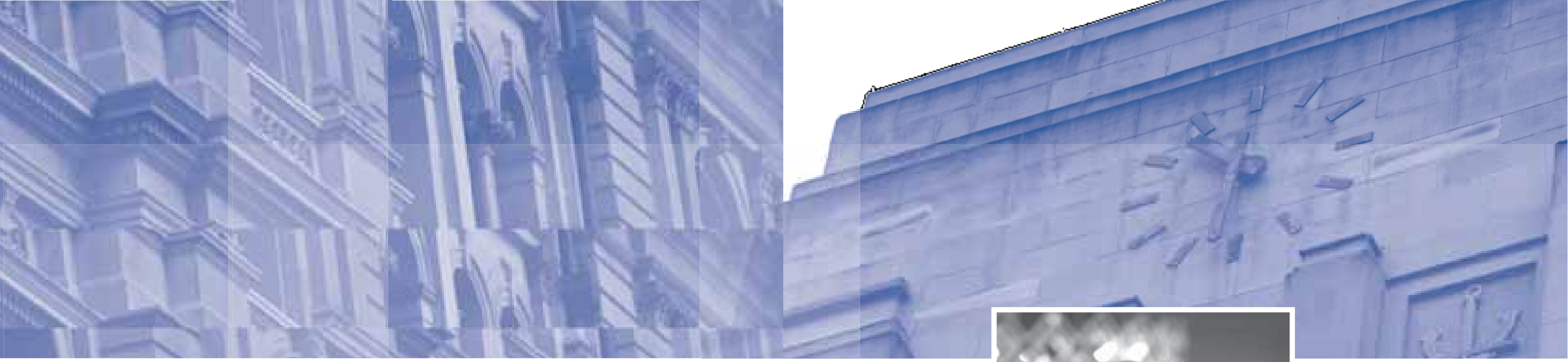
wotton
kearney

Insurance Year in Review 2012



The Year in Review

David Kearney, Chief Executive Partner
Tel 02 8273 9916
Email david.kearney@wottonkearney.com.au

Welcome to the 2012 Wotton + Kearney Insurance Year In Review publication.

We delayed the publication of this edition slightly this year to ensure it covered the 2012 year in its entirety. This has allowed us to include reference to some material developments in insurance law which occurred at the very end of last year – particularly affecting the D&O insurance market and extending to the liability insurance market generally.

The 2010 and 2011 publications emphasised the impact of severe weather events on the insurance industry. Whilst insurers will no doubt be very pleased with the dearth of severe weather events in our region in 2012, the catastrophic weather events of recent years have now given rise to various common law and legislative developments. In the Property and Public and Product Liability sections, there are references to legal developments flowing from earthquake, flood and bushfire events in our region in recent times.

As alluded to above, one of the more material developments in 2012 stems from the New Zealand Court of Appeal decision in ***Bridgecorp*** which goes a considerable way towards clearing up the significant uncertainty in the liability insurance market in both New Zealand and Australia following on from the original November 2011 Bridgecorp decision. I recommend to you Patrick Boardman's article on this topic in the D&O section.

Finally, I encourage you to contact any of our authors directly if you have any queries arising from any of the articles in this publication.

Enjoy the 2012 Insurance Year In Review publication.

David

28th February, 2013

wotton + kearney

the Lawyers Weekly 2012 Australian Law Awards Winner

ALB Australasian Law Awards 2012 FINALIST

Corporate INTL Global Awards 2012 Winner

Sydney

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

Melbourne

Tel +61 3 9604 7900
Fax +61 3 8414 2852

Level 6
550 Bourke Street
Melbourne VIC 3000
Australia

Email melbourne@wottonkearney.com.au

www.wottonkearney.com.au

First published in 2013
by Wotton + Kearney

Wotton + Kearney

Wotton + Kearney is a leader in the provision of insurance legal solutions in Australia

Our sole focus is insurance law and with a team of more than 70 specialist insurance lawyers we are preferred by clients consisting of some of the largest insurers, brokers, private companies and industry participants in Australia and globally.

As the only Australian law firm based in more than one city practising solely in insurance law, we have a detailed understanding of the domestic insurance industry and of the litigation landscape relevant to the successful resolution of insurance claims. Our commitment to the insurance and reinsurance 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 specialise in reinsurance, regulatory and compliance advice and policy drafting. We have expertise in all forms of insurance claims litigation including claims relevant to:

+ Professional Indemnity
+ Public and Products Liability
+ ISR/Commercial Property
+ Directors & Officers Liability
+ Class Actions
+ Life Insurance and Superannuation
+ Trade and Transport
+ Accident and Health
+ Reinsurance and Regulatory

Contents

Wotton + Kearney
Insurance Year in Review - 2012

The Year in Review – An Overview

Developments for Insurers Generally

Public + Product Liability

Contents

Professional Indemnity

Directors + Officers / Financial Lines

Contents


wotton
kearney

Contents

Accident + Health

Pro Bono

Insurance Year in Review 2012
Developments for Insurers Generally

Privileged documents – to give or not to give?

Written by Claire Tingey, Special Counsel
Tel 02 8273 9915
Email claire.tingey@wottonkearney.com.au

Introduction

The courts have this year considered claims for privilege over:

- an expert report which was not served in proceedings but was referred to in another expert's report; and
- reports prepared for insurers by adjusters and investigators.

Actone Holdings Pty Ltd v Gridtek Pty Ltd [2012] NSWSC 991

The facts

In October 2001, a fire damaged part of a shopping centre in St Ives, Sydney. Acetone Holdings Pty Ltd (**Acetone**) sued Gridtek Pty Ltd (**Gridtek**) alleging its negligence caused the fire.

Both parties retained experts to provide opinions on various issues in dispute. The NSW Supreme Court made orders by consent for the service of expert evidence. Acetone served the reports of Dr Grantham and Mr Plaister. Some of these reports referred to an unserved expert report by the late Dr Walshe (**the Walshe report**).

Gridtek sought a copy of the Walshe report. Acetone resisted production, arguing that the Walshe report was privileged and that privilege had not been waived.

There was no argument that the Walshe report was privileged. Acetone argued that it was not required to produce the Walshe report as the privilege attaching to it had not been waived, given that:

- any report referring to the Walshe report was provided to Gridtek only under compulsion of law; and
- in any event, Acetone had not yet sought to tender the reports of Dr Grantham and Mr Plaister.

The decision

Section 122 of the **Evidence Act 1995 (NSW)** states that privilege is not lost if "*the substance of the evidence has been disclosed ... under compulsion of law*". Harrison J found that disclosure of Dr Grantham's and Mr Plaister's reports in accordance with the orders of the Court was a disclosure "*under compulsion of law*" so privilege was not waived.

His Honour further found that:

- as neither expert purported to rely on or incorporate Dr Walshe's reasoning or analysis in forming their own opinions, there was no inconsistency between relying on anything contained in the Walshe report and maintaining the privilege; and
- Gridtek was not prejudiced unless or until the reports of Dr Grantham and/or Mr Plaister were tendered in evidence.

Melrose Cranes and Rigging Pty Ltd v Manitowoc Crane Group Australia Pty Ltd [2012] NSWSC 904

The facts

Melrose Cranes and Rigging Pty Ltd (**Melrose**) claimed repair costs and business interruption losses from Manitowoc Crane Group Australia Pty Ltd (**Manitowoc**) following fire damage to Melrose's crane on 29 June 2009. Manitowoc had sold the crane to Melrose in September 2007 and from time to time serviced it under warranty. The last service took place on 23 and 24 June 2009. Manitowoc disputed that its work caused the fire.

Manitowoc subpoenaed the records of factual and technical investigators (**the third parties**) retained by Melrose's property damage insurer. The insurer claimed privilege over the documents, though it was not a party to the proceedings.

The documents included reports prepared by the third parties in the course of investigating the incident; reports addressed to the insurer's solicitors; and correspondence between the insurer, its solicitors, Melrose and the third parties. The insurer argued that the documents were brought into existence for the dominant purpose of use in, or to aid in, conducting recovery litigation.

The insurer received notice of Melrose's claim on 30 June 2009. The insurer's claims manager gave evidence that her intention in retaining the third parties was to ascertain whether there was any potential recovery action against Manitowoc. The insurer retained investigators to investigate the cause of the fire and loss adjusters to assess the damage to the crane.

From 27 July 2009, the insurer retained solicitors to advise on the prospect of recovery and any anticipated legal proceedings against Manitowoc. From that date, the solicitors – rather than the insurers – instructed the third parties directly.

The decision

Campbell J confirmed that the "*dominant purpose*" in the context of a privilege claim is the ruling, prevailing or most influential purpose. Further, His Honour held that for litigation privilege to attach there must be a real prospect of litigation, but the prospect of litigation does not have to be more likely than not. The question of dominance must be determined objectively with reference to the intention of the insurer that commissioned the report, rather than the intention of the report's author.

The insurer initially had more than one purpose in commissioning the reports. It was aware that Melrose attributed the incident to Manitowoc. Although at the outset the insurer had in mind the prospect of a recovery action, there was also the question of whether to admit Melrose's claim.

Campbell J was not persuaded that, as at 30 June 2009, the insurer's dominant purpose in obtaining the reports was to pursue a recovery action, as opposed to merely ascertaining the relevant facts.

However, by 27 July 2009 Melrose's claim was admitted and the insurer's focus turned to the recovery action. From this point, the purpose of advising on recovery was paramount, so reports prepared after that date attracted litigation privilege.

Manitowoc argued that the insurer had waived privilege by its conduct – as other documents and reports Melrose relied on in the case referred to the documents in dispute - and this was inconsistent with maintaining the confidentiality of the reports.

Campbell J rejected this argument and found no inconsistency between maintaining privilege in the reports and the insurer's conduct. His Honour did not agree that references to the investigators in various disclosed documents were inconsistent with maintaining privilege.

Ultimately, the insurer's claim for privilege was successful.

Ensham Resources Pty Ltd v AIOI Insurance Company Ltd [2012] FCA 710

The facts

After heavy rain in January 2008, the Nagoa River and Old Winton Creek overflowed adjacent to an open cut mine owned by Ensham Resources Pty Ltd (**Ensham**). Flooding occurred in three of Ensham's pits.

On 22 January 2008 Ensham notified its insurer AIOI Insurance Company Ltd (**AIOI**) of a potential claim. AIOI declined Ensham's claim in September 2010 on grounds of material non-disclosure. Ensham sued AIOI for failing to provide cover under the policy. At issue were the questions of whether a particular levee was insured property, and whether the policy covered damage and business loss associated with the incident.

Following the floods, AIOI engaged a loss adjuster. After a conversation with the loss adjuster and before the adjuster prepared any reports, AIOI engaged a solicitor and withdrew its retainer with the adjuster so the solicitor could retain the adjuster directly. The adjuster was instructed to prepare his report on a "*privileged and confidential basis*" and in anticipation of future litigation.

Ensham sought access to the adjuster's reports. AIOI claimed privilege over some of them. Ensham argued that the reports were part of AIOI's normal claims investigation process and were therefore not privileged.

The decision

Cowdroy J found the reports were privileged as AIOI's solicitor had foreseen a real prospect of litigation at the time the adjuster was preparing the various reports. His Honour recognised that privilege did not necessarily attach simply because of a self-serving letter from a solicitor to an adjuster asserting that reports were to be privileged and confidential. However, Cowdroy J accepted that litigation was contemplated in light of a contemporaneous file note by the solicitor, prepared around 18 February 2008 following discussions with the adjusters.

Implications

We can take a number of lessons from the above cases:

- Parties should take care when instructing experts with privileged material they may not necessarily wish to disclose to other parties;
- If served and unserved expert evidence is inextricably linked, privilege over the unserved material may be called into question;
- The mind of the person instructing investigators and the like is relevant in determining the dominant purpose of a document;
- Privilege may be waived if maintaining the privilege is inconsistent with references to privileged material made in other communications;
- Merely stating a report is privileged and confidential is not sufficient to attract privilege. Contemporaneous file notes recording the purpose for which third-party reports are commissioned may support a claim for privilege; and
- The question of privilege over unserved expert reports is to be determined at trial, when a party seeks to tender reports into evidence.

The future for discovery

Written by Andrew Moore, Partner
Tel 02 8273 9943
Email andrew.moore@wottonkearney.com.au

Introduction

On 22 March 2012, the NSW Supreme Court issued Practice Note SC Eq 11 (**the practice note**) regarding disclosure of documents (**disclosure**) in the Equity Division. The practice note has altered the way claims are managed in the Commercial, Construction and Technology, and Admiralty Lists of the NSW Supreme Court.

The term "*disclosure*" in the practice note has the same meaning as the frequently used term "*discovery*". This is the process by which parties to a proceeding disclose their relevant documents with a view to identifying and narrowing the issues in dispute.

The practice note provides that disclosure orders will not be made (even if the parties have mutually consented):

- until after the parties have served their evidence (unless there are "*exceptional circumstances necessitating disclosure*"); and
- only if "*it is necessary for the resolution of the real issues in dispute in the proceedings*".

"*Evidence*" in this context means all statements submitted by the parties to support their case, and includes affidavits, witness statements and expert reports.

Once evidence has been exchanged, if the parties still consider that disclosure is necessary they must file and serve an affidavit setting out:

- why disclosure is required "*for the resolution of the real issues in dispute*";
- the classes of documents for which disclosure is requested; and
- the estimated cost of the disclosure process.

The Court will then decide if an order for disclosure is warranted and may impose a limit on the amount of recoverable costs for disclosure.

The practice note does not preclude parties from implementing private agreements for the disclosure of documents.

Why the change?

With the advent of emails and other electronic documents, parties' discovery obligations have become prohibitively expensive, sometimes to the extent of being crippling, particularly in examples of so called 'mega-litigation' such as ***Seven Network Limited v News Limited*** [2007] FCA 1062.

The practice note is designed to realise the Supreme Court's endeavours to reduce the complexity, time and cost of litigation. It achieves this by delaying disclosure until the real issues in dispute are identified, by both the pleadings and the evidence.

Bergin CJ succinctly described the impact and operation of the practice note in ***Armstrong Strategic Management and Marketing Pty Limited v Expense Reduction Analyst Group Pty Ltd*** [2012] NSWSC 393:

"The intention is that early service of evidence would result in the need for disclosure being defined not just by the pleadings but also the evidence, and far more focused attention given to the actual need for discovery by reference to the issues revealed by the pleadings and evidence in chief."

This approach bears some similarity to the US process of pre-trial oral examination where 'depositions' are taken before discovery in an attempt to set out the factual background to the litigation. The difference here is that the Court insists on affidavit evidence that will be relied upon throughout the proceedings.

Practical application

The traditional order of steps in the litigation process has changed considerably. Parties now have to consider their evidence almost from the outset and without reference to their opponent's documents.

As you would expect, litigants have been testing the boundaries of what constitutes "*exceptional circumstances*" and when disclosure is necessary. The leading authority on this issue is ***Leighton International v Hodges*** [2012] NSWSC 458. In that decision, McDougall J emphasised that "*exceptional circumstances*" are "*not normal or usual, they must be out of the ordinary*". They need not, however, be unique. His Honour held that circumstances may be characterised as "*exceptional*" if disclosure is necessary in order to achieve the just, quick and cheap resolution of the real issues in dispute.

The matters that have come before the Supreme Court suggest that if an application for pre-evidence disclosure is focused and supported by meaningful affidavit evidence, it is not particularly difficult to satisfy the requirement that the particular documents need to be disclosed to ensure a just, quick and cheap resolution of the real issues in dispute. A successful example is a letter from an expert explaining the types of documents which he/she needs in order to reach a conclusion about liability or quantum. This letter was annexed to a solicitor's affidavit.

The effect of the practice note is that a party can obtain some limited discovery before serving evidence, but that request for discovery must be focused and justified.

Has the practice note worked?

The answer so far seems to be yes. Parties now appear to be spending more time assessing and planning their cases at the front end of the litigation process. Time will tell whether this results in:

- fewer speculative claims being commenced or included in actions in the hope of identifying documents to prove those speculative claims; and
- greater efforts to resolve disputes prior to the commencement of formal litigation, given that the cost and inconvenience of preparing evidence is now incurred early on.

Assuming the practice note continues to achieve its objectives, it seems inevitable that other courts in New South Wales and Australia will move to adopt a similar regime with respect to disclosure in large commercial, technology and construction, and admiralty disputes. ■

Damming evidence – judges empowered to restrict the flow of expert evidence

Written by Andrew Seiter, Partner and Jonathan Katsanos, Solicitor
Tel 03 9604 7906 | 03 9604 7919
Email andrew.seiter@wottonkearney.com.au
jonathan.katsanos@wottonkearney.com.au

On 28 August 2012, following considerable debate in the Victorian Legislative Council, the **Civil Procedure Amendment Bill 2012 (Vic)** (**the amending Bill**) passed into law by the narrowest of margins (21 votes out of 40) (**the amendments**).

The amendments alter and increase the Court's powers and discretion to deal with how expert evidence is obtained and used.

The amendments build on the foundations of the **Civil Procedure Act 2010 (Vic)** (**CPA**), which commenced operation at the beginning of 2011. Put simply, the CPA imposes a paramount duty to the Court on all parties to litigation, as well as an obligation to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute. The CPA also enlarged the Court's discretion in relation to how civil proceedings can be conducted.

Before the amendments, the law on expert evidence in Victoria was found in the **Evidence Act 2008**, the Court Rules – including the **Supreme Court (General Civil Procedure) Rules 2005** – and the CPA. The relevant provisions gave parties guidance as to the form expert evidence must take to be admissible, with only limited guidance on what expert evidence is admissible and how it should be presented to the Court.

The rest of the law relating to expert evidence resides in common law. Recently, for instance, the High Court in ***Dasreef Pty Ltd v Hawchar*** [2011] HCA 21, considered when expert evidence is admissible, and said that an expert must base their opinion on their training, study or experience.

The reforms now impose restrictions on when expert evidence should be used; who should be appointed to give expert evidence in a proceeding; and, where that evidence is permitted, how it should be adduced at trial.

The amending Bill's Explanatory Memorandum makes it very clear that the Bill (now the Act) is intended to reduce lengthy delays

and the substantial costs that flow from what is perceived by the Government as a "*disproportionate use of expert witnesses*".

It is important to promote case management and court efficiency; however, we question whether the potential consequences of expanding the Court's discretion into the field of expert evidence have been fully considered. This article identifies the relevant reforms and provides some observations and comments on their potential impact.

The amendments

The amendments introduced (amongst other things) Part 4 to the CPA.

The most important of the amendments:

- require parties to apply to the Court for leave to adduce any expert evidence;
- allow parties to engage joint experts and give the Court residual power to appoint its own expert; and
- enable the Court to order experts to disclose the basis on which they were retained, including whether payment of fees is contingent on the outcome.

An application to adduce evidence

The amendments (contained in section 65G of the CPA) require any party wishing to adduce expert evidence to first seek a direction from the Court allowing them to do so.

