which the person knew or ought to have known;
+ the risk was not insignificant; and
+ a reasonable person in the circumstances could have taken those precautions. →

The Court of Appeal confirmed that an inquiry into whether a reasonable person would have taken those particular precautions must include a consideration of:

+ the probability of the harm occurring if the care was not taken;
+ the likely seriousness of the harm;
+ the burden of taking precautions to avoid the risk of harm (and other similar risks of harm); and
+ the social utility of the activity that creates the risk of harm.

The Court of Appeal concluded that the trial judge regarded the defendant as under a duty to ensure that the flood lights were operating at a particular time or times, rather than a duty to *take reasonable care* to ensure that the lights were operating.

The Court of Appeal held that the trial judge sought to impose a higher standard of duty on the defendant in circumstances where there was no evidence from the claimant as to what precautions a reasonable person in the defendant's position could and should have taken to minimise the risk that both lights in its car park would be inoperative at the same time during the night.

On that basis, the Court of Appeal found that the trial judge erred in describing the defendant's duty in terms of *"ensuring"* the operation of the flood lights rather than a duty to take reasonable steps to ensure that the lights were operating.

Implication

The decision confirmed that section 5B of the CLA does not impose an obligation on the owner or occupier of premises to exercise reasonable care and skill. The purpose of the section is simply to set out a number of necessary conditions that need to be satisfied before a defendant will be held liable for a failure to exercise reasonable care and skill. Satisfaction of the conditions is a necessary, but not a sufficient, pre-requisite for civil liability to arise. ■

Recreational activities and exclusion clauses

Written by Lesley Wooodmore
For further information contact
Belinda Henningham, Partner
Tel 02 8273 9913
belinda.henningham@wottonkearney.com.au

Belna Pty Limited v Irwin [2009] NSWCA 46 (26 February 2009) involved an injury claim by Ms Irwin who hurt her knee whilst performing lunge exercises at a Fernwood Gym. She sued the gym and won $36,093. At first instance it was held that Fernwood had breached its duty of care and an implied contractual term to *"exercise reasonable skill and care in its performance*".

Recreational activities

Fernwood argued that by reason of s5M(1) of the **Civil Liability 2002 (NSW)** (**CLA**) it did not owe a duty of care to Irwin. Section 5M(1) is to the effect that no duty of care is owed to a plaintiff who engages in a recreational activity to take care in respect of a risk of the activity, if the plaintiff was warned of the risk.

The trial judge held that the exercise program undertaken by Irwin was not a *"recreational activity"* as she undertook it to lose weight and get fit. The Court of Appeal found that the trial judge erred in this regard. The Court looked to the ordinary definition of "*sport*" which includes "*participation in activities involving physical exertion and skill*" and noted that the loss of weight and achievement of physical fitness was only a by-product of the exercise.

In regards to the risk warning, the Court found that the following did not warn Irwin about any risk involved in the lunge or any other exercise she undertook and was not a risk warning within the terms of s5M:

"*I understand that Fernwood… is not able to provide me with advice in regard to my medical fitness and that this information is used as a guideline to the limitations to my inability to exercise. I will not hold this club liable in any way for the injuries that may occur while I am on the premises.*"

Accordingly, Fernwood's arguments under the CLA failed.

Breach of contract

Fernwood argued that the following clause in its contract with Irwin excluded it from liability:

"*It is my expressed interest in signing this agreement, to release Fernwood … from any and all claims for professional or general liability, which may arise as a result of my participation, whether fault may be attributed to myself or its employees… I also understand that each member or guest shall be liable for any … personal injury while at the Centre.*"

The Court of Appeal agreed with the trial judge's finding that "*The clause is not merely ambiguous, it is likely unintelligible*". They found that at best for Fernwood, the clause provided a release, which ordinarily has effect after liability has been incurred and is not an exclusion of liability in the future. It was further noted that the phrase "*professional or general liability*" may or may not encompass negligence or breach of contract.

Accordingly, the application for leave to appeal was dismissed.

The moral

This case demonstrates that the CLA does not release recreational service providers from their duty of care and that a risk warning must be specific and not broad in order for the relevant provisions of the CLA to have effect.

Further, if a recreational service provider is to include an exclusion clause in its contract, the exclusion must be free of ambiguities and legally enforceable. ■

High Court reaffirms principals' duties to contractors

Written by Charles Simon, Partner
Tel 02 8273 9911
charles.simon@wottonkearney.com.au

On 2 September 2009, the High Court of Australia (French CJ, Gummow J, Hayne J, Heydon J and Bell J) delivered a unanimous decision in ***Leighton Contractors Pty Ltd v Fox & Ors and Calliden Insurance Limited v Fox & Ors***[1] and reaffirmed the duties owed by principals to contractors on construction sites. The High Court reinforced the principles enunciated in ***Stevens v Brodribb Sawmilling Co Pty Limited***[2] and held that:

+ a head contractor owes no stringent or strict common law duty to train subcontractors engaged to work on a site in the manner in which the subcontractor is to perform its speciality work; and
+ a contractor who subcontracts work on a construction site to a competent subcontractor is not subject to an ongoing general law obligation with respect to the safety of the work methods employed by the subcontractor.

Facts

Mr Fox, the respondent, suffered injuries to his neck and head whilst working at a construction site at the Hilton Hotel in Sydney (**the construction site**). Leighton Contractors Pty Limited (**Leighton**), the principal contractor, contracted Downview Pty Limited (**Downview**) to carry out concreting. Downview subcontracted the concrete pumping to Toro Constructions (**Toro**). Toro's pump purportedly failed which lead to Toro contracting Aggforce Concrete Pty Limited (**Aggforce**) to supply a pump to pump the concrete. Aggforce retained Warren Stewart Pty Limited (**Stewart**) to operate the pump. Mr Fox, an independent contractor, attended with Stewart to act as his general labourer.

On 7 March 2003, Mr Fox was cleaning the concrete delivery pipe at the construction site when the end of the pipe struck him on the head.

The courts below

At first instance, Mr Fox sued Leighton, Downview, Stewart and Toro. Gibb DCJ in the District Court of NSW found that the accident was caused by the negligent conduct of Stewart and awarded damages of $472,562. The claims against Leighton and Downview were dismissed (the claim against Toro having been discontinued during the course of the hearing).

Mr Fox appealed to the NSW Court of Appeal (**CoA**) against the dismissal of his claims against Leighton and Downview. The CoA held that Leighton was subject to a general law duty of care to subcontractors coming onto the construction site, the scope of which included induction training in matters of safety associated with the tasks to be performed by the subcontractors. The CoA held that the only way Leighton could discharge its duty of care was to ensure that all persons coming onto the site had undergone relevant induction training. While the evidence before the primary judge was that →

1 (2009) HCA 35 – Calliden Insurance Limited was substituted for Downview Pty Ltd pursuant to section 6 of the **Law Reform Miscellaneous Provisions Act 1946**

2 (1986) 1960 CLR 16

all persons coming on site were given a general induction of general hazard and safety issues, the CoA inferred that the induction training of Stewart and Mr Fox would have included training in relation to pipe line cleaning and those matters addressed in the WorkCover Authority of NSW's Code of Practice: Pumping Concrete (approved as an industry code of practice under section 44 of the **Occupational Health & Safety Act 2000** (NSW)) (**OH&S Act**). Leighton was held to have breached its duty of care by allowing Mr Fox to enter the site without having undergone induction training.

The CoA found that Downview had a general law obligation to its subcontractors to conduct its operations safely. The CoA held that Downview's conduct in failing to instruct them on the procedures and requirements relevant to the contract works equated to a breach of its duty of care.

The CoA found that both Leighton and Downview were subject to a common law duty of care for the benefit of Mr Fox and that each was in breach of that duty. Accordingly, Mr Fox was successful. The CoA apportioned liability 80% to Downview and 20% to Leighton.

The High Court

The High Court unanimously upheld Leighton and Downview's appeal. Both Leighton and Downview successfully argued that the imposition on each of them of a common law duty of care owed to Mr Fox, an independent contractor, involved an unwarranted extension of the liability of principals for negligent acts of independent contractors engaged by them.

A critical consideration for the High Court was the extent of the duty owed by a head contractor to induct subcontractors coming onto its site in matters relevant to safety associated with the tasks to be performed by that subcontractor and/or addressed in an industry code of practice as may be applicable to that speciality.

The High Court acknowledged that whilst obligations under statutory enactments have relevance to determining the existence and scope of a duty, it is necessary to exercise caution in translating those obligations into a duty of care at common law. This is consistent with the High Court's decision in ***Roads and Traffic Authority (NSW) v Dederer***[3] where it was held that *"whatever their scope, all duties of care are to be discharged by the exercise of reasonable care. They do not impose a more stringent or onerous burden".*

While the High Court recognised that a head contractor owed a duty to persons coming onto its site to use reasonable care to avoid physical injury to them, it emphasised that the common law does not recognise a "*special or strict*" liability flowing from breach of a duty to provide induction training. To do so would impose a burdensome obligation on a principal/head contractor to provide training in the safe method of every trade on site. The High Court found that such a duty was inconsistent with the distinction drawn at common law between employers and their employees and of principals to subcontractors.

With reference to Downview's liability, the High Court stated that had Downview failed to engage a competent subcontractor, it may not have avoided liability for negligent failure of the subcontractor to take reasonable care to adopt a safety system of work. In the absence of such a finding, the Court recognised that a contractor was not subject to an ongoing general law obligation with respect to the safety of the work methods employed by its subcontractor or those with whom that subcontractor subcontracted.

Implications

The High Court's findings are of relevance to insurers of construction risks. Had the High Court refrained from interfering with the CoA's decision, it would have signified a widening of the scope of the duty of care of principals with respect to independent contractors which would have had the potential to impact significantly on how parties to construction projects assess and allocate their risks. →

3 (2007) 234 CLR 330

The High Court's decision signifies:

- that while a principal/head contractor owes a duty to persons coming onto its site to use reasonable care to avoid physical injury to them, the principal/head contractor is not under a stringent or more onerous duty to provide training in the safe method of every trade on site;
- that a contractor who contracts work on a construction site to a competent subcontractor is not subject to an ongoing general law obligation with respect to the safety of the work methods employed by the subcontractor or those with whom that subcontractor subcontracted; and
- while obligations under statutory or other enactments have relevance to determining the existence and scope of duty, it is necessary to exercise caution in translating the obligations imposed on employers, principal contractors and others under the OH&S Act and Regulations into a duty of care.

Baker-Morrison v State of NSW: The Limitation Act reviewed

Written by Juliet Eckford, Solicitor
Tel 02 8273 9934
juliet.eckford@wottonkearney.com.au

The NSW Court of Appeal has provided interpretation of the amended **Limitation Act 1969 (NSW)** (**the Act**). Under section 50D(1) of the Act, a cause of action in personal injury actions is *"discoverable"* on the first date that the claimant knew or ought to have known that:

+ the injury has occurred (50D(1)(a));
+ the injury was caused by the fault of the defendant (50D(1)(b)); and
+ the injury was sufficiently serious to justify bringing an action (50D(1)(c)).

The first fact is usually uncontroversial, however facts under s.50D(1)(b) and (c) are more difficult to establish.

Determination of the discoverability date is subjective, dependent upon the claimant's knowledge and actions (or lack thereof, subject, under s.50D(2), to "*reasonable steps*" being taken). Consideration is no longer given to prejudice likely to be suffered by a prospective defendant.

Background

In ***Baker-Morrison v State of NSW*** (2009) NSWCA 35 a 3 year old child, Baker-Morrison, suffered injuries when her hand became trapped in sliding entrance doors to Gosford Police Station. She underwent surgery. A Statement of Claim was issued 3 years and 26 days after the injury occurred. The defendant sought to strike out the claim on the basis that it was statute barred under the Act.

The claimant's mother consulted a solicitor, who wrote to the defendant 6 days after the accident, putting it on notice and requesting a view of the site.

At first instance, the Court held that the limitation period had not expired. The defendant appealed.

"*Fault*" under section 50D(1)(b)

It is arguable that a claimant cannot *"know"* the injury was caused by the fault of a defendant until the conclusion of proceedings when the Court has made a determination of liability. However, it is accepted that facts pursuant to section 50D do not need to be known in an absolute sense, rather that they may be established on the balance of probabilities sufficient for the purpose of legal proceedings.

On appeal, the defendant argued that at the date of the claimant's solicitor's letter to the defendant, the claimant was aware of the defendant's fault for the purposes of s.50D(1)(b).

The Court held that the claimant's notice to the defendant was not evidence that fault had been determined. The claimant was not in a position to determine fault until expert liability evidence had been obtained and the claimant's solicitor had considered whether any practical measure to improve safety would have been reasonable. →

"*Sufficiently serious*" under section 50D(1)(c)

On appeal, the defendant argued that it would have been immediately evident that the injury was clearly *"sufficiently serious"* to justify the bringing of an action as the claimant required hospitalisation. However, the Court held that reference should be made to the various statutory limits placed upon damages. In this case, whilst one expert assessed the claimant's injuries at 16% of a whole person impairment, another had assessed it at just 1%. The Court held that the seriousness of the injury was not therefore straightforward. In this case, the claimant could not have known whether her injury was "*sufficiently serious*" at the time she was injured.

The Appeal Court refused to find that the claimant was statute barred from bringing her action.

Implications for insurers

The amendments to the Act afford the courts extensive discretion in determining the date on which the 3 year personal injury limitation period commences to run. An insurer moving to prove that a claim is statute barred faces a difficult evidentiary burden.

Developments in labour hire liabilities

Written by Andrew Seiter, Senior Associate

Tel 03 9604 7906
andrew.seiter@wottonkearney.com.au

In Victoria workers who suffer a Serious Injury have a right to seek common law damages against the worker's employer and, where applicable, against other negligent third parties. Such actions have been frequent in labour hire situations, e.g. where a temporary employee is placed with a host employer. Insurers will be aware of the frequency and exposure of these claims as the liability of the host employer falls under a general liability policy.

On 21 May 2009, after a 19 day trial, Justice Beach handed down his decision in (1) ***Papadopoulos v MC Labour Hire Services Pty Ltd & Anor (No 4)*** [2009] VSC 193 and (2) ***Victorian WorkCover Authority v Concept Hire Ltd & Ors*** [2009] VSC 194. The first judgment is of interest to those in the industry who deal with "*labour hire*" cases from the Victorian Workcover Authority and other statutory bodies seeking to recover from allegedly negligent third parties.

The feature of the case is the legal consequences of the fact that the Plaintiff, Mr Christopher Papadopoulos (**the Plaintiff**), had suffered an antecedent work injury which he reported to his labour hire employer, MC Labour Hire Services Pty Ltd (**MC Labour**). MC Labour took a conscious decision not to refer the Plaintiff's WorkCover claim to the Authorised Insurer as required by the **Accident Compensation Act** (**the Act**). Instead, after surgery and an extended period off work, MC Labour sent him off to a host employer, Concept Hire Ltd (**Concept**), to work as a labourer. It did not put in place a documented Return to Work plan (**RTW**) prior to his placement as required by the Act and it did not tell Concept about the injuries.

The Plaintiff suffered a further workplace injury on 10 May 2001 and successfully sued both MC Labour and Concept. MC Labour's interests were indemnified by Victorian WorkCover Authority.

The key issue in the judgment is that MC Labour was held 50% liable, which is a significant amount in the context of the usual awards in this area. It represents a landmark decision since up to now the usual range for liability of a labour hire company was, at most, 35%. Accordingly, the case will be studied carefully going forward.

This case also demonstrates the importance of making an early, well-considered Offer to Contribute in multi-defendant actions. The final outcome was that MC Labour was ultimately ordered to pay Concept's party-party costs as and from the date of the offer including the costs of the 19 day trial.

Andrew Seiter, a Senior Associate with Wotton + Kearney, represented Concept.

The facts

The Plaintiff brought a proceeding in respect of lumbar spine injuries he alleged he sustained on 10 May 2001 when working at a building site controlled by Concept.

The Plaintiff was a qualified carpenter. On 25 June 2000 he commenced employment with →

MC Labour, a labour hire company. Essentially, he worked as a labourer.

On 19 September 2000 he injured his right knee whilst climbing down a ladder at a construction site where he had been sent by MC Labour. The Plaintiff completed a WorkCover claim which was handed to MC Labour. Although it was required to do so by the Act, MC Labour did not lodge the claim with the WorkCover Insurer. Justice Beach held that the reason was that *"it looks bad on* [MC Labour's] *books"* and would affect its WorkCover premiums. MC Labour chose to self-manage the claim and agreed to pay the Plaintiff's medical bills and his wages for time off work relating to the injury.

The Plaintiff continued to work for MC Labour between October 2000 and March 2001. He had several days off work due to the knee injury.

In late March 2001 the Plaintiff underwent arthroscopic surgery on his knee. MC Labour paid the full cost of the surgery and his time off work. The Plaintiff then had what he described as a *"niggle"* in his back. Three days after the surgery, as he was getting dressed, he experienced severe pain in his buttocks and down his left leg.

The Plaintiff was diagnosed with "*lumbar disc prolapse of the nuclear type*". He was prescribed a back care programme, traction and physiotherapy.

The evidence was that the Plaintiff's condition improved. As a result, he was advised he should be right to go back to work but to initially "*do a little bit of light duties*". The Plaintiff gave evidence he told MC Labour of his back injury. This evidence was accepted by Justice Beach over MC Labour's denials.

The Plaintiff's first placement after the March surgery was on 24 April 2001 with Concept.

On 10 May 2001 the Plaintiff suffered further lumbar spine injuries while lifting a roll of membrane. The estimates of the weight of the 1.2 metre long roll ranged between 25 to 50 kilograms.

The jury verdict and apportionment

The Plaintiff's proceeding was heard by a Jury as is permissible in Victoria. The Jury awarded the Plaintiff damages of $677,825 after reduction of 11.5% for contributory negligence (**the Damages Award**) and WorkCover payments received to that date.

MC Labour and Concept sought apportionment of the Damages Award.

In apportioning Justice Beach was required to take into account the comparative culpability of the two defendants. The judgment is interesting in its detail.

MC Labour submitted Concept was more culpable as it had actual control of the site and directed the work. Concept submitted that MC Labour was significantly more culpable because of its failure to comply with the RTW process and to inform it of the Plaintiff's recent injuries.

However, Justice Beach found that had MC Labour complied with its statutory RTW obligations there would have been consultation with the plaintiff's general practitioners, if not other appropriately qualified rehabilitation specialists. Further, Justice Beach found it likely that the plaintiff would have been placed on a RTW programme which required no heavy lifting for at least one month following his return to work and thus, even if the plaintiff was employed at Concept's site and was directed to lift an inappropriate weight (it having required him to do so on 10 May 2001), it was likely he would not have complied or would have sought appropriate assistance, thereby avoiding injury.

Justice Beach thus found a causal link between MC Labour's conduct in not properly managing its RTW obligations in accordance with law and the happening of the injury.

On the other side of the coin, Justice Beach held that Concept had controlled the premises, it supplied any plant and equipment and it was wholly responsible for devising, instituting and maintaining the system of work. Whilst both defendants bore a responsibility for the →

Plaintiff's training and safety induction, MC Labour did not have an ability independently of Concept to avert the hazard caused by attempting to lift the roll.

Justice Beach went on to say that having regard to the more significant negligence of MC Labour (over a prolonged period) compared with the more significant causal potency of Concept's acts, the appropriate apportionment was 50/50.

The cost consequences

MC Labour and Concept were ordered to each pay 50% of the Damages Award.

Concept had served MC Labour with a Notice of Contribution some six months prior to the trial offering to contribute 50.01% towards any judgment or settlement sum.

Justice Beach ordered that MC Labour pay Concept's party/party costs from the date of the offer. As such, MC Labour bore the bulk of the significant costs incurred by Concept in defending the action from shortly after the mediation of the matter, including a 19 day trial.

Implications

The decision raises a number of issues to consider in labour hire and Section 138 recovery actions (which is the action brought by the VWA to recover compensation benefits paid by it to a worker):

+ the liability of the labour hire employer for breach of its duty of care to the worker was 50% which is the highest known award in this area;
+ the potential relevance of a labour hire company's conduct prior to placement of the worker. Consistent with the decision, it may be relevant to apportionment to consider what steps the labour hire company took in determining the suitability of a particular employee to a placement with a 'host' employer; and
+ the importance of serving a well-considered Offer of Compromise at an early stage in order to protect the client against unavoidable trials. ■

Who is to blame when treatment is refused?

Written by Georgie Mullighan, Solicitor
Tel 02 8273 9931
georgina.mullighan@wottonkearney.com.au

The decision in ***Neal v Ambulance Service of NSW*** [2008] NSWCA 346 held that ambulance officers were not liable for the injuries of an intoxicated man who refused treatment.

The facts

On 21 July 2001, Mr Neal suffered a serious blow to the head, possibly the result of an assault, while walking alone at night. Police officers discovered him and called an ambulance. Mr Neal was heavily intoxicated and refused treatment from the ambulance officers. Given Mr Neal's inebriated state, the police took him into custody under the **Intoxicated Persons Act 1979 (NSW)** (**the Act**). The following morning police officers discovered that Mr Neal's condition had deteriorated and an ambulance was called to transport him to hospital. A CT scan revealed an extradural haematoma with a fracture to the skull which required immediate surgery. As a result of his injuries Mr Neal suffered various ongoing disabilities including paralysis of the right side of his face.

He brought proceedings in the NSW District Court against the State of NSW (i.e. the NSW Police) and the Ambulance Service of NSW for failing to take him to hospital for assessment of the seriousness of his head injury.

At first instance, Mr Neal was successful against the Ambulance Service on the basis of a *"loss of chance"* of a better medical outcome had treatment been received earlier. However, no negligence was found on the part of the State. He appealed against the trial judge's findings with respect to the State's liability and on the question of damages. The Ambulance Service cross-appealed in relation to its liability.

The Appeal

The issues for determination on appeal were:

+ whether the ambulance officers were negligent by failing to advise the police that Mr Neal needed to be taken to hospital for treatment;
+ whether the police were negligent by failing to take Mr Neal to hospital; and
+ whether damages were assessed correctly on a loss of chance basis.

In respect of the ambulance officers, the Court of Appeal held they had a duty to pass on information about Mr Neal's condition to the police as they were unable to provide medical assistance and knew he was to be taken into custody. That being so, the crucial question was whether Mr Neal would have submitted to medical treatment. Based on the evidence available, the Court of Appeal found the only reasonable inference was that he would not have submitted to medical assessment. Therefore, Mr Neal could not establish that any breach of duty by the ambulance officers was causative of his delay in receiving treatment and consequential ongoing disabilities.

In relation to the police, it was noted that they had a general legal obligation to provide medical treatment to detainees, however there was no breach of that duty with respect to Mr Neal. Although the police lawfully exercised the power to detain Mr Neal under the Act, they could →

not have forced him to receive medical treatment, which in probability, he would have refused.

Ultimately, Mr Neal's claim failed in its entirety.

Implications

The decision in ***Neal*** raises the question of what is the appropriate response for an ambulance officer faced with an intoxicated patient who refuses treatment. The case begs the question of whether intoxicated persons should be deemed capable of making decisions, which may be life-saving, about their medical treatment.

A final thought: failure to render treatment may render a medical provider liable for consequential injuries, however if the treatment is administered without consent the provider may be liable for assault or trespass to the person. There appears to be a need for a specific protocol for such matters which balances the welfare of the injured person and the duty of a medical provider to provide every assistance to the injured person.

No duty to rescue

Written by Justin Carroll, Solicitor
Tel 02 8273 9932
justin.carroll@wottonkearney.com.au

Section 10 of the **Mental Health Act 1986 (VIC)** (**the Act**) gives police a power to apprehend a person who:

+ appears to be attempting suicide; and
+ appears to be mentally ill.

Do police officers owe a duty to exercise that statutory power in circumstances where a person appears to be attempting suicide but does not appear to be mentally ill? The High Court says no. In ***Stuart v Kirkland-Veenstra*** [2009] HCA 15 it was held that control lay not with the police officers, but with the person attempting to commit suicide.

Facts

On 22 August 1999 two police officers came across Ronald Veenstra (**Veenstra**) sitting in his car in a public carpark with a hose running from the exhaust pipe into the interior of his vehicle. The engine was cold. The officers questioned Veenstra who told them that he had been about to do something stupid but that he had changed his mind and was going to go home to talk to his wife.

The two officers gave evidence, which was accepted by the trial judge, that Veenstra sounded calm and rational. He declined the officers' offers of assistance and removed the hose from the exhaust pipe. The officers let him go from the carpark.

Later that day, Veenstra committed suicide at his home by sitting in his car with the engine running and a hose conducting exhaust fumes into the interior of his vehicle.

Prior proceedings

Veenstra's widow, Mrs Kirkland-Veenstra (**the plaintiff**), sued the two police officers and the State of Victoria (**the defendants**) alleging that the officers had breached their duty of care towards her husband and herself by failing to apprehend him under s10 of the Act.

The trial judge ruled that there was no duty of care and gave judgment for the defendants. The plaintiff appealed to the Court of Appeal which allowed the appeal by majority. The High Court granted the officers special leave to appeal.

High Court proceedings

The High Court rejected any duty to rescue under the common law. In the majority's view, recognition of a duty of care on the facts of the present case would require every person who knows (or who ought to know) that another was threatening self-harm to take reasonable steps to prevent that harm, regardless of whether the person threatening self-harm was, actually or apparently, mentally ill.

It was noted that such a duty would be diametrically opposed to the common law rule that knowledge of a risk of harm and a power to avert or minimise that harm does not, without more, give rise to a duty of care. The majority concluded that to depart from that rule by recognising a duty to prevent another from engaging in conduct that may cause that person harm would be to permit a significant intrusion into one's personal dignity and liberty.

Implications

This case confirms the aversion of the common law to imposing a duty on strangers to prevent harm to others even where the stranger has the power to do so. ■

Occupiers' liability: Sleepovers count too

Written by Judy Truong, Solicitor
Tel 02 8273 9965
judy.truong@wottonkearney.com.au

In ***Thomas v Shaw*** [2009] NSWSC 510 the Supreme Court of NSW awarded $853,396 in damages plus costs to a plaintiff who suffered brain damage after falling from the top bunk of a bunk bed in a private home. This decision looks at an occupier's duty of care owed to guard against reasonably foreseeable risks of injury to invitees on their premises.

Facts

On 23 April 2004 10 year old Cameron Thomas was invited to stay the night at 13 year old Joel Shaw's house. The boys slept in Joel's bedroom on two bunk beds – Joel was on the top and Cameron slept on the one below. During the night, Cameron climbed up to Joel's bunk. Cameron later decided to slide down the bunk and in doing so placed one foot on a chest of drawers. He slipped and landed on the floor, fracturing his skull causing a brain injury with permanent impairment of brain function and psychological injuries.

The bunks had been purchased by Joel's parents. The safety features of a ladder and guard rail were removed prior to the sleep over, apparently because they had broken shortly after the bunks were purchased. Joel's parents said that the bolts had stripped out of the framework when one of their children had climbed off the bunks, so they removed the guard rail from both bunks considering this the *"safer"* option.

Cameron (through tutors) sued Joel's parents (**the Shaws**) for his injuries.

Decision

Cameron argued that the risk of being injured when using the bunks without a guard rail and ladder was *so* significant that Australian/New Zealand Standard 4220:1994 mandated the fitting of guard rails and ladders to bunk beds to ensure access.

Mrs Shaw gave evidence that other children had stayed over and used the same bunk bed setup without injury. However, she admitted that whilst she had seen the boys use the end of the bunk to climb up, she never saw them climb down – she only ever saw them jump down conceding *"Boys do a lot of jumping."*

Justice Kirby held that it was foreseeable that young children of Cameron's age would climb onto the top bunk and "*improvise*" in getting down. He found the Shaws ought to have known that there was a risk of harm when there was no ladder and guard rail. He held that they negligently allowed Cameron to sleep on the bunk bed without a ladder and guard rail and failed to warn him to take care when climbing (and descending) the bunk bed.

The Shaws argued that Cameron entertained an *"obvious risk"* within the meaning of section 5F of the **Civil Liability Act (2002) NSW** in attempting to dismount the top bunk as did. The Court rejected this argument citing the Shaws' failure to plead an obvious risk defence. In any event, the Court held that the risk was not obvious to a 10 year old boy. →

The Court made no allowance for contributory negligence on the basis of Cameron's age and the "*challenge*" he faced in getting down from the bunk bed without a ladder or guard rail. The Court accepted that Cameron was accustomed to using a ladder and that his method of lowering himself onto the chest of drawers and then to the lower bunk (or lowering himself onto the chest of drawers and jumping) was a reasonable response in the circumstances.