The Court can now make directions in relation to:

- the preparation of the report;
- the time for service of the report;
- limiting the report to address certain issues;
- precluding expert evidence from addressing certain issues;
- the number of experts and who may be called to give evidence; and
- the appointment of single joint experts or Court-appointed experts.

The amendments do not deal with how parties should seek these directions. Presumably, parties will need to make a formal application, probably supported by oral or affidavit evidence, addressing the need for expert evidence. We assume also that the opposing party will have an opportunity to respond to that application. It is difficult to see, on the face of it, how this will promote the intended expediency rather than creating a preliminary battle ground.

Choice of expert and joint expert evidence

Probably the most contentious amendment is in the provisions that give the Court specific powers to order, at any time during the proceeding, that the parties engage a single expert, or alternatively, that there be a Court-appointed expert.

The Court can take into account many considerations when making such an order, including:

- whether the engagement of two or more expert witnesses would be disproportionate to the complexity or importance of the issues in dispute and the amount in dispute in the proceedings;
- whether the issue falls within the substantially established area of knowledge;
- whether it is necessary for the Court to have a range of expert opinions; and
- the likelihood of the engagement expediting or delaying the trial.

If a joint expert or court-appointed expert is engaged, the parties must endeavour to agree on the written instruction provided to the expert, and the facts and assumptions on which the expert's report is to be based[1]. If the parties cannot agree, they must seek directions from the Court.

If a single expert is engaged or appointed, a party cannot adduce any other expert evidence unless the Court has granted the party leave to do so. In deciding whether to grant leave, the Court must consider:

- what evidence is in dispute;
- whether the additional evidence will be

1 Section 65N of the CPA.

disproportionate to the complexity of the proceedings and the amount in dispute;

- whether there is already expert evidence on the issue; and
- whether the expert evidence sought to be adduced goes to some other issue, and that issue:
    - is not in consideration; and
    - is not already in evidence for which the court has granted leave.

Adducing evidence from experts

The Court Rules set out the Court's general powers to direct how expert evidence should be adduced, including the Court's power to direct an expert conference (often referred to as 'hot tubbing' of experts[2]). The CPA gives courts general discretion to take steps to promote the efficient and timely use of court resources. A number of judges have recently used this discretion to facilitate how expert evidence is adduced including, for instance, requiring experts to give their evidence at the same time or after all the 'lay evidence' has been given.

The amendments expand the Court's current powers. For example, the Court now has an express power to compel any two or more experts to:

- give evidence concurrently;
- narrow their evidence down to only the issues in dispute; and
- comply with special arrangements made by the Court regarding cross-examination of expert witnesses, including timing and questions that can be asked concurrently to help the Court determine and understand the issues in dispute.

Disclosure of arrangements

The amendments allow any party to apply to the Court for an order that an expert witness must disclose all arrangements – or specified aspects of the arrangements – under which the expert witness was retained.

2 The amendments put into law what is already contained in Order 44 Rule 6 of the **Supreme Court (General Civil Procedure) Rules 2005**.

The Court can now make any order for disclosure it considers appropriate.

While parties have always had the right to obtain a letter of instruction – and any material considered by an expert relevant to the opinion the expert expresses – this amendment will extend to fee arrangements and may lead to the production of privileged conversations or materials that are not usually obtainable.

The amendments give the Court the express power to require an expert witness to disclose whether their charge or the payment of fees is contingent on the outcome of the proceeding.

This new disclosure obligation seeks to address a recent trend where 'experts', particularly in personal injury claims, have been retained on a 'no-win no-fee' basis. It is difficult to imagine how an expert can assure the Court of his or her independence – or to comply with the Code of Conduct for witnesses – in circumstances where payment of his or her fees is contingent on the party achieving a successful outcome in the proceeding.

Problems that may arise under the new regime

Whereas judges in the past were criticised by the superior courts for 'entering the arena', the amendments reinforce that there is a growing legislative mandate for courts and judges to take a greater lead in how proceedings are conducted. The amendments promote courts taking control over the flow of evidence and, in particular, determining what expert evidence is adduced, and how.

Critically, the application for leave requirements place the Court in a position where it will need to identify at the earliest stage the material issues in a proceeding, and to decide what expert evidence will help the Court make a determination. These matters were previously left for advocates to determine.

Some provisions are troubling, especially where the practical effect is to remove a party's right to instruct their own expert if the Court considers there are sufficient grounds to do so. This is best evidenced by the provision for the use of a single joint expert (section 65L of the CPA).

Litigation can be complex, and often deals with issues outside the ordinary realm of knowledge or judicial experience. The extent to which the Court sees itself as being assisted by expert evidence, especially at the early stages of the proceeding, may not reasonably balance the disparity of opinion in the expert community or give appropriate recognition to the different views held by advocates on how a claim should ultimately be proven.

The imposition of Court-appointed experts in litigation also imports a real risk that, in some cases, a judge may usurp his or her traditional role as the arbitrator of the facts. In other cases, there is a risk of the process being flavoured by inherent judicial prejudices that may see the character or flow of evidence favour one party's position.

There are also foreshadowed procedural problems with the proposed legislation.

If, as is contemplated by section 65N, a court gives directions as to what questions and evidence will go before an expert, the amendments give us no guide as to how this process will take place. The parties are expected to agree, but beyond that there is no guidance. Considering, for instance, how Medical Panels are instructed under the **Wrongs Act 1958 (Vic)** or **Accident Compensation Act 1985 (Vic)**, those familiar with the accident compensation and personal injury jurisdictions will know that the referrals themselves can become the subject of lengthy and complex legal argument. This has become a fertile ground for litigation.

Furthermore, if the evidence or assumptions each party seeks to rely on are successfully challenged or defeated at trial, the foundation upon which the joint report has been obtained may be compromised. Rather than promote the aims of the amendments, this is likely to cause delay and expense.

Conclusions

Case management is an important aspect of litigation and should continue to be encouraged. However, if it encroaches on a party's right to prepare their case there is a real risk that justice will be sacrificed in the pursuit of more efficient outcomes.

The Law Institute of Victoria quite vehemently raised concerns about the potential effect of the amending Bill (as it then was). President Michael Holcroft wrote in his blog[3] about the lack of consideration given to consultations with the legal community, and noted that the pragmatic aspects of the amendments have not been fully explored. Mr Holcroft ended his article by expressing his concern that there is a real prospect of injustice to the parties. He fears that there is a risk that future amendments will be necessary to wind back the courts' reach.

The Law Institute's concerns were picked up by those members of Parliament opposing the amendments in the Legislative Council debate. Most notably, those members raised issues regarding the appointment of a single expert by the Court, echoing the concerns expressed in this article.

The judiciary in recent times has referred recalcitrant parties to potential sanctions under the CPA, so the courts may be keen to invoke the amendments and the powers they confer.

As with many amendments, only time will tell what impact they will have. Until the issues are canvassed more fully in open court, we can only speculate as to the judiciary's response.

We will continue to monitor the situation and advise on any future developments. ■

3 http://www.liv.asn.au/LIVPresBlog2012/June-2012/Proposed-Amendments-to-Civil-Procedure-Aczt-go-too-

Shifting sands – costs protection in NSW

Written by Karen Jones, Special Counsel
Tel 02 8273 9908
Email karen.jones@wottonkearney.com.au

On 22 December 2011 the NSW Court of Appeal delivered its somewhat surprising decision in ***Old v McInnes*** [2011] NSWCA 410 (***McInnes***), ruling that an offer of compromise that provided for payment of costs "*as agreed or assessed*" was invalid. The Court said that an offer in this form did not comply with Rule 20.26(2) of the **Uniform Civil Procedure Rules 2005 (NSW)** (**UCPR**), which states:

> "*an offer must be exclusive of costs except where it states that it is a verdict for the defendant and that the parties are to bear their own costs*".

The position was revisited in ***Vieira v O'Shea (No 2)*** [2012] NSWCA 121 where the Court observed, in obiter, that to comply with the UCPR an offer of compromise need not expressly state that it is "*exclusive of costs*"; however, it must not contain any reference to costs contrary to Rule 20.26(2).

The NSW Supreme Court has since wrestled with this issue in the following key cases:

- ***Cheal Industries Pty Ltd – Fitzpatrick v Cheal*** [2012] NSWSC 932, in which an offer of compromise analogous to the offer under consideration in ***McInnes*** was held to be invalid for the reasons outlined in ***McInnes***;
- ***Rail Corporation NSW v Vero Insurance Ltd (No 2)*** [2012] NSWSC 926 (***Rail Corporation***), in which Garling J considered himself bound by "*no clear or consistent guideline*" and that an offer of compromise expressed to be "*plus costs*" could comply with the UCPR. Further, Garling J held that even if the offer of compromise was not valid, it was akin to a Calderbank offer entitling the offering party to indemnity costs;
- ***Ziliotto v Dr Hakim (No 2)*** [2012] NSWSC 1079, in which Davis J agreed with Garling J's decision in Rail Corporation; and
- ***JKB Holdings Pty Ltd v de la Vega (No 5)*** [2012] NSWSC 1238, in which Rein J expressed the view that McInnes should be followed in determining that an offer of compromise providing for payment of costs "*as agreed or assessed*" did not comply with the UCPR.

The ***Rail Corporation*** decision is under appeal and the appellate decision may clarify the application of Rule 20.26(2). For now, however, offers of compromise should be silent as to costs, and any reference to the offeree's entitlement to costs should be outlined in separate correspondence. It is also prudent to make any offer as an alternative Calderbank offer. These measures may well be critical in ensuring the costs protection provided to the offeror. ■

The practical implications of changes to the **Insurance Contracts Act 1984 (Cth)**

Written by Nick Lux, Partner and Suzanne Craig, Solicitor
Tel 03 9604 7902 | 03 9604 7921
Email nick.lux@wottonkearney.com.au
suzanne.craig@wottonkearney.com.au

Background

The Federal Government has been intending to amend the **Insurance Contracts Act 1984 (Cth)** (**the Act**) for some time now. In 2003, the Government announced a comprehensive review of the Act, and in 2004, Alan Cameron and Nancy Milne released a report outlining a number of recommendations.

In 2010, the **Insurance Contracts Amendment Bill 2010** (**the 2010 Bill**) was released, but ultimately lapsed when the Federal election was called.

Parliament has now released the exposure draft of the **Insurance Contracts Amendment Bill 2013** (**the 2013 Bill**). Submissions in respect of this Bill closed in late 2012.

The 2013 Bill

The 2013 Bill contains the changes proposed in the 2010 Bill, along with amendments relating to:

- the insured's duty of disclosure;
- remedies available to life insurers in respect of life insurance contracts; and
- bundled insurance contracts.

In practical terms, the 2013 Bill proposes amending section 21 of the Act to provide that courts should consider (among other factors):

- the nature and extent of cover provided by the contract of insurance; and
- the class of persons who would ordinarily be expected to apply for cover of that type

when determining what a reasonable person ought to know is relevant to an insurer's decision to accept the risk.

The purpose of this proposed amendment is to prescribe certain factors that will assist in interpreting section 21. The expectation is that these two factors will balance the competing interests of both insurers and insureds. The amendments will not come into effect for 30 months after the 2013 Bill receives Royal Assent.

The proposed amendments to the Act also

provide that the Australian Securities and Investments Commission (**ASIC**) will be able to exercise powers when an insurer fails to comply with its duty of utmost good faith in handling or settling a claim or potential claim. ASIC will now be able to exercise its powers as if the failure to comply with the duty of good faith was a failure to comply with a financial services law.

The law relating to unfair contract terms

In 2012, submissions also closed into the Draft Regulation Impact Statement on Unfair Terms in Insurance Contracts. This statement deals with the Productivity Commission's 2008 recommendation to introduce a national generic consumer law that applies to all sectors of the economy, including laws dealing with unfair contract terms. The relevant existing consumer law does not apply to insurance contracts.

Parliament released the statement so it could "*receive feedback on potential options for ensuring that consumers who purchase insurance have an equivalent level of protection as that which currently applies to other financial products and services*".

As it stands, the 2013 Bill does not seek to deal with unfair contract terms or remove the exemption associated with insurance contracts. However, on 20 December 2012, the Government indicated that draft legislation will be released to extend unfair contract terms laws to general insurance contracts.

Under the proposed changes, ASIC will have enforcement powers to administer the new laws. If a term is found to be unfair, the insurer will be in breach of its duty of utmost good faith and will be unable to rely on that term.

Further, the Court may consider whether a party should be provided a more appropriate remedy. The regime will apply to consumer contracts that are standard-form insurance contracts.

Under the proposed legislation, a contract term will be considered to be "*unfair*" if it:

- would cause a significant imbalance in the parties' rights and obligations under the contract;
- would cause detriment to a party if relied on; and
- is not reasonably necessary to protect the legitimate interests of the party advantaged by the term. A term will be "*reasonably necessary to protect legitimate interests*" if it reflects the underwriting risk accepted by the insurer.

The insurer will carry the onus of proof in establishing that a term is "*reasonably necessary to protect its legitimate interests*".

Implications

Insurers will need to watch this space to see what types of contracts are considered by the legislation to be "*consumer contracts*" and "*standard-form insurance contracts*". However, it is clear that the Government is seeking to impose further protection for insureds, potentially at the expense of insurers.

While the proposed changes to the Act have so far proceeded with 'glacial speed', we may see some reasonably significant amendments in 2013. ■

Insurance Year in Review 2012
Public + Product Liability

Factual causation – evidence of possibilities will not suffice

Written by Greg Carruthers-Smith, Senior Associate
Tel 02 8273 9965
Email greg.carruthers-smith@wottonkearney.com.au

Introduction

In ***State of NSW v Mikhael*** [2012] NSWCA 338, the NSW Court of Appeal considered what is required for a determination of factual causation under section 5D **Civil Liability Act 2002 (NSW)** (**CLA**).

The case

Mr Mikhael sustained serious injury when he was assaulted by a fellow student, T, following a French class at a state high school (**the school**). Six weeks earlier, T had been suspended for assaulting another student after a football match.

Mr Mikhael sued the school alleging that it had breached its non-delegable duty of care by failing to advise T's teachers about the circumstances of the prior assault and T's propensity to become violent upon hearing a minor slur. Mr Mikhael alleged that he would not have suffered injury if his French teacher had been provided with that information.

The decision

At first instance, Sorby DCJ found in favour of Mr Mikhael and ordered the school to pay $318,288 in damages. The school appealed.

The Court of Appeal upheld the trial judge's finding on breach of duty, and in doing so confirmed that:

- the determination of whether a duty of care has been breached should be assessed prospectively, with regard to the wording of section 5B of the CLA;
- while section 5B(1)(a) requires a determination as to whether the risk was foreseeable, the common law test of foreseeability enunciated in ***Wyong Shire Council v Shirt*** (1980) 146 CLR 40 remains the touchstone (that is, that "*the risk is not one that is far-fetched or fanciful*"); and
- section 5B(2) requires the Court to consider the burden of taking precautions. The evaluation of that burden should not be confined to issues of cost; it should also include considerations of time, distance, communication and other less tangible factors, such as privacy concerns.

Ultimately, the appeal was allowed on causation grounds, in particular due to a lack of factual causation required by section 5D(1)(a) of the CLA. In this case the duty was breached by an omission. Beazley JA (with whom Allsop P and Preston J agreed) confirmed that "*notwithstanding the almost universal criticism of 'but for' causation in cases of omission ... the [CLA] imposes that test as the first gateway to proof of causation*". Factual causation therefore required the Court to determine the probable course of events had the French teacher been informed of T's propensity to become violent when minimally provoked.

Mr Mikhael contended that 'but for' the school's negligence, his French teacher could have taken a number of precautions, including observing T after class to defuse any potential violence; escorting Mr Mikhael to a position of safety; separating T's and Mr Mikhael's desks during class; and inquiring as to whether Mr Mikhael had any fears for his safety after class.

Beazley JA reiterated that causation must be determined with regard to the factual circumstances in which the duty of care was owed and breached. That included the school's overall assessment of T's general behaviour and personality, and the French teacher's familiarity with T.

The Court determined that the suggested precautions offered no more than a series of possibilities which, if implemented, might have averted the incident. Following the High Court's decision in ***Adeels Palace Pty Ltd v Moubarak*** [2009] HCA 48, 'but for' causation requires a court to be satisfied that such a precaution, if taken, *would*, on the balance of probabilities, have averted the harm suffered. In this case, the Court was not satisfied that there would have been a different outcome had the French teacher been armed with the relevant information.

It was significant that neither the French teacher nor the school principal had been cross examined regarding what steps they would have taken if the information about the prior assault had been disseminated. Since the French teacher's evidence had been used as evidence of the breach of duty, Beazley JA determined that it was imperative for her to be questioned on the issue, for the purpose of establishing causation. In the absence of that evidence, the Court was not prepared to speculate as to what might have occurred, which scuppered any chance Mr Mikhael had of establishing factual causation.

Comments

This case confirms that establishing 'but for' causation requires the plaintiff to collate sufficient evidence to satisfy a court that any precaution or step that ought to have been taken, would, on the balance of probabilities, have averted the harm suffered – merely presenting a range of possibilities will not suffice.

Labour-hire arrangements – worth the risk?

Written by Andrew Seiter, Partner and Gemma-Jane Cooper, Senior Associate
Tel 03 9604 7906 | 03 9604 7914
Email andrew.seiter@wottonkearney.com.au
gemma-jane.cooper@wottonkearney.com.au

The use of so-called 'labour-hire arrangements' by businesses has become common practice in recent times. This is unsurprising, since this type of arrangement can offer both administrative and commercial benefits.

Labour-hire arrangements can be:

- at arm's length, whereby a business supplements its permanent workforce with employees contracted from an unrelated labour-hire company; or
- between related companies, where a business creates a service company to employ its entire workforce, which is then contracted back to the business.

Although the relationships between related and non-related companies differ, the implications for businesses using labour-hire workers are the same in each case.

This article discusses the risks and liabilities that businesses (or 'host employers') using labour-hire arrangements face in the workers' compensation arena, and the steps they can take to reduce their exposure.

Workers' compensation insurance

In Victoria, employers (with limited exceptions) are required to hold workers' compensation insurance through the Victorian WorkCover Authority (**VWA**).

Labour-hire companies are considered to be the true 'employers' and must pay the VWA premiums for all employees. When a labour-hire employee is injured while working for a host employer, the WorkCover claim is made on the labour-hire company's WorkCover policy, and no-fault benefits are paid on its behalf.

However, host employers can also face their own independent liability for injuries suffered by a labour-hire worker when the worker is determined by the VWA or the Court to have suffered a "*serious injury*" in accordance with section 134AB of the **Accident Compensation Act 1985 (Vic)** (**ACA**), which entitles the worker to bring common law proceedings. This section allows a worker who has suffered a "*serious injury*" to sue his or her employer, and any other negligent third party, for damages arising out of that injury.