Implications

The Shaws owed the usual occupier's duty to exercise reasonable care to protect persons entering the premises from risk of injury by reason of the state of that premises. This same standard of care applies to guests invited to visit the premises, including children.

Personal injury litigation in Victoria: The year in review

Andrew Seiter, Senior Associate
Tel 03 9604 7906
andrew.seiter@wottonkearney.com.au

A number of trends have emerged in Victoria over the past twelve months.

The personal injury claims schemes

In terms of the numbers of claims currently being issued, personal injury litigation in Victoria can be grouped in the following order of magnitude:

+ Transport accident or worker's compensation injuries.

  To be entitled to claim common law damages, the claimant must have a 30% whole person impairment (**WPI**) assessed under the AMA Guides Edition 4 or obtain a Serious Injury Certificate based on a narrative test of serious injury (**Statutory Liability Actions**).

+ Actions brought by Transport Accident Commission (**TAC**) or Victorian WorkCover Authority (**VWA**) to recover from liable third parties the no fault compensation paid to or on behalf of entitled persons (**Recovery Actions**).

+ Other personal injury claims, other than asbestos and dust diseases litigation. Part VBA **Wrongs Act 1958 (Vic)** (as amended) applies.

  To recover pain and suffering damages the claimant must obtain a Certificate of Assessment from an approved medical practitioner which states that the degree of impairment resulting from the injury satisfies the threshold level. The threshold level, in the case of physical injury, is more than 5% WPI. For psychological injuries, the permanent non-physical injury threshold is more than 10% WPI. There is no narrative test (**General Liability Actions**).

+ Asbestos and dust diseases claims which are not subject to the threshold tests or other statutory restrictions that apply to statutory liability or General Liability Actions (**Dust Disease Actions**).

Once applicable thresholds are met, there are very few restrictions on a claimant's entitlement to recover damages as assessed by the common law.

Victoria does not have a graduated scale for the assessment of pain and suffering damages as exists, for example, in New South Wales or under the **Trade Practices Act 1974 (Cth)**. The sole significant restriction is a cap on pain and suffering damages of $450,460 (as from 1 July 2009), which is indexed annually.

The developments in brief

Over the last 12 months, we have observed a general rise in claims activity. The number of claims being filed, particularly in the Supreme Court of Victoria, and those being litigated to judgment have increased.

The trend is also towards a significant inflation in pain and suffering damages awards at all levels, which means the value of the individual claim is rising. →

Underwriters and claims managers need to ensure they are allowing for these developments.

Inflation of damages

Our assessment of inflation of pain and suffering awards at all levels has been formed after detailed analysis of all personal injury decisions handed down in Victoria in the past 18 months.

A fair conclusion is that awards are as much as 50% higher than pre-2008 assessments.

Future awards will be determined by reference to these earlier decisions. Section 28HA **Wrongs Act 1958 (Vic)** (as amended) expressly permits the Court to refer to earlier decisions of that or other Courts for the purpose of establishing the appropriate pain and suffering damages award and permits Counsel to bring the Court's attention to these awards.

Statutory liability actions

The Victorian WorkCover Authority continues to be the initiator of the majority of personal injury litigation in Victoria.

Underwriters and claims managers will already be aware that the VWA receives favourable treatment in the assessment of its entitlements against third parties in Recovery Actions because of the operation of the formula in Section 138 **Accident Compensation Act 1985 (Vic)**.

However, in December 2008, the Victorian Government passed the **Compensation and Superannuation Legislation Amendment Act 2008 (Vic)** which has further increased TAC and VWA recovery entitlements.

The purpose of that Act was to overturn the Court of Appeal decision in ***Alcoa Portland Aluminium Pty Ltd v Husson & Anor*** [2007] VSCA 209. The Court of Appeal had unanimously said that TAC and VWA's entitlements in their Recovery Actions were restricted by the tort law reform provisions introduced into the **Wrongs Act 1958 (Vic)** (as amended) in 2003. This placed restrictions on the manner of assessment of personal injury and non-economic-loss damages. For instance, to the extent Part VBA thresholds applied, they reduced Recovery Action assessments in smaller cases. The 5% discount rate (rather than 3% at common law) and restrictions of gratuitous attendant care impacted on VWA's entitlements for Recovery Actions involving more serious injuries which had resulted in long term impairment.

Mr Kim Wells, the Opposition Member for Scoresby, made comment on the likely impact of the Act to insurers when he said in Parliament:

"*Our concern about this provision in the bill is that when the Wrongs Act was amended in 2003 the intent was to try to decrease the cost of public liability. My concern is that public liability costs will increase as a result of the amendments that are being made.*"

Thus, TAC and VWA Recovery Action entitlements are now calculated by reference to the much more favourable pre tort-law reform common law principles. The Act was passed with retrospective effect and therefore applied to claims already being litigated. Recovery Actions will cost insurers more as a result.

General liability actions

Since tort law reform in 2003 and the introduction of a threshold injury requirement for recovery of pain and suffering damages, the number of General Liability Actions has been very low.

Precise figures are not available for the last 12 months but the evidence is that more General Liability Actions are now being pursued. We are seeing more 'slips & trips' and claims at the lower end.

A major contributing factor to this developing trend is the growing familiarity and body of experience approved medical practitioners now have with the AMA Guides. As a result more Certificates of Assessment are issued as injuries are assessed more favourably to the claimant. →

These Certificates of Assessment are subject to review by a Medical Panel on application by the defendant. Whilst a Medical Panel's medical opinion is not subject to appeal on its merits, there have been a number of recent applications to the Supreme Court seeking judicial review of the medical opinions. To overcome restrictions placed on appeal rights, the application attacks the adequacy of reasons and the methodology adopted by the Medical Panel. Where successful, the medical opinion may be quashed and referred back to the Medical Panel for further determination. We anticipate seeing further developments in 2010 in this area.

There have also been further moves by the Plaintiff law representative groups, the Law Institute of Victoria and the Bar Association to roll back the impact of tort-law reform. Recently these organisations have again sought reductions in the Part VBA threshold levels referred to above and the introduction of a narrative test of 'significant injury' for claimants who do not meet the WPI thresholds.

If introduced, the narrative test will lead to more litigation and claim costs. This has been the experience with Statutory Liability Actions, which are in many cases determined by reference to the narrative test.

The Government has not indicated whether it supports the introduction of changes. We anticipate the efforts of these associations will continue.

Streamlining of personal injury litigation in the Supreme Court of Victoria

In the past 12 months there has been an increase in the number of reported personal injury decisions, particularly in the Supreme Court.

We have also noted a developing trend towards more claims being filed in the Supreme Court even though the County Court of Victoria shares unlimited jurisdiction.

This may in part be influenced by more favourable costs entitlements in the Supreme Court jurisdiction. We also suspect that a plaintiff's decision to file in this Court has been influenced by the Supreme Court's '*streamlining*' of personal injury proceedings.

A new specialist Personal Injury list was established and commenced operation this year. Both a trial date and a presiding judge will be allocated at the first directions hearing. Cases in the Supreme Court will come on for hearing more quickly than had been the tendency in the past. The allocation of a judge also means the parties will now know who will hear the claim, which may influence decisions. ■

Insurance Year in Review 2009
Professional Indemnity

Failure to notify: Section 54 revisited

Written by Colleen Palmkvist, Senior Associate
Tel 02 8273 9954
colleen.palmkvist@wottonkearney.com.au

In ***Aussie Tax Ltd v Markel Capital Ltd*** [2008] VSC 592 Byrne J had to determine whether an insurer of a claims made and notified policy is entitled to deny a claim based on an insured's failure to notify within the period of insurance and whether section 54 of the **Insurance Contracts Act** (Cth) 1984 (**ICA**) operates to preserve the insured's rights under the policy.

Facts

Between July 1999 and October 2001 Ronald Asquith and a company under his control, Aussie Tax Pty Ltd (together **Aussie Tax**) gave certain professional advice in the course of their accounting practice to a group of clients (**the clients**). On 16 May 2006 the clients commenced proceedings against Aussie Tax for breach of the duty of care owed with respect to that advice. In January 2007 the proceedings were settled, with Aussie Tax agreeing to pay $935,000 to the clients.

Aussie Tax participated in a professional indemnity insurance scheme (**the Scheme**) and entered into policies of insurance under the Scheme as follows:

+ policy issued by GIO General Ltd (**the 1999 insurer**) for the period 30 September 1999 to 30 September 2000 (**the 1999 policy**);
+ policy issued by Lloyds (**the 2000 insurer**) for the period 30 September 2000 to 30 September 2001 (**the 2000 Policy**); and
+ policy issued by Lloyds (**the 2001 insurer**) for the period 30 September 2001 to 30 September 2002 (**the 2001 policy**).

In February 2002 Aussie Tax advised the 2001 insurer of the existence of a potential claim by the clients and in the same month requested indemnity for the clients' potential claim.

The issue in dispute

Aussie Tax brought proceedings against Markel Capital Ltd (**Markel**) (representing the 2001 insurer) seeking declarations that the 2001 insurer was liable to indemnify it in respect of its civil liability to the clients and for certain costs and expenses.

Aussie Tax conceded that prior to the period of insurance of the 2001 policy, it knew of circumstances that were likely to give rise to the clients' claim (**the relevant circumstances**). This brought into operation the prior known facts and circumstances exclusion clause that provided:

"***Exclusions***

1. The insurer shall not indemnify the Insured in respect of any civil liability or loss arising from -

a) any circumstances of which the Practitioner, the Firm or the Company, as the case may be, knew, or a reasonable person in the circumstances could be expected to know, prior to the Period of Insurance, to be circumstances likely to give rise to a claim against the Insured in respect of civil liability". →

To get around this Aussie Tax sought to rely on a Continuity Extension provision contained in Extension Clause 4 to the 2001 policy (**Continuity Extension 4**).

Continuity Extension 4 provided that if an Insured had been insured under the Scheme continuously from the point in time that the Insured knew or ought to have known that the circumstances were likely to give rise to a claim, then Exclusion Clause 1(a) would not operate. However, the effect of sub-paragraph (c) of Continuity Extension 4 was that the extension would not apply if the Insured was entitled to indemnity for the claim under a preceding policy.

Markel argued that Continuity Extension 4 was not engaged because Aussie Tax was and remained entitled to indemnity under either the 1999 or the 2000 policy for the clients' claim. Markel argued that Aussie Tax was so entitled through the operation of section 54 of the ICA.

The trial before Byrne J turned on the question of whether Continuity Extension 4 was engaged.

The decision

The preliminary questions for consideration by Byrne J were:

+ whether the 1999 or the 2000 policies, or both of them, excluded indemnity as a result of Aussie Tax's failure to report the relevant circumstances to those insurers during the period of insurance; and
+ if so, whether Aussie Tax's rights under the 1999 and the 2000 policies were preserved by the operation of section 54 of the ICA.

The 1999 and 2000 policies were claims made and notified policies that contained a deeming provision. It was agreed that Aussie Tax was aware of the relevant circumstances but did not notify the 1999 insurer or the 2000 insurer of the relevant circumstances during the period of insurance. Applying the reasoning in ***FAI v Australian Hospital Care Pty Ltd*** (2001) 204 CLR 641 Byrne J held that:

+ the 1999 policy permitted the 1999 insurer to refuse to pay by reason of the omission of Aussie Tax to give notice to that insurer, unless section 54 was engaged as in ***Hospital Care***;
+ by section 54(6) of the ICA an "*act*" includes an omission, so that Aussie Tax's failure to notify was an act within the meaning of section 54(1) of the ICA that occurred after the 1999 policy was entered into;
+ the effect of section 54(1) of the ICA is that the 1999 insurer was not entitled to refuse indemnity under the 1999 policy or put affirmatively, the liability of the 1999 insurer was engaged; and
+ as Aussie Tax was, by the operation of section 54, entitled to indemnity under the 1999 policy, the exception at subparagraph (c) to the Continuity Extension 4 applied so that Aussie Tax could not rely on Continuity Extension 4 to obtain cover under the 2001 policy.

Implications

While Byrne J's decision reaffirms the operation of section 54, this decision involved an unusual set of circumstances requiring an insurer (Markel) to argue that section 54 of the ICA should be applied to provide cover.

The matter also illustrates the risk to an insurer (here the 1999 insurer and the 2000 insurer) of effectively being bound by a decision relating to cover under its policy where it is not a party to the litigation and is therefore not able to present arguments against its liability.

Aussie Tax conversely found itself in the unenviable position of having to argue (for an absent insurer) that the absent insurer's policy did not apply, well knowing that if the decision went against it that it would have to seek cover under that very policy. ■

Claiming contribution from concurrent wrongdoers: Lessons from Victoria

Written by Hannah Keane, Solicitor
Tel 02 8273 9983
hannah.keane@wottonkearney.com.au

The Victorian Court of Appeal's unanimous decision in ***Godfrey Spowers (Victoria) v Lincolne Scott Australia Pty Ltd*** [2008] VSCA 208 provides valuable guidance on the interplay between contribution and proportionate liability when a settling wrongdoer wishes to claim contribution from other wrongdoers. Although the judgment deals with the relationship between Part IV (Contribution) and Part IVAA (Proportionate Liability) of the **Wrongs Act 1958 (VIC)** (**the Act**) the principles are applicable to equivalent legislation in all states[1].

The Court distinguished between court ordered judgments and settlements, holding that where a concurrent wrongdoer settles a claim, that defendant does not lose its right to seek contribution to the settlement sum from other concurrent wrongdoers.

Facts

The principals of an office building project (**plaintiff**) sued the project's architects, Godfrey Spowers (Victoria) Pty Ltd (**Spowers**) and the building contractor claiming damages of $10 million.

Spowers denied liability, pleading in the alternative that its liability was limited to the extent to which it was responsible for the loss and damage under Part IVAA of the Act. Spowers also brought third party proceedings against the identified concurrent wrongdoers, the engineer and surveyors (**third parties**).

Spowers settled the plaintiff's claim out of court agreeing to pay $3.9 million to the plaintiffs in full and final settlement of the plaintiff' entire claim. The settlement agreement provided that the plaintiff was obligated to provide a release to the third parties if Spowers so required.

Spowers then sought contribution from the third parties toward the settlement sum.

First instance

The trial judge, Justice Mandie, held that:

+ the amount for which Spowers had settled could only have related to a potential proportionate liability finding pursuant to an assessment by the Court under Part IVAA;
+ settling an apportionable claim could not place Spowers in a better position than a party against whom judgment had been given; and
+ the claims for contribution therefore could not succeed. →

1 *Wrongs Act 1958 (VIC)* Part IVAA (1/01/04); *Civil Liability Act 2002* (NSW) Part 4 (01/12/04 & 26/7/04); *Civil Liability Act 2002* (WA) Part 1F (01/12/04); *Civil Liability Act 2003* (QLD) Chap 2 Part 2 (01/03/05); *Civil Law (Wrongs) Act 2002* (ACT) Chap 7A (08/03/05); *Civil Liability Act 2002* (TAS) Part 9A (12/04/05); *Proportionate Liability Act 2005* (NT) (05/05/05); *Law Reform (Contributory Negligence and Apportionment of Liability) Act 2001* (SA) (08/09/05)

The Appeal

Spowers appealed on the grounds that Justice Mandie had misconstrued the basis of the settlement in 2 ways:

- His Honour had assumed that the settlement payment equated to Spowers' proportionate liability as it would have been assessed under Part IVAA; and
- His Honour had not taken into account the fact that Spowers' payment had secured the third parties' release against their prospective liability to the plaintiff.

Spowers' appeal was allowed by Nettle, Ashley and Neave JJA. The Court of Appeal held that where a concurrent wrongdoer settles an apportionable claim (and so no judgment is given under Part IVAA) there is nothing in the Act that prohibits it from claiming contribution from other responsible parties.

The Court came to this conclusion based, amongst other things, on the following reasoning:

- Part IVAA did not obligate an assumption that the settlement sum represented no more than Spowers' sectioned off liability.
- There is nothing in Part IVAA that prevents a concurrent wrongdoer from settling for a settlement sum that is greater than that which a court would have determined to be just if the matter had gone to judgment.
- If a concurrent wrongdoer settles an apportionable claim for more than the amount that would have been determined to be just if the claim had gone to judgment, there is nothing in Part IVAA that prohibits the concurrent wrongdoer from claiming contribution in relation to the settlement amount.

Implications

There are many instances in which an insurer for a defendant may wish to settle the entirety of a claim with a plaintiff to prevent costs from blowing out but still retain the right to seek contribution. This decision is authority for the proposition that it is possible to do so. However, it is advisable to have regard to the following prior to making any such settlement offer:

- assess the financial viability of the identified concurrent wrongdoers to settle a claim for contribution; and
- give initial consideration to whether the identified concurrent wrongdoers should be joined to the action having regard to the particular proportionate liability regimes in the relevant jurisdiction, noting that:
  - in Victoria the Court *must not* have regard to the liability of non-parties;
  - in New South Wales, Queensland, the Australian Capital Territory, the Northern Territory and the Commonwealth the Court *may* have regard to the liability of non-parties; and
  - in South Australia, Western Australia and Tasmania the Court *is* to have regard to the liability of non-parties.

It would also be advisable (although arguably not strictly necessary) to have the settlement agreement provide that:

- the plaintiff will release the identified concurrent wrongdoers upon request by the insured; and
- the settlement is for the *whole* of the plaintiff's claim and not only an amount reflecting the insured's proportionate liability. ■

The NSW Court of Appeal goes back to basics

Written by Matthew Foglia, Special Counsel & Clare Branch, Senior Associate

Tel 02 8273 9905 / 8273 9938
matthew.foglia@wottonkearney.com.au
clare.branch@wottonkearney.com.au

Baulderstone Hornibrook Engineering Pty Ltd v Gordian Runoff Ltd& Ors [2008] NSW CA 243 demonstrates that in the course of resolving the most complex of disputes, courts will often have regard to the very basic and fundamental tenets of insurance law.

Facts

A dispute arose between the Federal Airports Commission (**FAC**) (later Sydney Airports Corporation Limited (**SACL**)) and Baulderstone Hornibrook Engineering Pty Limited (**BHE**) about the adequacy of the construction of reinforced earth walls forming the perimeter of the third runway at Sydney Airport and adjacent areas.

BHE was engaged as head contractor on the project to build the third runway. BHE engaged subcontractors in relation to the design and engineering of the reinforced earth walls.

FAC put in place a $50 million programme of insurance policies to cover professional indemnity risks but not construction risks. The policies were for the benefit of all consultants undertaking responsibilities in the design and construction of the third runway. HIH underwrote the primary layer of $20 million; Gordian provided the next $10 million; QBE the next $6 million; CGU the next $5 million; and a Lloyd's syndicate the final $9 million.

BHE also had its own policy of professional indemnity insurance underwritten by AMP General Insurance Co Ltd (**AMPG**). This policy provided for insurance for breach of professional duty up to $20 million for any one claim, and $40 million in the aggregate.

Work commenced in 1993. Practical completion occurred in August 1994. By late 1996, the backfill behind facing panels of the reinforced earth walls had subsided. BHE notified its insurers.

In June 2002, SACL sued BHE for damages in the Building and Construction List of the Equity Division of the Supreme Court of New South Wales. In June 2004 the proceedings were settled with BHE undertaking to rectify the defects at a sum which was estimated to exceed the levels at which both the Gordian and CGU policies would fully respond. BHE sought indemnity from the insurers participating in the professional indemnity programme. In December 2003, BHE commenced proceedings against the professional indemnity insurers.

In January 2005, AMPG agreed to indemnify BHE for $20 million.

At first instance, his Honour Einstein J concluded that neither the Gordian nor the CGU policies responded because the liability of BHE for SACL's claim against it under the design and →

construction contract could be described for the purposes of the professional indemnity policies as arising out of (uninsured) construction risks and not arising out of (insured) professional indemnity risks. BHE appealed.

Court of Appeal decision

The leading judgment was handed down by Allsop P, with whom Beazley and Campbell JJA agreed.

The Notice of Appeal raised 3 primary propositions for consideration by the Court. It was said that his Honour Einstein J had erred in holding:

+ that Special Provision 2 was not engaged;
+ that Insuring Clause 1 was not engaged; and
+ that Exclusion 1(p) was engaged.

The crux of BHE's argument was that Einstein J had failed to recognise that by reason of the design documents and directions prepared and issued under the contract (with which BHE had to comply), the design was fundamentally flawed and incapable of bringing about a reinforced earth wall free of problems. It was therefore wrong to criticise BHE for failing to properly build the wall. The error had been of a technical (and professional) nature. It was argued that the claim fell within the terms of the professional indemnity policy. The Court had to consider the two competing mechanisms which were said to be the cause of the sand loss, namely:

+ Mechanism 1: BHE's failure to compact the backfill to the required density and to conduct appropriate testing to ensure the required compaction density was achieved (as absent the required compaction density, the sand would settle under the influence of the tide); and
+ Mechanism 2: BHE's failure to use a compacting method which would not involve compacting forces capable of inducing stresses into the geotextile material (between the sand backfill and the retaining wall) causing it to be stretched and folded and thereby creating an avenue for sand to escape.

In a lengthy decision which included a thorough analysis of the relevant clauses of the insurance policy, as well as pertinent case law, the Court of Appeal dismissed the appeal.

Policy

Both the Gordian and CGU policies followed form to the HIH wording. The Court therefore considered the relevant clauses of the HIH policy. The primary insuring clause was in terms whereby the insured agreed:

"…. To indemnify the Insured against any claim or claims which may be made against them or any of them and which are notified to the Company during the period specified in the Schedule, for breach of professional duty in the profession stated in the Schedule, by reason of any act, error or omission whenever committed unless limited by the retroactive date stated in the Schedule or wherever the same was or may have been committed or alleged to have been committed on the part of the Insured in the conduct and execution of the Professional Activities and Duties as defined herein."

"Professional Activities and Duties" were defined as including:

"Engineering, project management, surveying, design and geotechnical environmental monitoring, construction management, certification and as defined in the Policy wording."

A relevant exclusion in the Policy appeared in the following terms:

"1. This Policy shall not indemnify the Insured in respect of any claim made against them:

…

(p) arising out of construction work performed involving the means, methods, techniques, sequences, procedures and use of equipment, of any nature whatsoever which are →

employed by the Insured's contracting staff or others in executing any phase of any Project."

Under the section entitled *"Exclusions"* there was a section headed *"Special Provisions"*, under which the following provisions appeared:

"2. The coverage provided by this Policy is extended to indemnify the Insured, subject to the Policy's terms and conditions, against their legal liability for claims … arising out of any act, error or omission in the conduct of professional activities or duties committed by specialist designers or consultants acting on the Insured's behalf pursuant to any contract for service and for whom the Insured are responsible."

The HIH Policy was therefore seen to relate to engineers in the professional activities and duties described above.

Did the Policy cover the claim?

Allsop P found that the various design documents did not mandate the particular backfilling and compacting techniques to be used by BHE. As such, his Honour concluded that the proximate cause of the claim against BHE by FAC and SACL was defective construction. His Honour agreed with the primary judge's conclusion that BHE's comprehensive failure to comply with testing in the hard compaction zone and the adoption of inadequate construction techniques, including a failure to experiment and test, were aspects of executing construction responsibilities which lead to the engagement of Exclusion 1(p).

Allsop P found Exclusion 1(p) to be clear: the Policy *"shall not indemnify"* BHE in respect of a claim made against it *"[a]rising out of construction work performed involving the means, methods, techniques, sequences, procedures and use of equipment of any nature whatever … in executing any phase of"* the works. Allsop P held it was not open to doubt that BHE's failure to test and employ proper construction techniques fell within Exclusion 1(p).

In his view, there could be no doubt that a cause, being a relevant proximate cause, of the claim was the construction inadequacy of BHE in its means, methods, techniques and procedures of construction such that the claim arose out of that inadequacy. On this basis, the primary judge had rightly concluded that BHE's liability did not arise out of the acts of its subcontractors, or out of BHE's co-ordinate responsibility for such.

The proper construction of special provision 2 as a so-called stand alone insuring clause

Allsop P found special provision 2 to be an extension of the indemnity and subject to the policy's terms and conditions. The extension was to cover acts, errors and omissions by specialist designers or consultants, not by the Insured. The relationship with the Insured's "*Professional Activities and Duties*" arose from the fact that the act, error or omission of the specialist designer or consultant must likewise have been in the conduct of "*Professional Activities or Duties*", acting on the Insured's behalf and for whom the Insured was responsible.

His Honour found that BHE's responsibility was to engage and take responsibility for its subcontractors. BHE was also responsible for the necessary co-operation in the design function. On that basis, it was a perfectly natural use of language to say that the subcontractors were acting on BHE's behalf and were consultants for whom BHE was responsible.

The so-called Gordian attachment points

At first instance, Einstein J had held that Gordian's obligation to provide indemnity only arose upon the occurrence of one or more of the preconditions in clause C of the Gordian policy. These preconditions were expressed by the statement that Gordian would *"only be liable after [relevantly, HIH]"* had:

+ "*paid*";
+ "*admitted liability*"; or
+ "*been held liable to pay the full amount of its indemnity*". →

Had HIH *"paid"* ?
Allsop P agreed with the first instance finding that the Gordian policy distinguished between admission, being found liable and paying. He found that there was no requirement for HIH to have actually dispersed funds for the indemnity of Gordian to attach: HIH could admit liability or be held liable to pay.

Had HIH admitted liability?
Allsop P rejected the finding at first instance that HIH had, by granting indemnity subject to the terms of the policy, not admitted liability. The Court found that in granting an indemnity subject to the terms of the policy, HIH had stated an acceptance of the response of its policy. This position was not altered by reason of such a grant of indemnity having been made *"subject to policy terms, conditions and exclusions and based on the facts presently known to HIH*". His Honour observed that the limiting of the indemnity to the terms, conditions and exclusions of the policy was illustrative of nothing more than an abundance of caution. Likewise, if subsequent facts had become known to the insurer, it may well have had a basis to withdraw its admission. In other words, the qualifications may have served to limit the scope of any agreement but they did not detract from the character of the communication–a recognition of liability (that is, an admission), under the terms of the policy and on the basis of what was known.

Could HIH be held liable to pay?
At first instance, Einstein J found that this condition was not satisfied because of his finding that the policies did not respond. Although the Court affirmed the first instance findings and therefore did not need to decide this issue, it nevertheless did so for completeness. Gordian argued that, in the event the HIH policy wording did respond, HIH could not be found liable because BHE had been indemnified by AMPG and therefore gave up its right to seek indemnity from HIH.
The Court commented that Gordian's submission was misconceived and reiterated that where several insurers have severally insured a risk, the insured can only receive one indemnity for its loss. Upon the receipt of that full indemnity from one insurer, the others are discharged against the insured, although they remain liable to contribute to the insurer that has paid. In the context of the case before the Court, however, BHE still had a loss to be indemnified because the full indemnity from AMPG did not indemnify the full amount of BHE's loss.

A further issue raised by the appellants was that long term maintenance of the runway to rectify the subsidence identified in 1996 could have been conducted for less than $20 million. The cost of the solution ultimately implemented by BHE was over $65 million and incorporated protection against corrosion, as well as subsidence. The appellants argued that this was a solution which did not "*arise out of*" the claim notified and could not be a reasonable settlement of the notified claim.

His Honour rejected this submission, finding that there was ample basis to conclude that attempting to alleviate subsidence issues by a method that could well lead to additional problems was unreasonable and to avoid that risk was reasonable.

His Honour dismissed the appeal with costs.

Comment

The decision, which is broad in scope and multi-faceted, demonstrates that the Court will frequently have recourse to the most fundamental issues of insurance law in determining the most complex of disputes. It is a "*text book*" and "*black letter*" judgment which should offer insurers some comfort that the Courts can and will construe policies according to their plain meaning. ■

Dishonourable causes – a bar to action

Written by Charles Thornley, Special Counsel
Tel 02 8273 9910
charles.thornley@wottonkearney.com.au

On 30 July 2009, in ***Moore Stephens v Stone Rolls Limited*** (in liquidation) (2009) UKHL 39, the House of Lords struck out a claim brought by liquidators of Stone & Rolls Limited (**S&R**) against its auditors Moore Stephens (**Auditors**) for breach of duty to act with reasonable skill and care in detecting S&R's own fraudulent activity. The majority applied the principle of *ex turpi causa non oritur actio* (the Latin maxim meaning "*from a dishonourable cause an action does not arise*") to find that S&R should not benefit from its own illegal conduct.

The facts

S&R was owned and controlled by Mr Stojevic. He, through S&R, operated an elaborate Ponziesque scheme utilising letters of credit that led various banks to believe they were financing bona fide commodity trades. The letters did not relate to actual goods and once S&R had obtained the funds it would assign or forfeit the letters of credit to third parties under Stojevic's control. The third parties reimbursed the banks for the maturing letters of credit and then sought larger letters of credit. This fraud continued until the third parties ceased repayment of the loans leaving the banks with large unsecured losses.

One of the defrauded banks was awarded damages in excess of US$94m against S&R and Stojevic. S&R could not pay the damages and was placed into liquidation. The liquidators discovered that Stojevic had stripped S&R of its assets. The liquidators (and creditors) of S&R considered that the Auditors should have detected Stojevic's fraudulent activity. S&R (in liquidation) brought proceedings to recover about US$173m from the Auditors for failure to exercise reasonable skill and care in carrying out their auditing duties and for breach of contract.

The application

The Auditors sought orders striking out S&Rs claim. They contended that as S&R and Stojevic were one and the same entity for the purpose of carrying out of the fraud, his conduct should be imputed to S&R. The Auditors accepted for the purpose of the application that they were negligent but argued that S&R could not benefit from its own illegal conduct based on the *ex turpi causa* principle.

S&R relied on ***In re Hampshire Land Company*** (1896) 2 Ch.743 in opposing the Auditors' application. That case held that a company officer's knowledge of his own fraud or breach of duty was not to be attributed to the company. S&R argued ***Hampshire Land*** meant Stojevic's conduct could not be attributed to S&R and that the application of the *ex turpi causa* principle would be improper in circumstances where the fraud was "*the very thing*" the Auditors were brought in to prevent.

The decisions below

The Commercial Court, in dismissing the Auditors' application, considered ***Hampshire Land*** was distinguishable because S&R lost nothing other than its fraudulent gains, but was more attracted by S&R's argument that fraud was "*the very thing*" the Auditors were brought in to prevent. The Court of Appeal agreed with →

the Commercial Court regarding ***Hampshire Land***, but felt that *ex turpi causa* was such a powerful principle that it left no discretion to the court, so upholding the Auditors' appeal.

House of Lords

By a 3-2 majority the House of Lords upheld the decision of the Court of Appeal, allowing the principle of *ex turpi causa* to defeat a claim of negligence brought by the corporate perpetrator of fraud against its own auditors for not discovering its own misconduct.

Lord Phillips wrote the majority opinion. He found that the fraud was properly attributable to S&R holding that where a single person managed all aspects of a company's activities there was "*no difficulty in identifying the fraud as the fraud of the company*", so distinguishing ***Hampshire Land*** where that was not the case. He considered that the *ex turpi causa* principle had to apply in this instance. He was however careful to distinguish this matter from a situation where an auditor aided and abetted a scheme of fraud. Lords Walker and Brown concurred, being careful to hold that the *ex turpi causa* defence be restricted to situations where the company and the fraudulent actor were one and the same.

Lord Mance and Lord Scott disagreed. They considered the ***Hampshire Land*** rule was applicable despite that matter not concerning a one-man company. They were also of the opinion that the Auditors owed a duty to protect the interests of S&R's creditors by preserving the assets of the company. They considered that this duty existed because S&R was at each audit date insolvent. Lord Scott felt the application of the *ex turpi causa* principle should be different in a situation where a solvent company brings an action for the benefit of its shareholders as opposed to a situation where an insolvent company brings an action for the benefit of creditors. The latter situation would not result in the perpetrator of fraud benefiting from the claim.

Lord Mance considered S&R to be a victim of the fraud and held that the *ex turpi* principle could not be used to defeat a claim for breach of duty to detect an officer's fraudulent activities as "*it would lame the very concept of an audit – a check on management for the benefit of shareholders – if the higher the level of managerial fraud, the lower the auditor's responsibility*".

Implications

This is a landmark decision on the application of the *ex turpi causa* principle. There is much else in the 130 page House of Lord's decision that will be of interest to auditors and their insurers. However, for all its importance, the decision is limited in its application to cases involving fraud by a "*one man*" company. That said, this is the area where smaller auditing firms and their insurers have real exposure.

A final thought: Would the decision have been different if the matter was litigated in Australia where causes of action would lie under the **Trade Practices Act** and **ASIC Act**? The answer has to be quite possibly.

The Court of Appeal clarifies solicitors' duties to advise

Written by Clare Branch, Senior Associate

Tel 02 8273 9938
clare.branch@wottonkearney.com.au

On 29 July 2009 in ***Paul Manuelpilai Dominic v Omar Riz*** [2009] NSWCA 216 Allsop, Hodgson and McColl JJA of the New South Wales Court of Appeal unanimously clarified the scope of a solicitor's duty to advise a client on matters relating to the underlying risks associated with a transaction. The decision is welcome news to lawyers and their professional indemnity insurers.

Background

The appellants, Dominic David Stafford (**DDS**) were the solicitors retained by the Riz family to advise on loan and mortgage documents. The Riz family borrowed $275,000 from Perpetual, $150,000 of which it invested with Karl Suleman Enterprises (**KSE**) on the promise of enormous returns. Perpetual took security over the Riz family home. DDS were not retained to advise in relation to the underlying investment transaction. The investment scheme subsequently failed and the Riz family lost the majority of their money.

The Riz family sued DDS alleging breach of fiduciary duty and negligence. They argued that DDS, through their employed solicitor and in breach of their retainer and their common law and fiduciary duties to the Riz family, had failed to bring home the risk of the investment to them.

First instance decision

At first instance, His Honour Brereton J held that DDS had breached its duty of care to its clients by not advising them to seek independent legal and financial advice about the proposed investment in adequately firm terms. His Honour accepted that DDS' retainer was to advise on the loan and mortgage transaction and that they were not retained to advise on the proposed investment in KSE. However, His Honour found that the scope of a solicitor's duty of care to a client was not confined to the contract of retainer but may extend in the circumstances of a particular case to require the taking of positive steps beyond the specifically agreed task or function where such steps are necessary to avoid a real and foreseeable risk of economic loss being caused to the client. His Honour then turned to the question of solicitors giving advice in relation to financing and mortgage transactions raising money in the following terms:

"…solicitors providing 'independent advice' are expected to warn clients against improvident transactions, and while they are not required to provide the type of financial analysis that might be expected of accountants or stockbrokers or financial planners, they are expected to form a view as to the fairness of a transaction and whether it is reasonable for the client to enter into it, and if it is beyond their capacity to do so, to obtain appropriate specialist assistance."

Brereton J also found that the solicitor advising the Riz family was not reasonably entitled to be satisfied that the clients would follow up on the advice given to them or that they understood the importance of it. →

The Appeal

The issues on appeal were:

- whether the solicitor's advice to the clients that they should seek independent legal and financial advice was adequate in the circumstances;
- whether it was reasonable for the solicitor to think that the clients understood her advice that they should seek independent legal and financial advice about the proposed investment;
- whether a solicitor retained by a borrower/mortgager is required to give consideration to the purpose of the loan and the reasonableness or providence of the transaction, including the proposed application of loaned funds; and
- whether there was a causal connection between the solicitor's alleged failure to provide adequate advice and the investment by the clients into the high risk investment.

The Court of Appeal found that there was no negligence by the solicitor advising on the loan and mortgage transaction. The Court held that the advice given by the solicitor was adequate in the circumstances to discharge her duty of care to the client. The solicitor was not retained to advise on the underlying investment transaction and did not know the details of the investment. The solicitor thought that the investment involved large risks, but knew that the clients themselves thought that the investment was risky. The Court of Appeal found that the solicitor gave clear advice about the necessity for receiving independent legal and financial advice about the proposed investment.

The Court found that the solicitor was reasonably entitled to believe that the clients had understood her advice that independent legal and financial advice about the proposed investment was required. To the extent that a solicitor who, when executing a retainer learns of facts which put him or her on notice that the client's interests are at risk, may then be required to bring attention to aspects of concern and advise of the need for further advice, that duty was discharged.

The Court of Appeal also held that the retainer did not extend to advising on the underlying investment transaction and that there was no breach of fiduciary duty in the circumstances. It also found that, had such a duty existed, it was difficult to understand precisely what the solicitor should have said beyond the advice she gave to the Riz family. In her discussions with the Riz family, the solicitor used expressions that conveyed the necessity to seek legal and financial advice: *"need"*, *"must"*, *"should"*. The Court found that it was difficult to understand how the solicitor was negligent in failing to label the underlying transaction as *"improvident"* or otherwise to *"bring home"* the importance of the obtaining of advice. On the question of causation, the Court found that even if the solicitor advising the Riz family had been more forceful in her views, they were not persuaded that it would have made the slightest difference.

Comment

This judgment will be embraced by lawyers as a reasonable limitation on the duties of a solicitor to advise a client about matters beyond the subject of their retainer. It offers lawyers a degree of comfort that they are not required to advise on the underlying risks associated with a transaction or to take extraordinary steps to ensure that clients obtain independent advice in relation to the prudence of, or risks associated with, a transaction. We will watch with interest to see whether an application for special leave is made to the High Court. ■

How far does an architect's duty extend?

Written by Paul Spezza, Special Counsel
Tel 02 8273 9909
paul.spezza@wottonkearney.com.au

The decision in ***Drummond & Rosen Pty Ltd v Easey*** [2009] NSWCA 74 is a useful reminder for architects and other professionals in the construction industry that any duty of care they owe to third parties will be restricted where the terms of the relevant professional's retainer is limited to a specifically defined role during the construction phase.

The NSW Court of Appeal considered an appeal by an architect against a finding of negligence in a case in which Barry Easey sustained injuries after falling on a tiled ramp providing access to Miller Shopping Centre in NSW (**the premises**). Mr Easey sued the owner of the premises, the builder and the architect. At first instance all defendants were found negligent. The architect successfully appealed that finding which had been based on its provision of sample tiles for the ramp for the approval of its clients.

Facts

On 19 March 2002, Barry Easey slipped and fell on a tiled ramp at the premises. It was raining at the time and the tiles were wet. The premises had recently undergone refurbishment. The architect, Drummond & Rosen Pty Ltd (**D&R**), prepared the plans and had a defined role during the construction phase which was essentially limited to the *"final selection of finishes and colours"*.

Phase 2 *"Design Development and Building Construction Certificate Documentation"* included:

+ *"Preparation of colourboard, schedule of finishes and provision of relevant samples to illustrate concept.*
+ *Preparation of building specification in conjunction with the working drawings."*

Phase 3 *"Project Construction Documentation"* included:

+ *"Final selection of finishes and colours."*

Phase 4 *"Quality Control"* included:

+ *"Inspection of the works for verification that the works are executed in general accordance with the documents prepared by us. Verification and quality control will be based only on a visual inspection of the works and our responsibility will exclude any matters not readily apparent on a visual inspection."*

D&R provided specifications to the builder for the tiling work which included a requirement that manufacturer's data, product warranties and technical specifications (including confirmation that the minimum co-efficient of friction of the tiles exceeded values required by Australian Standard 3661 Part 1) be obtained prior to installation.

A sample of tiles for the entry to the premises and other areas were chosen by D&R. Those samples were provided to the project manager with no accompanying document. The project manager and builder indicated that the manufacturer's data, product warranties and information dealing with co-efficient of friction values for the tiles used in the refurbishment were not obtained prior to installation. →

Trial

Mr Easey sued the owners of the premises, the builder and D&R. Cross Claims were issued between the defendants.

The main allegation against D&R was that it selected tiles which were not fit for the purpose of being laid on an access ramp exposed to the weather at commercial premises, and that it failed to check and ensure that the tiles complied with Australian Standard 3661 Part 1.

Expert evidence established that the tiles in question had a co-efficient of friction in wet weather well below that required by the relevant Australian Standard.

The trial judge, Quirk DCJ, found that the tiles failed to comply with the relevant Australian Standard by a substantial margin and were *"inadequate and not suitable for the ramp"*. Her Honour found that all defendants had been negligent and apportioned liability 50% to the owners, 30% to D&R and 20% to the builder. As for D&R, Her Honour held that D&R selected the tiles, knew of the relevant Australian Standard and failed to test the tiles to ensure that they were compliant. Mr Easey was awarded damages totalling $304,792 plus costs.

Appeal

D&R's appeal to the Court of Appeal of NSW was successful. The Court of Appeal held that:

+ D&R provided tile samples pursuant to the duty to make *"a final selection of finishes and colours"*. There was no basis for a finding that it intended to step outside its limited role, without additional remuneration, and undertake responsibilities which the specifications imposed on the builder.
+ D&R was entitled to assume that the builder would, among other things, ensure that the product complied with the specification. Handley AJA held:

  "In my judgment therefore the architects, by delivering these samples to the project manager, and by their associated conduct at the time, did not represent to the project manager or the owners or the builder that those tiles complied with the technical requirements of the specification or assume any responsibility to them for such compliance".
+ In providing the samples D&R made no representation that they met the technical requirements of the specification (nor were they required to).
+ There was no evidence that D&R sought to select tiles which complied with the technical requirements of the specification.
+ D&R therefore did not breach the duty of care owed to its client. It also did not breach the duty of care owed to persons, such as Mr Easey, who used the ramp. D&R had no separate duty to patrons of the premises to ensure that the tiles complied with the specifications, and it was never suggested that it was negligent in the design of the ramp or in framing the technical specifications.

The Court of Appeal of NSW revised the apportionment of liability to 50% against the owners and 50% against the builder. The owners had been on notice of deficiencies with the ramp shortly after it had been completed.

Implications

The appeal judgment highlights the importance of clearly defining (preferably in writing) what role an architect or other building professional is to play in a project and for building specifications to assign responsibility where a task is to be done by someone other than the relevant architect or building professional. This will colour the scope of any duty of care owed to third parties. The judgment is welcome news for insurers of professionals involved in the construction industry. ■

Watson v Ebsworth and Ebsworth: A solicitor's duties and conflicts of interest

Written by Ella Gould, Solicitor
Tel 02 8273 9957
ella.gould@wottonkearney.com.au

On 25 November 2008 in the matter of ***Watson & Ors v Ebsworth & Ebsworth (A Firm)*** [2008] VSC 510 Beach J of the Victorian Supreme Court examined whether there was a retainer between the parties and the duty of a solicitor to avoid conflicts of interest. The decision reiterated the importance of the role and conduct of the solicitor where a conflict of interest does arise.

Background

The facts giving rise to the plaintiffs' claim concern the establishment in 2001 of a new V8 Supercar racing team. Mr Craig Lowndes (**Lowndes**) had contacted Mr Watson and requested his help in finding new management and a new team to race with. Lowndes was managed by Tom Walkinshaw Racing Group Ltd (**TWR**) pursuant to a contract which did not expire until January 2007. Lowndes also had a driver's agreement with Holden Racing Team (**HRT**) a wholly owned subsidiary of TWR which expired at the end of 2000. Lowndes retained Mr Battye of Ebsworths to act for him.

By the end of December 2000, after investigations into the options available and various negotiations, a consortium was arranged whereby it was agreed that:

+ the team would be owned by Mr Forbes;
+ the team would be managed by Mr Gibson;
+ Mr Watson was to manage and run the merchandising;
+ the team would be sponsored by Ford; and
+ Lowndes would be the driver of the car.

In order to put together the team a Touring Car Entrants Group Australia Pty Ltd (**TEGA**) franchise and race car equipment had to be purchased. It was agreed that the TEGA franchise would be purchased by Mr Gibson and held by a company that Mr Gibson controlled, F.C. Gibson Pty Limited (**FCG**), the fourth plaintiff. The race car and equipment were to be purchased by Mr Forbes and held by a company that he controlled, Gibson Motorsport, the entity which eventually became known as Racecar Preparation and Management Pty Ltd (**RPM**). A company was also to be incorporated to exploit team merchandise and intellectual property, in which Mr Forbes, Mr Watson and Mr Gibson would all be equal shareholders but the running of the company was to be the responsibility of Mr Watson. That company was Gibson Motorsport Merchandise Pty Ltd (**GMM**), the third plaintiff.

As part of this agreement, Lowndes was to enter into a driver's contract, committing him to drive for RPM for between two to five years. Mr Lowndes was also to enter into a separate driver's contract with Ford, committing him to drive for five years. →

Lowndes was released from his contract with TWR, allowing him to sign the driver's agreements with RPM. The other arrangements, which had been agreed to in principle between the parties, were not formally documented.

On 2 February 2001 Mr Watson contacted Mr Battye and asked him whether he would be prepared to act on behalf of the *"team"*. Mr Battye expressed his concern about the possibility of a conflict of interest between acting for the *"team"* and being Lowndes' lawyer, but on 9 February 2001 Mr Battye agreed to accept a retainer.

The central issue to this disagreement was that the plaintiffs contended that the retainer was a retainer to act for each of them. The defendants on the other hand contended that the retainer was limited to a retainer for Gibson Motorsport (later RPM), the entity with whom Lowndes had entered into a driver's agreement on 4 January 2001.

In a letter dated 9 February 2001, Mr Battye informed Mr Gibson and Gibson Motorsport, that while there were currently no actual conflicts of interest, his retainer with Lowndes and his entities may potentially give rise to a conflict of interest in the future. Mr Battye accepted the retainer on the condition that if at any stage in the future a conflict of interest did arise *"we will be free to cease our retainer by you in respect of the particular matter."*

The defendants contended that the expression *"the team"* meant RPM. The plaintiffs argued that the term had a wider meaning and encompassed at least RPM, GMM and FCG plus Mr Watson, Mr Gibson and Mr Forbes.

In a series of negotiations and conferences in January 2001 the parties met along with their respective advisors. Mr Watson's dealings with Mr Damien Butler (accountant) and Mr Daniel Butler of DBA Butler and Mr Gibson's dealings with Mr Kitchener (accountant) and Mr Falconer of White Cleland were the basis for the defendants' submissions that the fact that Mr Gibson and Mr Watson were getting advice from these professionals demonstrated that Mr Battye was not their solicitor.

Two disputes arose which began to sour the relationship between the parties. The first occurred in December 2000 when Mr Forbes received a letter from Mr Falconer (of White Cleland) advising that the business name *"Gibson Motor Sport"* was being transferred to FCG. Mr Forbes was of the understanding that the name was to be transferred to RPM. The second was that Mr Forbes requested that the issue of the entity whom Ford was to deal with be sorted out. These remained disputed issues between the parties during 2001.

The relationship between Mr Forbes on the one hand and Mr Gibson and Mr Watson on the other deteriorated to the point that in October 2001, Mr Gibson and Mr Watson were excluded from the team.

Mr Watson and Mr Gibson then sought to buy out Mr Forbes' interest in the team. This did not eventuate.

Issues

The plaintiffs' claim was that in 2001 the defendants were their solicitors, supposedly acting on their behalf and on behalf of the *"Forbes interests"*. They contended that as a result of breaches of duty by the defendants (which were said to involve the defendants preferring the Forbes interests over the plaintiffs' interests) they suffered economic loss in excess of $24 million. The defendants denied that they were acting for the plaintiffs in the relevant matters. The plaintiffs responded to this denial by saying that even if the defendants were correct, because of the dealings between them (the plaintiffs and the defendants), the defendants owed to the plaintiffs the duties owed by solicitors to their clients. The defendants denied owing the duties alleged and argued that, even if duties were owed, there was no breach. →

The decision

Beach J held there was no general retainer between the plaintiffs and the defendants and that Mr Battye acted only for the Lowndes interests. The existence of such a retainer would not have been consistent with the dealings between the parties – "*there was no assumption of responsibility on the part of the defendants to look after the interests of the plaintiffs, nor was there any known reliance*".

Mr Gibson, Mr Watson and Mr Forbes were all experienced and sophisticated businessmen, able to protect their own interests and used to obtaining advice from lawyers and accountants acting solely in their own interests as and when they thought it was required. The fact that Mr Battye took steps that were in the interest of the Lowndes companies and also for the interests of Mr Watson and Mr Gibson at one stage or another was not the point. There was no assumption of responsibility by the defendants to advise or act for the plaintiffs. Mr Battye did not give advice or fail to give advice in circumstances where he knew or ought to have known that he was being relied upon to look after the interests of the plaintiffs. No relevant tortious or fiduciary duty was owed by the defendants to the plaintiffs.

Implications

Solicitors need to be alert to potential conflicts of interest where multiple parties are in involved. The conduct of the solicitor and any reliance placed on that conduct will be closely examined so as to ascertain the "*actual relationship between the parties*". Solicitors need to make plain in whose interest they are acting and conduct themselves accordingly. ■

wotton kearney
insurance lawyers

Husband's lawyer owes no duty to wife

Written by Kimberley Donaldson, Solicitor

Tel 02 8273 9945
kimberley.donaldson@wottonkearney.com.au

In a recent NSW Local Court decision of ***Muharrem Colak v Serap Ayteniz***, unreported, 21 August 2009, the Court found there was no retainer between a lawyer and Mrs A, and no consequent duties incumbent upon the lawyer, in circumstances where Mrs A alleged that an implied retainer existed because the lawyer was *"the family lawyer"*.

Facts

Mrs A was a former director and major shareholder with her husband in a company in which they held 61% of the shares. Her husband director and the controlling mind of the company. The company was placed into liquidation by order of the Supreme Court on 18 October 2005. Shortly afterwards, the lawyer was retained by Mrs A's husband to apply to have the winding up order terminated. During the process of determining the Application to set aside the winding up order, Justice Barrett on 16 November 2005 noted that the company was likely to be insolvent due to the quantum of directors' loans. His Honour stated that if the directors were prepared to convert their directors' loans into shares, he would be prepared to make the order terminating the winding up. Proceedings were adjourned to 9am on 17 November 2005.

On 16 November 2005 the lawyer met with a number of directors and shareholders of the company in his office. He prepared documentation converting the directors' loans to equity. Following the debt to equity conversion, Mrs A and her husband increased their shareholding in the company to 74.4%. Mr C, a former director and shareholder of the company said he would only agree to assign the debt to Mrs A if an arrangement was made whereby Mrs A and the company guaranteed and indemnified him for any claims made against him pursuant to personal guarantees he had given for the benefit of the company whilst he was a director. A deed was executed by Mrs A, Mr C and the company and contained an indemnity in favour of Mr C.

On 31 August 2007 Mr C commenced proceedings in the Local Court against Mrs A seeking to enforce the indemnity provisions in the deed. Mrs A consented to judgment against her and then cross claimed against the lawyer who drafted the deed. That cross claim was brought on the basis that there was an implied retainer and that as her lawyer he breached several duties of care to her in failing to:

+ ensure that she received independent legal advice;
+ take steps to provide accurate and complete advice in relation to the meaning and legal effect of the terms in the deed;
+ identify the nature and quantum of the guarantee which Mr C provided before she executed the deed; and
+ advise her and identify any relevant guarantees before she executed the deed.

The lawyer denied Mrs A's allegations and said he was retained by Mrs A's husband to apply to have a winding up order in relation to the company terminated. →

Decision

The Court found in favour of the lawyer and held that there was no retainer between Mrs A and the lawyer and no consequent duties incumbent upon the lawyer. The Court found that the lawyer was acting for Mrs A's husband.

Mrs A submitted that an implied retainer arose in circumstances where the lawyer assumed the obligation of explaining the deed to Mrs A: ***Fleeton v Fitzgerald*** (1999) ANZ Convr 571. Mrs A also submitted that the circumstances in this case were closely analogous to ***Hendriks v McGeoch*** [2008] NSWCA 53 where the Court of Appeal inferred the existence of an *"implied retainer"* in circumstances where the lawyer (there described as the *"family lawyer"*) had explained the documents and advised a family member who had not formally retained the lawyer.

The Court noted that the existence of a retainer, express or inferred, is to be determined objectively, not by subjective intention. The Court referred to the following important matters which were taken into account by Giles JA in ***Hendriks***:

+ the existence of many legal dealings between the lawyer and all family members on many occasions (the lawyer had also described himself as the *"family lawyer"*);
+ the lawyer was expressing views as to the commerciality of the transaction (i.e. what was fair between the parties); and
+ the lawyer had not made clear that on this occasion he was acting for the mother alone.

The Court accepted the submissions made on behalf of the lawyer that the matters of significance for Basten JA in ***Hendriks*** were:

+ that the test was whether the objective bystander would infer that the lawyer was acting for each member of the family;
+ one relevant matter is to ask whether the third party should reasonably be seen to have accepted an obligation to pay the lawyer's fees; and
+ another relevant matter is to ascertain, objectively, whose instructions the lawyer was acting upon.

Applying the facts of this case to the principles established in ***Hendriks***, the Court considered that:

+ by the time of the meeting in question on 16 November 2005, the lawyer had once acted for Mrs A and her husband, in a non-contentious conveyancing transaction in 2002;
+ there was no evidence of any subsequent retainer between Mrs A and the lawyer prior to the meeting on 16 November 2005 and no suggestion of repetitive legal work;
+ there was no evidence that the lawyer held himself out to Mrs A as Mrs A's family lawyer;
+ the only express contract under which the lawyer was acting at the time of the meeting was his retainer by Mrs A's husband to perform services necessary to facilitate the termination of the winding up of the company;
+ in preparing documents and securing the execution of them involved a number of contracting parties. It is common experience that a lawyer may be employed by one party to use his skills to accurately document an agreement between multiple parties and it does not follow that in doing so the lawyer entered into a retainer with any of those contracting parties; and
+ in drafting the documents in this case the lawyer did not take steps to advise any of the contracting parties beyond that which would be properly characterised as casual assistance to achieve the principal contractual objective of securing the termination of the winding up. →

The Court considered that the lawyer was *"clear, spontaneous and unshaken in giving his evidence"* and that he was *"frank and forthright in his oral evidence which was given spontaneously and which was substantially consistent and undamaged"*. The Court accepted the lawyer's evidence that he explained the nature and extent of the personal guarantees, he discussed the potential quantum of the indemnity and that Mrs A was prepared to provide the indemnity.

Mrs A said in evidence that she did not read the deed nor did she have any discussions before signing it and the word *"indemnity"* was not spoken during the meeting on 16 November 2005. The Magistrate rejected that evidence and stated that her evidence was *"not cogent"* and in giving her oral evidence her *"memory was unclear and often uncertain"* and that overall she was an *"unimpressive witness"*.

The Court accepted the lawyer's submission that a ***Jones v Dunkel*** inference ought to be drawn from the fact that Mrs A did not adduce any evidence in chief from her husband on the topic of what was said during the 16 November 2005 meeting.

The Court found Mrs A was aware of the terms of the substance of the agreement she executed at the time of execution and, that being so, there was no breach of duty. The Court also concluded that the entering into of the subject transactions by Mrs A on 16 November 2005, resulting in the termination of the winding up of AIS, was the commercially preferable option for her to take and a highly desirable commercial outcome for her personally.

The Court also considered the issue of whether the lawyer owed a duty of care to Mrs A independently of any retainer between them. The Court considered that the lawyer could not be found to owe a duty of care in the absence of an express assumption of responsibility: ***Hill v Van Erp*** [1997] HCA 9 and ***David v David*** [2009] NSWCA 8. The Court considered that the steps upon which a duty could arguably be based were all accurately undertaken and no breach could be established.

Implications

This decision is welcome news for lawyers and their professional indemnity insurers. It highlights the need for lawyers to be conscious of circumstances in which a retainer may be implied. ■

Watch out for inter family conflicts

Written by Kimberley Donaldson, Solicitor
Tel 02 8273 9945
kimberley.donaldson@wottonkearney.com.au

In ***Permanent Custodians Limited v King*** [2009] NSWSC 600 a lawyer acted for a father and son in relation to loans taken out to re-finance the son's business which were secured by a mortgage over the father's property. The lawyer was found to have breached his duty of care and to have had a conflict of interest.

Facts

A lawyer was retained to advise a father and son in relation to a loan with Peppers Finance Corporation for $353,000 in 2002 and a further loan for $450,000 from Permanent Custodians Limited in 2003. The loans were taken out by the son to re-finance his business. Prior to the lawyer being retained in 2002, the father and son were already parties to a previous loan using the father's property as security such that by 2002 the total amount guaranteed by the father was approximately $212,000.

Proceedings commenced by the mortgagee were settled on terms which permitted the father to reside in the property during his lifetime. The father's cross claim against his former lawyer remained for determination by Her Honour.

The father alleged that the lawyer breached his duty of care or retainer, that he had a conflict of interest of which he failed to advise him and that he gave negligent advice. The father alleged that the lawyer failed to advise him that under the documents which he executed he was a co-borrower, not a guarantor, and that the lawyer did not explain the significance, nature and effect of the documents. The father believed that his son could cover the loan amount at any time by selling his home. The lawyer did not meet separately with the father.