This means that, in addition to suing the labour-hire company, the worker can – and almost always will – sue the host employer.

Pursuant to the terms of the WorkCover policy, the VWA will indemnify an employer in relation to a claim by an employee injured in the course of employment. However, a host employer is not entitled to such cover because it is not the legal employer. The host employer is therefore required to seek indemnity under its public liability policy in relation to a claim against it by a labour-hire employee.

wotton kearney

The liabilities of host employers

At common law, an employer owes a duty of care to an employee to take all reasonable steps to ensure that he or she is not injured in the course of his or her employment with the employer. The duty is non-delegable and the standard of care is high; the obligations imposed by the law on employers are onerous.

An additional statutory duty of care is imposed on all "*employers*" (including host employers) by the **Occupational Health & Safety Regulations 2007 (Vic)** (**the Regulations**). The Regulations require an employer to take all "*reasonably practicable*" steps to prevent injury. The obligations imposed by the Regulations are more onerous than the common law and, in recent times, the courts have held that a breach of the Regulations can form the basis of a cause of action.

A host employer owes a duty of care to a worker akin to that of the legal employer, due to its level of control over the workplace and the worker. Accordingly, in a worker's claim for damages against a labour-hire company and a host employer, the host employer – as the entity with responsibility for the overall supervision and management of the worker – will almost always end up bearing the lion's share of the liability. The proportion of liability attributed to labour-hire companies generally falls between 15% and 35%, except in unusual cases.

Even where the labour-hire company and host employer are related companies with the same directors and managers, the courts have been prepared to attribute the majority of liability to the host employer.

For example, in ***Hoad v Peel Valley Exporters Pty Ltd*** [2008] NSWSC 981, a business had structured its operations into two related companies. One company, the host employer, owned the business's plant and equipment and paid all the business expenses, and another labour-hire company employed all workers but had none of its own assets. The Court held that the arrangement was a "*mercantile choice*" and of "*convenience*", but that actual and ultimate control was retained by the host employer because it owned the premises and the equipment, and still had overall operational control. The host employer was therefore apportioned 75% of the liability. The case turned on its own facts, but demonstrates the risk that host employers face when engaging others' employees to work for them.

Accordingly, in that case, although the host employer was "*footing the bill*", for the labour-hire company's WorkCover insurance, the host employer received no cover from the WorkCover insurer in relation to its 75% of the liability. It would also have incurred an increase in its public liability premium.

Section 138 claims

Where a worker suffers an injury at work, a host employer may also be subject to a recovery claim by the VWA, seeking an indemnity for no-fault statutory benefits paid to the worker.

Pursuant to section 138 of the ACA, the VWA can usually recover from the host employer 100% of the compensation paid to the worker, even where the labour-hire employer was also negligent.

The case law has strictly interpreted "*third party*" as being any party that did not pay the compensation (that is, anyone but the legal employer). In ***DSG Pty Ltd v Victorian WorkCover Authority*** [2008] VSCA 42, the court held that any party that is not the legal employer indemnified by the VWA can be pursued for recovery of benefits under section 138.

Accordingly, in addition to paying out a large proportion of damages in a worker's common law claim, a host employer may find itself repaying the VWA all of the no-fault benefits it has paid and will pay to the worker on behalf of the legal employer.

This makes workers' claims a very expensive exercise for businesses that use labour-hire companies, or that structure their business affairs in such a way that labour and business operations are conducted by separate, related companies.

Can host employers protect themselves?

There is some ability for host employers to protect themselves or limit their exposure through contractual provisions that:

- require indemnity from the labour-hire company in respect of any claims; and/or
- require the labour-hire company to take out public liability insurance in joint names.

However, due to a recent amendment to section 138 of the ACA, contractual indemnities are void if they require – or have the effect of requiring – the employer to indemnify a third party in relation to a section 138 claim.

The future

The above analysis highlights the exposures host employers face in using labour-hire employees in their workforce, and the importance of ensuring that the risk has been fully considered, quantified and understood.

It is important for the VWA to remain financially viable so it can protect employees' entitlements. However, the current arrangements arguably go too far, effectively transferring employer risk from the VWA to private insurers. The VWA takes the premium but bears very little of the burden. Furthermore, legislation removes the rights of parties to contractually allocate risk in a manner they regard to be commercially appropriate.

The risks and liabilities assumed by a host employer have been recognised by the industry for some time and were considered in the last review of the ACA, but no changes were made. The VWA's access to the Government, combined with the Government's desire to protect the VWA's profitability, means that there is unlikely to be any change in the foreseeable future. ■

Liability of equipment suppliers for injuries to workers

Written by Rebecca Hosking, Senior Associate
Tel 02 8273 9935
Email rebecca.hosking@wottonkearney.com.au

Introduction

In ***Coregas Pty Ltd v Penford Australia Pty Ltd*** [2012] NSWCA 350 the NSW Court of Appeal considered Coregas' liability to contribute, as a joint tortfeasor, to its customer Penford's settlement of a work injury damages claim. The claim was made by Penford's employee (**the worker**).

Facts

Coregas supplied hydrogen chloride gas cylinders to Penford. The cylinders were delivered in a cage, one side of which operated as a ramp. The cages held 12 cylinders, each weighing around 125 kilograms when full. The floor of the cage was about 140 millimetres above ground level. To unload the cylinders, the front of the cage was lowered as a ramp. The cylinders were then manoeuvred by hand ("*shimmied*") down the ramp to a trolley, which was specifically designed for moving the cylinders.

Removing the first cylinder from the cage was difficult because the full cage made it hard for a worker to get a foothold on the cage. The worker reported this difficulty to Penford and it was discussed at safety meetings, but no changes were made to the unloading system before the worker's injury.

At the time of the incident the ramp was also wet from exposure to the elements, because the cages were stored outside so that if any gas was vented from the cylinders, it did so into the open air. While Coregas may not have had power to direct Penford as to where to store the cages, it had the power to veto any position it deemed inappropriate.

The incident occurred when the worker was shimmying the first gas bottle from a full cage. He stepped back for the purpose of tilting the gas bottle to roll it down the ramp. The ramp was wet and his foot slipped, causing him injury.

To obtain a contribution from Coregas, Penford had to prove that if Coregas had been sued by the worker, it would have been liable. Coregas denied that its role as supplier of gas cylinders to Penford gave rise to a duty of care owed to the worker. Coregas also submitted that as the cylinders and the cage were branded "*BASF*" it was not the relevant manufacturer; rather it was a non-manufacturing distributor of goods.

Dr Cooke, architect, provided an expert opinion for Penford to the effect that having tested a similar ramp to that involved in the accident, its coefficient of friction was 0.65, which was greater than the 0.63 specified by Australian Standard 1657-1992. Dr Cooke opined that although the Standard did not strictly apply, it was indicative of the reasonable

standard for "*industrial situations*".

He added that while the slip resistance of the ramp exceeded that set by the Standard, taking into account the slope of the ramp and the manual handling task being undertaken, the ramp was not sufficiently slip-resistant to be safe in all the circumstances.

Decision

The Court of Appeal upheld the trial judge's finding that Coregas owed the worker a duty of care and that it breached that duty. The duty arose because:

> *"In supplying the cage loaded with full cylinders to a customer such as the respondent, the appellant did not merely supply a product or plant and equipment. The cage was designed to enable the cylinders to be unloaded in the manner described ... and that was the most likely method that the customers and their employees would use to unload the cylinders from the cage ... there was a duty on the appellant to provide a cage and ramp which did not, used in this way, subject those foreseeable users to an unreasonable risk of slipping on the ramp in doing so."*

The Court of Appeal reduced Coregas' apportionment from 50% (as determined by the trial judge) to 25%, on the basis that Penford had been notified of its employee's difficulties with the unloading system and failed to act on this prior to the accident. In circumstances where Coregas provided a cage with an integrated ramp for unloading the gas bottles and had some say as to where and how the cage was to be stored, to discharge its duty of care to the worker Coregas needed to ensure the ramp was safe and appropriate for use in the unloading process.

In the course of its judgment, the Court of Appeal also confirmed that objections to Dr Cooke's evidence were unfounded.

The Court commented that:

- Dr Cooke's testing of the coefficient of friction of a "*similar cage*" as that which would have been in use at the time of the incident was indicative of the likely coefficient of friction of the actual ramp; and
- Dr Cooke's qualifications extended beyond his title of architect and he was appropriately qualified to comment on alternative methods of unloading the cylinders, albeit that that the responses suggested by Dr Cooke were largely matters of common sense and did not require any particular expertise.

Implications

This case confirms that where a product is supplied with the intention that it be integrated into a workplace and the supplier plays some part in the method or mode of integration, the supplier could find itself liable for breach of duty of care if the method or mode is not adequately safe. ■

Trends in Victorian Personal Liability litigation

Written by Andrew Seiter, Partner
Tel 03 9604 7906
Email andrew.seiter@wottonkearney.com.au

An introduction to the framework in Victoria

In Victoria, most personal injury litigation involves claims brought by injured workers or the statutory WorkCover insurer, or else are 'general liability' claims. There is also, sadly, still a lot of asbestos diseases litigation.

This article identifies and discusses current trends that have contributed to the substantial inflation in the average claim cost to respondents (referred to in this paper as **third parties**) and their insurers in both areas of litigation.

Claims involving injured workers

By far the most common claims in Victoria involve injuries sustained in the course of employment.

Two classes of claims fit into this category:

- actions brought by seriously injured workers, known as "*serious injury*" proceedings (under section 134AB of the **Accident Compensation Act 1985 (Vic)** (**ACA**)); and
- actions brought by the Victorian WorkCover Authority (**VWA**) against negligent non-employer third parties, to recover the compensation it has paid a worker pursuant to the provisions of the ACA, known as "*section 138 actions*".

While workers injured in Victoria are entitled to generous 'no-fault' benefits under the ACA, those who are seriously injured may also pursue common law claims if they first comply with the "*serious injury*" process set out in section 134AB of the ACA.

Under the ACA, a worker who recovers common law damages under section 134AB is not required to repay the VWA compensation received. Rather, the worker is restricted to a claim for general damages and pecuniary loss (largely in the future). The VWA, on the other hand, can bring its own cause of action under section 138, claiming indemnity from any negligent third parties in respect of the compensation it has paid or may pay in the future. This means that in many cases the third party will be subject to two separate proceedings and, as a consequence, two sets of costs.

The VWA continues to vigorously pursue its statutory right under section 138. The section uses a formula that is extremely unfavourable to third parties. Furthermore, the traditional view is that the limitation period is six years from the date of each payment being made to the injured worker, which means litigation can be commenced many years after the injury has occurred.

General liability claims

General liability claims are claims that

rely on common law causes of action, including for negligence or breach of contract. This type of claim includes 'slip and trips', sports or recreational injuries, medical negligence and claims by injured hotel patrons.

In 2003, sweeping torts law reform resulted in many changes to the law of negligence, substantially reducing the volume of claims by as much as 90%.

The most significant reform was the introduction of injury thresholds. Under Part VBA of the **Wrongs Act 1985 (Vic)** a claimant can only claim pain and suffering damages if an approved medical practitioner provides a certificate of assessment certifying the injuries at more than 5% of permanent physical whole-person impairment (**WPI**) using Australian Medical Association guides, or as more than 10% permanent psychiatric impairment.

As AMA guides assess "*impairment*", Part VBA tends to favour certain types of injuries. Claimants who suffer shoulder or arm injuries are, for instance, much more likely to satisfy the thresholds than those who suffer from scarring, or wrist or ankle injuries. Indeed, even quite serious and painful lumbar spine injuries will often not satisfy the threshold.

Our experience has therefore been that this system favours a certain demographic. The 'typical' claimant is an elderly person who has fallen and sustained a shoulder or cervical injury. The claims are increasingly significant in value; it is now quite common for even the 'typical' elderly claimant to argue for general damages upwards of $100,000 plus costs.

That said, we have continued to have a lot of success in having the original certificates of assessment overturned by referring the claimant to an independent medical panel. The cost of referral has substantially increased in the last 12 months; the average referral cost (which the third party must pay) has risen to around $5,000.

Current challenges facing defendants

There are no publicly available figures on the current claims volume or the annual cost of public liability claims to third parties and their insurers. However, in recent years we believe the claims volume has increased in all categories.

More concerning is the increasing cost of these claims, with unrelenting upward pressure from a number of sources and factors. The continuing and significant inflation of general damages awards puts Victoria well above other Australian jurisdictions.

As for worker's claims, even 'small' claims (when accompanied by a section 138 action) rarely assess at under $150,000, while claims involving a "*serious injury*" can assess at more than $1 million, not taking into account contribution from other liable parties.

There has also been a significant spike in the number and quantum of claims involving pure psychiatric injuries. The increased focus on 'bullying' would seem to be having a flow-on effect to increase common law litigation in this area.

This upward trend in both claims' volumes and value is also illustrated by the VWA's financial accounts setting out its recoveries revenue. In 2007, the VWA reported recoveries revenue of $68 million, representing approximately 4% of the statutory insurer's premium income. This represents the revenue recovered from third parties and their insurers under section 138. Since then, there has been a substantial increase in the VWA's recoveries revenue. Based on 2011 figures, the VWA reported recoveries revenue of $152 million and in 2012 reported recoveries revenue of $134 million.

In terms of the litigation itself, our view is that claimant lawyers (including the

VWA wearing its 'section 138 hat') are more aggressive than ever. Whereas it used to be rare for a matter to proceed to hearing, it is now common.

In worker's claims where the VWA is the employer's insurer, it is becoming more difficult to settle contribution at an early stage, if at all. Litigating to judgment can therefore become an unavoidable prospect unless third parties are prepared to make concessions for purely commercial reasons, which is often unpalatable.

Statutory duty – the new frontier

The **Occupational Health & Safety Act 2004 (Vic)** imposes some of the most rigorous and onerous obligations on employers, manufacturers and designers of plant or equipment in the world, and is usually much more onerous than the common law or principles of negligence recognise.

While these statutory duty cases have tended to be brought against actual employers, over the next 12 months we anticipate seeing more claims for breach of statutory duty against the 'host employers' of labour-hire workers and those who provide plant and equipment to workplaces, which then result in injuries to workers. The VWA, in its section 138 recovery claims, is likely to be a key promoter of this 'new frontier'.

The Civil Procedure Act

An area that is getting more attention is the 'new' regime under the **Civil Procedure Act 2010 (Vic)** (**CPA**), which commenced in Victoria at the start of 2011.

The courts have embraced the CPA and there has been an increased focus on ensuring that all parties to litigation (and not just those named on the writ) comply with their paramount duty to the Court and their "*overarching obligations*". Those obligations include the duty:

- to co-operate in the conduct of civil proceedings;
- not to mislead or deceive;
- to use reasonable endeavours to resolve disputes;
- to narrow the issues in dispute;
- to minimise delay; and
- to disclose the existence of critical documents.

It is not uncommon for a court, even on its own motion, to inquire into whether a party's lawyers should be paying costs 'wasted' or whether there have been breaches for which other penalties ought be imposed. We, by way of example, recently completed a claim where the Court had ordered that the claimant's own expert should now be called before the Court to show cause as to why an order should not be made against him because of alleged breaches of the Supreme Court Rules Expert Witness Code of Conduct.

Sweeping amendments to the CPA commenced in Victoria on 1 January 2013, giving the Court a lot more discretion as to when and how experts can be used.

This could shake up the way personal injury litigation is presented, particularly in industrial injuries litigation where injured workers commonly seek to validate their claims (particularly in front of a jury) by calling the 'usual' plaintiff 'experts' to give evidence.

The future for claims

Unfortunately for third parties and their insurers, we envisage that in the short to medium term, costly trends look likely to continue – at least until the pressure on insurers becomes too great for them to bear without sizeable premium increases or withdrawal from the liability market, as happened in early 2000. Only then is the political pressure likely to be great enough to promote the radical change that will be needed to reverse, or at least stop, these trends. ■

Safe site access for independent contractors

Written by Belinda Henningham, Partner and Justin Carroll, Solicitor
Tel 02 8273 9913 | 02 8273 9846
Email belinda.henningham@wottonkearney.com.au
justin.carroll@wottonkearney.com.au

In ***Miljus v Watpow Constructions Pty Ltd*** [2012] NSWCA 96 the Court of Appeal considered the scope of the duty of an occupier of a building site to provide a safe means of access to visitors entering the site along a public road.

Facts

Watpow Constructions Pty Ltd (**Watpow**) was the head contractor of a residential building project in Seaforth (**the site**). Watpow retained CSR Ltd (**CSR**) to provide concrete to the site. To transport the concrete from its depot to the site, CSR engaged Edensor Transport Pty Ltd (**Edensor**), a concrete delivery company. Edensor was one of a number of concrete delivery contractors engaged by CSR to transport concrete to the site. Damien Miljus (**the plaintiff**) and his father were shareholders and directors of Edensor and Edensor employed the plaintiff as a truck driver.

To access the site, the plaintiff had to back his truck up a narrow road through bushland. Parts of the road were not much wider than his truck. The plaintiff was injured when he lost control of his truck and it fell into an adjacent gully. The incident occurred on a public road outside the site.

Trial

The plaintiff sued Watpow in negligence on the basis that:

- Watpow failed to provide safe access to the site (**the unsafe access case**); and
- the way in which he was required to deliver concrete to the site was dangerous, such that Watpow should have set up an alternative system (**the unsafe system case**).

The unsafe access case faced the immediate obstacle that the accident occurred not on the site but on a public road. The plaintiff sought to overcome this by arguing that, since the concrete pump was situated on the road outside the site, and as it was the concrete pump he was directed to use, the road itself was the access that Watpow was required to make safe.

The unsafe system case, by contrast, was that the position of the concrete pump on the road adjacent to the site put the plaintiff at risk because it required him to back down a narrow road to unload the concrete. The plaintiff argued that regulation 73(2) of the **Construction Safety Regulations 1950 (NSW)** required Watpow to devise a means for the plaintiff to deliver concrete that did not expose him to a risk of injury. The trial judge was not prepared to find that Watpow owed a duty of care to make the road safe or to devise an alternative and/or safer means of delivering the concrete. As the plaintiff was not an independent contractor to Watpow, the case did not fall within the exceptions to the general rule in ***Stevens v Brodribb Sawmilling Company Pty Ltd*** [1986] HCA 1 that a head contractor does not owe an independent contractor a common law duty of care.

However, the trial judge found that if a duty of care had been owed, Watpow would have been liable for breach of that duty because it could have easily set up a second concrete pump further down the road which would likely have prevented the accident.

Appeal

The plaintiff appealed the trial judge's decision on both liability and damages. The Court of Appeal upheld the finding that Watpow owed no duty of care to the plaintiff in circumstances where Watpow had retained competent independent contractors to pump and deliver the concrete and where the accident had not even occurred on the site. In fact, the Court went further and considered that the plaintiff's case did not even need to be analysed with reference to ***Stevens v Brodribb*** because the accident had not occurred within the boundaries of the site for which Watpow was head contractor.