The matter was heard on 30 and 31 March 2009 and 1, 2, 7 and 30 April 2009 and 13 May 2009. By notice of motion dated 14 April 2009 the father sought leave to amend his claim to advance an allegation of breach of fiduciary duty against the lawyer. Her Honour denied leave on the basis that the hearing was too advanced and a claim in equity gave rise to different issues in terms of causation and damages and the differing onuses which fell on the parties. Her Honour could not "*in justice*" grant the leave sought because the parties had, by that stage, closed their evidentiary cases and "*it was simply too late to fairly permit the* [father] *to embark upon such a marked alteration in course.*"

Decision

The Court held that the lawyer had a conflict of interest which he failed to disclose and explain with the result that he failed in his duty to the father. The Court also found that the lawyer failed to advise the father that it was in his interest to obtain independent legal and financial advice.

During a meeting with the father and the son, the lawyer said to the father "*you are entitled to have a separate solicitor represent you*". Her Honour considered that those words did not clearly convey to the father the existence of a conflict or explain to him why it would be wise for him to be advised separately from his son. Schmidt AJ stated: →

"*The immediate difficulty for* [the lawyer] *arose from the need to give the father advice, which might be to the detriment of the son, who wanted the loan for his company's business purposes. This situation required the exercise of careful judgment, particularly given the information which* [the lawyer] *had about difficulties with the financial position of the son's business*."

The Court held it would have been prudent for the lawyer to meet separately with the father to ensure no undue influence was being exerted upon him.

The lawyer made no enquiries about the state of the son's business or its capacity to meet loan repayments. The Court held that it would have been prudent for the lawyer to make simple enquires such as a company or a title search to ensure that the son's instructions were accurate. The Court noted that a simple company search would have revealed that a liquidator had been appointed to the son's company and a title search would have revealed that the son did not have a share in the matrimonial home as represented.

The expert lawyer retained on behalf of the lawyer was of the opinion that there was no conflict. He considered that the lawyer did not have to recommend that the father obtain independent legal and financial advice in circumstances where the transaction was a re-financing and the father had previously provided his home as security for earlier borrowings. The lawyer's expert did however consider that it was a matter of judgment for the lawyer to assess whether the father understood the transaction and the risks being undertaken. Her Honour weighed up competing views from the expert lawyers retained by the parties and held that the lawyer had a conflict which he failed to disclose and fell short of the standard of competent professional practice: section 5O of the **Civil Liability Act 2002 (NSW)**.

The Court found that the lawyer had failed to comply with Rule 45 of the Revised Professional Conduct and Practice Rules 1995 as he had failed to inform the parties of the conflict and had failed to obtain the informed consent of each party in writing before proving the advice.

Her Honour held that the lawyer breached his duty of care to the father as he took no steps to ensure that he had informed consent, or satisfy himself properly that the father was conversant with his son's financial affairs and his business and that he appreciated the nature of the transaction or the real risks he was taking on.

The lawyer did not have a causation argument. Her Honour held that it was not open on the evidence to conclude that the father would not have taken a different course if properly advised. Her Honour stated:

"…*that* [the father] *would have agreed to increase the loans he was involved with from some $212,000 to $353,500 and then $450,000, at real risk of ending up homeless, in circumstances where he came to know that his son had lied to him in 2002 about his asset position and in 2003, about that and his business' ability to make repayments given that it had already been put into liquidation, is a conclusion which I am satisfied is not open on the evidence.*"

Implications

This decision highlights the importance for lawyers of obtaining a client's informed written consent in circumstances where a conflict or potential conflict of interest arises. It is important for lawyers to explain to clients the existence and nature of the conflict and why it would be in their interests to obtain separate advice. This decision also highlights the importance for lawyers to exercise sound judgment in assessing whether a client understands and appreciates the risks being undertaken in a transaction. Here, even though the father had already mortgaged his home to support the son's business, and the lawyer had suggested to the father that he seek a separate lawyer, the Court found that the lawyer, in acting for the both the father and the son on the subsequent loans, was in a position of conflict. ■

Tasmanian Sandstone Quarries Pty Ltd v Tasmanian Sandstone Pty Ltd & Ors [2009] SASC 111

Written by Lisa Feltz, Solicitor and Ella Gould, Solicitor

Tel 02 8273 9937 / 8273 9957
lisa.feltz@wottonkearney.com.au
ella.gould@wottonkearney.com.au

On 24 April 2009 Justice White of the South Australian Supreme Court handed down his decision in the matter of ***Tasmanian Sandstone Quarries Pty Ltd v Tasmanian Sandstone Pty Ltd & Ors*** [2009] SASC 111. The decision examined, amongst other things, the principle of double satisfaction and whether a solicitor's failure to arrange and/or failure to advise his client to arrange a pre-settlement inspection of a property constituted a breach of contract or alternatively a breach of his common law duty of care.

Facts

During the 1990's the first defendant Tasmanian Sandstone Pty Ltd (**TSPL**) owned and operated a sandstone quarry in south-east Tasmania. By January 2000 TSPL was facing insolvency and its directors (Peter and Marie Wood) appointed administrators.

At about the same time, Mr Wood (**Wood**) contacted Mr Rito Calabrese (**Calabrese**), who was an Adelaide stonemason and a purchaser of stone from the quarry. He suggested that Calabrese consider buying the assets of the quarry. Calabrese was immediately interested and retained Legalcom to act as his solicitors in relation to the proposed purchase. Mr Goldberg (**Goldberg**) was the principal of Legalcom.

The purchase negotiations were protracted and complicated. Calabrese acquired a newly incorporated company, Tasmanian Sandstone Quarries Pty Ltd (**TSQ**), of which Calabrese became a director, to be the purchaser. A number of events regarding the possession of the quarry and the sale of stone led to an acrimonious breakdown in the relationship between Calabrese and Wood.

Settlement took place on 19 June 2000. As TSQ attempted to recommence operations it became apparent that serious and substantial damage had been done to the quarry's plant, equipment and machinery. Further, vital documents such as the machinery operation manuals and service histories were missing. Operations were not able to be resumed in June 2000.

On 31 March 2004 TSQ commenced proceedings against TSPL, the administrators of TSPL and Legalcom. As against TSPL and the administrators, TSQ alleged they had breached the implied terms of the sale agreement by failing to maintain the plant and equipment in the same condition as it had been and for failing to transfer the plant and equipment in the same state as it had been when inspected and operated by Calabrese at the end of April 2000. As against Legalcom, TSQ alleged that the solicitors had breached their contractual duty and the common law duty of care by failing to advise TSQ to arrange a pre-settlement →

inspection of the quarry or, alternatively, by failing to conduct a pre-settlement inspection of the quarry themselves.

The proceedings against the administrators were settled prior to the matter going to trial. By consent, judgment was entered in favour of TSQ in the sum of $225,000.

The issues considered by the Court were:

+ Did the principles against double satisfaction have the effect that the judgment which TSQ obtained against the administrators precluded it from pursuing its claim for damage against Legalcom in respect of the same losses?
+ Did Legalcom have a contractual relationship with TSQ so as to provide a basis for a claim for damages for breach of contract?
+ If there was a contract of retainer between TSQ and Legalcom, was the omission of Legalcom to advise TSQ to arrange an inspection of the plant and equipment immediately before settlement or, in the alternative, to arrange such an inspection itself, a breach of the implied contractual term that Legalcom would use reasonable care and skill in performing its retainer?

Decision

Double satisfaction

Justice White held that the principle of double satisfaction applied in circumstances where it would be unconscionable for a plaintiff who has recovered against one tortfeasor to pursue a further claim in relation to the same damage against another tortfeasor (***Baxter v Obacelo Pty Ltd***, Gleeson CJ and Callinan J).

The Court held that the fact that TSQ had accepted the administrators' offer of settlement of the claim against them did not mean there was a settlement of the overall claim. The Court found that it was clear that neither TSQ nor the administrators intended their compromise to be a settlement of the whole of TSQ's claims.

Accordingly, TSQ was not precluded by the principles of double satisfaction from pursuing its claim against Legalcom.

A contractual relationship between TSQ and Legalcom

Legalcom asserted that it had a contract with Calabrese only, and denied the existence of any contract between it and TSQ. Accordingly, it denied that any of the conduct relied upon by TSQ could amount to a breach of contract.

Plainly, Legalcom could not have been retained by TSQ before 18 April 2000, which was the date on which TSQ was incorporated.

The Court found that a contractual relationship did exist between Legalcom and TSQ as evidenced by correspondence in TSQ's file. In particular, a letter written by Goldberg dated 30 May 2000 commenced with the words *"as you are aware we act for TSQ on instructions from its director, Mr Calabrese"*.

What standard of care did Legalcom owe TSQ?

The Court held that given the fact that Legalcom owed both contractual and common law duties of care to TSQ, the preferable approach was to consider whether it acted unreasonably in failing to advise TSQ to carry out a pre-settlement inspection or, alternatively, to carry out its own inspection.

The Court stated that in commercial transactions, a solicitor must exercise the care and skill of a reasonably competent solicitor in a transaction of the kind in question. The extent of the solicitor's duties is informed by the terms and limits of the retainer, as any duty of care must be relative to what the solicitor was instructed to do. Ordinarily solicitors are retained to give professional legal advice and assistance. Subject to the circumstances which may exist in a particular case, the solicitor acting in a commercial conveyancing transaction will not be found liable for the failure to give commercial or economic advice on topics unrelated to the legal aspects of the retainer for which he or she was retained. →

The court followed ***Neagle v Power*** (1967) SASR 373 in determining that expert evidence was not necessary to establish a lawyer's duty of care. The court is presumed to know for itself what the ordinary, reasonable, prudent and careful solicitor ought to know and do.

Did Legalcom breach a duty of care by failing to advise a pre-settlement inspection?

The Court held that Legalcom did not act unreasonably by failing to advise TSQ to carry out a pre-settlement inspection.

The court relied on the following facts:

+ Calabrese knew all of the facts and was in a better position to assess the significance of them than Goldberg;
+ Calabrese had more knowledge of the quarry and its equipment than did Mr Goldberg;
+ the sale agreement did not provide that TSQ was entitled to a stocktake or pre-settlement inspection prior to settlement; and
+ Legalcom was retained to provide legal advice and not as an advisor generally. The boundary between legal and commercial advice is not always clear but the pre-settlement inspection was found by the Court to be of a commercial nature.

Should Legalcom have carried out its own inspection?

Calabrese argued that Legalcom had a duty to carry out a pre-settlement inspection of the property prior to settlement. Calabrese argued that in conveyancing matters lawyers had a duty to perform pre-settlement inspection of title prior to settlement and stated the pre-settlement inspection of assets such as the machinery in this instance required the same duty of care by Legalcom.

The Court distinguished pre-settlement inspection of assets from pre-settlement checks on title for the sale of real property. The Court held that title was an abstract concept and involved a legal conclusion within the skill of a legal practitioner. An inspection of physical property can be carried out by most purchasers and did not require the application of any legal skill.

The Court rejected that Legalcom was required under its ordinary retainer to inspect the assets of the quarry prior to settlement.

Orders made

The claim against Legalcom was dismissed.

Implications

This case provides useful commentary on the scope of a solicitor's duties and the sometimes blurred relationship between legal as opposed to commercial advice. It is important to be mindful of what the Court will consider reasonable in relation to duties owed to clients by solicitors under their ordinary retainer. ■

Insurance Year in Review 2009
Directors + officers / Financial lines

The Bell Group Ltd (in Liq) v Westpac Banking Corporation

Written by Justin Carroll, Solicitor and Matthew Foglia, Special Counsel

Tel 02 8273 9932 / 8273 9905
justin.carroll@wottonkearney.com.au
matthew.foglia@wottonkearney.com.au

On 28 October 2008, Justice Owen of the Supreme Court of Western Australia issued his long-awaited decision in one of the longest running civil trials ever heard in Australia. The mammoth 2,643 page judgment relating to the 1991 collapse of the Bell Group will no doubt be a guiding hand and an influential feature in addressing the corporate collapses of today.

A snapshot of the factual background

The Bell Group Ltd (in liquidation) (**TBGL**) was a listed public company controlled by interests associated with Robert Holmes a Court (**RHaC**). TBGL was the holding company of various companies in the Bell Group, including Bell Group Finance Pty Ltd (**BGF**), Bell Group NV (**BGNV**) and Bell Group (UK) Holdings Ltd (**BGUK**). TBGL also owned 39% of the shares in Bell Resources Group Ltd (**BRL**).

In the mid-1980's, TBGL or BGF had banking facilities with 6 banks in Australia. The facilities were unsecured but supported by a negative pledge (which means that the companies required the banks' consent before dealing with certain of their assets). In 1986, BGUK established a loan facility with a syndicate of 14 non-Australian banks (**the Lloyds syndicate banks**). That facility, like the Australian bank facilities, was also unsecured but supported by a negative pledge.

Between 1985 and 1987, the Bell Group raised $585 million through five separate bond issues: three by BGNV in the open market which raised approximately $435 million which was then on lent by BGNV to TBGL or BGF and one each by TBGL and BGF to other interests associated with RHaC which raised approximately $150 million. The bond issues were described as "*convertible subordinated bonds*". The on-loans for the $435 million were not formally documented and there is a dispute whether the loans were made on a subordinated or unsubordinated basis. In 1988, the $150 million of RHaC bonds were transferred to the State Government Insurance Commission (**SGIC**).

In April 1988, RHaC sold his interests in TBGL to Bond Corporation Holdings Ltd (**BCHL**). The BCHL takeover of TBGL was complete by late 1988, by which time the board of TBGL and BRL consisted entirely of persons associated with BCHL.

Following the takeover by BCHL (which was itself the subject of public speculation about its financial health), some of the Australian banks sought repayment of the loan facilities that they had granted to TBGL and BGF. In the second half of 1989, after it became apparent that the debts owed to the Australian banks could not be repaid, negotiations began to restructure the facilities. A central part of the negotiations →

related to the provision of security over the assets of the Bell Group, the most valuable assets being assets of the Bell Publishing Group Pty Ltd (**BPG**) and TBGL's shareholding in BRL. Due to the negative pledge arrangements, it was necessary to include the Lloyds syndicate banks in the negotiations. By the end of 1989, the Australian banks were owed $131.5 million, all of which was due on demand. The Lloyds syndicate banks were owed the equivalent of approximately $131 million, which was due for repayment on 19 May 2001. In addition, the face value of the outstanding bonds, which were due to mature between 1995 and 1997, was about $546 million.

On 26 January 1990, the major refinancing and security documents were executed, providing for, among other things, the following arrangements:

+ All of the bank facilities were extended so as to be repayable on 30 May 1991.
+ If during the currency of the facility, the group sold assets, the proceeds of sale were to go to the banks pro rata in reduction of the bank debt.
+ All intra-group indebtedness (with some exceptions) was subordinated behind the claims of the banks.

These arrangements were entered into in circumstances where a month earlier (in December 1989) the following three significant events occurred:

+ TBGL raised with at least one of the banks the possibility that the bondholders might not be subordinated and might rank equally with the banks in a liquidation.
+ BCHL lost control of the board of BRL after a minority shareholder commenced proceedings alleging breaches of duty by the directors.
+ The NAB successfully applied for the appointment of a receiver to Bond Brewing Holdings Ltd.

On at least two occasions in late 1990, as well as in January, February and March 1991, the banks (at TBGL's request) agreed to defer payments of the monthly interest due to them. On 16 April 1991, the banks issued formal notices of demand for unpaid interest and two days later TBGL applied for the appointment of a provisional liquidator.

The banks realised on their securities (which they obtained in the 26 January 1990 restructure) and recovered approximately $283 million from the sale of the publishing assets and the BRL shares.

The litigation

In 1995, the liquidators commenced proceedings against the banks and the directors challenging the way in which the securities were given and taken and seeking recovery of the proceeds of realisation and consequential relief. The liquidators discontinued the proceedings against the directors at an early stage, leaving the banks as the target defendants.

In summary, the liquidators contended as follows:

+ That the main companies in the Bell Group were insolvent when the securities were given on 26 January 1990.
+ That the effect of the securities was to give the banks priority over the claims of all other creditors of the companies in the Bell Group, with the consequence that the creditors (including the bondholders) were prejudiced by the giving of securities.
+ That the giving of securities involved breaches by the directors of duties that they owed to the companies to, among other things, act in the best interests of the companies. In this regard, the essence of the alleged breach was that there was no corporate benefit to the individual group companies, rather than to the group as a whole.
+ That the banks were aware of these matters and: →

- received property from the companies knowing it arose from a breach of a fiduciary duty (the 1st limb of ***Barnes v Addy***[1]); and
- knowingly assisted the directors to breach their fiduciary duties (the 2nd limb of ***Barnes v Addy***).

The banks took issue with each of these contentions. Significantly, the banks contended that the bondholders were not prejudiced by the giving of securities to the banks because the bondholders were, from inception, subordinated and thus always ranked behind the banks.

The findings

After more than 400 days of hearing and 2,600 pages of judgment, the liquidators and the banks each scored partial victories in the litigation. We identify below a selection of the relevant findings in relation to the Australian companies in the Bell Group.

Were the Bell Group companies insolvent as at 26 January 1990 and did the directors know?

Owen J found that the Bell Group was indeed insolvent at 26 January 1990, however, he stopped short of finding that the directors were aware of this. He found only that the directors were aware that the companies were nearly insolvent.

In finding that the Bell Group was insolvent, Owen J considered that the companies faced a recurring annual deficiency of approximately $60 million which could only be bridged by proceeds from asset sales. On 26 January 1990, control of those proceeds had been ceded to the banks.

In causing the companies to enter into the 26 January 1990 transactions with the banks, did the directors breach the duties they owed to the Australian companies in the Bell Group?

1 [1874] CR 9 Ch App 244

Although the liquidator did not allege, and Owen J did not find, that the directors were dishonest or guilty of conscious wrongdoing, his Honour did find that the directors had breached their duties to their companies in the following ways:

+ They concentrated on the interests of the Bell Group of companies at the expense of the individual companies of which they were directors. By reason on the 26 January 1990 transactions, all of the worthwhile assets of the Bell Group of companies were made available to the banks for repayment of the debts owed to the banks by BGF and BGUK in priority to the claims of all other creditors and future creditors of the companies. In doing so, the various companies in the Bell Group incurred an obligation to the banks that had previously been limited to BGF (in relation to the Australian banks) and BGUK (in relation to the Lloyds syndicate banks) and TBGL as guarantor.
+ They failed to ensure that there was corporate benefit, for the relevant companies of which they were directors, in entering the transactions. In this regard, the directors (who knew that TBGL, BGF and BGUK were nearly insolvent), by entering into the transactions, exposed the companies (and their creditors and shareholders) to a probable prospect of loss and no probable prospect of gain.
+ The directors' purported plan to restructure the financial position of the Bell Group (of which the transactions were a step) was revealed to be no plan at all as none of the directors was able to say what exactly the plan was, how it was to be implemented or how the companies could survive in the meantime.

Significantly, Owen J found that the duties that were breached by the directors were fiduciary duties. →

Are the banks liable under the 1st limb of Barnes v Addy (knowing receipt)?

More controversially, Owen J also found that the banks, by taking all the worthwhile assets of the Group with knowledge that they did so as a result of the directors' breaches of fiduciary duty, were liable under the first limb of ***Barnes v Addy***. Although the property that Owen J found that the banks had received was not trust property, his Honour was prepared to find the banks liable under the first limb where:

+ fiduciary duties attached to the property;
+ the property was dealt with in breach of fiduciary duty; and
+ the banks received that property with knowledge that their receipt of it was in breach of fiduciary duty.

As such, the banks were liable to account for the property as constructive trustees.

In making that finding, Owen J relied upon a distinction first drawn by Young J in ***Rogers v Kabriel*** [1999] NSWSC 368 between trust property in the 'strict' sense, i.e. property whose beneficial title is vested in a beneficiary and whose legal title is vested in a trustee, and trust property in a 'broader' sense which included property to which fiduciary obligations attach. Owen J also relied upon the NSW Court of Appeal decision in ***Kalls Enterprises Pty Ltd (In Liquidation) & Ors v Baloglow & Anor*** [2007] NSWCA 191 which examined the authorities in which the first limb of ***Barnes v Addy*** had been applied to persons receiving property with knowledge of breach of a director's fiduciary duty. In ***Kalls Enterprises***, Giles JA said that this was a "*line of authority that should be followed until the High Court says otherwise*". Owen J also relied on the more recent case of ***Farah Constructions Pty Ltd v Say-Dee Pty Ltd*** [2007] HCA 22 in which the High Court noted "*that in recent times it has been assumed, but rarely if at all decided, that the first limb applies not only to persons dealing with trustees, but also to persons dealing with other types of fiduciaries*", but declined to proffer any further views on the issue.

Are the banks liable under the 2nd limb of Barnes v Addy (knowing assistance)?

Owen J found that the banks were not liable under this limb. As the plaintiffs never properly formulated as part of their case a critical element of such a cause of action, namely, that the directors engaged in a dishonest and fraudulent design.

Did the banks establish that the bondholders were subordinated behind the claims of the unsubordinated creditors?

Owen J found that the bondholders were subordinated and that this "*creates a huge hole in the plaintiffs' case*" and "*complicates the overall result of the litigation.*"

To what relief are the plaintiffs and the banks entitled?

In his October 2008 judgement, Owen J left this issue open. He spent many pages of the judgement imploring the parties to resolve this aspect by negotiation. The parties were unable to do so. On 30 April 2009, Owen J handed down his final judgement ordering the banks to pay $350 million plus $1.2 billion in interest to the plaintiffs. The banks have, we understand, appealed this final judgement.

Implications

This decision is likely to be the subject of scrutiny and debate for years to come. In particular, we do not expect that this decision will be the last word on whether or not the first limb of ***Barnes v Addy*** should apply to the knowing receipt of property as a result of directors' breaches of fiduciary duty. This decision serves as one more link in a growing chain of authority supporting the broadening of the first limb of ***Barnes v Addy*** to include property over which fiduciary duties attach – a proposition which the High Court will undoubtedly be invited to consider in the future. →

In the meantime, the decision will no doubt be welcome news to liquidators and creditors of failed companies as the expanded view of the first limb of ***Barnes v Addy*** places a powerful arrow in the liquidator's quiver.

More broadly, because of its comprehensive analysis of the issues, this case will no doubt also serve as a guiding hand in the liquidations of the recent stream of corporate collapses. Over the past year there have been a number of fairly high profile companies who have publicly struggled to restructure their banking facilities only to eventually collapse. To the extent that the banks' interests in such restructuring efforts have been focused on perfecting their own security, we would not be surprised to see the liquidators taking aim at the banks with their ***Barnes v Addy*** arrow.

For directors (particularly those who sit on the boards of multiple companies within a group), this decision should serve as a stark reminder of the need to focus on the separate and individual interests of each individual company and not just the interests of the group.

Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd [2008] NSWCA 206

Written by Matthew Foglia, Special Counsel
Tel 02 8273 9905
matthew.foglia@wottonkearney.com.au

In September 2009, the High Court denied the special leave applications from various parties in the Ingot proceedings finally bringing to a close the long running litigation over the 1999 convertible notes issued by New Cap Re.

Consequently, the December 2008 NSW Court of Appeal decision is the final word on a number of significant legal issues, two of which we discuss in this article, namely:

+ whether a mere conduit can be held liable for a misleading representation; and
+ the viability of 'indirect causation' in claims for misleading or deceptive conduct.

Before turning to discuss these legal issues, it is necessary to first provide a brief overview of the facts.

The facts

In January 1999 New Cap Re effected a convertible notes issue. The plaintiffs were various companies associated with Mr Duncan Saville who invested approximately $40 million in the notes issue, which effectively became worthless several months later when New Cap Re was placed in liquidation. The plaintiffs sought damages from 13 separate defendants who were involved in various capacities in the notes issue.

The plaintiffs' claims fell into three broad categories:

+ The first category involved a claim of alleged misleading or deceptive conduct against Macquarie Bank (the lead manager, underwriter and broker for the notes issue) who the plaintiffs alleged made misleading representations to Mr Saville before the Prospectus was issued by providing him with a draft of the Prospectus and a draft of the Underwriting Agreement, which representations allegedly induced certain of the plaintiffs to enter into sub-underwriting contracts for the notes issue. The 'mere conduit' issue referred to above arises in relation to this category of claim.
+ The second category involved alleged contraventions of s 995 (misleading conduct in dealings in securities) and s 996 (misstatements in a prospectus) of the **Corporations Law** against directors and officers of New Cap Re and members of the Due Diligence Committee (**DDC**) appointed by the board in relation to the Prospectus for the notes issue.
+ The third category involved alleged contraventions of s 995 during the period from the time the Prospectus was issued →

to the time the notes were issued. The plaintiffs contended that the financial circumstances of New Cap Re changed so significantly during this time frame so as to falsify statements in the Prospectus. The plaintiffs' claims in this regard were against the DDC and Mr Daya, the Managing Director of New Cap Re.

The 'indirect causation' issue referred to above was relevant to both the second and third categories of claim.

The decision at first instance

At first instance, McDougall J concluded that the plaintiffs established liability only against Mr Daya (as an accessory to misleading or deceptive conduct by New Cap Re), however, he nevertheless dismissed all of the claims (including against Mr Daya) because he found that the plaintiffs failed to prove their loss.

The appeal

The Court of Appeal upheld McDougall J's findings except in one respect; it held that the plaintiffs did prove their loss in the amount of the entirety of their investment. Accordingly, the plaintiffs now have a judgment against Mr Daya for $40 million.

We turn now to discuss some of the significant legal issues.

The mere conduit issue

The plaintiffs had contended that Macquarie made various representations to Mr Saville about New Cap Re's financial position by providing the draft documents to him in November 1998. Notably, the drafts contained disclaimers by Macquarie of any responsibility for the content of the drafts. Moreover, Mr Saville gave evidence that he understood that Macquarie was not the source of the representations. Both McDougall J and the Court of Appeal held that Macquarie was merely a conduit for the representations made by others and did not itself make the representations.

In determining that Macquarie's conduct was not misleading or deceptive, it looked at all relevant factors. Three factors which were significant in characterising Macquarie's conduct as a mere conduit were:

+ It was not the source of the information;
+ It expressly or impliedly disclaimed any belief in its truth or falsity; and
+ It simply passed that information on for what it was worth without adopting or endorsing it.

The indirect causation issue

Section 1005 of the **Corporations Law** permits a person who suffers loss or damage by conduct of another person that was engaged in contravention of [for example ss 995 or 996] to recover the amount of the loss or damage by action against that other person. The word "*by*" requires a causal nexus between the contravention and the loss.

In the second and third category of claims, the alleged contraventions were by the DDC. The alleged misleading representations were neither made to the plaintiffs nor directly relied on by the plaintiffs. This was not a case where the plaintiffs relied on the representations by the DDC. As such, there was no direct causal nexus between the contraventions and the plaintiffs' loss. Instead, the plaintiffs' claims rested on a theory of indirect causation, that is, but for the DDC representations to the Board, the Board would not have approved the Prospectus and the allotment of the notes issue and, therefore, the notes issue would not have proceeded and the plaintiffs would not have invested and suffered loss.

McDougall J held that this theory of indirect causation was not viable, as it was rejected by the Court of Appeal in its 2004 decision in ***Digi-Tech (Australia) Ltd v Brand*** [2004] NSWCA 58.

Ipp JA wrote the lead judgment, in which both Giles JA and Hodgson JA agreed. Ipp JA drew →

a distinction between cases in which the plaintiff is a passive victim of misleading conduct (such as ***Janssen-Cilag Pty Ltd v Pfizer Pty Ltd***) and cases where the plaintiff's own conduct is a necessary link in the chain of causation (such as the present case). He held that in the latter, the plaintiffs can only succeed if they are in fact misled by the misleading conduct, "*otherwise, such plaintiffs could succeed on the ground that, by making false representations, the defendants engaged in misleading conduct, even though the plaintiffs well knew the truth of the representations or were indifferent to them.*"

In his concurring opinion, Giles JA expanded on the above distinction:

"*The distinction drawn in [Digi-Tech] is between cases where conduct on the part of the plaintiff 'forms a link in the causation chain' and where it does not. Where it does, there must be reliance on the misleading conduct in the manner next explained. Where it does not, there may be recovery if the act of the innocent party induced by the misleading conduct 'by its very nature, causes the plaintiff's loss', but that is where the plaintiff suffers loss from another's act (as in Janssen-Cilag Pty Ltd v Pfizer Pty Ltd), where consumers were led by misleading conduct to buy less of the plaintiff's product.*

In saying that in a case of 'misrepresentation inducing a transaction' reliance on the misrepresentation was required for proof of causation, from the facts before them and their Honour's discussion they meant a case where the plaintiff was not a passive sufferer from another's act, but was someone who made a decision to enter into the transaction to which the representation was material. Their Honours did not mean direct inducement, but that the decision and the materiality to it of the representation was a link in the causal chain."