Conclusion

In declining to find that Watpow owed the plaintiff a duty of care, the Court reaffirmed that the exception to the general rule that a head contractor owes no common law duty of care to an independent contractor is to be confined to that identified in ***Stevens v Brodribb***.

Attempts to widen the ambit of that exception by reference to statutory provisions or industry codes of practice are unlikely to succeed because this would run counter to the High Court's warning in ***Leighton Contractors Pty Ltd v Fox*** [2009] HCA 35 against translating statutory obligations into a common law duty of care. ■

A chip, a slip and causation in negligence - Part II: the High Court's decision in *Woolworths Limited v Strong* [2012] HCA 5

Written by Charles Simon, Partner and Jacqueline Grace, Senior Associate
Tel 02 8273 9911 | 02 8273 9931
Email charles.simon@wottonkearney.com.au
jaqueline.grace@wottonkearney.com.au

Introduction

On 7 March 2012, the High Court upheld Kathryn Strong's appeal from the NSW Court of Appeal in her claim for damages against Woolworths Limited (**Woolworths**)[1]. The High Court found, by majority, that on the balance of probabilities, Woolworths's negligence caused Ms Strong's injuries.

The NSW Court of Appeal decision was canvassed in our 2011 Insurance Year in Review publication and provided some welcome relief to occupiers and their insurers. It raised the bar for a plaintiff to establish a causal connection between a defendant's breach of duty and the plaintiff's injury.

The High Court has further clarified the steps a court must take when considering causation under section 5D of the **Civil Liability Act 2002 (NSW)** (**CLA**).

The facts

Woolworths operated a supermarket and a Big W store at the Centro Taree Shopping Centre. Ms Strong walked with the aid of crutches as a result of an above-the-knee amputation decades earlier.

On 24 September 2004, Woolworths held a "*sidewalk sale*" in an area in front of the Big W store. Ms Strong was walking around the sidewalk sale when the tip of her crutch slipped on a hot chip (or on oil from the chip) and she fell.

1 ***Strong v Woolworths Ltd*** [2012] HCA 5

The centre manager engaged contract cleaners to conduct cleaning rotations in intervals of no more than 15 minutes. However, these cleaners were not required to clean the area within the "*sidewalk sale*". Woolworths was responsible for cleaning that area, but other than requiring Big W employees to keep a lookout for spillages, Woolworths had no cleaning system in place.

At first instance, Woolworths was found liable in negligence to Ms Strong and she was awarded damages in the sum of $580,299.12. The claim against the centre manager was dismissed.

Woolworths appealed to the Court of Appeal, which held that Ms Strong had failed to establish that Woolworths' negligence was the cause of her injury.

Detailed consideration was given to section 5D of the CLA and the factors the Court will consider when making out "*factual causation*" pursuant to that section. As there was no basis on which to conclude that the chip had been on the ground for a period long enough for it to have been detected by a reasonable cleaning system, causation was not established pursuant to section 5D, and the District Court's judgment against Woolworths was set aside.

The High Court decision

Ms Strong's appeal to the High Court was upheld by a majority of 4[2] to 1[3]. The High Court held that factual causation required a plaintiff to prove that the defendant's negligence was a "*necessary condition of the occurrence of the particular harm*" pursuant to section 5D(1)(a).

Woolworths submitted that it was necessary for Ms Strong to point to some evidence that would permit an inference to be made as to when the chip was deposited on the floor. The High Court rejected this submission and held that a plaintiff could overcome the evidentiary burden by employing a probabilistic reasoning of when the chip came to be on the ground.

The majority stated that reasonable care required inspection and removal of slipping hazards at intervals not greater than 20 minutes in the "*sidewalk sale*" area (which was adjacent to the food court). The majority held that the evidence did not permit a finding of when the chip had been deposited on the ground between when the stands of the "*sidewalk sale*" were put in place at 8am and when the accident occurred at 12.30pm.

Against that background, and in the absence of evidence as to an adequate cleaning regime, the High Court held that probabilities "*favoured the conclusion that the chip was deposited in the longer period between 8.00am and 12.10pm and not the shorter period between 12.10pm and the time of the fall*".

The High Court concluded that, on the balance of probabilities, it could be deduced that the chip was left on the floor for a sufficient time for it to be detected, had an adequate cleaning regime been in operation. Accordingly, it was decided that Woolworths's negligent failure to implement a system of periodic inspection was a necessary condition of Ms Strong's harm.

Implications

Where an insured has breached its duty of care, liability insurers' focus often shifts to the question of causation. The High Court's decision reinstates the lower evidentiary threshold for plaintiffs to overcome the question of causation.

In determining factual causation under section 5D of the CLA, liability insurers should consider whether, on the balance of probabilities, and "*but for*" its insured's breach, the plaintiff would have suffered harm. If the answer is yes, the insured will

2 French CJ, Gummow, Crennan and Bell JJ

3 Heydon J

escape liability.

While the defence strategy of any claim will turn on the facts of that case, in 'slip and fall' cases in particular, it is critical for occupiers of commercial premises to be in a position to prove the adequacy of their cleaning regime and adduce evidence that the area of the plaintiff's fall was being inspected at intervals of no more than 20 minutes.

For underwriters of commercial premises, the case highlights the importance of assessing the risk with reference to the adequacy of the insured's cleaning regime and its system for maintaining detailed records of its cleaning schedules/rosters to counter a 'slip and fall' claim. ■

Liability by design? The NSW Court of Appeal considers the apportionment of liability between an architect and occupier

Written by Paul Spezza, Partner and Danielle Skinner, Solicitor
Tel 02 8273 9909 | 02 8273 9934
Email paul.spezza@wottonkearney.com.au
danielle.skinner@wottonkearney.com.au

As acutely observed by Heydon JA in ***Wilkinson v Law Court*** [2001] NSWCA 196, "*stairs are inherently, but obviously, dangerous*".

In ***Indigo Mist Pty Limited v Palmer*** [2012] NSWCA 239, the NSW Court of Appeal considered the liability of an occupier and a firm of architects for an incident which occurred when Ms Palmer (**the plaintiff**) slipped and fell down a staircase at the Oxford Hotel (**the hotel**) in Sydney in 2008.

The facts

The plaintiff and a friend were patrons at the hotel. She slipped on a wet substance and fell while descending a staircase connecting two upper floors. The two upper floors both had bars, and the toilets which serviced those bars were located on the top floor. Hotel patrons were allowed to carry drinks between the two upper floors.

The plaintiff was injured as a result of the fall and commenced proceedings in negligence against, among others, the occupier, Indigo Mist Pty Limited (**Indigo**), and a firm of architects, Paul Kelly Design Pty Ltd (**PKD**).

In 2006, Indigo engaged PKD to design a substantial refurbishment of the hotel. As part of these works Ms Williams, an architect in the employ of PKD, recommended that the subject staircase be constructed of glass blocks within a steel frame. The staircase was lit from below and there was some dim lighting in the ceiling.

At first instance the trial judge, Elkaim DCJ, found in favour of the plaintiff (awarding damages in the order of $115,000) and apportioned liability equally between Indigo and PKD. Both Indigo and PKD appealed this decision.

The decision

The NSW Court of Appeal, comprising Beazley JA, Macfarlan JA and Hoeben JA, upheld the trial judge's decision that PKD had been negligent in recommending and designing the staircase, and that Indigo had been negligent by failing to respond to the risks posed by the staircase.

Elkaim DCJ considered that if Ms Williams had contemplated the potential hazards created by the staircase she would have realised that the glass blocks had insufficient slip resistance when wet and therefore were not appropriate for use as a staircase.

One of the issues raised on appeal was the content of the duty owed by Indigo and whether there was evidence of a breach of that duty.

Hoeben JA, who handed down the leading judgment, found that given the layout of the hotel, the risk of drinks being spilt on the stairs was clearly foreseeable, and there was a high likelihood of such an event occurring. The Court of Appeal held that the risk posed by the staircase should have been obvious to a reasonable occupier and there was no evidence of Indigo responding to this not insignificant risk. Such a response could have included a prohibition on travelling between the two upper floors with drinks, or the provision of signage or warnings. In addition, Indigo did not have in place a system of regularly inspecting or cleaning the staircase.

Indigo contended that it was not obliged to respond as it had delegated responsibility to PKD for the design of a suitable staircase. In this regard, Indigo attempted to rely upon the authority of ***Bellevista Pty Ltd v Liberty International Insurance Co*** [2009] NSWCA 16, which involved the delegation of responsibility by an occupier to a cleaning contractor. The facts of Bellevista were distinguished from this case. PKD was responsible for implementing the refurbishment of the hotel, which included designing and determining the materials to be used in the stairs. Notably, PKD had no responsibility for the management or day-to-day running of the hotel. Hoeben JA stated that:

> "*the content of the duty owed by the occupiers was not only to provide safe premises but to exercise reasonable care to conduct the hotel premises so as to avoid exposing patrons to a foreseeable risk of harm. Their responsibility for the management and day-to-day running of the hotel could not be delegated to the architect*."

With regard to Macfarlan JA's judgment, Indigo could theoretically have avoided liability if it had determined that a foreseeable risk of injury existed in relation to the staircase and sought expert advice as to that matter, "*thereby effectively delegating performance of its duty to the expert*".

Here, delegation had not occurred, as Indigo simply assumed that PKD had satisfied itself of the safety of the staircase. However, PKD had not done so and had not been specifically requested to do so by Indigo.

Implications

It is paramount that occupiers take reasonable steps to identify foreseeable risks that may arise from the use of their premises, and take reasonable precautions in response to those risks.

Only where there is a clear overlap of responsibilities will a court find that there has been a full delegation of responsibility from one party to another. ■

Council liability – a wrap-up of recent cases

Written by Belinda Henningham, Partner and Olivia Dinkha, Senior Associate
Tel 02 8273 9913 | 02 8273 9986
Email belinda.henningham@wottonkearney.com.au
olivia.dinkha@wottonkearney.com.au

Part V of the **Civil Liability Act 2002 (NSW)** (**CLA**) provides powerful protections against civil liability for public and other authorities. However, two decisions of the NSW Court of Appeal in the last year demonstrate that those authorities bear a heavy onus of proving the elements necessary to obtain the benefit of the Part V protections.

Bathurst Regional Council as Trustee for the Bathurst City Council Crown Reserves Reserve Trust v Thompson [2012] NSWCA 340

In this case, the plaintiff suffered serious injuries when he slipped and fell while descending steps on a heritage-listed rotunda in a park in Bathurst. The plaintiff sued the defendant Council as the trustee of the occupier of the rotunda. He succeeded at first instance.

The Council appealed, contending, amongst other matters that the primary judge erred in failing to apply section 42 of the CLA. That section provides that in determining whether a public or other authority (including a local council) has a duty of care, or has breached its duty of care, the following principles apply:

- the functions the authority is required to exercise are limited by the financial and other resources that are reasonably available to it;
- the general allocation of those resources by the authority is not open to challenge;
- the functions the authority is required to exercise are to be determined by reference to the broad range of its activities, not only by reference to the matter to which the proceedings relate; and
- the authority may rely on evidence of its compliance with the general procedures and applicable standards for the exercise of its functions, as evidence of having properly exercised its functions in the matter to which the proceedings relate.

In dismissing the Council's appeal, Hoeben JA (with whom Meagher JA and Tobias AJA agreed) held that the Council led no evidence as to its relationship with the trust as was required for the Court to determine whether section 42 applied.

Confirming the approach adopted in RTA of ***NSW v Refrigerated Roadways Pty Ltd*** [2009] NSWCA 263, His Honour further held that even if section 42 did apply, the

Council had adduced no evidence of its financial and other resources, or of the general allocation of those resources or the range of its activities, as required for the Court to apply section 42.

The decision confirms that in order to obtain the protections provided by section 42, public or other authorities must prove the state of their "*financial and other resources*" and lead evidence as to the general allocation of those resources.

Bellingen Shire Council v Colavon Pty Ltd [2012] NSWCA 34

In this case, the plaintiff's prime mover and tanker rolled down an embankment adjacent to a narrow section of a road in Dorrigo. The accident occurred when the edge of the road gave way. The edge was not part of the formed roadway; it was a soft section of built-up soil and loose material that had been pushed to the side of the road during periodic grading work.

The plaintiff sued the defendant Council, alleging that it was negligent in failing to install guide posts along the road to guide heavy vehicles away from the edge of the downhill slope. The plaintiff succeeded at a retrial before McLoughlin DCJ.

The Council appealed, contending that His Honour erred in failing to determine that the Council's authority to install the guide posts was pursuant to a "*special statutory power*" within the meaning of section 43A of the CLA.

Section 43A provides a complete defence to a claim against a public authority, based on the authority having exercised – or having failed to exercise – a "*special statutory power*" conferred on it, unless it can be established that the act or omission was:

> "*so unreasonable that no authority having the special statutory power in question could properly consider the act or omission to be a reasonable exercise of, or failure to exercise, its power.*"

By a notice of contention, the plaintiff argued that the primary judge erred in allowing the Council to rely on a defence under section 43A in circumstances where that defence was not specifically pleaded. The first time the Council raised the defence was in its written submissions following completion of evidence at the retrial.

In dismissing the Council's appeal and upholding the plaintiff's notice of contention, Beazley JA (with Whealy JA and Sackville AJA agreeing) noted that a statutory provision that provides a complete defence to a claim, and which if not pleaded would take a party by surprise, must be pleaded pursuant to Rule 14.14 of the **Uniform Civil Procedure Rules 2005 (NSW)**.

Beazley JA rejected the Council's argument that the late raising of a section 43A defence would cause no prejudice to the plaintiff. It was a question of law as to whether the Council's power to install guide posts was pursuant to a "*special statutory power*", and the question involved evidentiary considerations as well as the determination of factual circumstances.

Beazley JA recognised that:

> "*there does not appear to be any rule that could or should be applied generally or uniformly to determine whether an entity acts pursuant to a* 'special statutory power'."

Her Honour took the view that the section raised questions of law and of fact. She went on to suggest that, since the Council owned the road, it was "*difficult to see that … [its] entitlement to install guide posts [was] pursuant to a*

'special statutory power'".

Comment

These decisions confirm that, while Part V of the CLA affords considerable protections against civil liability for public and other authorities, those authorities must specifically plead the sections on which they rely, and then discharge the heavy burden of proving the elements necessary to successfully invoke those provisions. ■

Pushing the boundaries – *Orcher v Bowcliff Pty Ltd* [2012] NSWSC 1088

Written by Paul Spezza, Partner and Justin Carroll, Solicitor
Tel 02 8273 9909 | 02 8273 9846
Email paul.spezza@wottonkearney.com.au
justin.carroll@wottonkearney.com.au

Introduction

In ***Smith v Leurs*** [1945] HCA 27 Dixon J observed that it was exceptional to find in the common law:

> "*a duty to control another's actions to prevent harm to strangers. The general rule is that one man is under no duty of controlling another man to prevent his doing damage to a third. There are, however, special relations which are the source of a duty of this nature*".

The relationship that exists between an occupier of licensed premises and a patron on those premises is not considered "*special*" in this sense. However, NSW courts have recognised that an occupier of licensed premises owes patrons a duty of care that may extend beyond the real property boundaries of the premises. The basis of this duty lies in:

- the control and knowledge that an occupier is expected to have regarding the conduct of patrons on its premises; and
- the obligations owed by a licensee of licensed premises under the **Liquor Act 2007 (NSW)** not to permit "*indecent, violent or quarrelsome conduct*" on the premises.

Until recently, decisions where this duty was found to exist involved cases where aggressive conduct had occurred inside the licensed premises and had then reignited outside after the warring parties had been ejected or permitted to leave the premises.

However, in ***Orcher v Bowcliff Pty Ltd*** [2012] NSWSC 1088 (***Orcher***), the duty was found to exist where there was no relevant aggressive conduct inside the licensed premises and where the parties were well beyond the boundaries of the premises at the time the violent conduct occurred.

Facts

Early in the morning of 25 November 2007, John Orcher (**the plaintiff**) left the Bridge Hotel in Rozelle (**the hotel**) with his partner and a friend and walked

across to the other side of the road. Shortly afterwards, the plaintiff and his friend fell into an argument (**the altercation**).

Tamiano Paseka (**Paseka**) was standing just outside the hotel and saw the altercation from across the road. Paseka was employed as a glass collector at the hotel. Earlier that night, the manager of the hotel had allowed Paseka to cease work and Paseka had remained at the hotel as a paying customer. Paseka did not know the plaintiff or his friend.

Crossing the road, Paseka approached the plaintiff and his friend in an apparent attempt at conciliation. However, on seeing Paseka, the plaintiff assumed a boxing stance and challenged Paseka "*to have a go*". Paseka punched the plaintiff in the face, causing him to fall back and hit his head on the kerb (**the assault**). The assault resulted in the plaintiff suffering severe head injuries.

Decision

The plaintiff sued the occupier of the hotel, the licensee and the hotel's independent security contractor claiming they were negligent for failing to prevent Paseka's assault on the plaintiff.

It was common ground at the trial that there had been no prior altercation between Paseka and the plaintiff inside the hotel of which the hotel should have been aware, and that Paseka was not affected by alcohol before the assault.

Furthermore, while Harrison J did not accept that Paseka had ceased work at the time of the assault, his Honour did not find the hotel vicariously liable for Paseka's conduct.

Rather, all three defendants were found liable for "*failing either to take steps to intervene in the disturbance* [between the plaintiff and his friend] *in the first place, or to prevent* [Paseka] *from doing so himself*".

His Honour found that this failure gave rise to the risk that others (such as Paseka) who lacked security training and were liable to react impulsively might intervene and cause harm to the plaintiff. As such, the basis of the defendants' negligence was that they had failed to exercise reasonable care in preventing Paseka from assaulting the plaintiff.

Conclusion

Viewed in the context of similar cases that have found that the duty of care of an occupier of licensed premises may extend outside the legal boundaries of the premises, the decision in ***Orcher*** represents a significant development in the law of occupier's liability.

The decision shows that an occupier of licensed premises may be liable for the injury suffered by one patron in an assault by another patron that occurs outside the licensed premises, notwithstanding the absence of any prior relevant conduct inside the premises. The decision seems to assume that occupiers have a duty to anticipate and intervene in disputes occurring well beyond the licensed premises purely on the basis that one or more of the parties to the dispute had earlier been patrons of the licensed premises.

It remains to be seen whether the decision in ***Orcher*** comes to represent the current state of the common law in Australia. The defendants are appealing the decision. The outcome of the appeal is likely to be heard later this year when it will be the subject of a further update.

Bushfire litigation – an update on current Victorian cases

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

Background

The class actions against Victorian power distributors arising out of 'Black Saturday' in February 2009 have continued to keep the Supreme Court of Victoria busy over the past year.