Giles JA's judgment, however, leaves open the possibility that indirect causation could be available in certain circumstances, which were not present in this case:

"*Section 1005 should be applied in a way that promotes provision of correct information to investors … But this does not warrant compensating investors regardless of the effect on their decision-making of the misleading conduct … Perhaps in some circumstances a plaintiff enters into a transaction simply because the opportunity to do so is available, when it would not have been available had there not been the misleading conduct, and that plaintiff can be regarded as in like position to the passive sufferer from another's act. That will not be so as a matter of course, and was not so in the present case.*"

Hodgson JA, in his concurring judgment goes even further in his obiter comments:

"*I am inclined to think that investors may be able to claim damages on the basis of misleading conduct where:*

+ *because of misleading conduct that misleads people involved in putting together an investment opportunity, an investment opportunity is made available to investors which would not have been made available at all but for the misleading conduct;*
+ *Investors invest in it; and*
+ *The investors lose money because the investments are, by reason of matters concealed by the misleading conduct, worth less than the investors paid for them.*

… On that basis, it does seem to me arguable that loss of that kind would be loss suffered 'by' the misleading conduct, at least so long as the investors did not know the truth."

Implications

On the current state of the law, the indirect causation theory would seem to be wounded, but not yet dead. ■

James Hardie: Directors under ASIC scrutiny

Written by Patrick Boardman, Special Counsel
Tel 02 8273 9941
patrick.boardman@wottonkearney.com.au

In 2001 the James Hardie Group sought to restructure its business so as to 'ring fence' its historic asbestos liabilities. James Hardie Industries Limited (**JHIL**) was the parent company of the James Hardie Group which included two subsidiaries with the greatest exposure to asbestos claims, James Hardie & Company Pty Ltd (**Coy**) and Jsekarb Pty Ltd (**Jsekarb**) which had manufactured and sold asbestos products from 1937 to 1987.

On 15 February 2001 the JHIL board resolved to create a separate foundation, the Medical Research & Compensation Foundation (**MRCF**), to manage and pay asbestos claims against Coy and Jeskarb. It also considered a JHIL Deed of Covenant & Indemnity (**DOCI**) with Coy and Jeskarb and a draft ASX announcement about the creation of the MRCF which referred to the MCRF as being "*fully funded*".

The MRCF was not fully funded which initially resulted in a NSW Special Commission of Inquiry into the MRCF by David Jackson QC. On 15 February 2007 ASIC commenced proceedings against all executive and non-executive directors of JHIL and the JHIL corporate counsel. ASIC also brought proceedings against JHIL and its Netherlands based company (**JHINV**) alleging misleading and deceptive conduct, false statements in relation to securities and continuous disclosure breaches.

Much of the ASIC prosecution concentrated on whether the representation that the MRCF was fully funded was misleading and whether each of the relevant directors and officers had breached their duty in failing to scrutinise all available information prior to providing their consent to the draft ASX announcement.

Findings

On 23 April 2009 Gzell J handed down his finding. In essence His Honour found that the draft ASX announcement was approved by the board on 15 February 2009 and that that announcement was false and misleading as it contained a number of false statements to the effect that the MRCF would have sufficient funds to meet all legitimate asbestos claims and was therefore fully funded and would provide certainty for people with legitimate asbestos claims.

The decision largely turns on its own facts and does not create any new law. Notably the non executive directors argued that they did not approve, and would not have approved, the draft ASX announcement on 15 February 2001. However, Gzell J held that the draft ASX announcement was discussed at that board meeting because the relevant board minutes referred to that having occurred and those minutes were subsequently approved by all the directors.

Gzell J held that:

+ each of the non executive directors breached their duty under s 180(1) of the **Corporations Act** in approving the draft ASX announcement;
+ Mr McDonald (the CEO and director) was guilty of 8 separate breaches of →

s180(1) in relation to the draft and final ASX announcement; the failure to advise the board of JHIL that the review of the cashflow model by PWC and Access Economics Limited was limited; failure to raise issues of the DOCI disclosure with the board and the Chairman; in relation to the Final ASX announcement; the Press Conference Statements (although this was found not to be a breach of s181(1)); the further ASX announcements of 23 February 2001 and 21 March 2001 (the latter was also held not to be a breach of s181(1)); and the Roadshow presentations (although this was also held not to be a breach of s181(1));

+ Peter Saffron (James Hardie General Counsel) was found to be in breach of his duties under s180(1) in respect of the draft ASX announcement; his failure to advise the JHIL board about the limitations in the PWC and Access Economic models and his failure to consider whether JHIL was required to disclose the DOCI to the ASX and to advise the board accordingly;

+ Mr Morley in respect of his failure to advise the board of JHIL that the reviews of the cashflow model by PWC and Access Economics were limited; and

+ various breaches of the **Corporations Act** by JHIL and JHINV.

Non executive directors

Gzell J held that each of the non executive directors was expected to "*take a diligent and intelligent interest*" in respect of the information available to them. He noted that the majority in ***AWA Limited v Daniels***[1] recognised that the role of the non executive director was to guide and monitor the management of the company rather than be involved at an *"operational level"*. However that duty involved *"becoming familiar with the business of the company and how it is run and ensuring that the board has available means to audit the management of the company so that it can satisfy itself that the company is being properly run*…[The] *responsibilities of directors require that they take reasonable steps to place themselves in the position to guide and monitor the management of the company…"*.

It was acknowledged that directors are entitled to rely on officers of the corporation however, that reliance is *"unreasonable where directors know, or by the exercise of ordinary care should have known, any fact that would deny reliance on others"*.

Gzell J held that the non executive directors were not entitled to rely on others when approving the draft ASX announcement because:

+ all directors should have known the importance of the ASX announcement regarding a significant restructure of the James Hardie Group;

+ there was significant evidence previously before the board which was inconsistent with such an emphatic assertion that the MCRF was "*fully funded*"; and

+ management had specifically sought the board's approval of the draft ASX announcement. Accordingly the non executive directors could not "*abdicate*" responsibility because of any breach of duty by the executives.

Each of the non executive directors were held to have breached their duties under s180(1) by voting in favour of the draft ASX announcement. However, His Honour also suggested that the duty under s180(1) may have gone further than merely an obligation not to approve the announcement as it was also "*incumbent*" upon each of the non executive directors to *"speak against or in modification of*" the draft ASX announcement.

Executive director and CEO

Against Mr McDonald it was relevantly held that:

+ the role and office of CEO imposed on him an additional obligation to positively →

1 [1992] 7 ACSR 759

advise the board that the draft ASX announcement was too emphatically expressed (and therefore false and misleading). The failure to do so amounted to a breach of s180(1); and

+ he had an express duty to advise the board regarding the limitations of the external experts and to bring those limitations to the attention of the board. The failure to do so was a breach of s180(1).

ASIC also alleged that Mr McDonald was in breach of s181 (relating to a failure to exercise duties in good faith or for a proper purpose). Gzell J considered the differing judicial opinion on the nature of dishonesty provided by s181. Gzell J preferred the view of Gowings J in ***Marchesi v Barnes*** [1970] VR 434 which required some form of moral turpitude on the part of the director. In his consideration of the principles relevant for the operation of s181 Gzell J specifically referred to the judgment of Malcolm CJ in ***Chew v R***[2] (regarding a duty to act in good faith and in the best interests of the company) and Ipp JA in ***Permanent Building Society v Wheeler***[3] regarding a "*proper purpose*".

Gzell J ultimately held that while Mr McDonald may have been misguided in his actions, at all times he believed he was acting in the best interests of JHIL. Consequently those actions were not in breach of s181.

General counsel

Importantly Mr Saffron, JHIL's Company Secretary and General Counsel, was held to be an officer of JHIL. Gzell J held that Mr Saffron had a duty to protect JHIL from legal risks and was not entitled to remain silent on those issues. It was therefore incumbent upon him to warn the board regarding the limited nature of the external experts' reports (which are matters which Mr Saffron knew or ought to have known about) irrespective of any failure on the part of the executive.

James Hardie companies

Gzell J also found that JHIL and JHINV had respectively breached ss999 and 1041E of the **Corporations Act**. Both those provisions are serious contraventions and are criminal offences. It is unusual for ASIC to criminally prosecute corporations for a breach of the **Corporations Act** without any corresponding allegation against an individual director.

Summary

The decision is very much dependent upon its facts and the manner in which the non-executive directors defended the ASIC prosecution. The biggest statement to arise out of the decision is more a policy statement of ASIC's intention to pursue an entire board for alleged breaches of duty, in circumstances where little or no loss may have occurred to any third party. Gzell J struggled to identify the persons who would have been misled by the ASX announcement.

The judgment emphasises the positive duty of executive directors to ensure that full and proper information is provided to the board and that the board is fully aware of any limitations in that information. It also emphasises the fact that all board members will be held to have read and acknowledged all the information that has been provided to them and that they each have a positive duty to make their own decision and not "*abdicate*" that to another party.

General Counsel have a duty to protect the company from legal risks which includes an express duty to warn the board of any foreseeable legal risk notwithstanding that the executive officers have not raised those risks with the board or may have expressed a contrary view. ■

2 [1991] 4 WAR 21

3 [1994] 11 WAR 187

Insurance Year in Review 2009
Reinsurance

Shutting the gate as the horse bolts (Part 1)

Written by Robert Carey, Special Counsel
Tel 02 8273 9942
robert.carey@wottonkearney.com.au

Having held in ***HIH v Wallace*** that Pt 6 of the **Insurance Act 1902 (NSW)** (**the Act**) applies to reinsurance contracts, the NSW Supreme Court has recently sought to confine the application of s 18B of the Act in the recent case of ***Westport Insurance Corporation & Ors v Gordian Runoff Limited*** [2009] NSWSC 245, an application for leave to appeal from the decision of an arbitration panel under section 38(4)(b) of the **Commercial Arbitration Act 1984 (NSW)**.

The facts

Following its acquisition by HIH Winterthur Holdings Limited (**HIH**), FAI Insurances Limited (**FAI**) purchased a directors and officers liability "run off" policy (**the FAI policy**) underwritten by insurers who subsequently became known as Gordian Runoff Limited (**Gordian**). The FAI policy incepted on 31 May 1999 and provided D&O run off cover for the benefit of FAI's former directors and officers on a claims made basis for a period of 7 years.

Gordian was reinsured for such risks by Westport Insurance Corporation and five other reinsurers (**the reinsurers**) under a number of excess of loss reinsurance treaties which covered losses on original policies of no more than 3 years' duration, underwritten during the period between 1 January 1999 and 31 December 1999 (**the reinsurance contracts**).

Claims were subsequently made against a number of FAI's directors and officers in connection with its acquisition by HIH. All but one of those claims was made within 3 years of the inception of the FAI policy.

Gordian made payments on the claims and sought to recover part of its loss under the reinsurance contracts. The reinsurers contended that the reinsurance contracts did not respond because the FAI policy was for a period of 7 years. The reinsurance contracts only responded to losses on policies for periods of up to 3 years. Gordian in turn sought to rely upon section 18B(1) of the Act in an attempt to recover losses relating to the claims that were made within 3 years of the inception of the FAI policy.

Section 18B(1) provides that:

"Where… under the provisions of a contract of [re]*insurance …:*

> *(a) the circumstances in which the* [re]*insurer is bound to indemnify the* [re]*insured are so defined as to exclude or limit the liability of the* [re]*insurer to indemnify the* [re]*insured on the happening of particular events or on the existence of particular circumstances, and*
>
> *(b) the liability of the* [re]*insurer has been so defined because the happening of those events or the existence of those circumstances was in the view of the* [re]*insurer likely to increase the risk of loss occurring, the* [re]*insured shall not be disentitled to be indemnified by the insurer by reason only of those provisions of the contract of insurance if, on the balance of probability, the loss in respect of which the insured seeks to be indemnified* →

was not caused or contributed to by the happening of those events or the existence of those circumstances, unless in all the circumstances it is not reasonable for the [re]*insurer to be bound to indemnify the* [re]*insured."*

The arbitration award

At the arbitration Gordian argued that the fact that the reinsurance contracts responded only to losses on policies with terms of no more than 3 years was an exclusion or limitation for the purposes of section 18B(1) such that it was entitled to indemnity in relation to the claims made against FAI's directors within the first 3 years of the FAI policy. The arbitrators agreed and made their award on that basis.

The judgment

The reinsurers submitted that the arbitrators had used section 18B(1) of the Act in an unorthodox manner to entitle Gordian to recover under the reinsurance contracts. In the Supreme Court, Einstein J allowed their appeal.

His Honour considered that the arbitrators had incorrectly equated the terms of the reinsuring clauses in the reinsurance contracts, which he considered defined or delineated the class of business covered by those contracts, with an exclusion clause or limitation which prevents recovery for an otherwise covered loss, by reference to the existence of a particular set of circumstances, in this case the effluxion of time. However Einstein J considered that the reinsuring clause defined the scope of cover and could not be considered to be an exclusion clause or limitation on cover.

Significance

This case limits the ability of reinsureds to rely upon section 18B(1) of the Act to circumstances in which a reinsurer seeks to rely upon a genuine exclusion clause. His Honour's reasons for judgment suggest that the section's application will therefore depend upon a traditional black letter characterisation of the policy term in question. ■

Shutting the gate as the horse bolts (Part 2)

Written by Robert Carey, Special Counsel
Tel 02 8273 9942
robert.carey@wottonkearney.com.au

The recent decision in ***AIG UK Limited & Ors v QBE Insurance (Europe) Limited*** [2008] QSC 308 confirms that reinsurance agreements are not automatically governed by the law of the jurisdiction where the original or underlying claim was determined.

The underlying claim

QBE Insurance (Europe) Limited (**QBE**) was the insurer of the Confederation of Australian Motor Sports (**the Insured**). Following an accident at a raceway for which it was liable and in which a driver was injured, the Insured made a claim on the policy issued by QBE (**the direct policy**).

The direct policy included a "*service of suit*" clause which provided that each party was to *"submit to the jurisdiction of any Court of competent jurisdiction"*. Whilst the accident occurred in New South Wales, the claim was made and settled in Victoria for $3.25 million.

AIG UK Limited and two other reinsurers (**the reinsurers**) reinsured QBE's exposure under the direct policy under a facultative reinsurance agreement (**the reinsurance agreement**). QBE made a claim on the reinsurance agreement in relation to the settlement of the underlying claim.

The reinsurance agreement

The reinsurance agreement included a "*claims cooperation clause*" which provided that as a "*condition precedent*" to any liability on the part of the reinsurers: →

"*(a) The Reinsured shall upon knowledge of any loss or losses which may give rise to a claim under this policy advise the Underwriters thereof as soon as practicable and without undue delay….*

(b) The Reinsured shall furnish the Underwriters with all information available respecting such loss or losses and shall cooperate with the Underwriters in adjustment and settlement thereof."

It also included a jurisdiction clause that provided as follows:

"*Commonwealth of Australia and New Zealand only, as original*".

The dispute

The reinsurers disputed QBE's right to recover under the reinsurance contract on the basis that it had not complied with the claims co-operation clause. They commenced proceedings in Queensland seeking a declaration that they were not bound to indemnify QBE because QBE had failed to notify them of the claim in accordance with the claims co-operation clause.

QBE applied to have the proceedings dismissed or alternatively transferred to the Supreme Court of Victoria under section 5 of the **Jurisdiction of Courts (Cross-vesting) Act 1987 (Qld)** (**the Cross-vesting Act**), which provides that the Supreme Court may transfer a matter to the Supreme Court of another State if (broadly) it is in "*the interests of justice*" to do so. QBE asserted amongst other things, that as Victorian law had applied to the direct policy and the underlying claim, Victoria was the most suitable place to deal with the proceedings relating to the reinsurance agreement.

If the proceedings were to be heard in Victoria, QBE no doubt would have sought to rely upon section 27 of the **Instruments Act 1958 (Vic)** (**the Instruments Act**) to excuse any failure on its part to comply with the claims co-operation clause. No court has considered whether section 27 of the **Instruments Act** applies to reinsurance contracts. However QBE's approach to the case assumed that it does (in the same way that Pt 6 of the **Insurance Act 1902 (NSW)** was held by the NSW Supreme Court to apply to such contracts in ***HIH v Wallace***).

Section 27 of the **Instruments Act** provides as follows:

"*Maintenance of proceedings under insurance contracts*

If by reason of accident, mistake or other reasonable cause any [re]insured fails to give any notice or make any claim in the manner and within the time required by the contract of [re]insurance such failure shall not be a bar to the maintenance of any proceedings (whether legal proceedings or arbitration proceedings) upon the contract by the [re]insured unless the court or the arbitrator or umpire (as the case may be) considers that the [re]insurer has been so prejudiced by such failure that it would be inequitable if such failure were not a bar to the maintenance of such proceedings."

However, before the Supreme Court of Queensland there would be no equivalent provision upon which QBE could rely. The reinsurers submitted that QBE was trying to "*forum shop*".

In spite of the apparently clear terms of the jurisdiction clauses in both the direct policy and the reinsurance contracts, QBE submitted that:

+ the reinsurance contract had its closest and most real connection with the law of Victoria;
+ the proper law of the reinsurance contract was therefore the law of Victoria; and
+ the fact that the underlying claim was made and heard in Victoria meant that Victoria was the most appropriate forum in which to hear the dispute under the reinsurance agreement. →

QBE also argued that the Queensland Supreme Court was able to, and should, transfer the proceedings to Victoria under the **Cross-vesting Act** on the basis that it was in the interests of justice to do so.

The decision

QBE's claim that Victoria was the proper jurisdiction in which to determine the reinsurance dispute was rejected. McKenzie J held that the reinsurance contract exhibited a *"clear submission to the jurisdiction of competent Australian courts."* That included the Supreme Court of Queensland and was not limited to the court which heard the underlying proceedings. His Honour held that the fact that the underlying proceedings took place in Victoria was *"little more than an incidental connection"*. His Honour was not persuaded that it was in the interests of justice to move the matter to the Victorian Supreme Court.

Significance for insurers and reinsurers

The decision highlights the jurisdictional problems created by the NSW Supreme Court's decision in ***HIH v Wallace & Ors*** and the application of superseded state laws relating to insurance (in New South Wales and Victoria) to reinsurance contracts. Where there is inconsistency in reinsurance law in different Australian states and territories, such disputes are bound to follow. ■

Shutting the gate as the horse bolts (Part 3)

Written by Catherine Osborne, Partner

Tel 02 8273 9930
catherine.osborne@wottonkearney.com.au

On 1 September 2009 the Insurance Regulation 2009 (NSW) (the Regulation) came into force.

The Regulation replaces the Insurance Regulation 2004 (NSW) and exempts reinsurance contracts from the application of sections 18, 18A, 18B and 19 of the Insurance Act 1902 (NSW) thereby reversing, for reinsurance contracts incepting on or after 1 September 2009, that aspect of the decision of the NSW Supreme Court in HIH v Wallace [2006] NSWSC 1150. The result is that reinsurance contracts incepting after that date and subject to NSW law, will once again be subject to common law principles. Of most immediate significance, the exemption of reinsurance contracts from the application of section 19 means that otherwise valid arbitration clauses in reinsurance contracts will now be binding on both the reinsured and the reinsurer.

It is a development which will be welcomed by reinsurers in Australia. ■

Rough justice and reinsurance: A colonial perspective

Written by Catherine Osborne, Partner and Robert Carey, Special Counsel

Tel 02 8273 9930 / 8273 9942
catherine.osborne@wottonkearney.com.au
robert.carey@wottonkearney.com.au

On 30 July 2009, in one of a series of final opinions before its abolition, the Appellate Committee of the House of Lords upheld an appeal by reinsurers in ***Lexington Insurance Company v WASA International Insurance Company Limited*** [2009] UKHL 40 and in doing so confirmed some orthodox and very fundamental principles of English reinsurance law. Whilst the decision will no doubt be as popular in the United States as a new tax on tea, we ask: what are its implications for insurers in England's much less rebellious antipodean former colony?

Background

The Aluminium Company of America (**Alcoa**) and its subsidiary Northwest Alloys Inc (**NWA**) were insured for loss of or damage to their property occurring during the period between 1 July 1977 and 1 July 1980, under an insurance policy (**the original insurance contract**) issued by Lexington Insurance Company (**Lexington**). So far as disputes were concerned, whilst it included no governing law clause, the original insurance contract included a US service of suit clause which required Lexington to submit to the jurisdiction of any court of competent jurisdiction within the United States.

Lexington was reinsured for part of this risk under a facultative reinsurance contract (**the reinsurance contract**) by AGF Insurance Limited and other reinsurers in the London market represented by Wasa International Insurance Company Limited (**the reinsurers**). The reinsurance contract was expressed to cover "*All Risks of Physical Loss or Damage*" and also provided cover in respect of loss and damage occurring between 1 July 1977 and 1 July 1980. However it included no express term in relation to either jurisdiction or its governing law.

The US proceedings

Following action taken against them by the US Environmental Protection Agency, Alcoa and NWA were required to undertake a clean up of pollution at various sites which they owned across the US and Canada. They sought to recover those costs from their insurers and commenced proceedings against Lexington and other insurers in the Superior Court of Washington State in December 1992 (**the US proceedings**). The property damage which was the subject of the claim under the original insurance contract was the result of contamination of various sites by waste products generated and disposed of by Alcoa and NWA over periods dating back to the 1940's.

The US proceedings were tried before Judge Learned who found that the law of Pennsylvania governed disputes under the original insurance contract. That finding was significant →

because Pennsylvania courts adopt the "*triple trigger*" approach to insurance coverage for latent injury and damage, developed by courts in some US states in the context of claims for asbestos related injuries. Under that approach courts may hold all insurers liable to indemnify an insured for all loss suffered by an insured from injury or damage which is the result of continuous exposure to a pollutant, irrespective of each insurer's time on risk or the period in which the relevant injury or damage occurred.

However at first instance (and following a jury being unable to draw a conclusion on the issue) Judge Learned held that the damage to some of Alcoa's sites occurred more or less by a linear process, i.e. damage occurred as the sites were contaminated over time and the clean up costs could be apportioned accordingly. She therefore held that Lexington was liable for clean up costs only in respect of damage which occurred during the period 1 July 1977 to 1 July 1980.

However Alcoa appealed to the Supreme Court of Washington, which held that under Pennsylvania law, as there was no exclusion relating to damage which occurred outside the relevant policy period and as some damage occurred within that period, Lexington was jointly and severally liable in relation to the clean up costs for all of the damage to Alcoa's sites, even though some (indeed most) of the damage occurred before (or after) inception of the underlying insurance contract.

The English proceedings

Lexington subsequently settled the claim by Alcoa on the basis of the Washington Supreme Court's decision, for US$103 million. It then sought recovery from the reinsurers under the reinsurance contract. The reinsurers responded by commencing proceedings in the High Court in London seeking a declaration that they were not liable to indemnify Lexington for the settlement.

At first instance, both parties agreed that the reinsurance contract having been placed in London, was governed by English law. Simon J agreed that the reinsurers could not be liable for the settlement, holding that the three year period clause in the reinsurance contract was fundamental and that under English law the reinsurers could only be liable to reimburse Lexington in relation to loss referrable to damage which occurred during that period. In doing so Simon J distinguished the decisions of the House of Lords in ***Forsikringsaktieselskapet Vesta v Butcher*** [1989] AC 852 (***Vesta v Butcher***) and the Court of Appeal in ***Groupama Navigation et Transports v Catatumbo CA Seguros*** [2000] 2 Lloyd's Rep 350 (***Groupama***) each of which involved the interpretation of warranties incorporated into reinsurance contracts from the relevant original insurance contract.

In both ***Vesta v Butcher*** and ***Groupama*** the original insurance contract was governed by foreign law and the reinsurance contract was governed by English law. The relevant warranty was construed so as to have the same effect that it would have under the law governing the original insurance contract, rather than the effect that it would have under English law. The result was to preclude reinsurers from denying indemnity to the direct insurer for breach of warranty by the original insured where the breach did not cause the loss in question. Simon J thought that such a result was within the contemplation of the reinsurers in ***Vesta v Butcher*** and ***Groupama*** but that no one in 1977 could have predicted the *"strained construction"* given to the original insurance contract in ***Wasa*** by the Washington State Supreme Court.

However the Court of Appeal in ***Wasa*** disagreed and held that ***Vesta v Butcher*** and ***Groupama*** could not be distinguished. The court held that the wording of the period clause in both the original insurance contract and the reinsurance contract was the same, namely the meaning ascribed to it by the Supreme Court of Washington. The Court of Appeal held further that in agreeing to reinsure Lexington the reinsurers assumed the risk of adverse legal developments in the US. →

The appeal to the House of Lords

In a unanimous decision the House of Lords upheld the reinsurers' appeal. In the two leading opinions, Lord Mance and Lord Collins (with whom the other Law Lords agreed) confirmed:

+ that a reinsurance contract is not simply a species of liability insurance, no matter how attractive the analogy may be for practical purposes, rather a reinsurance is an insurance of the same subject matter as the original insurance: ***Tommey v Eagle Star*** [1994] 1 Lloyd's Rep 516; ***British Dominion General Insurance v Duder*** [1915] 2 KB 394;
+ a reinsurer is not obliged to indemnify a reinsured unless the loss in question falls within the cover created by both the original insurance and the reinsurance: ***Hill v Mercantile & General Reinsurance Co Plc*** [1996] 1 WLR 1239;
+ whether a loss is within the cover provided by the reinsurance contract depends upon the proper construction of that contract, in accordance with the governing law of that contract; and
+ whilst facultative proportional reinsurance involves a presumption of "*back to back*" cover, that presumption may be displaced by the clear language of the reinsurance contract.

On the fundamental issue of whether the language used in the period clause in the reinsurance contract incorporated the meaning given to it by the Washington Supreme Court, unlike the Court of Appeal, the Law Lords were prepared to distinguish ***Vesta v Butcher*** and ***Groupama***. The House of Lords held that the clear language of the reinsurance contract, as construed in accordance with English law and as would have been ordinarily understood in the London market, meant that cover extended only to loss resulting from damage occurring during the policy period.

Vesta v Butcher and ***Groupama*** involved original insurance contracts expressly governed by foreign law and the legal principles applicable to the construction of the relevant warranties were well known at the time the reinsurance contracts were concluded. However in 1977 when Lexington sought reinsurance for the risk it assumed under the original insurance contract in ***Wasa***, Lord Collins noted:

"*there was no readily identifiable system of law applicable to the* [original] *insurance contract which could have provided the basis for construing* [the reinsurance contract] *in a manner different from its ordinary meaning in the London market* ".

Implications for Australian reinsureds?

The decision in ***[1]Lexington v Wasa***, whilst it involves an extreme set of circumstances, should be of some concern to Australian reinsureds whose reinsurance contracts are or may be governed by English law. Whilst Australian and English courts tend to adopt a similar approach to matters of construction, that is not universally the case[1]. Moreover English and Australian courts may well take different approaches to policy coverage where latent damage or injury is involved (see the decision of the English Court of Appeal in ***Bolton Metropolitan City Council v Municipal Mutual Insurance Limited*** [2006] EWCA Civ 50, c.f. that of the NSW Court of Appeal in ***Orica Limited & Anor v CGU Insurance Limited*** [2003] NSWCA 331).

Further, most original insurance contracts underwritten in Australia will be governed by the provisions of the **Insurance Contracts Act 1984** (**Cth**). A number of the provisions of the Insurance Contracts Act specifically alter the operation of various terms in direct insurance contracts. The decision in ***Wasa*** demonstrates that where such provisions are incorporated into the corresponding English law reinsurance contracts, English courts cannot necessarily be relied upon to follow the interpretation given to them by an Australian court. →

1 See Spiegelman CJ "*From Text to Context Contemporary Contractual Interpretation*" (2007) 81 ALJ 322

However the overwhelming potential for the decision to have an adverse impact so far as Australian reinsureds are concerned is in relation to historical liabilities. From 1 January 2009 amendments to prudential standards made by the Australian Prudential Regulation Authority (**APRA**) under the **Insurance Act 1973 (Cth)** (**the Insurance Act**) require all APRA regulated reinsureds to ensure that any reinsurance contracts under which they are reinsured by non APRA regulated reinsurers are governed by Australian law and that any disputes in relation to those agreements are referred to an Australian court. Where reinsurance contracts do not comply with this requirement, an ARRA regulated reinsured will be unable to take the benefit of reinsurance provided by a foreign reinsurer for regulatory capital purposes. Compliance with this requirement is likely to mean that the range of circumstances in which Australian reinsureds could find they are in a position similar to ***Wasa*** will narrow over time.