It is generally agreed that 7 February 2009 was one of the worst days for fire conditions in the history of the State. Nevertheless, plaintiffs have pursued litigation against power distributors in the tort of negligence, based on largely common allegations that criticise the distributors' asset maintenance regimes. The claims in western Victoria have been resolved, but the Kilmore East fire is approaching its trial date in March. Many lives were lost in this fire and there was significant property damage, making the Kilmore East Class Action (***SPI Electricity Pty Ltd v Matthews and ors*** [2011] VSC 168) the largest claim ever litigated in Victoria.

Philosophical questions of whether electricity distributors should be made liable for losses on days of extreme bushfire raise fundamental questions and emotions, and produce many different views. At the end of the day, the moral debate is irrelevant because the legislature has promulgated rules enabling class actions and mass tort litigation.

Accessing information

The common problem faced by defendants seeking to assess a class action is the inability to delve meaningfully into the value of the overall litigation through the discovery process (for example, for the purposes of mediation). The obligations of discovery only exist between the lead plaintiff and the defendant. Significant difficulties arise in quantifying losses because members of a class generally cannot be compelled to produce any discovery or information.

There are various possible ways to obtain better overall information. In ***Thomas v Powercor (No 1)*** [2010] VSC 489 the Court ordered 10 group members who had retained the same solicitors as the Plaintiff to provide particulars of loss and any documents substantiating the particulars. This order was made after a submission by Powercor that documentation on quantum would assist settlement discussions.

In other cases, mediators have sought the assistance of the courts, but at the end of the day these initiatives have been largely unsatisfactory. If the plaintiff's lawyer is unwilling to provide information and documents, the process becomes frustrated, and expensive and complex settlement processes become inevitable.

Settlements

Some of the Victorian class action cases have ended in settlements, but settlement of the individual underlying claims has been far from straightforward. The Court encourages parties to cooperate and proceed through a negotiated settlement; however, the rigour inherent in litigation (thanks to the Rules of Court) is not present in consensual processes, which has tended to lead to exaggerations and other difficulties, more often than not in the area of uninsured loss.

The issue of restitution

A particular issue regarding restitution was resolved by the Court of Appeal in ***Powercor Australia Limited v Thomas*** [2012] VSCA 87, where the Court confirmed that the measure of loss is the reasonable cost, on a commercial basis, of repairing or reinstating the damaged property.

The plaintiff in that case had undertaken repairs himself and with the assistance of volunteers. The Court of Appeal held that the plaintiff was entitled to recover the cost of doing the work based on an entitlement measured by reference to the commercial cost of repairs, even though there had been no payment for the repairs.

This case has resulted in the pursuit of underlying claims that liability insurers would not normally consider compensable. Subsequent litigation include significant claims for restitution for 'own labour' and for undertaking administrative tasks (including making insurance claims and seeking additional Government grants).

The value of trees and gardens

The value to be attributed to trees and gardens has been a contentious issue in damages claims, especially because there is no substantive authority on the matter. Claims for hundreds of thousands of dollars have been advanced based upon "*amenity value*", in one case for more than $10 million.

"*Amenity value*" seeks to establish a value not by reference to the cost of reinstatement, but by calculating the "*community value*" of the tree based on its size, location and other features. The courts are likely to be looking at the measure of loss for trees and gardens in the near future and how these are to be assessed.

Claims against the State

A rare 'win' on the defendant's side was the finding in favour of the State of New South Wales in ***Warragamba Winery Pty Ltd v State of New South Wales*** [2012] NSW SC 701. The allegation in that case was that the State had failed to contain the bushfire or give earlier warnings about the consequences of an accidental bushfire. The Court decided that there was no duty of care for public bodies to manage fires on their own property and in a particular manner, so the litigation against the statutory body failed.

In Victoria, there are cases against statutory bodies and instrumentalities currently before the Court. It will be interesting to see how the Supreme Court of Victoria approaches this issue of the State's duty of care in the Kilmore East fire. ■

General damages in personal injury claims – a comparison of damages awarded for pain and suffering

Written by Andrew Seiter, Partner and Natasha Sung, Solicitor
Tel 03 9604 7906 | 03 9604 7904
Email andrew.seiter@wottonkearney.com.au
natasha.sung@wottonkearney.com.au

Introduction

What price should we put on a person's pain and suffering?

In Australia, it is a longstanding principle that the amount awarded to a claimant in common law proceedings for personal injuries must be fair and reasonable compensation, having regard to the injuries received and the disabilities caused (***Planet Fisheries Pty Ltd v La Rosa*** (1968) 19 CLR 118 at [11]). That being the theory, it may be surprising to hear that the answer to the question above can largely depend on the jurisdiction in which the injury occurred or where the claimant's common law proceedings are issued.

This article examines the degree to which the amounts awarded for pain and suffering damages (**general damages**) vary between Australian jurisdictions, and the reasons for that variation.

Victoria

In Victoria, a claimant must satisfy statutory injury thresholds (with few exceptions, such as dust diseases litigation) in order to claim general damages.

The impairment thresholds are different depending on the circumstances in which the injury was caused. In the case of transport accidents or workers compensation injuries, the claimant must have a 30% whole person impairment (**WPI**) assessed under the American Medical Association Guides (Edition 4), or otherwise satisfy the more subjective test called a narrative test of "*serious injury*".

In most other cases, the claimant must obtain a Certificate of Assessment from an approved medical practitioner, which

may be subject to independent review by a Medical Panel. In the case of physical injury, the injury must be permanent and assessed at more than 5% WPI. The threshold for psychiatric injury is higher, being 10% permanent psychiatric impairment (Part VBA of the **Wrongs Act 1958 (Vic)**).

Once the thresholds are satisfied, the Court (or jury) may assess general damages "*at large*". The only real statutory restriction is a set maximum, which in most cases is just over $500,000. Once again, dust diseases are a notable exception, for which there is no set maximum.

Juries are a further complication to the assessment process in Victoria. While judges may take into account previous awards when assessing general damages, juries are not even informed of these previous awards. This can result in a measure of unpredictability.

Furthermore, an appellate court will only interfere with a jury verdict if it is beyond what a "*reasonable jury properly instructed and with all due attention to the evidence could arrive at*" (***Amaca Pty Ltd (under NSW administered winding up) v King*** [2011] VSCA 447 at [184]), which means that jury verdicts are rarely successfully challenged.

We have observed that in recent years, there has been a significant inflation of general damages awards in personal injuries litigation in Victoria. In mid-2000, for example, damages for lumbar spine injuries were typically assessed at between $80,000 to $180,000. Today, damages for the same category of injury are assessed closer to $300,000 – even more, if there has been surgery.

New South Wales

In NSW, general damages for injuries (excluding claims against employers, motor vehicle accidents or dust diseases) are usually assessed by reference to a percentage of a most extreme case (section 16 of the **Civil Liability Act 2002 (NSW)**).

Under the **Civil Liability Act**, the maximum amount that can be awarded for general damages is presently $525,000 (**the maximum**). If an injury is assessed at below 15% of a most extreme case, the award is nil. Between 15% and 32%, a table states what percentage of the maximum applies[1]. From 33%, the entitlement is that percentage of the maximum. While the meaning of "*most extreme case*" is not defined, it has been suggested that it would include quadriplegia or total blindness with loss of limbs (***Mason v Demasi*** [2012] NSWCA 210). Accordingly, this method of assessment imports a substantial degree of judicial subjectivity.

In practical terms, the scale means that a claimant in NSW is more likely to be able to claim general damages for more minor injuries that would not satisfy the minimum thresholds in Victoria. On the flip side, more serious injuries in NSW are likely to be assessed at a lower amount than they would be in Victoria.

In a recent case, ***Coles Supermarkets Australia Pty Ltd v Haleluka*** [2012] NSWCA 343, a 48 year old woman who suffered hip injuries after she was struck by a trolley in a supermarket had her non-economic loss assessed at 30% of a most extreme case, equating to $115,000. By way of comparison, in Victoria, a 40 year old man who suffered a hip and groin injury in the course of his employment was recently awarded $150,000 (***Mould v ABM Plastics (Australia) Pty Ltd*** [2010] VCC 1346).

In NSW, back injuries have tended to be assessed close to either side of 30%, which on a dollar basis is now

1 For example, an injury assessed at 15% entitles the claimant to 1% of the maximum. An injury assessed at 25% entitles the claimant to 6.5%, but rapidly rises to parity after that.

approximately $123,000 – substantially less than what those injuries would be assessed at in Victoria.

South Australia

Similar to the NSW approach, general damages in South Australia are usually assessed by reference to a scale, assuming some minor thresholds are met. Non-economic loss is assigned a numerical value running from 0 to 60, with 60 reflecting non-economic loss "*of the gravest conceivable kind*" (section 52 of the **Civil Liability Act 1936 (SA)**). However, corresponding general damages awards are significantly lower in South Australia, where it is not unusual to see damages for back injuries assessed at around $30,000.

Queensland

In Queensland, general damages are also usually assessed by reference to a scale. The Court is required to assign a numerical value (known as an "*injury scale value*") on a scale from 0 to 100, which in turn informs the amount of general damages. The Court must take into account the injury scale values of similar injuries in prior proceedings (section 61 of the **Civil Liability Act 2003 (Qld)**; **Civil Liability Regulations 2003 (Qld)**).

Moderate cervical spine injuries including, for example, soft tissue injures for which there is no radiological evidence, may be assessed at as low as $11,000, representing an injury scale value of 10.

Parties must also comply with the lengthy **Personal Injuries Proceedings Act 2002 (Qld)** process, which is intended to promote pre-litigation settlement.

Tasmania and Western Australia

In both Tasmania and Western Australia, restrictions apply on the amount of general damages that can be awarded. In Western Australia, for instance, the minimum threshold to recover general damages is $18,000 (for injuries sustained after 1 July 2012) (sections 9 and 10 of the **Civil Liability Act 2002 (WA)**). A formula applies to the assessment up until a certain sum, after which the statute does not apply and the Court can assess general damages "*at large*". However, the Courts have consistently demonstrated that even where legislation does not control their discretion, the amounts awarded will be significantly less than those awarded in the eastern states, as low as 25%.

Other factors at play

There is little doubt that, where legislation permits, the "larger" states (Victoria, NSW and Queensland) tend to assess general damages much more generously.

Recently, we published a paper (available on the Wotton + Kearney website) that compared recent awards to claimants who had contracted mesothelioma from exposure to asbestos dust and fibres.

As most of the statutory intervention discussed above does not apply to dust diseases litigation, general damages are assessed "*at large*". In ***Booth v Amaca Pty Limited and Amaba Pty Limited*** [2010] NSWDDT 8, the NSW Dust Diseases Tribunal awarded a 70 year old plaintiff $250,000. In ***Lowes v Amaca Pty Ltd*** [2011] WASC 287, Corboy J of the Supreme Court of Western Australia also awarded a plaintiff $250,000. In South Australia, the awards have tended to be closer to $100,000 (see, for example, ***Hamilton v BHP Limited*** [2012] SADC 25).

It may come as no surprise that the highest award of general damages for a mesothelioma claim to date in Australia is the recent Victorian case of ***Amaca Pty Ltd (under NSW administered winding up) v King*** [2011] VSCA 447, in which the Court of Appeal refused to disturb a jury award of $730,000. Being a jury award, this does not establish a binding "*tariff*"

for future mesothelioma claims. However, the Court of Appeal's refusal to interfere with the award goes some way to demonstrate the absence of jurisdictional parity. It is also therefore unsurprising that Victoria, quite apart from its status as a popular fashion destination, is a preferred destination for personal injury claimants seeking to engage in "*forum shopping*".

Implications

Our discussion has revealed major differences in the amounts awarded for general damages across the country. Given that the cost of a loaf of bread hardly changes between the states, it is difficult to find a compelling reason for why different dollar values are placed on pain and suffering depending on the jurisdiction.

In part, it may be attributed to the tort law reform in early 2000 and the consequential statutory intervention. In some states, general damages are assessed by reference to a percentage of a worst case scenario, while in other states, impairment thresholds must be met before any entitlement arises, depriving many of any compensation at all.

That being said, we cannot ignore the presence of other factors. In Victoria, for instance, the fact that most personal injury claims are heard by juries clearly has some bearing. However, there must also be different social mores at play, an analysis of which goes far beyond what this article can address.■

Insurance Year in Review 2012
Professional Indemnity

The right type of "claim"?

Written by Jane Bochenek, Senior Associate
Tel 02 8273 9811
Email jane.bochenek@wottonkearney.com.au

The recent decision of the Supreme Court of Victoria in ***Kyriackou v ACE Insurance Ltd*** [2012] VSC 214 has shed further light on professional indemnity policies and what claims will trigger coverage.

Background and ASIC proceedings

ASIC commenced proceedings against Mr Kyriackou in relation to his alleged involvement in an unregistered managed investment scheme. ASIC sought interlocutory and final relief against Mr Kyriackou by way of injunctions and declarations under the **Corporations Act 2001 (Cth)**.

Mr Kyriackou engaged solicitors to act on his behalf in defending the proceedings. The proceedings were ultimately discontinued with no determination on the merits.

Mr Kyriackou sought indemnity for defence costs incurred in the proceedings, pursuant to a professional indemnity insurance policy with ACE Insurance Limited (**ACE**). ACE denied indemnity on the basis that the claim fell outside the insuring clause and, in the alternative, that the claim was the subject of a number of exclusions.

The Supreme Court decision

The Court held that no "*claim*", as defined under the policy, had been made against Mr Kyriackou because the nature of the relief sought by ASIC did not include claims for "*civil compensation or civil damages*" as required to trigger cover under the insuring clause. Rather, ASIC sought only declaratory and injunctive relief against Mr Kyriackou.

Further, the Court held that Mr Kyriackou was not entitled to indemnity because the claim did not arise from a breach of duty owed in a "*professional capacity*".

Notwithstanding the broad meaning of the term "*professional*" (see ***GIO General Limited v Newcastle City Council*** [1996] 38 NSWLR 558), the Court considered that ASIC's claim was not in respect of Mr Kyriackou acting in a "*professional capacity*". Rather, it was in respect of his capacity as an entrepreneur in the management of the Australvic Group of Companies and the scheme managed or promoted. It involved activities in a commercial, rather than a professional sphere. It was in this capacity that ASIC sought relief against Mr Kyriackou, not in his "*professional capacity*" as a finance broker.

The Court therefore upheld ACE's denial of indemnity.

Implications

When an insured seeks indemnity for defence costs it is important to consider the nature of the claim or proceedings and the scope of the policy.

Where there is no claim for damages,

it is likely that there is neither the "*civil compensation*" nor the "*civil damages*" necessary to trigger cover under a professional indemnity policy.

Furthermore, while the courts have purported to take a broad view of the term "*professional capacity*", consideration needs to be given to the precise activities the subject of the claim and whether those activities are "*professional*", or merely "*entrepreneurial*" or "*commercial*".

Peer professional opinion – a standard of care or simply a defence?

Written by Cain Jackson, Partner and Lauren Fieldus, Solicitor
Tel 03 9604 7901 | 02 8273 9827
Email cain.jackson@wottonkearney.com.au
lauren.fieldus@wottonkearney.com.au

Introduction

In the case of ***Brakoulias v Karunaharan*** [2012] VSC 272, Macaulay J of the Supreme Court of Victoria considered the effect of section 59 of the **Wrongs Act 1959 (Vic)** (**section 59**), which bears the title "*Standard of care for professionals*". The question before the Court was whether section 59 set out a defence, shifted the evidentiary burden or created a new standard of care for professionals. Ultimately, His Honour found that section 59 operated as a defence.

Background

The plaintiff was a patient of the defendant doctor. The defendant prescribed the plaintiff a weight-loss drug. Four months later the plaintiff suffered a cardiac arrest, depriving her of oxygen and ultimately causing her serious and long-term injuries.

The plaintiff alleged that the defendant was negligent in prescribing the drug.

There was a trial by jury before Macaulay J, who considered how to instruct the jury on the effect of section 59.

The decision

Section 59 provides that a professional is not negligent if the service provided is deemed to be competent professional practice by a significant number of respected practitioners in the field (**peer professional opinion**). Peer professional opinion does not have to be universally accepted and there may be competing peer professional opinions on the issue. Ultimately, however, the Court has the power to determine that the peer professional opinion is an unreasonable one.

His Honour discussed the content of section 59 and the differing arguments presented by counsel as to its effect, namely:

- the "*exclusive standard*" approach, which states that the section supersedes the common law standard of care set out in ***Rogers v Whitaker*** (1992) 175 CLR 479 (***Rogers***

v Whitaker) and provides a new standard of care for professionals;

- the "*evidentiary burden*" approach, which states that once the plaintiff has met the ***Rogers v Whitaker*** standard, the defendant may adduce evidence of peer professional opinion. At this point, section 59 sets a new standard of care, which the plaintiff must prove the defendant failed to meet; and
- the "*defence*" approach, which states that the ***Rogers v Whitaker*** standard continues to apply but that once the plaintiff makes out a *prima facie* case, peer professional opinion may provide a defence.

In considering which approach to take in construing section 59, Macaulay J considered the introduction and history of the Act and the associated Bill.

Section 59 was introduced in response to the Ipp Report. The main issue raised in that report was the question of who should be responsible for determining the standard of care for professionals: the court or the profession? In answer to that question, the legislature adopted a modified version of the test set out in ***Bolam v Friern Hospital Management Committee*** [1957] 1 WLR 582 (**the *Bolam* test**) – that is, that peer professional opinion is the main consideration, but the Court retains the ability to decide whether the opinion is irrational.

Despite the title of the section being "*Standard of care for professionals*", and after determining that the ***Bolam*** test sets out a standard of care rather than a defence, His Honour ultimately decided against the "*exclusive standard*" approach.

His Honour was guided by a textual analysis of the section. Only the defendant has an interest in establishing the existence of and compliance with peer professional opinion, so they can gain the benefit of the section. His Honour found that this "*bespeaks a defence*". Furthermore, if negligence is assumed to exist before section 59 is raised, this negligence must have been *prima facie* established according to some standard – that of ***Rogers v Whitaker***.

Macaulay J also referred to two decisions of the New South Wales Court of Appeal regarding the equivalent provision found in section 5O of the **Civil Liability Act 2002 (NSW)**. In both ***Dobler v Halverson*** (2007) 70 NSWLR 151 and ***Sydney South West Area Health Service v MD*** (2009) 260 ALR 702, it was determined that section 5O provided a defence. While section 5O and section 59 are not identical, judicial comity led His Honour to determine that section 59 also provides a defence.

His Honour also rejected the "*evidentiary burden*" approach as section 59 provides that the defendant must establish that they acted in accordance with peer professional opinion. The section does not merely require the defendant to introduce evidence to that effect, after which the plaintiff must establish that the defendant did not act in such a manner. To follow the "*evidentiary burden*" approach would be to rewrite the section.