Finally, if accepted in Australia, the view taken by the House of Lords, that reinsurance is insurance upon the same subject matter as the original insurance, may have consequences so far as the application of state legislation relating to insurance is concerned. In particular this view (if accepted) may further complicate issues relating to the potential application to reinsurance contracts of section 6 of the **Law Reform (Miscellaneous Provisions) Act 1946 (NSW)** and Part 6 of the **Insurance Act 1902 (NSW)**.

New Cap Reinsurance Corporation Ltd v A E Grant [2009] NSWSC 662

Written by Matthew Foglia, Special Counsel
Tel 02 8273 9905
matthew.foglia@wottonkearney.com.au

This case involved an application by the plaintiffs, the liquidators of New Cap Re, for orders that the defendants return "*unfair preference*" payments of US$5,980,600.

Facts

The defendants are members of a syndicate at Lloyd's who entered into a whole of account reinsurance contract in 1997 with New Cap Re as the reinsurer and the defendants as the reinsured.

Following significant losses in the 1997 and 1998 policy years, New Cap Re and the defendants entered into a commutation agreement in December 1998, by which New Cap Re became liable to pay US$5,980,760 to the defendants, by way of sums of US$2,697,380 and US$3,283,380, which were expressed to be due and payable on 31 December 1998.

New Cap Re made two payments in relation to this commutation agreement, namely, US$2,000,000 on 8 January 1999 and US$3,980,600 on 14 January 1999.

New Cap Re went into voluntary administration on 21 April 1999 and liquidation on 16 September 1999.

The Liquidators sought to recover the payments as an "*unfair preference*" under section 588FF of the **Corporations Act**.

The statutory provisions

The following provisions of the **Corporations Act** are relevant:

+ Pursuant to s 588FA, a transaction is an unfair preference if "*the transaction results in a creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company.*"
+ Pursuant to s 588FC, a transaction is an insolvent transaction if, among other things, it is an unfair preference given by the company and the transaction is entered into at a time when the company was insolvent.
+ Pursuant to s 588FE(2), a transaction is voidable if it is an insolvent transaction and, among other things, it was entered into during the 6 months ending on the relation-back day.
+ Pursuant to s 588FF(1), on the application of the company's liquidator, the Court may, where it is satisfied that a transaction is voidable because of s 588FE, order a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction. →

The decision

The defendants did not appear or otherwise take part in the proceedings.

Barrett J found that there was no doubt that the payments were made and that they were transactions. He further found that the transactions consisted of payments made within 6 months of the "*relation-back day*", namely, the day on which the voluntary administration began. His Honour also noted that the issue of whether New Cap Re was insolvent at the time of the payments was the subject of an order for separate determination by White J on 30 September 2008 (see the 2008 Wotton + Kearney Insurance Year in Review). White J found that New Cap Re was insolvent at all relevant times from 31 December 1998, including at the time of the payments on 8 and 14 January 1999.

Barrett J held that on the making of the commutation agreement, "*there thus arose, on the part of the defendants and as a matter of contract, two liquidated claims properly regarded as debts…Each was an unsecured debt. The defendants were a creditor of [New Cap Re] because of the existence of those debts.*"

Given the fact that the net deficiency in New Cap Re's assets is approximately US$198 million, Barrett J concluded that unsecured creditors will receive substantially less than 100 cents in the dollar. Accordingly, the payments to the defendants (which were 100 cents in the dollar of debt) were unfair preferences.

As a result, Barrett J ordered the defendants to pay the sum of US$5,980,600 (plus interest from 23 August 2002, the date on which the defendants were aware of the claim) to New Cap Re.

Although not necessary to do so, Barrett J addressed an objection raised by the defendants in correspondence to the liquidators in 2002, by which the defendants asserted that the proceedings in Australia were in breach of the arbitration agreements in the relevant reinsurance contracts. He concluded that the arbitration clause in the reinsurance contracts was irrelevant to the present proceedings:

"There was no cause of action and no claim upon the defendants until the winding up of [New Cap Re] intervened. The arbitration provision in the reinsurance contract -- which ceased to be in force between [New Cap Re] and the defendants when, in December 1998, they became parties to the commutation agreement -- has no bearing on the statutory right that the subsequently appointed liquidator of [New Cap Re] subsequently acquired to seek orders against the defendants under s 588FF(1)."

Lastly, to assist with enforcement of the orders, Barrett J also directed the Registrar to transmit to the English court a letter of request.

Implications

This case provides a good analysis of the unfair preference legislation and the willingness of the Courts in Australia to enforce that statutory regime against parties residing outside Australia. ■

So what is trade credit anyway?

Written by Lisa Feltz, Solicitor and Robert Carey, Special Counsel
Tel 02 8273 9937 / 02 8273 9942
lisa.feltz@wottonkearney.com.au
robert.carey@wottonkearney.com.au

In ***General Reinsurance Australia Limited v HIH Casualty and General Insurance Limited (In Liquidation)*** [2009] NSWCA 22, the NSW Court of Appeal considered the nature of trade credit business in determining that certain insurance policies were reinsured under a quota share reinsurance covering "*trade credit*".

The trade finance arrangements

From 3 December 1997, Suncorp Metway Limited (**Suncorp**) provided Daewoo Australia Pty Limited (**Daewoo**) with commercial funding under a 12 month trade finance facility. Daewoo's repayment obligations under the facility were secured by a guarantee provided by its parent company and a fixed and floating charge over Daewoo's assets. However by November 1998 Suncorp had become concerned about Daewoo's financial position and a different arrangement was proposed under which Suncorp would extend "*financial accommodation*" to Daewoo, but under which Suncorp's interests would be protected by using trade credit insurance.

The new arrangements were to be set out in a *"trade finance agreement"* between Suncorp and Daewoo in March 1999 (**the trade finance agreement**) under which:

+ at Daewoo's request Suncorp would order goods from a supplier;
+ the supplier would invoice Suncorp but send the relevant bills of lading to Daewoo and ship the goods directly to Daewoo; and
+ Suncorp would pay the supplier under a documentary letter of credit and then invoice Daewoo for 111% of the amount of the supplier's invoice.

The trade finance agreement included the following term in relation to title to the relevant goods:

"*Property in Goods*

[Daewoo] *agrees that upon* [Suncorp] *making payment to a Supplier under a Documentary Letter of Credit,* [Suncorp] *will be beneficially entitled to the Goods in respect of which the Documentary Letter of Credit has been issued and property in those Goods will pass to* [Suncorp]."

The insurance policy

The new arrangement was supplemented by an insurance policy (**the insurance policy) issued by HIH Casualty &** General Insurance Limited (**HIH**). Under the insurance policy HIH agreed to indemnify Suncorp for 90% of the value of any invoice which it issued to Daewoo which was not paid. This meant that Suncorp was exposed to a notional 10% retention so far as the credit risk on each invoice was concerned. However, as HIH was aware, the 11% uplift on each invoice issued by Suncorp meant that there was in fact no retention. (This fact was not subsequently disclosed to HIH's reinsurers.)

The insurance policy covered Suncorp's "*Insurable Turnover*", which was in turn defined to mean: →

"…the aggregate invoice value of goods sold and delivered by [Suncorp] *during the 'Policy Period' to* [Daewoo]*".*

"Delivered" was in turn defined to mean:

"…the time during the 'Policy Period' at which goods pass from [Suncorp] *into the physical control of* [Daewoo]*, or legal title to the goods has transferred from* [Suncorp] *to* [Daewoo]*."*

The quota share

On 18 December 1998 Gen Re had bound itself to a quota share treaty reinsuring HIH's "*trade credit*" book of business (**the quota share**). The quota share included very few additional terms and the central issue in the case was whether the revised arrangements described above, as they operated in practice as between Daewoo, Suncorp and the suppliers, could in fact be described as "*trade credit*".

The dispute

Gen Re contended that the financing arrangements as they were put into practice were not true trade credit arrangements, because title in the relevant goods never passed from the supplier to Suncorp. The relevant bills of lading were in practice sent directly to Daewoo. Gen Re therefore argued that the insurance policy properly construed did not respond to those arrangements or alternatively, that if it did, it was not itself the subject of the reinsurance provided by the quota share.

The main issues were therefore:

+ whether Suncorp's claims fell within the terms of the insurance policy; and
+ whether the insurance policy was a trade credit policy.

The decision at first instance

At first instance, McDougall J examined three shipments of goods under the trade finance agreement. Each transaction took place in April 1999. His Honour concluded that in each case the supplier passed title to Suncorp which in turn passed title to Daewoo in a sale on credit. When Daewoo defaulted on payment, the insurance policy was triggered. In his Honour's view the insurance policy therefore constituted trade credit insurance and Gen Re was therefore liable to HIH under the quota share for its share of the loss.

The appeal

The passing of title was essential for the application of the definition of "*Delivered*" in the insurance policy, because at no time were the goods under the physical control of Suncorp. In order to trigger the insurance policy legal title to the goods in question had to pass from Suncorp to Daewoo.

Gen Re's position on appeal was that the supplier sold the relevant goods direct to Daewoo. Gen Re therefore sought to characterise the risk assumed by Suncorp as a "*financial risk legal relationship*" rather than a "*trade credit*" risk and argued that the mere fact that the risk had a connection with trade was insufficient to make it trade credit. Gen Re argued that Suncorp did not ordinarily trade in the goods acquired by Daewoo or physically supply them. Gen Re contended further that a policy insuring a financial institution would only constitute a trade credit insurance policy if the institution supplied, in the narrow sense, the relevant goods on credit.

In the leading judgment Allsop JA (with whom the other judges agreed) considered whether:

+ the supplier sold the goods to Suncorp; and
+ if so, Suncorp on sold the goods to Daewoo.

His Honour was of the view that the delivery of invoices to Suncorp by the supplier, and the payment of those invoices amounted to a contract under which the title to goods passed to Suncorp. It created a legal relationship at the request of Daewoo between the supplier and Suncorp with a clear commercial intention of on-sale by Suncorp to Daewoo. →

His Honour noted:

"[the supplier] *can be taken as offering to sell the goods to Suncorp by directly invoicing it (having been requested to do …).* [The supplier] *was intending to divest itself of title by sale. Given that Daewoo … and Suncorp had a commercial relationship in which the latter provided the former with financial accommodation, the nature of any title to be held by Suncorp rested on their mutual intention. That intention was to be found in the unequivocal terms in the trade finance agreement specifically cl 4.7*".

The appeal was therefore dismissed.

Implications

The court's decision should act as a reminder of the importance of not relying upon vague language or common understandings of the meaning of terms which are commonly used in commercial practice. Reinsurers and reinsureds alike should ensure that the scope of reinsurance treaties are defined with precision. This is particularly the case where the term in question is so fundamental as to define the very class of business to which the treaty in question relates. ■

Insurance Year in Review 2009
Industrial special risks / Construction

The commercial interpretation of policies gets the 'Gong'

Written by Simon Black, Solicitor
Tel 02 8273 9951
simon.black@wottonkearney.com.au

This recent decision of the ***Council of the City of Wollongong v Vero Insurance Ltd*** [2009] NSWSC 475 reaffirms the approach taken in ***McCann v Switzerland Insurance Australia Ltd*** [2000] 203 CLR 579 that the Courts will view a policy of insurance as a commercial contract which should be given a "*businesslike*" or commercial interpretation. In circumstances where an insurance policy has been entered into on the basis of *"agreed values"*, the Courts will be inclined to treat those agreed values as forming a key component of the policy's commercial purpose.

The decision also highlights the importance of insureds ensuring the accuracy of any asset valuations conducted for the purposes of insurance as they will ultimately be considered part of the underlying commercial purpose of the policy.

Wotton + Kearney represented Vero Insurance Limited (**Vero**) in these proceedings.

The facts

Vero insured Wollongong City Council (**the Council**) under an Industrial Special Risk Policy for the period 31 May 2006 to 31 May 2007 (**the policy**). The policy covered a wide range of buildings owned by the Council, one of which was a former National Emergency Shelter Hall (**the NES Hall**) at Port Kembla. The NES Hall had not been in regular use for some time.

The valuation

In September 2005 the Council engaged Scott Fullerton Valuations Pty Limited (**SFV**) to conduct valuations of the Council's properties for the purposes of arranging the renewal of its ISR insurance for 2006. In April 2006 the Council's broker submitted a quotation slip to Vero, annexing a schedule prepared by SFV entitled *"Wollongong City Council – Building and Contents Asset Schedule as at February 2006"* (**the Asset Schedule**). The Asset Schedule listed each of the Council's properties against which the relevant SFV valuations were recorded. Relevantly, the following values were ascribed to the NES Hall in the Asset Schedule:

+ "*reinstatement with new value*" - $322,000;
+ "*demolition and removal of debris*" - $19,000;
+ "*lead time and reconstruction allowance*" - $24,000;
+ "*contents insurance value*" - $17,000; and
+ "*total value for insurance purposes"* - $365,000.

The Council's ISR insurance was renewed with Vero on the basis of the Asset Schedule.

The fire

On 20 August 2006 a fire broke out in the NES Hall which rendered the building a total loss. The NES Hall was demolished and the site cleared of debris. →

Rather than rebuild on the site, the Council claimed the reinstatement value of the NES Hall under the policy and intended to use those funds in an alternative Council building project. With that in mind, in October 2006 the Council engaged a quantity surveyor who determined that, contrary to the SFV valuation contained in the Asset Schedule, the total cost of reinstating the NES Hall to its pre-existing state would be $758,365. That included $163,375 for essential upgrades to comply with mandatory Council and/or statutory building standards.

Vero granted indemnity to the Council on the basis of the declared value of the NES Hall contained in the Asset Schedule and paid the Council $302,000 (the declared value of the NES less the applicable deductible of $20,000) plus some additional minor payments for items such as debris removal costs. Vero considered this to be the extent of its liability under the policy.

The Council informed Vero of the apparent "*discrepancy*" between the Asset Schedule valuation and the quantity surveyor valuation and demanded that Vero indemnify the Council for the "*actual*" reinstatement value of $758,365.

The ISR policy

The ISR policy was a form of *"declared values"* policy with the property insured under Section 1 totalling some $523,580,460. The Insuring Clause for Section 1 was headed *"The Indemnity"* and stated:

"In the event of any physical loss, destruction or damage … the Insurer(s) will, subject to the provisions of this Policy including the limitation of the Insurer(s) liability, indemnify the Insured in accordance with the applicable Basis of Settlement".

The applicable Basis of Settlement under the policy was provided in the *"Partial Loss – Total Loss"* endorsement, namely *"the value … stated in the book of accounts or other records of the Insured".*

Relevantly, the policy also contained a "*Memorandum to all Sections*" entitled *"Misdescription, Non-Disclosure and Alteration"* which stated:

"… the insured shall not be prejudiced by any unintended and/or inadvertent error, omission or misdescription of the risk, interest of property insured under the policy, incorrect declaration of value …" (the **Misdescription Clause**).

The Council argued that the NES Hall had been unintentionally undervalued by its valuer SFV which resulted in an *"incorrect declaration of values"* so stated in the books of accounts or other records of the Council. Vero maintained that the Council was entitled only to the declared value of the NES Hall as contained in its books or records.

The Council subsequently commenced proceedings against Vero in the Supreme Court of NSW.

The trial

The Council argued before McDougall J that, by reason of the Misdescription Clause, it was entitled to have the policy respond on the basis of the actual value of the NES Hall and not on the basis of the figures contained in the Asset Schedule. The Council argued that either the recording of the value of the NES Hall or the provision of the Asset Schedule to Vero represented an *"inadvertent error, omission or misdescription of the risk"* within the Misdescription Clause.

Vero disagreed with that interpretation of the policy and directed the Court to the comments of Gleeson CJ in ***McCann v Switzerland Insurance Australia Ltd*** (2000) 203 CLR 579:

"A policy of insurance … is a commercial contract and should be given a businesslike interpretation. Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure".

Vero also argued that the *"Partial Loss – Total Loss"* Endorsement of the policy did not →

operate by reference to "*declarations*" but by reference to the *"books of account or other record of the insured"*. The agreement recorded in the policy involved an acceptance by both parties to the policy of the accuracy of those records for the purposes of the contract. It further argued that, on a proper construction of the policy, the Misdescription Clause should not be read as overriding the agreement between the parties that, where values for insurance purposes were recorded in the books or records of the insured, those values represented a pre-determined and agreed level of indemnity.

The decision

McDougall J accepted Vero's position that the parties *"intended to protect the Council against mistakes, not against the consequences of deliberate (even if 'wrong') decisions"*. While His Honour accepted that there were some anomalies in the way the policy had been constructed, specifically in relation to the Misdescription Clause, McDougall J concluded that:

"…the possibility of an anomaly does not seem to me to justify the rewriting of the bargain in the way for which, in effect, the Council contends.

In circumstances where the ordinary meaning of the language of the extending paragraph gives it work to do, and fits logically in the overall scheme of the policy, I do not think the paragraph should be construed to operate beyond the apparent limits of its words".

On that basis, His Honour concluded that:

+ the declaration of $322,000 (as being the value of the NES Hall) was not an incorrect declaration of value within the meaning of the Misdescription Clause of the policy; and
+ the entry into the books or other records of the Council of the sum of $322,000 as the insured value of the NES Hall was not an unintended and/or inadvertent error, or misdescription within the meaning of the Misdescription Clause of the policy.

His Honour awarded the Council $6,844, representing some outstanding ancillary costs incurred by the Council for debris removal as well as some interest on amounts previously paid by Vero to the Council. His Honour's judgment confirmed Vero's interpretation of the policy was correct and that the approach it had taken was appropriate. The Council's entitlement under the policy was therefore significantly less than the $758,365 it had claimed.

Conclusion

This decision should be of interest both to insurers and insureds as:

+ the Courts will look to apply a commercial and businesslike interpretation to an insurance policy;
+ when entering into an "*agreed values*" insurance policy, insureds would be well advised to ensure that the valuations underpinning those agreed values are accurate as they will form a key part of the "*commercial intent*" of the policy; and
+ insurers should ensure that their "*agreed values*" policies make it clear that those agreed values represent a pre-determined and agreed level of indemnity. ■

wotton kearney
insurance lawyers

Accidental damage and perils exclusions

Strategic Property Holdings No. 3 Pty Ltd v Suncorp Metway Insurance Ltd [2009] ACTSC 8

Written by Andrew Moore, Partner

Tel 02 8273 9943

andrew.moore@wottonkearney.com.au

Facts

Strategic Property Holdings No. 3 Pty Ltd (**the insured**) was insured under an industrial special risks policy with Suncorp Metway Insurance Limited (**Suncorp**) concerning the property and building comprising the Australian Defence Academy at Western Creek in the ACT (**the building**). The roof of the building, which comprised concrete roof tiles, was supported by a roof truss system. While each roof truss was a stand alone structural component they were all interdependent on each other and were each only able to support a specific load.

The trial proceeded on an agreed Statement of Facts which noted that design and construction inadequacies led to the failure of the trussed roof system and eventual collapse of the roof. It was agreed that:

+ the roof trusses were out of alignment;
+ the roof trusses had been uniformly installed incorrectly;
+ the sequence of failure commenced with 1 truss failing generally in the middle of the roof section; and
+ the failure of 1 roof truss induced the progressive failure of the adjoining trusses.

The qualified indemnity

Suncorp granted the insured a partial indemnity on the following basis:

+ the cost of replacement of the roof trusses and adjoining supports was excluded by perils exclusions 4(c) and (e);
+ the resultant damage to the roof was covered under section 1 of the policy as it came within the proviso to perils exclusions 4(c) and (e);
+ the roof's collapse came within the definition of accidental loss, destruction or damage and Suncorp's liability was sub-limited to a maximum of $200,000.

Perils exclusions 4(c) and (e) excluded loss, destruction or damage occasioned by or happening through error or omission in design, plan or specification or failure of design, fault in materials or faulty workmanship.

Suncorp accepted the principles set out in the "*famous*" or "*infamous*", depending on your point of view, decision of ***Prime Infrastructure Management Pty Ltd v Insurance Ltd and Ors*** [2005] QCA 369 (**Prime Infrastructure**) which dealt with the application of the proviso to perils exclusion 4. In applying the principles set out in that case Suncorp sought to exclude its liability to indemnify the insured in respect of replacement of the roof trusses and adjoining supports. Suncorp accepted that the resultant damage to the roof was covered by the proviso to perils exclusion 4. →

The issue in this case

Suncorp asserted that the peril, which it accepted was not excluded by perils exclusion 4, was subject to the sub-limit of $200,000 which applies when the event (or peril) covered by the policy is "*accidental damage as defined*".

His Honour Justice Gray noted that neither party had articulated the peril that was *"not otherwise excluded"*. Based on the principles in ***Prime Infrastructure*** we expect the parties considered that the subsequent peril was the risk that the roof would collapse if the roof trusses were not repaired or re-aligned.

For what it is worth the writer considers that the ***Prime Infrastructure*** decision produces a somewhat illogical result as it, in effect, holds the insurer liable merely because more than one excluded peril (i.e. exposure to loss, destruction, risk, jeopardy or damage – it is not a cause) had occurred to cause catastrophic loss – whereas the exclusion would apply if the damage resulted from a single excluded peril. The position will however remain as stated unless ***Prime Infrastructure*** is overturned.

The term "*accidental damage*", was defined by a non-exclusive definition which stated that it did not include the following (**the definition**):

"The terms Accidental loss, Destruction or Damage shall not include loss, destruction or damage caused by Fire, Lightening, Explosion, Implosion, Smoke, Impact, Aircraft or articles dropped therefrom, Riots, Strikes, Civil commotion, Storm, Tempest, Rainwater, Flood, Water or other Liquid Discharge or Leakage, Sprinkle, Leakage, Earthquake, Subterranean, Fire, Volcanic Eruption, Malacious (sic)*, Acts, Burglary, Theft, Breakage of Glass, Transit or any peril excluded by this policy…*".

As the definition was non-exclusive Justice Gray had reference to the following explanations of the meaning of "*accidental*":

+ "*happening by chance or accident, or unexpectedly*" (see the Macquarie Dictionary);
+ "*an unlooked for mishap or an untoward event which is not expected or designed*" (see ***Australian Casualty Co Ltd v Frederico*** (1986) 160 CLR 513 and ***Fenton v Thornley & Co Ltd*** [1903] AC 43).

Justice Gray found that:

+ if an event, outside of those events set out in the definition, causes damage Suncorp has limited its liability by listing those events in the definition that the policy is designed to cover without limitation;
+ damage occasioned by an event not listed in the definition must ordinarily be described as accidental, to be subject to the sub-limit.

In reaching his decision that the subsequent damage to the building was sub-limited by the definition Justice Gray made the following determinations:

+ the damage occasioned by the events described in perils exclusion 4 would not in ordinary parlance be described as "*accidental damage*";
+ it is that subsequent damage which is damage caused by a "*peril (not otherwise excluded)"* that must be described as otherwise accidental to the events not included in the definition;
+ the damage which was sustained to the roof trusses and adjoining supports was caused by "*faulty workmanship*" and was excluded by perils exclusion 4(e);
+ that damage which was caused by *"faulty workmanship"* amounted to a peril that caused subsequent loss which was not "*otherwise excluded*" by perils exclusion 4 and was not an included event in the definition; →

- all the subsequent damage to the roof caused by this peril could fairly be regarded as "*an unlooked–for mishap or untoward event which is not expected or designed*";
- the subsequent damage to the roof was not an inevitable consequence of the faulty workmanship which caused the damage to the roof trusses and adjoining supports;
- that being so, it was accidental damage within the meaning of the definition and the sub-limit applies.

Overview

Whilst not all policies sub-limit accidental damage, some do. This makes the definition of accidental damage important to the terms of cover provided. In this case the insured's entitlement to recover was significantly limited because the subsequent damage to the roof did not fit within one of the exclusions to the definition of accidental loss. ■

When doing nothing is really something

Written by Michael Bath, Senior Associate and Justin Carroll, Solicitor

Tel 02 8273 9953 / 8273 9932
michael.bath@wottonkearney.com.au
justin.carroll@wottonkearney.com.au

McConnell Dowell Middle East LLC v Royal and Sun Alliance Insurance plc [2008] VSC 501 provides a further example of the courts adopting a purposive approach to the interpretation of insurance policies in order to determine whether an insured has an entitlement to indemnity. In this case, Hansen J of the Supreme Court of Victoria considered, amongst other things, whether a third party's failure to respond to an Insured's request as to the location of and/or the return of its property constituted an *"Occurrence"* for the purposes of a construction risk material damage policy and whether loss resulting from that occurrence *"could be attributed to theft"*. Hansen J held that it did.

Facts

On 12 June 1999, McConnell Dowell Middle East LLC (**MDME**) entered into 3 agreements (**the first SMAP agreement**) with Societe Miniere Aoudou Pacco (**SMAP**) by which MDME hired to SMAP 132 items of plant and equipment for use in its open cut mining operations in the Central African Republic (**CAR**).

On 11 October 2000, MDME and SMAP entered into a second agreement (**the second SMAP agreement**) which replaced the first SMAP agreement. Relevantly, the terms of the second SMAP agreement provided that MDME retained ownership of the equipment until it had been fully paid for by SMAP and that SMAP was obliged to inform MDME of the location of the equipment on request. Furthermore, if MDME decided to cease mining operations in the CAR, SMAP was obliged to take all necessary steps to enable MDME to remove the plant and equipment from the CAR.

A representative of MDME attended the mine site on 13 October 2000. At that time, some items of equipment (items 1 to 20) were noted to be missing. In December 2000, MDME decided to cease mining operations in the CAR. On 8 January 2001, MDME advised SMAP that it was terminating the second SMAP agreement and requested SMAP to:

"…take all necessary steps to enable [MDME] *to remove the Plant from the CAR accordingly and advise the precise location of each piece of Plant and where and when it can be collected"*.

Between January 2001 and September 2001, MDME made numerous requests that SMAP advise of the location of the items of plant and equipment and to either purchase the equipment or assist MDME by taking all necessary steps to enable it to remove the plant from the CAR. None of MDME's requests received any meaningful response from SMAP.

Following investigations into the precarious civil and political situation in the CAR, MDME decided that none of its personnel would return to the CAR to seek to recover the missing equipment. Accordingly MDME never recovered equipment items 1 to 20 and 21 to 132. →

MDME sought indemnity from insurers under two construction risk material damage insurance policies in force from 30 June 1999 to 30 June 2002 and 30 June 2000 to 31 December 2002 (**policies**). Royal & Sun Alliance Insurance (**RSA**) was the insurer of the policies.

Policy provisions

The insuring clause of the policies provided that:

"This Section, subject to the limitations, exclusions and conditions hereinafter mentioned is to indemnify the Insured against physical loss of or damage to the Insured Property (as defined herein) in respect of any Occurrences happening during the period of insurance defined herein".

The policy defined *"Occurrence"* as *"an event or continuous or repeated exposure to conditions, which, during the Period of Insurance, causes or contributes to physical loss of or damage to the Insured Property"*.

Also relevant was Exclusion 5 to the policies which provided that:

"This Policy does not cover loss due to disappearance or revealed by inventory shortage alone, unless such loss can be attributed to burglary and/or theft and/or any attempt thereat".

The Court was asked to consider whether there was an *"Occurrence"* as defined by the policies and, if so, whether Exclusion 5 had been enlivened. In doing so, the Court needed to consider whether the policies responded to the loss of items 1 to 20 (which MDME was unable to locate) and items 21 to 132 which were never recovered.

In relation to the loss of items 1 to 20, MDME submitted that there had been an *"Occurrence"* for the purposes of the policies on the basis of SMAP's failure to return the equipment once it was discovered to be missing by MDME and failure to respond to MDME's communications in relation to the items of equipment.

RSA submitted that there was no *"Occurrence"* for the purposes of the policies essentially because MDME failed to show the happening of an *"event"*.

Findings in relation to *"Occurrence"*

In determining whether there was an *"Occurrence"*, Hansen J first looked at whether there had been a physical loss. In doing so, his Honour adopted the statement of Ashley J in ***Harris Paper Pty Ltd v FAI General Insurance Co Limited*** (1995) 8 ANZ Ins Cas 61-276, where his Honour had stated that:

"Distinct from 'destruction' or 'damage' to property, it refers to physical loss of possession of property; that is, to circumstances where it cannot be said that property has been destroyed or damaged, but only that physical possession once had of the property has been lost".