Comments

This case is significant because it is the first Victorian case to decide how section 59 of the **Wrongs Act** affects the determination of alleged breaches of duty of care by professionals. The ***Rogers v Whitaker*** standard remains unaltered by section 59, but professionals may be able to rely on peer professional opinion (as to the relevant standard of care) as a defence. ■

Fraudulent finance broker not the lender's agent

Written by Graham Jackson, Special Counsel
Tel 02 8273 9815
Email graham.jackson@wottonkearney.com.au

Introduction

Mortgage lending often involves a myriad of parties forming a chain from the lender to the borrower, including mortgage managers, originators, introducers and brokers. When things go wrong, trying to work out who is responsible for what can be a difficult exercise, particularly where misconduct has occurred. In ***Tonto Home Loans Australia Pty Ltd v Tavares*** [2011] NSWCA 389, the NSW Court of Appeal considered whether the lender was responsible for the actions of a fraudulent finance broker/mortgage introducer.

Facts

Streetwise was a finance broker and mortgage introducer. The respondents were three couples with moderate incomes but significant equity in their family homes.

Streetwise persuaded each of the respondents to enter into joint venture residential property developments with Streetwise, with promises of significant returns. Streetwise advised the respondents that they would need to enter into loan agreements but that Streetwise would make the loan repayments.

Streetwise submitted loan applications to Tonto Home Loans (**Tonto**) on behalf of the respondents. Tonto was a mortgage manager for the lender, Permanent Trustee Company Ltd (**Permanent**).

Streetwise fraudulently completed the applications. In particular, Streetwise inserted false details of the respondents' assets and income. Tonto approved the loans, which were secured by mortgages over the respondents' homes.

Streetwise initially made the loan repayments. When it eventually defaulted, Permanent sought to enforce its mortgages over the respondents' homes.

Agency issue

The respondents contended that they were not liable under the loan agreements and mortgages by virtue of Streetwise's fraud. In support of this, they sought to argue that Streetwise was Tonto's agent and thereby 'pin' Streetwise's actions onto Tonto.

The decision

The Court of Appeal held that the following questions were relevant in considering whether Streetwise was Tonto's agent:

- Did Tonto appoint Streetwise to undertake tasks for it, such that the knowledge gained or conduct engaged in by Streetwise in performing such tasks could be imputed to Tonto, or considered conduct for which Tonto could be held legally responsible by some form of vicarious attribution?
- Did Streetwise agree to receive and communicate information and otherwise act on Tonto's behalf in a capacity that could be characterised as one of agency?

At first instance, Price J found that Streetwise was Tonto's agent (and consequently Permanent's agent) on the basis that Tonto had delegated significant elements of the loan assessment process to Streetwise and had allowed Streetwise to badge the loans as its own.

The Court of Appeal, overturning Price J's decision, held that Streetwise was not Tonto's agent. The following factors were relevant to this finding:

- The introduction deed between Streetwise and Tonto included a provision that Streetwise would "*endeavour*" to introduce loans that complied with Tonto's terms and conditions. The word "*endeavour*" did not import an obligation on Streetwise to act in the interests of Tonto.
- Streetwise was contractually forbidden from disclosing to the borrowers the terms of its arrangement with Tonto.
- The fact that Streetwise did not hold itself out as working for Tonto meant that the facts could not give rise to ostensible or apparent authority.
- In its interactions between itself and the borrowers, Streetwise was canvassing for itself.

The Court of Appeal further held that:

- Price J's reasoning was flawed because it elevated the organisational structure of the business and activity as a key factor in determining agency;
- the correct task was to ascertain the legal content of the consensual arrangement between the parties; and
- agency is to be determined by an analysis of the consensual legal relations between the parties, not merely by a conclusion based on the agent performing a function that is important, even necessary, to the operation or functioning of the principal's business enterprise.

In finding that Streetwise was not Tonto's agent, the Court of Appeal did not need to consider whether the 'fraud exception' to agency applied. The 'fraud exception' states that a principal is not imputed with the knowledge of facts known to an agent if the agent is committing a fraud on the principal and the information known to the agent is relevant to the fraud.

Although the borrowers were unable to 'pin' Streetwise's actions onto Tonto, the Court declared the loan agreements to be unjust pursuant to the **Contracts Review Act 1980 (NSW)**, amongst other things, on the basis that Tonto had put in place a business structure that was significantly responsible for Streetwise preying on the borrowers.

Comment

In this case, the terms of the introducer deed specifically provided that the introducer was not the agent of the originator. Yet the arrangement they put in place came close to being an agency relationship, which could have had disastrous consequences for the lender.

The decision highlights the need for parties to tread very carefully when regulating their relationship in circumstances where one party

performs functions on behalf of another and the rights of third parties are affected.

In addition, the parties to such arrangements should not assume that, if an agency is established and the agent is found to have committed a fraud, the 'fraud exception' will necessarily apply and defeat the agency.

Can bad advice lead to prosperity?

Written by John Dillon, Senior Associate and Faith Geraghty, Senior Associate
Tel 02 8273 9806 | 02 8273 9964
Email john.dillon@wottonkearney.com.au
faith.geraghty@wottonkearney.com.au

Introduction

In ***Prosperity Advisers Pty Ltd v Secure Enterprises Ltd T/A Strathearn Insurance Brokers*** [2012] NSWCA 192, the NSW Court of Appeal upheld the dismissal of proceedings that were instituted by a financial planning firm against its insurance broker. The financial planning firm alleged negligence, breach of contract and misleading and/or deceptive conduct in contravention of section 52 of the **Trade Practices Act 1974 (Cth)**.

At first instance in the Supreme Court, Ball J held that while each of those causes of action had been established, the financial planner had not established that it had suffered loss as a consequence of the broker's breaches of duty.

Background

Prosperity Advisors Pty Ltd (**Prosperity**) appointed Secure Enterprises Ltd (trading as "Strathearn Insurance Brokers") (**Strathearn**) to arrange professional indemnity insurance on its behalf. Strathearn identified various options for Prosperity to consider. It recommended a professional indemnity policy with QBE, whereby Prosperity would obtain cover for its accounting and financial planning services on terms including:

- a premium of $98,230;
- an indemnity limit of $2 million for claims arising out of the provision of financial planning services for any one claim, or $6 million in the aggregate; and;
- an excess or deductible of $40,000 for each and every claim.

Prosperity was concerned about how the deductible would apply in respect of multiple claims arising from a single failed investment product Prosperity recommended to its clients. In particular, Prosperity requested Strathearn's advice on whether, under the terms of the QBE policy, those claims would be treated as one claim, with only one deductible payable. Prosperity asked Strathearn:

> *"If I say 100 clients had an investment in a particular product of, say, $40,000 and it went bad and we were found to be negligent in advice, would this*

> *be seen to be one claim or 100 claims?"*

According to Prosperity, Strathearn advised:

> *"Under the QBE Policy, the example you have given would be treated as one claim, not separate individual claims".*

Prosperity was satisfied with that answer and instructed Strathearn to take the cover with QBE.

In 2006, a number of Prosperity's clients lost money in the collapse of Westpoint Corporation. About 160 clients joined a class action against Prosperity, suing it for $17 million. Prosperity notified QBE of a claim under its professional indemnity policy. QBE informed Prosperity that the claims could not be aggregated as they arose out of the specific, individual advice given to each client. QBE's view was that a $40,000 deductible should apply to each investor's claim.

Ultimately, Prosperity reached an agreement with QBE that QBE would contribute $4.25 million (out of a maximum limit of liability of $6 million) to a settlement pool, and Prosperity would contribute $800,000. Prosperity then issued proceedings against Strathearn for its contribution.

At first instance, Ball J held that:

- the advice given by Strathearn was negligent, misleading or deceptive, or constituted a breach of contract; but
- Prosperity's claim failed because it was unable to identify an alternative insurance cover available in the market at that time and for the same premium, that would have imposed a single deductible for all of the claims against Prosperity; and
- while Ball J accepted that Prosperity had lost an opportunity to procure insurance on more favourable terms, Prosperity had not proven that such loss was of some value.

Prosperity appealed the decision.

Prosperity's appeal

Prosperity submitted that Ball J had erred in three fundamental respects:

- His Honour had failed to identify the lost chance or opportunity for Prosperity to instruct Strathearn to negotiate with underwriters, to obtain the wording of the aggregation clause it sought, or terms as close to that wording as could be achieved;
- even if His Honour did correctly identify the relevant lost opportunity, he failed to assess whether there was a 1% or more chance of Prosperity securing the cover it sought. His Honour had therefore erred in his conclusion that the chance of Prosperity entering into the desired policy with any relevant insurer was speculative, as there was at least a 1% chance of such a policy being offered by at least one insurer; and
- even if Ball J correctly identified the chance lost and applied the correct test to ascertain the value of that lost chance, he made a number of factual errors, which led to the erroneous conclusion that Prosperity did not have a substantial prospect of acquiring a policy on the required terms.

Court of Appeal decision

McFarlan JA, Barrett JA and Tobias AJA unanimously upheld the decision of the Supreme Court. Their Honours held that:

- Ball J correctly understood Prosperity's primary case: that it would have been able to negotiate an amendment or endorsement to the standard terms of an insurer's

existing policy to incorporate an aggregation clause of the type that it sought. Ball J did not agree that Prosperity would have had a "substantial prospect of acquiring" the type of policy it required, a finding that the Court of Appeal endorsed;

- their Honours rejected Prosperity's contention that the relevant question in assessing whether there was more than a "speculative" chance of Prosperity obtaining the cover it sought was whether there was a 1% or more chance of this happening. Their Honours stated that:

  > *"Whether or not a lost chance has some value which is more than just speculative involves an evaluative judgment based on all the circumstances and, in particular, the evidence elicited to support the proposition that the prospects of the chance coming to fruition was sufficient to enable a positive rational assessment of it to be made".*

The Court of Appeal found that there was insufficient evidence that Prosperity could have obtained the cover it wanted. In particular, the Court found that in assessing the value of the chance lost by Prosperity as merely speculative, Ball J correctly took into account:

- the fact that in 2005, no other insurer in the market offered the type of aggregation clause that Prosperity required; and
- the lack of any credible evidence that any insurer could have been persuaded to amend its standard terms to offer the cover Prosperity required.

Their Honours held that Ball J's assessment of the factual matrix of the matter was appropriate, and that Prosperity's criticism of His Honour's assessment of the facts could not be sustained.

Comments

The decision makes it clear that damages will not necessarily flow from every negligent act. To successfully bring a claim for damages, a party needs to establish that the negligent advice caused the loss or damage. The decision also provides a useful discussion of loss of chance claims in the context of insurance brokers.

This was a 'near miss' for the broker. The broker was fortunate that the particular type of cover required was not available in the market at the relevant time, otherwise the consequences of the broker's incorrect advice could have been dire.

The case also reinforces some familiar risk management messages. There was a dispute as to the advice given by the broker, with the Court ultimately accepting the client's version, (which was supported by a file note). If the broker had checked the policy before responding, confirmed (or corrected) the advice in a follow-up email or made a full file note of the (correct) advice given, the problem may never have arisen.

Brokers and other professionals must resist the temptation to respond immediately to complicated questions, or at least check any 'off the cuff' advice after it is given and immediately correct any errors. Otherwise 'shooting from the hip' may damage the hip pocket! ■

Strategic aspects of a broker's duty

Written by John Dillon, Senior Associate and Lauren Fieldus, Solicitor
Tel 02 8273 9806 | 02 8273 9827
Email john.dillon@wottonkearney.com.au
lauren.fieldus@wottonkearney.com.au

Introduction

In ***Strategic Property Holdings No. 3 Pty Ltd v Austbrokers RWA Pty Ltd*** [2012] NSWSC 1570, Stevenson J of the Supreme Court of New South Wales considered the implied terms of the retainer between an insurance broker and a potential insured. His Honour found that it is the duty of a broker to give advice as to the availability of different types of cover; the nature of any exclusions and limitations; and the material risks associated with the level of cover proposed, having regard to the value of the insured property.

Background

Strategic Property Holdings No. 3 Pty Ltd (**Strategic**) brought a professional negligence claim against Austbrokers RWA Pty Ltd (**RWA**) in relation to an industrial special risks policy (**the Policy**). While the declared value of the relevant property insured under the Policy was $22 million, the sub-limit of liability for "*accidental damage*" under the Policy was only $200,000.

The roof of the property collapsed, causing significant damage. The insurer admitted liability to pay under the Policy, subject to the accidental damage sub-limit. This left an uninsured loss of approximately $1.9 million.

The decision

Stevenson J found that RWA had breached its retainer and duty of care, and caused loss to the Insured.

It was common ground that RWA's retainer included implied terms that in providing insurance-broking services RWA would:

- exercise all reasonable skill, care and diligence; and
- follow the instructions of the Insured.

The main issue to be determined was whether RWA's retainer also included an implied term that RWA would advise the Insured on:

- the availability of different types of cover;
- the nature of any exclusions and limitations; and
- the material risks associated with

the level of cover proposed, having regard to the declared value of the insured property.

Stevenson J found that this term should be implied. In reaching this conclusion, His Honour considered expert broker evidence to the effect that a broker should:

- gain an in-depth knowledge of a client's business and its risks;
- draw to a client's attention those areas where the client might be exposed;
- satisfy himself that the client understands the policy being offered; and
- go through the various sub-limits with the client.

His Honour considered the circumstances and knowledge available at the time of the policy renewal. The wording of the sub-limit was standard. Furthermore, it was generally known within the broking industry (although apparently not by the broker concerned) that "*accidental damage*" was capable of causing significant damage. It was also common knowledge that accidental damage sub-limits above $200,000 were available, albeit at an increased premium.

Ultimately, Stevenson J did not need to decide whether a broker's duty includes the aspects suggested by the expert evidence; however, His Honour found that RWA was required to, at the very least:

- read the policy and see what it said about the sub-limit; and
- advise Strategic that the sub-limit meant that if the Insured property suffered "*accidental damage*", the insurer would only pay up to $200,000, despite the declared value of the property being $22 million.

Here, RWA gave the insured no explanation of the sub-limit. RWA was of the opinion that Strategic should read the Policy schedule and work out the significance of the sub-limit for itself. Furthermore, the Broker had never read the definition of "*accidental damage*" under the Policy and had a flawed understanding of what it meant. The Broker was also unaware of alternative types of cover that offered much higher accidental damage sub-limits.

His Honour was satisfied that if the Broker had properly advised the Insured, the Insured would have requested that the Broker obtain cover with a sub-limit of $2 million, and found that the Insured would not have hesitated to pay the substantially increased premium.

The Broker alleged that the damage should have been excluded under the faulty designs exclusion of the Policy or, alternatively, that the sub-limit did not apply. His Honour found that the insurer had made the correct decision under the Policy but, regardless, this was irrelevant and did not affect the outcome of proceedings. Rather, the relevant question is what actually happened as a result of the Broker's conduct.

Finally, the Broker alleged that the Insured had failed to mitigate its losses by declining to participate in proceedings brought by the insurer against the engineers involved in constructing the faulty roof. Stevenson J rejected this argument. The Insured had already unsuccessfully challenged the insurer's decision under the Policy in the ACT Supreme Court so, in these circumstances, it was not unreasonable for the Insured to decline to participate in these costly, complex proceedings.

Ultimately, the Broker was held liable. The Insured was entitled to damages that are still to be agreed or assessed, but are likely to be at least $2 million.

Comments

This decision provides useful guidance on the terms that are likely to be implied into the retainer between a broker and its client. These are likely to include obligations to:

- advise the intending insured about policy sub-limits and their effect;
- ensure the client understands the cover being offered;
- advise the client about the terms, exclusions, limitations and risks associated with the proposed cover; and
- advise of the availability of alternative types of cover.

This case related to a renewal of an existing policy and reinforces the risk management message: that brokers must always carefully consider the terms of the policy being renewed and their application to the client's business. This duty doesn't just exist for 'new business'; simply 'rolling over' policies at renewal without proper consideration is not good enough.

In the context of risk management, it is also important to note that:

- in light of this judgment, brokers should consider their standard documents and any '*template*' advice regularly given about policy sub-limits; and
- the Broker's case in this matter was not assisted by the apparent absence of any file notes or written confirmation of the advice given. While file notes evidencing the Broker's incorrect advice clearly would not have helped, the Broker had no record of conversations with the insured where it expressed a preference for breadth and quality of cover over the cost of the premium. Because the Broker had nothing in writing, the Court preferred the insured's evidence on this point. Brokers – and all professionals – must take care to file notes or confirm in writing their dealings with clients. ■

Moving the goalposts: what constitutes a "claim"

Written by Raisa Conchin, Senior Associate and Dearne Matheson, Solicitor
Tel 02 8273 9912 | 02 8273 9960
Email raisa.conchin@wottonkearney.com.au
dearne.matheson@wottonkearney.com.au

Introduction

In May 2012, the Supreme Court of Queensland handed down its decision in ***Livesay v Hawkins*** [2012] QSC 122. The case involved a tenant's claim for personal injuries allegedly suffered due to the negligent maintenance of a rental property. The Court was asked to determine whether the tenant's letter of complaint to the letting agent amounted to a "claim" for the purpose of a claims made and notified professional indemnity policy.

Background

In April 2005, Mrs Livesay (the plaintiff) and her husband rented a house in Meadowbrook from the first and second defendants, the Hawkins. The third defendant, Mr Newman, operated a real estate agency under the name Ray White Waterford Marsden Crestmead. The Hawkins retained Mr Newman to manage the letting of the property.

On 25 April 2005, Mrs Livesay was injured when a pelmet above a door in the house fell and struck her. The following day, Mrs Livesay and her husband sent a letter to Mr Newman complaining about the state of the property and identifying some 17 repairs urgently required (**the letter of complaint**). The letter of complaint documented the incident which had occurred on the previous day, noting that Mrs Livesay had been injured and intended to seek medical assistance. In the letter, Mrs Livesay and her husband asserted that the Hawkins and Mr Newman would be liable for any personal injury claims arising from the poor living conditions. The letter indicated that they would refrain from taking action if the defects to the property were repaired, but expressly excluded from that course of action Mrs Livesay's entitlement to recover damages for personal injury caused by a dangerous fixture.

The claim

In September 2005, Mrs Livesay served a Form 1 Notice of Claim on Mr Newman under the **Personal Injuries Proceedings Act 2002 (Qld)**. Mrs Livesay alleged that she had been injured by the falling pelmet and that Mr Newman had failed to take reasonable care in maintaining the property.

Mr Newman held a professional indemnity policy with American Home Assurance Company (**the insurer**), for the period 24 July 2004 to 24 July 2005 (**the policy**). On 4 October 2005, Mr Newman submitted a notification to his broker, attaching copies of the Form 1 Notice of Claim and the letter of complaint. The broker passed on the notification to the insurer.

In November 2005, the insurer declined indemnity on the basis that no claim had been made against Mr Newman during the policy period, and otherwise on the basis that Mr Newman had not notified the letter of complaint during the policy period. Mr Newman subsequently issued a third-party notice, claiming that the insurer was liable to indemnify him in respect of any civil liability to Mrs Livesay.

The proceedings

The policy

The policy was a claims made and notified policy, expiring on 24 July 2005 (that is, after receipt of the letter of complaint, but before service of the Form 1 Notice of Claim). In the policy, "*claim*" was defined as "*any written demand … for compensation made against the insured but only in respect of the performance of Professional Services by the Insured*".

The exclusions were contained in paragraph 3 of the policy. Relevantly, exclusion 3.5 provided that the insurer was not liable to indemnify any claims for bodily injury of any person.

The arguments

Mr Newman argued that the letter of complaint constituted a "*claim*" within the meaning of the policy because the letter:

- was a written notification setting out the facts establishing liability;
- identified the injury that had been suffered; and
- asserted that Mr Newman was liable to Mrs Livesay for damages for personal injury.

The insurer argued that the letter of complaint did not demand compensation, but merely advised of Mrs Livesay's intention to seek medical advice. The insurer submitted that the letter:

- related to the poor condition of the premises;
- mentioned the prospect of Mr Newman's liability for personal injury claims not as the subject of a demand, but as a reason why it would be prudent to carry out repairs to the property; and
- contained an enigmatic reference to a "*personal injury claim that we are currently entitled to due to injury caused by dangerous fixture*". The insurer submitted that whatever that meant, it was not a demand for compensation.

The decision

Daubney J reaffirmed that whether or not a "*claim*" has been made will depend upon the particular policy wording. The terms of a contract of insurance must be construed objectively and in accordance with what a reasonable person would understand them to mean. Whether a "*claim*" has been made – within the meaning of that term in the relevant policy – is a question of substance, not of form.

Ultimately, His Honour held that the letter of complaint amounted to a "*claim*" within the meaning of the policy. The letter expressly asserted an entitlement on Mrs Livesay's part to recover against Mr Newman for her personal injuries. Although the assertion was made in the context of a letter about defects to the property, Daubney J took the view that it was sufficient

to amount to a demand or assertion of liability. It was immaterial that the demand or assertion of liability was co-mingled with complaints about the state of the property.

The insurer conceded that if the letter of complaint was found to be a "*claim*" under the policy, Mr Newman's failure to notify during the policy period would be remedied by the operation of section 54 of the **Insurance Contracts Act 1984 (Cth)** (**ICA**).

The insurer submitted that any entitlement to indemnity Mr Newman had was subject to the operation of exclusion 3.5 for claims for bodily injury. His Honour agreed, finding that although the letter of complaint was a "*claim*" under the policy, Mrs Livesay's claim was for damages for bodily injury within the ambit of exclusion 3.5. Accordingly, Mr Newman was not entitled to cover in respect of any civil liability to Mrs Livesay.

Comments

This decision is interesting because the Court found that the policy requirement for a "*written demand ... for compensation*" was satisfied by the mere assertion of a liability against the insured, even though that assertion did not include any express demand for recompense.

Historically, when considering whether or not a communication constitutes a "*claim*", insurers have looked for words that convey a demand for payment or other form of compensation. With this case, the goalposts have shifted. Now it seems that the relevant test is whether the third party has asserted a liability against the insured. This relaxing of the requirements arguably swings the pendulum in favour of insureds. Insurers may be called upon to accept "*claims*" that previously would have fallen short because of the absence of any express demand for payment or compensation. ■

Unprecedented market turmoils and unforseen risk – *Rubenstein v HSBC Bank PLC*

Written by Phillip Wotton, Senior Partner and Antonia Gleeson, Solicitor
Tel 02 8273 9939 | 02 8273 9978
Email phillip.wotton@wottonkearney.com.au
antonia.gleeson@wottonkearney.com.au

The recent decision of the English Court of Appeal in ***Rubenstein v HSBC Bank PLC*** [2012] EWCA Civ 1184 is a useful reminder of how important it is that financial advisors take into account an investor's personal objectives, financial situation and needs when recommending investments.

Background

In 2005, Mr Rubenstein sought to invest the proceeds of the sale of his home into a 'safe' investment, pending the purchase of another property within one year's time. He informed Mr Marsden, a financial advisor from HSBC Bank PLC (**the bank**), that he wanted an investment that provided a higher interest rate than a standard bank deposit, but that he could not accept any risk to his capital.

Mr Marsden recommended an investment in an AIG Premium Access Bond (an insurance-based product with AIG Life) (**the PAB**). Mr Rubenstein invested in the PAB on Mr Marsden's assurance that the investment was the same as cash deposited into one of the bank's accounts and carried no risk.

Mr Rubenstein was unable to locate a house to purchase and his funds remained invested in the PAB for three years. When the global market went into turmoil in 2008, Mr Rubenstein sought to withdraw his money and eventually received less than his initial capital investment. Mr Rubenstein sued the bank for breach of its statutory duties, as well as in contract and tort.

At first instance, Havelock-Allan QC J concluded that Mr Marsden's advice was negligent and also breached various statutory duties. However, His Honour also found that the loss suffered was not caused by the bank's negligence or breach of duties. Rather, it was caused by *"extraordinary and unprecedented financial turmoil"*, which was unforseeable and too remote to impose liability on the bank. Mr Rubenstein was awarded only nominal damages in contract.

Both parties appealed.

The arguments

Mr Rubenstein appealed against Havelock-Allan QC J's conclusion as to causation, foreseeability and remoteness. Mr Rubenstein submitted that it was incorrect to hold that no loss flowed from the established breaches, because he:

- had been told that the recommended investment carried no risk of capital loss because it was the same as a cash deposit;
- suffered a loss of capital for that very reason: that the investment was not the same as a cash deposit; and
- was therefore misled and suffered loss of a type which should have been foreseen.

The bank argued that it had no duty extending beyond Mr Rubenstein's own assessment that he would be unlikely to need the investment for more than one year. The bank therefore submitted that any losses suffered three years later, during the global financial crisis, were beyond the scope of its liability.

The decision

The Court of Appeal overturned the first instance decision and unanimously held that:

- the loss of capital from market movements was foreseeable and was a danger Mr Rubenstein had specifically sought to be guarded against;
- the connection between the advice and the loss was the combination of investing Mr Rubenstein's moneys into a fund that was subject to market losses, while at the same time misleading him by advising that his investment was the same as a cash deposit (when it was not);
- the cause of Mr Rubenstein's loss was the loss in value of the assets in which the PAB was invested. The advice and the loss were not disconnected by an unforeseeable event. The fact that the size of the loss may have been greater than could have been expected was beside the point;
- it was the bank's duty to protect Mr Rubenstein from exposure to market forces when he made it clear that he sought an investment that was without any risk; and
- the bank could have recommended a similar investment that was more conservative and carried lower risk.

In relation to the bank's argument, the Court of Appeal accepted it was a "*powerful submission*", but was not persuaded by it. There was a possibility that Mr Rubenstein might take more than one year to purchase a house. Mr Marsden should have made it clear if he had wanted to put a time limit on the bank's responsibility.

Comments

This case provides a clear warning to financial advisors and banks that courts may not regard losses sustained from unprecedented market events as unforeseeable and therefore not recoverable, even if the extent of the loss is unforeseeable.

The case also suggests that financial advisors will be held to an increasingly high standard in relation to providing financial advice in circumstances where a claimant gives clear instructions and the financial advisor fails to consider a client's investment needs and risk profile. ■

The Supreme Court of Victoria's Professional Liability List

Written by Cain Jackson, Partner and Emily Schneider, Solicitor
Tel 03 9604 7901| 03 9604 7912
Email cain.jackson@wottonkearney.com.au
emily.schneider@wottonkearney.com.au

On 1 October 2012, the Supreme Court of Victoria created a Professional Liability List (**the List**) within the Common Law Division of the Court's Trial Division. The List is managed by the Honourable Justice Macaulay.

Aims of the List

The List is intended to expedite the determination of professional liability claim matters by identifying the key issues in dispute at an early stage, and providing a framework for proceedings to be actively 'case managed' by the Court.

Eligibility

For a proceeding to be eligible to enter the List, the claim must involve a "*professional liability claim*"; that is, a claim for economic loss against a professional, for a breach of:

- duty (in tort or contract);
- a related statutory contravention (such as misleading and deceptive conduct); or
- equitable duties.

Parties can commence proceedings in the List, or the proceedings can be transferred on the Court's own motion or on application by any party.

The List will hear claims for breach of professional duty against:

- insurance brokers;
- legal practitioners (in non-regulatory matters only);
- financial advisors including accountants, financial planners and finance brokers;
- stockbrokers;
- liquidators and other insolvency practitioners (in non-regulatory matters only);
- real estate agents and conveyancers; and
- valuers.

Importantly, the following professionals are excluded from the List:

- medical and health practitioners, who can be dealt with in the General List;
- building, construction and engineering practitioners, who can

be managed in the Technology Engineering and Construction List; and
- taxation professionals, who can be managed in the Taxation List.

Key features

The List is significant because it introduces:

- the 'first directions hearing' as a very significant step in managing and conducting a professional liability claim; and
- a new third-party procedure in professional liability proceedings.

First directions hearing

A proceeding will be listed for its first directions hearing within 14 days of the defence being filed. The List requires parties to:

- retain counsel to appear (rather than allowing them to wait and retain counsel closer to the trial date);
- make oral submissions in relation to the nature of the dispute and the substantial questions to be tried; and
- have a grasp of:
    - the likely duration and mode of the trial;
    - the utility of early mediation;
    - the joinder of any further parties and/or claims between the parties;
    - whether apportionment is sought against any party or other person;
    - the scope of discovery;
    - whether expert evidence is appropriate, and the nature and scope of any likely expert evidence; and
    - the timing of all pre-trial steps including filing and serving evidence, affidavits or witness statements.

Third-party procedure

Under the List, defendants no longer have an automatic right to join third parties. Instead, an application by summons must be made which requires a fee to be paid as well as being supported by an affidavit setting out the basis for the joinder and exhibiting the proposed statement of claim.

In line with the List's intention to closely 'case manage' proceedings, a third-party application must be made at the "*earliest opportunity*". The Court will take any delay into account in exercising its discretion to allow the application and in determining the question of costs.

The new third-party procedure also requires the application to be served on all existing parties to the proceedings, as well as the proposed third party. The proposed third party must be served within sufficient time to allow them to file a notice of appearance and to appear at the application for joinder. Previously, a third party was unable to oppose being joined and would not necessarily be aware of the proceedings until service.

Implications

From the date they are served a statement of claim, defendant professionals – and their insurers and legal representatives – will be given less than two months to make sure they have a comprehensive grasp of all aspects of the proceeding.

For professional indemnity insurers, the likely impact of this significant time constraint is that:

- insureds will be under greater pressure, within a short period of time, to provide information that is relevant to the defence of the claim and to claims for indemnity under the relevant professional indemnity policy;

- higher upfront defence costs will be incurred, because counsel are engaged immediately and all aspects of the claim must be investigated;
- insurers will be under greater pressure to make a swift decision in relation to indemnity; and
- insurers will be under greater pressure to make an early assessment of whether indemnity issues may arise and whether they will require the appointment of separate defence counsel to protect the interests of the insured.

However, while the timing constraints of the List will apply additional pressure to insureds, insurers and their legal representatives, the List may also see professional liability claims processed through the Court system in a faster and potentially more cost-effective way. One positive in this regard is that the List encourages all parties to have a greater understanding of their prospective cases far earlier in the proceeding and – importantly from a resolution perspective – before participating in mediation.

Accordingly, while parties to professional liability claims managed by the List will face higher upfront costs and practical pressures, this may prove to be a more time- and cost-effective way of dealing with these proceedings.

Note: At the date of writing this article there were 36 active proceedings in the List. ■

Insurance Year in Review 2012
Directors + Officers / Financial Lines

On a precipice – directors, insolvent companies and their creditors

Written by Chris Busuttil, Senior Associate and Stephanie Young, Solicitor
Tel 03 9604 7913 | 03 9604 7929
Email chris.busuttil@wottonkearney.com.au
stephanie.young@wottonkearney.com.au

Introduction

In ***Westpac Banking Corporation v The Bell Group Ltd (in liq***) ***[No 3]*** [2012] WASCA 157, the Court of Appeal of Western Australia addressed a series of issues arising from the liquidation of the Bell group of companies. In litigation lasting 16 years and occupying over 400 trial days, the Court of Appeal provided guidance on the question of directors' duties in circumstances where directors are called on to restructure the debts of an ailing company.

In the process, the Court of Appeal sounded a warning for company directors and banks, reminding them to make sure certain creditors are not given undue preference during the course of a restructure and to ensure directors have proper regard for the interests of the company in negotiations with financiers.

In this regard, the director's duty to ensure that a company complies with its statutory obligations, and the obligation of a company not to prejudice the interests of creditors, have been elevated to a fiduciary obligation, imposing equitable obligations with consequences for directors and lenders alike.

Background

The Bell Group Limited (in liquidation) was the holding company of the Bell group of companies located in Australia and Europe (**Bell Group**).

In the mid-1980s, the Bell Group had various loan facilities with Australian and overseas banks. These loans were unsecured but supported by negative pledges.

During the stock market crash of October 1987, the Bell Group embarked on a program of asset sales and debt reduction. During 1988 and 1989, there was public speculation about the financial health of the Bell Group and the Australian banks sought repayment of the facilities they had granted the Bell Group. Consequently, the Bell Group continued its asset sales and debt reduction. By mid-1989, it became clear that the loans could not be repaid and the Bell Group and the banks entered into a series of negotiations aimed at restructuring the loans.

In 1990, the banks agreed to extend the Bell Group's loans in exchange for guarantees and security over some of the Bell Group's assets (**the transactions**).

The transactions included the Bell Group entering into deeds of guarantee and indemnity, mortgage debentures, share mortgages, and directions and authorisations concerning share mortgages and subordination deeds. In exchange, the banks extended the loan facilities until 30 May 1991.

The transactions also included an arrangement whereby debts between various Bell Group entities were subordinated to the claims of the banks. This included subordinating the rights of various bondholders behind other creditors, to only rank in priority to shareholders.

By April 1991, it was clear that the Bell Group was unable to repay the banks, and on 16 April 1991, the banks issued formal notices of demand on members of the Bell Group in respect of unpaid interest.

The banks proceeded to realise their securities and recovered about $283 million. Liquidators were appointed to the Bell Group in April 1991.

In 1995, the liquidators commenced proceedings against the banks challenging the way in which the securities were given and taken, seeking recovery of the proceeds of realisation, and consequential relief. The trustee for the bondholders later joined the action as a plaintiff.

The liquidators argued, *inter alia*, that when the transactions were entered into, the directors of the Bell Group knew or ought to have known that the main companies in the group were insolvent. The liquidators argued that this constituted a breach of the directors' duties.

The Court of Appeal agreed and ordered the banks to pay the liquidators approximately $2 billion.

This article focuses on the findings regarding the breach of directors' duties by the Australian directors of the Bell Group.

Issues

Insolvency

At first instance, it was held that the Bell Group companies were insolvent at the time they entered into the transactions. This was not disputed on appeal.

Directors' duties: a fiduciary obligation

It is well established that directors owe general law duties to act *bona fide* in the best interests of the company and for a proper purpose. However, the liquidators alleged those duties were of a fiduciary nature and included an obligation to act in the interests of creditors of an insolvent company.

If a fiduciary obligation was established, the liquidators were entitled to argue that the banks, in accepting the securities granted by the Bell Group, had knowingly received or assisted the directors in their breach consistent with the principles outlined in ***Barnes v Addy*** (1873–73) LR 9 Ch App 244.

All of the Court of Appeal judges agreed that these directors' duties were fiduciary in nature. However, they disagreed as to whether the directors had breached those duties.

Lee AJA focused on the rights of the creditors of an insolvent company. His Honour held that in this situation, the

creditors have a direct interest in the company in the sense that:

> "*an obligation will then be imposed on the company not to prejudice the interests of its creditors. The fiduciary duty of a director to act bona fide in the best interests of the company would require the director not to have the company ignore or attempt to defeat that obligation to creditors*".

His Honour looked at the conduct of the directors and found that they had breached this fiduciary duty by not considering the company's obligations to the creditors. His Honour found a breach of duty, notwithstanding evidence that suggested the directors had acted in the interests of the company by restricting its debts to keep it solvent.

Drummond AJA agreed with Lee AJA's analysis. For both Drummond AJA and Lee AJA, it was important that the directors failed to turn their minds to the interests of the creditors before entering into the transactions.

Carr AJA held that the directors had not breached their fiduciary duties. His Honour focused on the beliefs the directors held and the purpose underlying their decisions. He held that the directors had no real commercial alternative but to restructure the company, and that, in doing so, they acted in good faith.

Duty to act bona fide distinguished from the duty to act for a proper purpose

Lee AJA and Drummond AJA drew a distinction between a director's duty to act *bona fide* and in the interests of the company, and the duty to act for a proper purpose. The test for determining whether the duty to act *bona fide* had been breached was a subjective one; however, the duty to act for a proper purpose was to be determined objectively.

The distinction is an important one. While the duty to act *bona fide* and in the interests of the company imports notions of individual business judgment, the duty to act for a proper purpose has regard to broader considerations, including the interests of creditors. Arguably, the duty to act for a proper purpose permits the courts to adopt a more interventionist role and to pay less deference to the role of directors in managing a commercial enterprise.

According to Lee AJA and Drummond AJA, on any objective view of the directors' conduct, it was clear that the sole purpose of the transactions was to provide the banks with security over all of the assets of the insolvent group so the banks could control the realisation of the assets of the Bell Group and apply the proceeds in priority to debts due to other creditors. That could not be a permissible purpose of the company.

Knowing receipt and assistance (application of the rule in *Barnes v Addy*)

In *Barnes v Addy*, Lord Selborne LC referred to two grounds (or limbs) on which third parties to a transaction (in this case, the banks) can be held responsible for receiving the benefits of the transaction as constructive trustees.

The first ground occurs in circumstances where the third party receives and becomes chargeable with trust property. This ground has been referred to as "*the first limb*" and is also referred to as "*knowing receipt*".

The second limb arises in circumstances where the third party assists in a dishonest or fraudulent design on the part of a trustee or party that owes a fiduciary obligation (in this case, the directors of the Bell Group). This ground has been referred to as "*the second limb*" and is also referred to as "*knowing assistance*".

Both Lee AJA and Drummond AJA found that the banks satisfied both limbs and, accordingly, received the assets of the Bell Group as constructive trustees.

There was some debate about the extent of knowledge required on the part of relevant participants to establish "*knowing receipt*" and "*knowing assistance*".

The majority decided that the first limb extends beyond cases involving trustees to cases involving breaches of duty by fiduciaries and, as such, extended to dispositions of company property made by a director in breach of his or her fiduciary duty.

Importantly, the majority found that no distinction should be drawn between the knowledge required to establish the first and second limbs of the rule.

In this regard, there was some debate about the scope of the second limb and whether, as the banks contended, the liquidators needed to demonstrate that the banks actually knew that the directors were acting improperly by entering into the transactions.