His Honour considered that under the terms of the second SMAP agreement, MDME remained the owner of the equipment and that there was an obligation on SMAP to inform MDME as to the location of the equipment upon request. While his Honour concluded that it might be more correct to say that SMAP retained possession of the items rather than that MDME lost possession, Hansen J stated:

"However that cannot alter the fundamental fact that the plaintiff remained the owner of the items, and SMAP was obliged to keep those items readily identifiable as the plaintiff's property and inform the plaintiff of their whereabouts on request. In effect, SMAP's failure to accurately respond to the plaintiff's request as to the whereabouts of the items, and SMAP's retention of those items after the plaintiff had inquired of their whereabouts on or shortly after 13 October 2000, were events causing or contributing to the plaintiff's physical loss or possession of the item. In short, there was an Occurrence under one or both of the policies". →

Whether Exclusion 5 was enlivened

His Honour then considered whether Exclusion 5 had been enlivened. Hansen J accepted that, since Exclusion 5 excluded loss due to disappearance, MDME's loss would not be covered unless the loss could be *"attributed to theft"*.

RSA submitted that it was not open to the Court to find that any of the items had been stolen because MDME led no evidence as to the law of theft in the CAR, nor was there sufficient evidence to establish theft under Australian law.

Hansen J considered that the meaning of *"theft"* was to be determined by *"reference to the intention of the parties, viewed objectively and having regard to the terms of the underlying commercial purpose of the policies, read as a whole"*. His Honour continued:

"In my view, the parties could not have intended the exclusion clause to require the identification of the thief, and proof of a criminal offence in all its constituent elements. Such a requirement would be inconsistent with the commercial reality of which the parties to the policy must have been aware, namely that theft often goes undetected, particularly in some of the places where [MDME] *was engaged in business, and that one of the very purposes of insurance policies like the present would be to cover losses arising from theft"*.

Having found that there was an unexplained absence or disappearance of property, the policy required MDME to establish that such loss *"can be attributed"* to theft. His Honour held that, while the words *"can be attributed to"* was language of causation, it was not the same as saying caused by theft. The former is less direct and permits an inference to be made, rather than requiring a definite conclusion that theft had occurred. The relevant question was, therefore, whether it could be reasonably inferred that there had been a dishonest appropriation of the property with no intention of returning it to its true owner.

Hansen J held that SMAP's failure to respond to MDME's numerous requests in relation to the location of the items of property supported the inference that SMAP (or someone acting with SMAP's knowledge and consent) dishonestly appropriated the items and turned *"what might have been an innocent hiring situation into a dishonest appropriation"*. That evidence led his Honour to infer that, shortly after 13 October 2000, SMAP (or someone acting with its consent) dishonestly appropriated items 1 and 3 to 20, with no intention of returning them to MDME. Hansen J held that the theft proviso to Exclusion 5 was triggered and the exclusion was not enlivened.

His Honour applied the same reasoning to hold that there was an *"event"* for the purposes of the policy in relation to the loss of items 21 to 132 and that the evidence permitted the inference that the loss could also be attributed to theft.

The judgment then considered the appropriate method of calculating MDME's loss.

Implications

This decision provides a further illustration of the courts applying a purposive approach to the interpretation of insurance policies in circumstances where a strict reading of the words used in a policy is susceptible of producing an uncommercial result. Insurers are reminded that if they intend words to have a particular meaning, that should be clearly articulated in the policy wording. ■

wotton kearney
insurance lawyers

Finding reason in the unreasonable: An insurer's liability to pay interest

Written by Justin Carroll, Solicitor
Tel 02 8273 9932
justin.carroll@wottonkearney.com.au

At what point does it become unreasonable for an insurer to withhold payment to an insured under a contract of insurance for the purposes of calculating the insurer's liability to pay interest pursuant to section 57 of the **Insurance Contracts Act 1984 (Cth)** (**ICA**)?

In ***McConnell Dowell Middle East LLC v Royal & Sun Alliance Insurance plc (No 2)*** [2009] VSC 49 Hansen J in the Supreme Court of Victoria held that the answer to this question is one of fact to be determined by reference to the particular circumstances of the case. The basic principle is that an insurer is entitled to *"a reasonable time to conclude its examination of the issues relating to the claim and of the amount which it should pay on the claim*".

While the facts giving rise to this decision are unusual, the judgment provides useful guidance on the considerations that a Court will have regard to in determining the date from which interest is payable for the purposes of section 57 of the ICA. Importantly for insurers, the decision reaffirms the position that a bona fide belief that a genuine dispute exists with an insured over liability is not a relevant consideration in determining whether an insurer has acted reasonably in declining to pay an insured.

Facts

In November 2008 Hansen J gave judgment in favour of ***McConnell Dowell Middle East LLC*** (**MDME**) in the substantive proceedings from which ***McConnell Dowell Middle East LLC v Royal & Sun Alliance Insurance plc (No 2)*** arose.

The circumstances relevant to MDME's claim for interest were as follows:

+ In June 1999 MDME agreed to lease certain of its plant and equipment to another company, Société Minière Aoudou Pacco (**SMAP**), in the Central African Republic (**CAR**) (**the agreement**).
+ In January 2001 MDME wrote to SMAP advising that it was terminating the agreement and requested SMAP to make available to MDME its plant and equipment (**the equipment**). SMAP failed to comply with this request.
+ In March 2001 MDME notified its insurer, Royal & Sun Alliance Insurance (**RSA**), of the possibility that a claim might be made under its policy in relation to the equipment.
+ In May 2001 loss adjusters appointed by RSA sent RSA their "*First Report on Construction (Theft) Loss"* which concluded that MDME's equipment had been stolen. The report noted that *"it occurs to us that there is an admissible claim in respect of the plant and equipment; no exclusions appear to apply".* The loss adjusters also referred to MDME's request for input from RSA on policy response and recovery. →

- In January 2002 MDME provided the loss adjusters with further information and documentation and requested that RSA provide it with a response on policy coverage by 31 January 2002.
- On 6 February 2002 RSA's lawyers wrote to MDME's broker requesting that MDME provide further information regarding the claim. MDME was delayed in responding to RSA.
- In November 2002 a meeting took place between MDME, its broker and RSA's lawyers at which MDME accounted for the delay in responding to RSA's letter of 6 February 2002. MDME confirmed that it was gathering the material sought by RSA.
- In January 2003 MDME sent further material to its broker in response to queries from RSA's lawyers.
- On 2 May 2003 MDME commenced proceedings against RSA.

MDME's Statement of Claim originally pleaded that its losses of equipment had been a *"total loss"* or that they had been *"appropriated by a person or persons unknown"*. Between February 2004 and May 2006 MDME then amended its Statement of Claim on three occasions, resulting in the vacation of two trial dates. It was only with the final amendment in July 2007 that MDME pleaded that the equipment had been stolen (which was the basis upon which it ultimately succeeded at trial).

While RSA did not dispute that it was liable to pay interest to MDME on the judgment amount under section 57(1) of the ICA, it did dispute the date from which interest was payable. Section 57(2) of the ICA relevantly provides that:

"[t]he period in respect of which interest is payable is the period commencing on the day as from which it was unreasonable for the insurer to have withheld payment of the amount and ending on whichever is the earlier of the following days:

(a) the day on which the payment is made;

(b) the day on which the payment is sent by post to the person to whom it is payable."

MDME submitted that the judgment amount should be divided into separate claims with the following start dates for the purposes of calculating interest:

- 9 May 2001 in relation to the sum awarded for 77 items of equipment included in the loss adjusters' first report (**the first loss**);
- 11 May 2006 in relation to the sum awarded for 55 items of equipment notified to RSA at various times (**the second loss**); and
- 9 January 2004 in relation to the sum awarded for MDME's professional costs (this being the date when the claim for professional fees first appeared in MDME's pleading).

RSA, by contrast, submitted that the appropriate start date was 1 August 2007 on the basis that the claim on which MDME ultimately succeeded at trial, i.e. loss attributable to theft, was not pleaded until the final version of the Statement of Claim was filed on 5 July 2007 and that prior to that date the claim pursued by MDME was materially different. RSA submitted it was then entitled to a further 4 weeks until 1 August to investigate and determine its position.

Hansen J accepted that MDME's claim remained uncertain for some time. Despite this uncertainty, however, His Honour found that MDME's claim did not essentially change. Importantly for insurers His Honour observed that:

"[t]he fact the exact circumstances surrounding the loss of the equipment remained unclear, even after the trial, does not mean that an insurer who chooses to request further information and defer a decision on policy liability until such time as the picture is clear (when the practical reality is that the picture may never become as clear as the insurer might wish) can avoid the running of interest on a payment →

which the Court has ultimately held should have been made by the insurer at an earlier time."

Hansen J concluded that RSA was entitled to a period of four months from the date on which MDME requested input from RSA as to the course it should adopt with respect to the loss of equipment.

Conclusion

This decision reaffirms the position that insurers are entitled to a reasonable time to investigate a claim and to conclude whether any amount is payable. What constitutes a reasonable time will vary with the nature of the claim and the circumstances under which it is made.

While the complexity of a claim and the sufficiency of the information provided to insurers concerning the circumstances of a claim will be relevant in determining what is a reasonable time for an insurer to determine its liability under a policy, a bona fide dispute as to an insured's entitlement to indemnity is irrelevant for the purpose of determining a start date under section 57(2).

In this regard, this decision follows ***Bankstown Football Club Ltd v CIC Insurance Ltd*** (unreported, NSWSC, Cole J, 17 December 1993) and ***HIH Casualty & General Insurance*** [2006] VSC 128 which are authorities for the proposition that the point at which it becomes unreasonable for an insurer to withhold payment is to be determined by a finding of whether or not liability exists. If liability exists, an insurer will be presumed to have known of that obligation, subject to being given a reasonable period in which to investigate the claim.

Once an insurer's liability under a policy has been established, it will not be open to the insurer in cases under section 57 of the ICA to point to reasons why it was reasonable for the insurer to have thought that it was not liable. To do otherwise, as Bongiorno J suggested in ***HIH Casualty & General Insurance***, would be to permit the insurer that decides to contest liability to profit from its mistaken view of the law and to disadvantage the insured who has succeeded in establishing the insurer's liability. ■

Building and Construction Industry Security of Payment Act: Application to an insurance policy

Written by Gabrielle Levette, Senior Associate

Tel 02 8273 9936
gabrielle.levette@wottonkearney.com.au

In ***Thiess Pty Ltd & Anor v Zurich Specialties London Ltd & Anor*** [2009] NSWCA 47 the NSW Court of Appeal found that, whilst an obligation pursuant to a Construction Risks Insurance Policy to take *"reasonable precautions"* was a condition precedent to an insurer's obligation to indemnify, it did not give rise to an enforceable promise by an insured to take those steps.

Background

Zurich Specialties London Limited and Swiss Re International SE (along with a number of other coinsurers) (**the insurers**) were insurers of Thiess Pty Limited and John Holland Pty Limited (trading as Thiess John Holland Joint Venture (**TJH**)) under a Construction Risks Insurance Policy (**the policy**). The policy provided cover in relation to the planning, development, design, construction and commissioning of the Lane Cove Tunnel Project. A dispute arose between the insurers and TJH by reason of the collapse of a portion of the tunnel on 2 November 2005.

On 2 September 2008 TJH purported to serve a payment claim on the insurers under the **Building and Construction Industry Security of Payment Act 1999 (NSW)** (**the Act**) seeking payment of the costs TJH alleged it incurred in rectifying the collapsed portion of the tunnel.

The Act

The Act enables a person who claims to be entitled to a progress payment to serve a payment claim on the person who, under the construction contract concerned, is or may be liable to make the payment. A person on whom the payment claim is served may reply to the claim by providing a payment schedule which identifies the amount the respondent proposes to pay to the claimant. If the respondent does not serve a payment schedule within 10 days after the payment claim is served the respondent becomes liable to pay the claimed amount.

If a payment schedule is served and there remains a dispute as to the amount claimed then the matter may be referred to an adjudicator for determination. If the respondent fails to make a payment once the adjudicator's determination has been received the claimant can request an adjudication certificate which can be filed as a judgment. The respondent has the right to commence proceedings to have the judgment set aside. However, it is obliged to pay into Court the unpaid portion of the adjudicated amount as security pending final determination of those proceedings.

The purpose of the Act was to reform payment behaviour in the construction industry by →

ensuring that any person who carries out construction work under a construction contract in New South Wales is provided with a statutory right to progress payments in relation to that work and has access to a fast track adjudication procedure. It has been described as a "*pay now, argue later*" scheme.

Interlocutory application

Wotton + Kearney acted on behalf of the insurers in relation to an interlocutory application filed on the insurers' behalf seeking urgent relief from the Court in relation to the payment claim. The insurers sought:

+ a declaration that the policy was not a construction contract within the meaning of the Act;
+ a declaration that so much of the policy as was relied upon by TJH as being a construction contract within the meaning of the Act forms part of a contract of insurance pursuant to section 7(2)(iii) of the Act; and
+ an injunction restraining TJH from taking any steps in relation to the payment claim and exercising any entitlements pursuant to the Act.

Construction contract

The term *"construction contract"* is defined in the Act to mean a contract or other arrangement under which one party undertakes to carry out construction work, or to supply related goods and services, for another party.

The insurers argued that TJH did not perform the rectification work in relation to the collapsed tunnel for the insurers, but pursuant to its contractual obligations to the principal contractor (the Roads and Traffic Authority of NSW), and that accordingly there was no *"construction contract"* for the purposes of the Act.

TJH looked to the terms of the policy and, in particular, to the provisions within the policy which stipulated that TJH was required by the insurers to take all reasonable precautions to safeguard the subject matter insured and to prevent loss and damage. TJH argued that the *"reasonable precautions"* provision within the policy was a discrete construction contract which required TJH to take steps that would include construction work.

Recognised financial institution

The insurers also relied on section 7(2)(a) of the Act which provides that:

"*(2) the Act does not apply to:*

a construction contract that forms part of…a contract of insurance under which a recognised financial institution undertakes:

…to provide an indemnity with respect to construction work carried out, or related goods and services supplied, under the construction contract."

A recognised financial institution is defined in the rules to mean a body regulated by APRA. A body regulated by APRA includes a foreign general insurer authorised to carry on business in Australia.

The insurers argued that as Swiss Re International SE was a subsidiary of a company authorised to carry on business in Australia (being Swiss Reinsurance Limited) it was a recognised financial institution within the meaning of the Act and that the carve out provided under section 7(2)(a)(iii) applied. In addition the insurers argued that it was sufficient that only one of the insurers was a recognised financial institution for the carve out to apply as the exclusion refers to "*…a contract of insurance under which* ***a*** *recognised financial institution…*".

First instance decision

The matter was heard at first instance before Bergin J. Her Honour considered that it was clear from the provisions of section 7(2) of the Act that the Legislature envisaged that there may be contracts of insurance that include construction contracts. However, before a contractor would be entitled to recover a progress claim from an insurer there would have to be some *"inclusion or incorporation"* of a →

construction contract so that it forms part of the insurance contract.

Further, an important aspect of the definition of construction contract in the Act is that it is a contract under which one party undertakes to carry out the work for another party. The work has to be carried out for that other party.

Her Honour found that the reasonable precautions provision within the policy was not an agreement by TJH to carry out construction work for the insurers, but an agreement by TJH that in carrying out construction work for the principals/owners they had to do so in a particular manner, that is, by taking reasonable precautions, in order to qualify for indemnity under the policy.

Her Honour found that the reasonable precautions clause was not a construction contract and that the Act did not apply to the policy. As there was no construction contract it was unnecessary to decide whether any Insurer was a recognised financial institution.

Appeal decision

TJH appealed to the NSW Court of Appeal. McFarlane J (with whom Allsop P and Sackville AJA agreed) identified the critical question as being whether a requirement to take *"reasonable precautions"* constituted a condition precedent to the TJH's right to indemnity under the policy or whether instead, or as well, it embodied a contractual promise by TJH to take the steps.

His Honour noted that the proper approach to the construction of an insurance policy is as a commercial contract and that it should be given a businesslike interpretation. His Honour noted that the commercial purpose of the insurance contract in question was to provide indemnity against certain loss and damage and not to enable the insurers to procure the performance of construction work.

McFarlane J opined that insurers could not sue TJH for damages if it failed to take the reasonable precautions required by the policy and that such a move would not be in conformity with the commercial purpose of the policy. His Honour found that the requirement of reasonable precautions was a condition of the insurers' obligation to indemnify and not a promise or undertaking by TJH to take those steps.

The Court of Appeal unanimously agreed with Bergin J's conclusions and the appeal of TJH was dismissed with costs.

Conclusion

The judgment is a significant decision for insurers which underwrite Construction Risks Insurance policies and provides a useful authority on the types of insurance policies which may be considered construction contracts for the purposes of the Act. It is also a beneficial judgment for insurers in that it is now clear that any obligations of an insured to mitigate its loss pursuant to a *"reasonable precautions"* type provision in a policy of insurance will not be seen as a discrete construction contract between insurers and insureds so as to attract the operation of the Act. ■

wotton kearney
insurance lawyers

Suncorp Metway Insurance Ltd v Owners Corporation

Written by Colleen Palmkvist, Solicitor

Tel 02 8273 9954
colleen.palmkvist@wottonkearney.com.au

In ***Suncorp Metway Insurance Ltd v Owners Corporation SP64487*** [2009] NSWCA 223 the Court of Appeal considered whether the individuals named in the relevant policy of insurance or a company controlled by them were the *"Contractor"* for the purposes of the policy. In its decision, the NSW Court of Appeal emphasised that documents contemporaneous with any contract will have far greater probative value in determining the identity of the contracting parties than any post-contractual material regarding performance of the contract.

Facts

Owners Corporation SP64487 (**the owners corporation**) owned 16 townhouse units (**the property**). On 4 April 2004 the owners corporation made a claim against Suncorp Metway Insurance Ltd (**Suncorp**) for the cost of rectifying defects arising out of the construction of the property. The owners corporation claimed to be entitled to indemnity under a *"Contractor's Annual Home Warranty Insurance Policy"* (**the policy**) which had been issued by Suncorp to the owners corporation in compliance with the **Home Building Act 1989 (NSW)** (**the HBA**).

The proprietor of the property at the time of construction was Kent Street Investments Pty Ltd (**Kent Street**). The directors of Kent Street were Clive Head and his 2 sons, Gregory Head and Andrew Head. The same 3 persons were directors of Head & Sons Constructions Pty Ltd (**the company**).

The policy indemnified the *"Building Owner"* for loss or damage in respect of residential building work arising from breach by the *"Contractor"* of section 18B of the HBA. The definition of *"building owner"* in the policy included both the person for whom the residential building work was to be carried out and any successor in title of the land or building. The Schedule to the policy named Clive Head and Andrew Head (**the Heads**) as the *"Contractor"*.

Dispute

The critical issue for determination by the Court of Appeal was whether the Heads had entered into a contract with Kent Street to do the residential building work at the property (**the work**) and therefore satisfied the definition of *"Contractor"* in the policy (**the critical issue**). *"Contractor"* was defined in the Policy as follows:

"The person named in the Schedule who enters into a contract with the Building Owner to do the work".

Suncorp's position (which the owners corporation disputed) was that despite being named in the Schedule the Heads were not the *"Contractor"* because they had not entered into a contract with Kent Street to carry out the work.

Trial

At the request of the parties, Bergin J at first instance separately determined 4 questions. Most attention at trial and in Bergin J's judgment was directed to question 1, being whether the work had been carried out by the Heads or the company.

In finding that the work was carried out by the Heads and that the relevant warranties in the →

policy were provided by the Heads and not the company, Bergin J determined that the policy responded to the claim by the owners corporation.

Court of Appeal

The Court of Appeal did not consider it necessary to focus their attention on who carried out the work. This is because irrespective of whether the Heads and/or the company were found to have carried out the work, it would still be necessary to consider other evidence bearing on the identity of the contracting parties to determine the critical issue.

The Court of Appeal rejected Suncorp's submission that Bergin J had accorded too much weight to communications that took place shortly before or at the time of the work and that the more revealing documents were those which came into existence after the work commenced. The Court of Appeal considered that Suncorp's criticisms of Bergin J's decision failed to recognise that documentation which was more or less contemporaneous with any building contract is likely to have greater probative value on the question of the identity of the contracting parties than post-contractual documentation bearing on the question of who actually carried out the work.

To determine the critical issue the Court of Appeal relied on correspondence between the Heads' insurance broker (**the broker**) and Suncorp's agent, Dexta (**the broker's correspondence**). On 27 August 1999 the broker sent a proposal for builder's warranty insurance to Dexta (**the proposal**). In the proposal the company was identified as the contractor and the Heads were named as the construction managers.

Dexta subsequently confirmed that it was willing to accept the risk subject to the following:

"Cover will be provided for Clive and Andrew Head and not Head & Sons Constructions Pty Ltd. As the company does not hold a builder's license (sic) any contracts entered into by the company will not be covered by our Policy".

When the broker responded confirming that cover was required it noted that:

"We would also like to confirm that the client has been made well aware that no cover applies if any contract is entered into in any other name than Clive and Andrew Head…

The particular contract at current (sic) is located at Epping where Kent Street Investments Pty Ltd owns the land. The directors of which are Clive and Andrew Head. As the owners of the land they will be the owners of the completed premises before being sold off and then becoming a Body Corporate. The developers/builders are Clive and Andrew Head. Therefore the contract for the construction is in the names of Kent Street Investments as owners and Clive and Andrew Head as developers".

Dexta confirmed acceptance of the risk later that day.

The Court of Appeal held that:

+ not one of the documents identified by Suncorp demonstrated that any building contract with Kent Street had been entered into by the company and not the Heads;
+ the broker's correspondence provided very strong evidence that a contract, whether or not in writing, was entered into between Kent Street, as the owner of the property and the Heads, as builders, for the construction of the property; and
+ since the Heads satisfied the definition of *"Contractor"* in the policy the owners corporation was entitled to indemnity under the policy for the cost of rectifying the defects.

Implications

This case demonstrates that a purchaser of a defective building from a developer may have difficulty ascertaining the identity of the parties to the original building contract, particularly if the contract is not in writing and the developer and the builder are related parties. In such a case the purchaser may be at risk of having an otherwise sound claim under an insurance policy rejected because the building contract was entered into by a party related to the developer but not referred to in the policy.

It is possible an amendment may be required to the HBA in order to overcome this gap in the protection afforded to purchasers who rely on certificates of insurance. ■

Insurance Year in Review 2009
Foreign shores

Underwriting agency agreements: Running-off to the courts

Written by Simon Black, Solicitor
Tel 02 8273 9951
simon.black@wottonkearney.com.au

Insurers routinely look to develop their business by moving into new or expanding insurance markets. In many cases, the initial start-up costs of entering a new market or producing a new insurance product, coupled with a lack of existing in-house expertise and market reputation, will encourage the use of underwriting agencies. Those agencies often have the benefit of an existing reputation, expertise in the specific market area and established contacts. The relationship between underwriter and agent is usually governed by an underwriting agency agreement or "*binding agreement*" (**Binder**).

On 6 April 2009 the Appeal Court of England and Wales dismissed an appeal of the UK High Court 's decision in ***Temple Legal Protection Ltd v QBE Insurance (Europe) Ltd*** [2008] EWHC 843. The decision by Lord Justice Rix, Lord Justice Moore-Bick and Justice Bennett highlights the importance of carefully drafting Binders to ensure that both underwriters and their agents are fully aware of their rights and obligations in the event that the agency relationship is terminated. In particular, the case shows the importance of carefully articulating how existing insurances are to be "*run-off*" following the termination of a Binder.

The case also confirms that, as a general rule, an insurer's entitlement to revoke the authority of its agent will be unfettered in all but the most limited of circumstances.

The facts

Temple Legal Protection Ltd (**Temple**) was a specialist legal expenses underwriting agency established in 1999 to take advantage of the boom in the UK "*legal expenses*" market following the introduction of the Conditional Fee Agreements (or *"no win, no fee"*) amendments implemented by the **Access to Justice Act 1999**.

As an underwriting agent, Temple did not carry the financial risk in the legal expenses insurance cover it facilitated. Rather, it developed and marketed the insurance products which, over the years, were underwritten by a number of insurers pursuant to respective Binders. Temple entered into one such Binder with QBE Insurance (Europe) Ltd (**QBE**) (**the QBE Binder**).

The QBE Binder came into effect on 1 January 2006 and authorised Temple to write "*after the event*" (**ATE**) legal expenses insurance on behalf of QBE. The QBE Binder also authorised Temple to sub-delegate authority to various "*coverholders*" – chiefly law firms whose clients required ATE cover.

An ATE insurance policy essentially provides cover for the costs incurred by a party in pursuing or defending litigation with the payment of premium usually deferred until the conclusion of the case. If the insured is successful, the insurer recovers the premium from the losing party. If the insured is unsuccessful the insurer pays the successful party's costs. →

Relevantly, the termination provisions of the QBE Binder stated that:

- both parties must give 240 days' notice before terminating;
- the QBE Binder would terminate automatically if Temple went into liquidation;
- the QBE Binder would terminate automatically if Temple ceased to be authorised by the Financial Services Authority (**FSA**);
- QBE was entitled to terminate the QBE Binder if Temple committed a material breach which it did not remedy within 60 days;
- QBE was entitled to terminate the QBE Binder if Temple entered into a Binder with another insurer; and
- Temple's authority to write insurance would cease immediately on termination but it would remain liable to conduct the run-off of existing insurances until their expiry or termination.

The relationship between Temple and QBE deteriorated rapidly and by August 2006 Temple gave notice that it wanted to terminate the QBE Binder. While the 240-day notice period specified under the QBE Binder would not expire until April 2007, Temple had entered into a new Binder with another insurer by October 2006.

As a result of Temple's actions in contracting with another insurer, QBE wrote to Temple in January 2007 terminating the QBE Binder with immediate effect. QBE informed Temple that it would assume all claims handling functions going forward and that Temple would not be entitled to conduct the run-off of existing insurances.

QBE wrote to a number of the coverholders informing them that Temple's authority had been revoked and asking them to deal directly with QBE in the future. Temple, in turn, wrote to the coverholders asking that they continue to deal with Temple and maintaining that the terms of the QBE Binder did not entitle QBE to take over the run-off of existing insurances.

The dispute went to arbitration.

The decision at arbitration

At arbitration Temple argued that it had a right to manage the run-off of the existing business on the basis that it was a party to the certificates of insurance. Temple also suggested that allowing QBE to take over the run-off of the existing policies of insurance would put Temple in breach of various contractual obligations it owed to third parties (the various coverholders and insureds).

Nonetheless, the arbitrator found that QBE was free to terminate Temple's authority to conduct the run-off by unilateral notice and had done so in its letter of January 2007.

Temple appealed the arbitrator's decision.

The High Court's decision

On appeal the High Court held that neither the QBE Binder, its commercial context nor the indications of the general law of agency established an entitlement on the part of Temple to conduct the run-off. While the Court accepted that Section 10.2.2 of the QBE Binder imposed an *obligation* on Temple to deal with the run-off, it did not go so far as giving Temple an *entitlement* to do so. Section 10.2.2 of the QBE Binder stated that:

"unless otherwise agreed by QBE, Temple shall remain liable to perform its obligations in accordance with the terms and conditions of [the binder] in respect of all insurances bound to termination until every such insurance has expired or has otherwise been terminated".

The Court also considered it important that, if it were to accept Temple's interpretation of the QBE Binder, QBE would have been unable to prevent Temple from acting as "*run-off agent*" even in circumstances where Temple had acted fraudulently or its directors were convicted of criminal offences.

While recognising that there were a series of complex relationships in place between QBE, Temple, the coverholders and the insured litigants, the Court held that any obligations →

owed by Temple to those third parties existed only so long as it was authorised by QBE. If the parties had intended for Temple to be entitled to conduct the run-off post-termination, the Court considered that such an entitlement would need to be clearly articulated in the QBE Binder. The Court considered that it was not.

Temple appealed the decision.

Decision of the Court of Appeal

In upholding the High Court's decision, the Court of Appeal confirmed that above all the relationship between QBE and Temple was one of principal and agent. That relationship was built on the principal's trust and confidence in the agent. In the Court's view it would be unusual and uncommercial *"for any principal who had employed an agent to manage some aspect of his business to be obliged to allow that agent to continue to act on his behalf once the necessary degree of trust and confidence had been lost".*

The Court held that it was clear from the terms of the certificates of insurance that Temple was acting as the agent of QBE and that once its authority was revoked by QBE, coverholders would be obliged to deal directly with QBE or with another agent it appointed. Nothing in the QBE Binder made the continued involvement of Temple essential.

Finally, the Court held that a principal would always be entitled to revoke its agent's authority *"save in an extremely limited and rare class of case, which can be described loosely as an agency coupled with an interest"*. Temple's right to sub-delegate authority under the terms of the QBE Binder did not create an agency coupled with an interest so as to fall within that *"rare class of case"*.

Implications

In upholding the High Court's decision, the EWCA has highlighted the need for underwriters and their agents to take particular care in drafting underwriting agency agreements to ensure that:

+ the termination provisions of underwriting agency agreements are clear and unambiguous;
+ the agency agreements clearly specify the rights of the parties, including those arising out of post termination administration and the protection of their respective business interests.

In particular, underwriting agencies would be advised to take particular care to ensure that they preserve some control over the business that they have created and the contacts they have developed.

Given the Court's confirmation that an insurer's right to revoke the authority of its agent will be unfettered in all but the rarest of cases, underwriting agents would be well advised to pay particular attention to the way in which Binders are drafted to ensure their products, rights and market contacts are protected as much as possible. ■

What amounts to a valid notification?

Written by Charles Thornley, Special Counsel
Tel 02 8273 9910
charles.thornley@wottonkearney.com.au

In ***HLB Kidsons (a firm) v Lloyds' Underwriters & Ors*** [2008] EWCA 1206 the English Court of Appeal had to consider what would amount to a valid notification of circumstances by an insured to an insurer. The decision is of particular relevance to insurers in Australia as the policy in question contained a deeming provision similar to that set out in section 40(3) of the **Insurance Contracts Act 1984 (Cth)** (**ICA**).

Facts

HLB Kidsons (**Kidsons**), a firm of chartered accountants, sold tax avoidance products through its subsidiary Solutions @ Fiscal Innovation Limited (**SFI**). Insurers had issued a professional indemnity policy on a claims made basis to Kidsons for the period 1 May 2001 to 30 April 2002.

In 2001 a Kidsons employee raised concerns about a particular tax scheme being sold by SFI. Kidsons' Board considered these concerns unwarranted, but in August 2001 Kidsons wrote to their broker saying:

"… the Inland Revenue, if minded, could be critical of some procedures followed in certain cases …" (**the August letter**).

The brokers did not provide the August letter to Underwriters. The August letter was, however, enclosed with a claims bordereau report (**the Bordereau report**) to the lead insurer in October 2001.

At the end of March 2002 Kidsons forwarded a further letter to its brokers that included the following:

"… in some instances there might be procedural difficulties involving … each scheme and this might lead to the possibility of criticism in the future" (**the March letter**).

The March letter was provided to Underwriters after the expiration of the policy period.

Claims were subsequently brought against Kidsons relating to the SFI product. Kidsons sought indemnity under the policy relying on General Condition 4 of the policy, which provided that:

"The Assured shall give to the Underwriters notice in writing as soon as practicable of any circumstance of which they shall become aware during the [policy period] *… which may give rise to a claim or loss against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after the expiration of the* [policy period] *shall be deemed for the purposes of this insurance to have been made during the subsistence thereof."*

Decision at first instance

In the High Court, Justice Gloucester held that strict compliance with General Condition 4 was required if the notifications were to be effective. Her Honour held that the August letter and Bordereau report were not valid notifications because they were insufficiently clear and unambiguous to constitute a notice of a circumstance and further did not identify any error, act or omission or identify the possible claim and/or the product in question. Her Honour held that the March letter was a →

proper notification but could not be viewed as having been given "*as soon as practicable*" coming, as it did, some months after Kidsons became aware of the matter and communicated to Underwriters some 3 months after the policy had expired.

The appeal

Kidsons' appeal was upheld by Rix LJ with Tulson LJ concurring and Sir Richard Buxton dissenting.

Their Lordships held that the March 2002 letter had not been given as soon as practicable and so was not a valid notification. The appeal accordingly turned on whether the August letter and Bordereau report were valid notifications.

Rix LJ felt that the August letter was not a satisfactory letter and, although agreeing with Justice Gloucester that the Bordereau report could not go further than the August letter, held that the Bordereau report read together with the August letter clarified the August letter.

His Honour concluded that the August letter and Bordereau report was an effective notification for the purposes of General Condition 4 saying that:

"The question for present purposes is what the letter said, not what the letter did not say. It was presented as a matter of the claim side of things. The letter did not say that any claim had been made, indeed it said that no claim had been made, and therefore the essence of it must, at any rate in theory have been to provide information of a circumstance which might give rise to a claim. That is what the Bordereau confirmed, when it was headed 'Claim Circumstance Notification Bordereau'."

His Honour went on to hold that:

"General Condition 4 says nothing about how a notification is to be made, other than that it must be in writing and given as soon as practicable after awareness of circumstances which may give rise to a claim. That is on the face of it, a fairly loose and undemanding test. … The Assured is thus put in danger of either being required to give notice at a time when the circumstance of which he is aware require investigation before he can speak precisely about them, or of being told that he has failed to give notice at all as soon as practicable." (our emphasis)

Underwriters took the point that Kidsons' Board had never considered that its employee's concerns were justified and had never intended to notify of possible claims. Rix LJ held that Kidsons' subjective belief as to what it was intending to notify to Underwriters was not relevant as the test was an entirely objective one to be considered from the objective standpoint of a reasonable recipient. The Court held that a circumstance which may give rise to a liability is one which *"objectively evaluated, creates a reasonable and appreciable possibility that it will give rise to a loss or claim against the Assured."*

Implications

Kidsons is authority for the proposition that the test as to whether valid notification has been provided is an objective one to be viewed from the standpoint of the insurer and that it will not be necessary for an insured to establish that it had a subjective element of belief in the possibility of a claim.

The decision is a warning to insurers that a letter as deliberately vague as the August letter can be held to be a valid notification and accordingly any insurer faced with an ambiguous or vaguely worded notification should demand further information and clarification from the insured.

That said, the Court of Appeal also held that while notification is not required to be comprehensive, a non-comprehensive notice of circumstances may carry its own penalty for the insured because the insured is *"unable to give notice of that which is omitted"*. Their Lordships also warned that if an insured chooses to be deliberately misleading or economical with the truth, so that the insurer is not given a fair picture of what the insured knows, then there might be an arguable case for saying that the notification should be treated as invalid. ■

wotton kearney
insurance lawyers

The insurer's duty to defend: A United States example

Written by Nick Lux, Partner

Tel 03 9604 7902

nick.lux@wottonkearney.com.au

In the matter of ***CACI International Incorporated & Ors v St Paul Fire and Marine Insurance Company***, the United States Court of Appeals (Fourth Circuit) considered the question of an insurer's duty to defend its insured in circumstances where there is uncertainty concerning whether or not the claim made against the insured falls within the scope of cover afforded by the insurance policy.

In doing so, the Court adopted a common-sense approach in analysing the claim – and the likely outcome of it – in determining the insurer's obligation to take over the conduct of the defence of the claim.

Facts

In 2003, CACI International Incorporated (**CACI**) entered into contracts with the United States Government to provide logistical and intelligence support for US operations in Iraq. The work primarily involved the screening and interrogation of detainees at Abu Ghraib and other prisons in Iraq.

Also in 2003, CACI took out an annual *"Commercial General Liability Protection"* policy with St Paul Fire and Marine Insurance Company (**St Paul**) (**the policy**). The policy provided, relevantly, that St Paul would defend CACI against any suit for covered injuries or damage and would indemnify CACI for up to US$2 million. The policy was renewed by St Paul in 2004 in materially identical terms.

In 2004, two groups of former Iraqi detainees and their survivors who alleged torture and abuse by CACI employees at Abu Ghraib and other prisons commenced proceedings against CACI (and other defendants) (**the proceedings**).

It was alleged that CACI implemented an ongoing "*torture conspiracy*" which began in 2001 with the aim of obtaining intelligence through torture. It was also alleged that CACI engaged in the negligent supervision and hiring of its employees which allowed the torture to occur.

Relevant policy provisions

The policy provided cover for "*bodily injury*" that was "*caused by an event*". The term "*event*" was defined as "*an incident, including continuous or repeated exposure to substantially the same general harmful conditions*". St Paul was obliged to pay any legally required damages for "*covered personal injury*" that was "*caused by a personal injury [offence]*".

However, as a limitation to cover, the operation of the policy was limited to certain geographical areas being:

+ the United States, its territories and possessions, Canada and Puerto Rico; and
+ the rest of the world if events causing the injury or damage "*result from the activities of a person whose home is in the coverage territory but is away from there for a short time on [CACI's] business*". →

Foreign shores

CACI notified St Paul of the proceedings seeking indemnity under the policy. St Paul denied it had a duty to defend or to indemnify the defendants. The District Court of Virginia agreed and CACI (and the other defendants) appealed to the Court of Appeals.

The principle

In assessing St Paul's obligation to defend the proceedings on behalf of CACI, the Court recognised the "*potentiality rule*" that an insurer will only have a duty to defend if "*…there is any possibility that a judgment against the insured will be covered under the insurance policy…*".

In the context of this case, St Paul was obliged to defend CACI (and the other defendants) against the proceedings if there was any potential that the policy covered the claims made in the proceedings.

However, the Court also recognised that the duty to defend was not without its limits. Most notably, the "*potentiality rule*" recognised that if it clearly appears that the insurer will not be liable under its policy of insurance for any judgment based on the allegations made, the duty to defend will not attach.

The Court's reasoning

The Court compared the allegations made in the proceedings to the scope of cover afforded by the policy. In doing so, the Court acknowledged that the parties had agreed that all of the alleged abuse took place in Iraq. However, CACI also argued that certain conduct – which was an alleged cause of the injuries – occurred in Virginia, California and elsewhere in the United States, being CACI's negligent supervision and hiring.

The Court dismissed this argument. In doing so, it recognised that under Virginian law it is the location of the injury – not its cause – that determines the location of the event for the purposes of insurance cover. In circumstances where the injuries took place in Iraq, the insuring clause clearly did not respond (and there was no duty to defend).

In the alternative, CACI argued that the extended definition of the "*coverage territory*" applied in that the injury or damage resulted from activities of a person who was away for a short time on CACI's business.

The Court dismissed this argument finding that the allegations did not concern conduct committed by CACI employees while away for a "*short time*". On the contrary, the Court found that the allegations made against CACI concerned conduct which took place over an extended period of time (in this case, years). In arriving at this conclusion, the Court adopted a common-sense approach by finding that the "*mere possibility*" of cover does not give rise to a sufficient level of "*potentiality*" to invoke a duty to defend.

The Court therefore upheld the District Court's finding that St Paul was not under a duty to defend the proceedings on behalf of CACI (or the other defendants).

Notably, Circuit Judge Shedd dissented holding that the mere existence of a *"possibility"* that a judgment against the insured would be covered by the policy was sufficient to invoke a duty to defend in circumstances where it was at least arguable that the *"short term"* extension applied to afford cover to CACI.

Conclusion

While the decision in CACI concerns principles of United States (or more specifically, Virginian) insurance law, it serves as a salient reminder of the position in which an insurer might be placed in having to make a decision whether or not to assume conduct of a defence where the insured's entitlement to indemnity under the policy remains unclear.

In the Australian context, the decision underscores the importance of an insurer making thorough investigations into the insured's likely entitlement to indemnity under the policy as soon as a claim is received with the aim of forming an indicative view on policy coverage as soon as possible and, preferably, before significant steps are required to be taken. ■

wotton kearney
insurance lawyers

The duty of care owed by an insurer to its insured: A Canadian example

Written by Nick Lux, Partner

Tel 03 9604 7902
nick.lux@wottonkearney.com.au

In the Canadian case of ***Drader v Sebastian & Ors*** (2009) SKCA 44, the Court of Appeal for Saskatchewan considered the circumstances in which an insurer will owe a duty of care to its insured (and the insured's broker) in relation to the arrangement of insurance cover.

Relevant facts

Mr Sebastian (**Sebastian**) was a licensed insurance agent employed by the insurance broking firm, Campbell & Haliburton – TWC Insurance and Investments (**TWC**). Mr and Mrs Drader (**Draders**) were homeowners who retained TWC to arrange insurance for their home including their crystal collection (which had an estimated value of approximately $9,950).

In 1993 Sebastian had the Draders complete an application form which:

+ cancelled the previous home insurance policy issued by Saskatchewan Government Insurance (**SGI**) which had been arranged by the Draders' previous insurance broker, McCallum Hill, in 1992 (**McCallum Hill SGI policy**); and
+ requested an alternative home insurance policy be issued by SGI for the upcoming insurance period.

Unknown to Sebastian at the time the application form was completed, McCallum Hill had arranged for cover for the crystal collection outside the normal cover offered by SGI to include accidental breakage.

In response to the application prepared and submitted by TWC on behalf of the Draders, SGI issued its standard form *"Comprehensive Perils"* home coverage policy which contained the standard exclusion for accidental damage to and breakage of fragile items (**TWC SGI policy**). The TWC SGI policy was renewed in subsequent insurance periods.

In 2004 the Draders' display case which contained the crystal collection fell with the collection being damaged and destroyed. The Draders made a claim on the SGI policy. SGI denied cover on the basis of the exclusion in the policy.

The decision at first instance

The Draders sued Sebastian and TWC alleging negligence and breach of contract for failing to obtain the coverage instructed.

Sebastian and TWC issued third party proceedings against SGI claiming SGI was negligent, or in breach of contract, or contributorily negligent, for failing to issue a policy of insurance in accordance with the application submitted on behalf of the Draders.

The trial judge found that Sebastian and TWC were negligent and liable for the loss suffered by the Draders. The trial judge also concluded that SGI owed a duty of care to Sebastian, TWC and the Draders to properly underwrite and deal with the application for insurance. On this basis, the trial judge found SGI contributed equally to →

the Draders' loss and held SGI 50% liable for the judgment amount.

The appeal

SGI appealed the trial judge's decision on the basis that:

+ there was no duty of care owed to the Draders, Sebastian or TWC when it received the application for insurance; and
+ SGI did not breach any such duty (if one existed).

In determining the appeal, the Court of Appeal considered the facts which were said to be relevant to the duty of care alleged to have been owed by SGI. In particular, the Court noted that:

+ Sebastian and TWC were not aware of the accidental breakage extension in the McCallum Hill SGI policy; and
+ the application form submitted by TWC (on behalf of the Draders) made express reference to the McCallum Hill SGI policy.

The trial judge found that because the application specifically directed SGI to the McCallum Hill SGI policy (which included an extension for accidental breakage) this gave rise to an obligation on SGI to clarify the scope of cover required by TWC on behalf of the Draders. The Court of Appeal disagreed. Rather, it held that there was no duty imposed on SGI when it received the application to conduct its own review of the needs, wishes or desires of the Draders.

The Court of Appeal agreed with the trial judge that the relevant duty of care was owed by the broker, TWC, to the Draders who carried the onus of making the appropriate enquiries of the Draders (including conducting a review of the McCallum Hill SGI policy) in arranging cover for the Draders with SGI. However, such a duty did not extend to SGI.

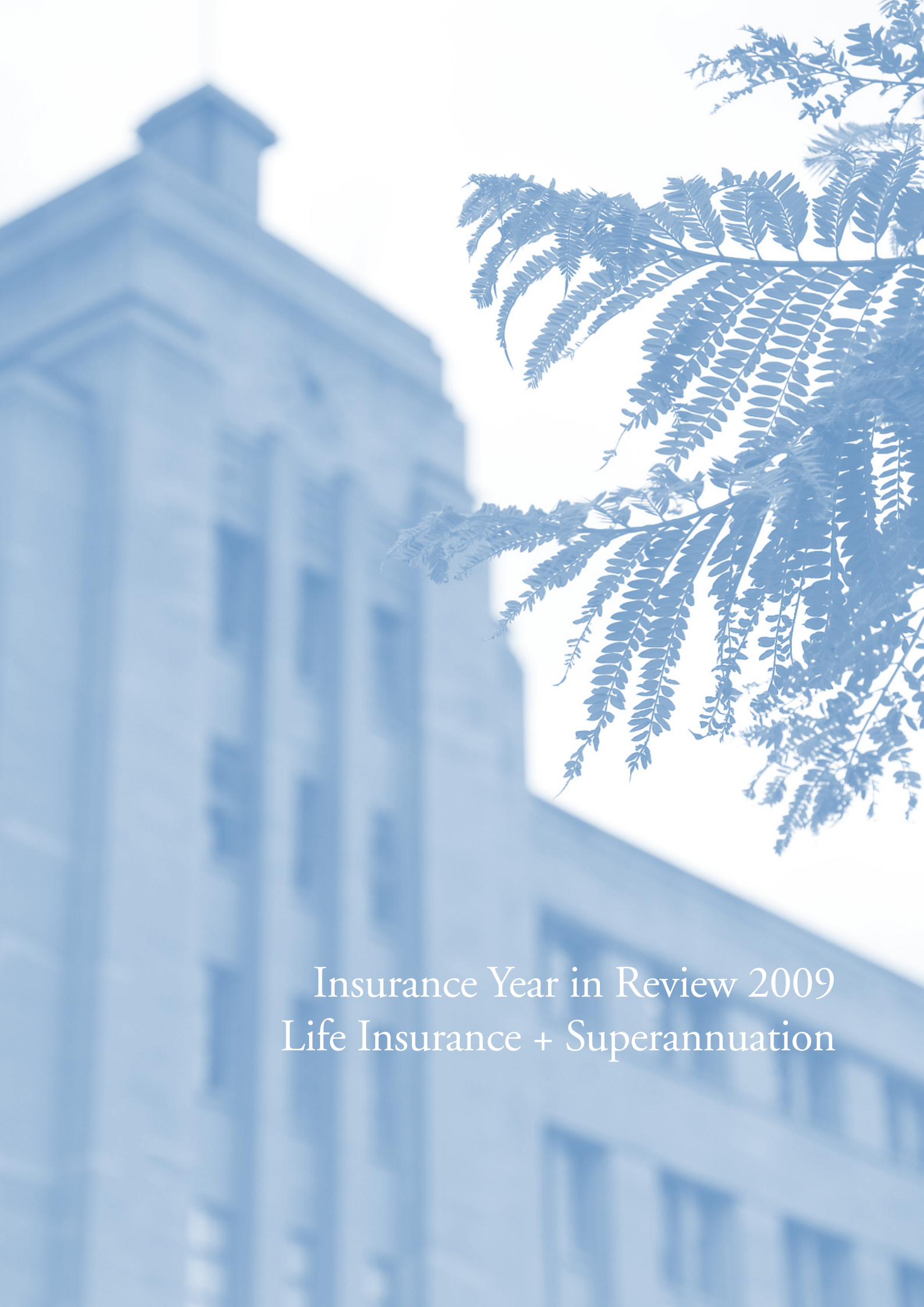
Moreover, a review of the applications completed in respect of the McCallum Hill SGI policy and the TWC SGI policy revealed material differences between the cover sought (and the premium charged) which, on an objective reading of the applications, suggested that the cover applied for by TWC (on behalf of the Draders) was not identical.

The Court of Appeal concluded that SGI's obligation to the Draders was to issue the policy in accordance with the application submitted. This is what it did. While the Court recognised that there may be other circumstances in which the law requires more of an insurer, the present case was not one of them. Indeed, the relationship of insurance brokers to their client insureds, and insureds to their insurers, is a matter of long-established law in both contract and tort and these principles should be reluctantly departed from.

Conclusion

By reference to the principles of Australian law, the Court of Appeal correctly overturned the trial judge's decision. While an insurer typically owes an obligation to its insured to arrange cover in accordance with the terms requested, an insurer should not be under a general obligation to make enquiries of its insured in respect of the cover sought. This is particularly so where a professional intermediary is involved.

Arguably, if the trial judge's decision had been allowed to stand, it would have had the effect of placing an unreasonable onus on the insurer to make substantial enquires of its insured (or potential insured) and by doing so in effect render the role the insurance broker redundant. ■



Insurance Year in Review 2009
Life Insurance + Superannuation

Disclose all: A matter of life and death

Written by David Brady, Solicitor
Tel 02 8273 9969
david.brady@wottonkearney.com.au

On 31 March 2009 the Federal Court handed down its decision in ***Phillips v ING Life Limited*** [2009] FCA 283. The decision focuses on an insured's duty pursuant to section 21 of the **Insurance Contracts Act 1984 (Cth)** (**the Act**) to disclose every relevant matter that is known to the insured prior to entering an insurance contract. The decision considers whether the insurer waived the insured's duty of disclosure. The Court also examined whether the insurer had validly exercised its rights pursuant to section 29(4) of the Act to vary the Policy and substitute the sum insured for a lesser sum.

Facts

In November 2002 the applicant's husband, Mr Phillips, entered into a life insurance contract (**the Policy**) with ING Life Limited (**ING**). Under the Policy, ING agreed to pay the applicant, Mrs Phillips $700,000 in the event that Mr Phillips died. On 6 September 2003 Mr Phillips died of oesophageal cancer. Mrs Phillips made a claim for $700,000.

On 3 December 2003 ING sent a letter pursuant to s29(4) of the Act to Mrs Phillips claiming that it was entitled to reduce the amount payable under the Policy to $466,667 as there had been nondisclosure and misrepresentation by the deceased prior to entering the life insurance contract (**the Notice**).

The nondisclosure and misrepresentation related to the fact Mr Phillips suffered from a condition known as "*Barrett's oesophagus*". This condition had not affected Mr Phillips for 5 years leading up to the insurance contract, and Mr Phillips had been described by his doctors as having the fitness of an "*elite athlete*". However, Barrett's oesophagus did increase his chances of contracting oesophageal cancer and required daily medication and ongoing observation.

ING argued that had the applicant disclosed this information, the underwriters would have offered a loading of +50% for life insurance.

Mrs Phillips claimed the remaining $233,333 and interest pursuant to s 57 of the Act from ING.

Issues

The Federal Court considered five central issues. These were:

+ whether Mr Phillips had failed to comply with his duty of disclosure;
+ whether Mr Phillips had made misrepresentations;
+ whether ING had waived Mr Phillips' duty of disclosure;
+ whether ING would have made the 50% increased premium loading had the disclosure been made or had the alleged misrepresentations not occurred; and
+ whether the respondent complied with the notice provisions of section 29(4) of the Act which required the respondent to notify the insured of the decision to vary the contract to reduce the amount payable under the Policy.

The decision

The Court addressed each issue separately.

The duty of disclosure

ING contended that Mr Phillips had not disclosed that: →

- he had been diagnosed with Barrett's oesophagus;
- he required medical treatment for the condition; and
- Barrett's oesophagus increased the risk of developing oesophageal cancer.

Mrs Phillips contended that:

- ING had failed to prove the conditions giving rise to the duty of disclosure; and
- there had been a waiver of compliance with that duty.

The Court held that Mr Phillips was aware, and that a reasonable person in his position would be aware, of the existence of his condition and the risk it posed in respect of his propensity to contract oesophageal cancer. This was relevant to ING's decision whether to accept the risk of insuring his life. This was the case despite the fact he had not suffered any symptoms of the condition for 5 years leading up to the insurance contract and may have not remembered the name of the condition having been diagnosed 5 years earlier.

Misrepresentation

The Court held that Mr Phillips knew, and that a reasonable person in his position could be expected to know, that certain answers he gave in the course of applying for the insurance in relation to his medical condition of Barrett's oesophagus amounted to misrepresentation. This was also relevant to ING's decision whether to accept the risk of insuring Mr Phillips' life and if so, on what terms.

Waiver of compliance

The Court further held that ING had not waived compliance with its requirement for Mr Phillips' duty to disclose relevant information. The basis for Mrs Phillips' argument that compliance had been waived was that ING had not asked any *specific* (emphasis added) questions in relation to whether Mr Phillips had Barrett's oesophagus, nor did any of the questions asked require "*Barrett's oesophagus*" as an answer.

The Court held that the terms of the disclosure statement, the nature of the insurance and the terms of the questions asked in the health evaluation form indicated that ING was seeking information relating to *any* (emphasis added) matter which might affect the life expectancy of the applicant for insurance.

Therefore, simply because a specific question was not asked in the application form did not mean that the insurer should be taken to have waived its entitlement to be informed of all relevant matters related to an insured's potential risk.

The acceptance of risk by ING

The Court accepted ING's underwriter's evidence that had Mr Phillips disclosed relevant medical information, he would have approved the issue of the life insurance cover but imposed a premium loading of 50%.

Notice under s 29(4) of the Act

The final issue was whether the Notice given by ING pursuant to s 29(4) of the Act was validly given. Mrs Phillips contended that ING had not discharged the onus of proving that it had complied with s 29(4) of the Act as its letter of 3 December 2003 was addressed to Mrs Phillips rather than to Mr Phillips as the insured, Mr Phillips having died prior to the giving of written notice.

The Court held that s 29(4) of the Act was to be read as permitting written notice to be given by an insurer to the insured's personal representative in the case of the death of the insured. This is because s 29(4) refers to the notice as a notice to vary the contract.

ING relied upon a document signed by Mrs Phillips and sent to ING as evidencing the fact that Mrs Phillips was the personal representative of Mr Phillips. The document comprised a written authority addressed to ING authorising the respondent to request information on Mr Phillips' medical history. Importantly, Mrs Phillips had signed this document as the personal representative of Mr Phillips. →

It followed that in sending the Notice to Mrs Phillips, ING gave notice which complied with s 29(4) of the Act.

The application was accordingly dismissed.

Implications

Phillips should be looked on favourably by insurers as it re-affirms that courts will strictly enforce an insured's duty to disclose to the insurer pursuant to s 21 of the Act every relevant matter that is known to the insured.

The decision is also of particular relevance in considering what amounts to waiver of an insured's obligation of disclosure pursuant to section 21 of the Act. Simply because a specific question is not asked in an insurance application, this does not automatically waive any obligation on the insured to disclose a relevant matter to the insurer pursuant to s 21 of the Act.

This sensible and reassuring decision should provide some comfort to insurers who are simply unable to cover every possible relevant matter in an application for insurance or proposal form.

Intra-fund superannuation advice to members: ASIC Class Order [CO 09/210]

Written by David Brady, Solicitor
Tel 02 8273 9969
david.brady@wottonkearney.com.au

CO 09/210 provides relief from section 945A of the **Corporations Act 2001 (Cth)** (**the Act**) to superannuation fund trustees and their authorised representatives (**advisers**) who provide personal advice to fund members about their existing super fund.

Section 945A of the Act – a reasonable basis for the advice

Generally, under section 945A of the Act financial advisers must only provide advice to a client if:

+ the adviser determines the relevant personal circumstances in relation to giving the advice and makes reasonable inquiries in relation to those personal circumstances;
+ the adviser gives consideration to the client's personal circumstances and conducts such investigation of the subject matter of the advice as is reasonable in all the circumstances; and
+ the advice is appropriate to the client, having regard to consideration and investigation.

CO 09/210

This order is of importance to those advisers who provide advice on superannuation, as it means they do not need to comply with section 945A where:

+ the trustee holds an Australian Financial Services Licence (**AFSL**) that covers the provision of the personal advice in relation to superannuation products;
+ the advice relates to the member's interest in the fund and does not also relate to any other financial product or anything that would be a financial product but for subsection 765A(1);
+ the advice does not relate to an investment strategy under member investment choice where the trustee is required to disclose:
    - an election to receive a pension; or
    - an election to be issued a new interest in the fund;
+ the fund is not a self-managed superannuation fund.

Conditions of CO 09/210

In order for the exemption to apply the adviser must:

+ before or at the time of advice inform the member that the advice is limited to the member's interest in the fund; and
+ as soon as practicable after the advice is given, inform the member that the advice is given in reliance of the relief provided under CO 09/210 and is limited to the member's interest in the fund. →

Where the advice results in increased fees, costs, charges, insurance premiums or remuneration payable then the adviser must notify the member in writing of the increase when the advice is provided or as soon as practical after the advice is provided.

Regulatory Guide RG 200 [RG 200]

In combination with CO 09/210 ASIC also released RG 200 which is a guide to advice to super fund members.

This guide is for those who provide financial advice to super fund members and sets out how this advice can be provided under either section 945A of the Act or under the relief set out in CO 09/210. RG 200 also gives guidance on the difference between factual information, general advice and personal advice in relation to superannuation. RG 200 is also a useful guide to illustrate how advice may be given in a variety of circumstances.

Implications

In the current economic downturn, providers of financial advice have seen increased scrutiny as a result of disillusioned clients seeking to recover for lost investment capital.

It is hoped, at least in relation to superannuation fund advice, that CO 09/210 and RG 200 will provide guidance to advisers dealing with superannuation funds and help to limit the number of claims which may be made against them.

Another by-product of CO 09/210 is that the amount and complexity of the paperwork required for the provision of advice will be reduced as simpler questions about superannuation can be answered under CO 09/210. ■