The majority of the Court did not think it was necessary to establish the banks' conscious knowledge of any "*dishonest or fraudulent*" design by the directors.

To establish the necessary wrongdoing on the part of the directors, it was sufficient to demonstrate that there had been a breach of a fiduciary duty by the directors, and that the breach was not trivial. It was not, according to Drummond AJA, necessary to establish "*some element of moral reprehensibility*" to satisfy the second limb.

Comments

This judgment is important for company directors who face financial distress within a company. The judgments of Lee AJA and Drummond AJA have a strong focus on the importance of the directors of a distressed company considering the creditors' rights as a whole when restructuring a company's debts.

The Court of Appeal has signalled that the courts intend to adopt a more interventionist approach to directors' conduct. Drummond AJA explained the reason for this as follows:

> "*Changes in the organisation of large corporations that occurred during the 20th century and changes in ideas about the proper role of corporations in society, particularly large and powerful ones, by those controlling them and by the public, may explain the change from judicial restraint to increased intervention in corporate decision making.*"

Banks will now need to tread more carefully in their negotiations with company directors. While it may be going too far to suggest that banks adopt the same inquiries as directors in respect to the position of the company's existing creditors, they will not be able to turn a blind eye to any evident financial distress and the consequences for creditors of the company.

The banks in this case have applied for special leave to appeal to the High Court. It therefore remains to be seen whether the High Court will endorse the views expressed by the Court of Appeal. ■

Repercussions from the global financial crisis – ratings agency and financial advisors held to account

Written by Heidi Nash-Smith, Senior Associate
Tel 02 8273 9975
Email heidi.nash-smith@wottonkearney.com.au

In 2012, the Federal Court of Australia handed down two important decisions that have wide implications for the liability of financial product issuers, financial advisors and ratings agencies, in respect of losses suffered by their clients or investors as a result of failed investments.

In ***Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)*** [2012] FCA 1028 (***Lehman Brothers***), Rares J found that Grange Securities (**Grange**), a wholly owned subsidiary of Lehman Brothers, breached its fiduciary duty and engaged in misleading and deceptive conduct in giving financial and investment advice to local councils. This was the first Australian decision on liability arising from failed synthetic collateralised debt instruments following the global financial crisis (**GFC**).

The ***Lehman Brothers*** decision was closely followed by ***Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)*** [2012] FCA 1200 (***Bathurst v LGFS***), also concerning the sale of complex synthetic instruments.

Local Government Financial Services Pty Ltd (**LGFS**) was the defendant in three separate but related claims brought by 13 local councils in New South Wales, in respect of investment advice provided to them by LGFS regarding complicated structured products known as the Rembrandt Notes (**the Notes**). The Notes were created by ABN AMRO, were assigned a 'AAA' rating by Standard & Poors (**S&P**) and were sold to the councils by LGFS.

The councils alleged that:

- the Notes were fundamentally ill-suited for their investment needs and LGFS should not have recommended or sold them to the councils; and
- the Notes should never have been given a 'AAA' rating.

LGFS also made a claim against ABN AMRO and S&P for the losses it suffered

as a result of its own investment in the Notes. LGFS purchased $45 million worth of Notes from ABN AMRO, selling $17 million to the councils that were parties to the proceedings, and retaining $26 million.

On 5 November 2012, Jagot J found that:

- LGFS, S&P and ABN AMRO were each liable for a third of the councils' losses. LGFS was held liable for misleading and deceptive conduct and negligent misrepresentation in its advice regarding the Notes, and was also found to be in breach of its fiduciary duties to the councils; and
- S&P and ABN AMRO were equally liable to compensate LGFS in respect of its own losses arising from the Notes.

This is the first case in the world where a ratings agency has been held liable to investors for the reliability of its ratings. Jagot J was persuaded that a reasonable ratings agency would not have rated the Notes 'AAA' and consequently S&P's 'AAA' rating was misleading and deceptive. She also found that ABN AMRO was knowingly concerned in S&P's misleading and deceptive conduct by its deployment of the 'AAA' rating and its own representations as to the meaning and reliability of that rating, which were not true and which ABN AMRO knew not to be true at the time they were made.

Implications

The following issues arising from the decision in ***Lehman Brothers*** and ***Bathurst v LGFS*** will also have implications for other disputes arising out of the GFC.

Both Grange and LGFS were found to owe, and be in breach of, fiduciary duties to the councils. Grange and LGFS each acted as a financial advisor to the councils and portrayed themselves as having that role. By doing so, they "*voluntarily assumed the well-established obligations such a person owes to its clients to the extent that it did not exclude those obligations contractually*" (***Lehman Brothers*** at 733). The obligations Grange and LGFS were held to owe were:

- not to obtain any unauthorised benefit from the relationship with the client, unless the financial advisor has the informed consent of the client; and
- not to be in a position where their interests or duties conflict, or where there is a real or substantial possibility of conflict with the interest of the client;

The respondents in both matters argued that the councils were guilty of contributory negligence by failing to take reasonable care of their interests. Neither judge found any contributory negligence by the councils. In:

- ***Lehman Brothers***, Rares J found that Grange was dealing with council officials he described as "*careless*" (at 462), "*financially quite unsophisticated and completely out of his depth*" (at 483), and "*uninformed*" (at 491). The council officers' relative unsophistication meant they were entitled to, and necessarily would have to, rely on the skilled advice they had received and the rating assigned by the ratings agency. We understand that this will be the sole point of appeal by the Lehman Brothers liquidators; and
- ***Bathurst v LGFS***, Jagot J found that "*[t]he reality is that the councils were told by their trusted advisor and confidant ... that they had the opportunity to invest in a safe, suitable, low-risk investment which carried a AAA rating*" (at 3345(3)).

Contributory negligence did not even extend to LGFS, clearly a most

sophisticated investor, which was able to recover the entirety of its own investment losses from S&P and ABN AMRO.

It may be difficult for financial service providers, investment banks and ratings agencies to rely on disclaimers to absolve themselves of liability. In ***Lehman Brothers***, Rares J held that the disclaimers used by Grange did not amount to informed consent for the purpose of releasing Grange of its fiduciary duties, nor did they relieve Grange of its contractual and tortious duty to exercise reasonable care and skill.

Both decisions charted new territory and provide valuable guidance as to how Australian courts will approach claims against financial product issuers, financial advisors and ratings agencies regarding failed investments following the GFC. ■

Developments in valuer's neligence

Written by Raisa Conchin, Senior Associate and Claire McGovern, Solicitor
Tel 02 8273 9921 | 02 8273 9826
Email raisa.conchin@wottonkearney.com.au
claire.mcgovern@wottonkearney.com.au

Introduction

The arena of valuer's negligence has seen some interesting developments in the past year. We have summarised three significant cases involving lender's contributory negligence, valuation methodology and retrospective valuation methodology respectively. The other point of interest is the trend of lenders commencing proceedings against the individual valuer as well as the relevant valuation firm.

Valcorp v Angas Securities [2012] FAFC 22

The lenders in this case relied on a valuation of $3.6 million when they advanced loan funds of $2.3 million to the borrowers. The loan was secured by a first mortgage over the relevant property. When the borrowers subsequently defaulted, the lenders sold the property for $1.7 million and sued the valuer to recover the shortfall. The lenders alleged that the valuer had negligently over-valued the property.

At first instance, the trial judge found that the valuer had been negligent and engaged in misleading and deceptive conduct in preparing the valuation. The lenders were awarded damages to reflect the shortfall on the sale of the property and the lost opportunity to have made other loans. However, the award was discounted by 25% on the basis of the lenders' contributory negligence. The trial judge found that the lenders had failed to carry out a proper assessment of the borrowers' capacity to repay the loan, despite the lenders' arguments that serviceability was a secondary consideration given the level of security.

On appeal, the valuer argued for a finding of 100% contributory negligence on the basis of the trial judge's finding that – had the lenders property assessed serviceability – the loan would never have been made. The lenders appealed the finding of contributory negligence.

The Court of Appeal dismissed the lenders' appeal, concluding that there was "*sufficient basis*" for the trial judge's finding that the lenders had failed to properly assess serviceability. However, the Court did not accept the valuer's argument that contributory negligence should be increased to 100%. The Court found that there was nothing to suggest that the lenders had been any more negligent than the valuer, so each party was equally liable. Contributory negligence was re-assessed at 50%.

The decision is of interest for two reasons. Firstly, the discount of 50% is the highest allowance to date for contributory negligence in the arena of valuer's negligence. It reflects the Court's preparedness to hold lenders to account for their failings in the loan assessment process. This is particularly relevant given that many valuer's claims concern valuations provided in 2007 and 2008 – a period of enthusiastic lending and relaxed application of lending guidelines and policies. Secondly, the decision signals that lenders will be penalised for failing to properly assess serviceability, even where the lending model is premised on obtaining adequate security to protect against the risk of borrower default.

Provident Capital Limited v John Virtue Pty Ltd (No 2) [2012] NSWSC 319

This case involved the valuation of a development site in Sydney. The valuer prepared two separate valuations, one in December 2004 and another in October 2005. The first valuation was for $12 million, which the lender relied on to advance funds of about $8 million to the borrower. The second valuation was obtained after the borrower defaulted on the loan; the valuer ascribed a value of between $6.25 million and $7 million.

The issue was the methodologies used by the valuer. The valuer used only one methodology in preparing the first valuation: a hypothetical development feasibility analysis. He did not use the direct comparison method because there were insufficient comparable sales in the previous 12–18 months. In the second valuation, the valuer used both methodologies (the hypothetical development method and the direct comparison method).

The lender did not sell the property until February 2007, when it suffered a shortfall on the sale. The lender subsequently commenced recovery proceedings against the valuation firm and the individual valuer, alleging that the difference between the first valuation and the second valuation was evidence of negligence, and that the valuer had been negligent in only using one method in the first valuation.

The Court found against the lender on both counts. The Court rejected the proposition that the difference between the two valuations signified negligence, finding that the market had slowed down by the end of 2005. Further, it was inappropriate to compare the two valuations in circumstances where they had been prepared on different instructions (the first valuation had been prepared on the basis of pre-sales, but the valuer was instructed to disregard the pre-sales for the purpose of the second valuation).

The Court otherwise rejected the lender's submissions on methodology. The Court held that the first valuation was within the reasonable range, and that the valuer was entitled to use only the hypothetical development method because there were insufficient comparable sales to also use the direct comparison method. The Court accepted the valuer's evidence that to rely on outdated sales would have compromised the exercise.

The lender was dealt a final blow when the Court concluded that its reliance on the first valuation was unreasonable. The valuer had stressed the importance of verifying the bona fides of the pre-sales, but the lender relied on the first valuation in circumstances where it knew that 17 of the 24 contracts were in trade dollars.

The decision is notable because the Court declined to make a finding of negligence, despite the valuation having decreased by almost 50% in about 10 months. The market had slowed and the second valuation was prepared on different instructions.

The decision otherwise indicates that, where there are no comparable sales, a valuer may be entitled to disregard the direct comparison method and use the hypothetical development method as the single method of valuation.

Propell National Valuers (WA) Pty Ltd v Australian Executor Trustees Limited [2012] FCAFC 31

This case confirms that a valuer cannot rely on sales evidence subsequent to the date of valuation to defend the accuracy of the valuation. Consideration of whether or not the valuer was negligent (and/or engaged in misleading and deceptive conduct) is limited to the sales evidence available at the date of the valuation.

The facts involved a property in Perth, which was valued at $1.6 million on 3 April 2007. The lender alleged that it relied on the valuation in advancing funds of over $1.2 million to the borrower, who subsequently defaulted. The lender sold the property as mortgagee in possession for $980,000, and sued both the valuation firm and the individual valuer to recover its outstanding losses.

At first instance, the trial judge was required to assess each party's valuation evidence. The opinion of the lender's expert was that, based on the sales evidence available at the date of valuation, the property had been worth about $1 million at the relevant date. The valuer's expert evidence was to the effect that the property had been worth $1.475 million. The valuer's expert relied on sales occurring before and after the date of valuation.

The trial judge held that the valuer's expert should not have had reference to any sales occurring after the date of valuation because these sales would not have been available to the valuer when he prepared the valuation. The Court determined that the market value of the property at the relevant date was in the order of $1.2 million, concluding that the valuation of $1.6 million had been a "*gross over-valuation*", and that the valuer had been negligent and had engaged in misleading and deceptive conduct. The judge did say that a valuation of up to $1.35 million would have been acceptable, allowing a "*generous*" 15% tolerance on the true value.

On appeal, the valuer argued that it was permissible to have regard to sales evidence post-dating the valuation date on the basis that the relevant question was the actual value of the property at the valuation date. The Court of Appeal rejected the proposition, finding that the relevant question was whether or not a competent valuer would have ascribed a value of $1.6 million to the property when preparing the valuation (Gilmour J dissenting). The exercise in determining liability was necessarily limited to the evidence available to the valuer when he prepared the valuation. The valuer's appeal was dismissed on this basis.

In a dissenting judgment, Gilmour J preferred the valuer's argument. His Honour considered that it was permissible to have regard to sales evidence post-dating the valuation date because the relevant question was the actual value of the property as at the relevant date. His Honour concluded that the trial judge had incorrectly formulated the question by reference to the valuer's approach or reasoning process in arriving at the valuation. ■

Bridgecorp Appeal

Written by Patrick Boardman, Partner
Tel 02 8273 9941
Email patrick.boardman@wottonkearney.com.au

On 20 December 2012, the New Zealand Court of Appeal in ***Steigrad v BFSL 2007 Limited & Ors***[1] overturned the original judgment of Lang J[2] which, since September 2011, had caused significant uncertainty in the liability insurance market in both New Zealand and Australia (see our November 2011 case note "*Steigrad & Ors v Bridgecorp Limited & Ors*" on the original **Bridgecorp** decision).

The New Zealand Court of Appeal held that the statutory charge on insurance monies created by section 9 of the New Zealand **Law Reform Act 1936** (**LRA**) does not prevent an insurer from paying defence costs under a Directors & Officers Insurance Policy (**D&O Policy**) because:

- the section 9 charge relates to "… *all insurance money that is or may become payable in respect of [the insured's liability to pay any damages or compensation]…*"
- payment of defence costs under a single aggregated limit (which includes defence costs) is not "*in respect of*" the Insured's liability. Consequently section 9 does not apply to payment of defence costs; and
- section 9 cannot operate to interfere with or suspend the performance of mutual contractual rights and obligations under the policy, such as payment and receipt of defence costs.

The first instance decision

At first instance, Lang J held that the section 9 statutory charge:

- applied when the potential claimants' cause of action accrued, which was said to be when Bridgecorp entered administration and could not therefore repay its obligations;
- applied to all insurance money under the D&O Policy (having a limit of liability of NZD$25 million), in circumstances where the potential claim was in excess of NZD$450 million; and
- prevented the directors from having access to the D&O Policy funds in order to meet their ongoing defence costs.

The effect of that decision created enormous uncertainty in the liability insurance market in New Zealand, as well as in Australia (given that legislation in NSW, the ACT and the Northern Territory all have a similar provision to section 9), as it meant that insurers could:

- be prevented from paying defence costs under a policy, and any defence costs that are paid could be ex gratia payments; and
- have difficulty paying any settlement or judgment pending

1 CA674/2001 (20 December 2012).
2 HC Auckland CIV – 2011 – 204 – 611 – 15 September 2011.

the determination of any prior charges or claims, which could mean that the insured would have to fund any settlement or judgment pending such determination.

The Court of Appeal's reasoning

The Court of Appeal's reasoning was:

- first to give effect to the words "*in respect of that liability*" in section 9, finding that:
  - "*The object and purpose of s9 is to provide a charge over money payable by an insurer to indemnify an insured party against his liability on a claim by a third party. It does not provide a charge or security over insurance money that is not payable in settlement or discharge of that liability*" [29]; and
  - there is a distinction between insurance money paid "*in respect of*" defence costs and money paid "*in respect of*" an insured's liability.
- second to look at the intent and purpose of section 9, finding that:
  - it has long been recognised that section 9 takes effect subject to the terms and conditions of the relevant policy (that is, it is only applicable if the policy responds, and is then subject to the limit of liability); and
  - section 9 was not enacted to have the unsatisfactory consequence of insurers being unable to fulfil their contractual obligations (for example, paying defence costs).

We consider that the Court of Appeal's conclusion is correct and applies a commercial interpretation of section 9 that accords with the intent of that section: to ensure that insurance money payable to the insured in respect of the insured's liability is made available to the claimant.

However, we consider that the judgment is not outside potential challenge on the basis that:

- it does not necessarily give effect to the words "*or may become payable*" in section 9(1). It is apparent that payment in respect of defence costs is not a payment in respect of an insured's liability; however, the words "*or may become payable*" arguably only require that there be a future possibility that such insurance money may be payable in respect of that liability. This would mean that the charge would apply not only to money that is payable in respect of that liability, but also to money that "may " become payable; and
- the Court of Appeal applied limited reasoning for its conclusion that section 9 was not intended to interfere with the parties' contractual obligations, which could arguably be said to be based more on "*the vibe*" of the legislation rather than any express intent.

The Court of Appeal also made an important finding [45] that:

- the statutory charge had not crystallised but remained contingent[3];
- the charge would not crystallise unless and until QBE became legally liable to meet any damages or compensation that Steigrad must pay; and
- crystallisation of that charge required the establishment first of the insured's liability to the claimant, and second the insurer's liability to the insured. In the meantime, the amount of the insurer's contingent liability, if any,

3 This was an issue raised in ***Bailey ats NSW Medical Defence Union Ltd 1995*** (132 ALR 1 per McHugh and Gummow JJ).

was unknown.

That finding is critical to the second effect of the original **Bridgecorp** decision (see above) regarding an insurer's ability to pay settlements and judgments. If the charge only crystallises when the two resultant liabilities are determined (that is, the liabilities of both the insured and insurers) insurers would be able to continue to pay liability on a 'first past the post' principle[4] without first having to determine all outstanding claims or charges.

Overall effect

The Court of Appeal's decision provides greater certainty in New Zealand and greater comfort to Australian insurers and insureds, since the Court of Appeal's decision will be most persuasive authority to an Australian court. However, until a superior Australian court determines the issue, there remains uncertainty as to how an Australian court may interpret relevant legislation in NSW, the ACT and the Northern Territory.

The issue has been sought to be put before the NSW Courts on a number of occasions, without any eventual judgment occurring. The next application is before the NSW Court of Appeal on 18 March 2013, in respect of purported statutory charges in litigation arising out of the collapse of Great Southern Pty Ltd. The issues to be considered by the NSW Court of Appeal will include an insurer's ability to advance defence costs, and the priority of any charges that arise.

Pending determination of the issue in Australia, both insureds and insurers should continue to adopt caution and recognise that this issue is not dead, yet. ■

4 ***Cox ats Bankside*** [1995] to Lloyds' Rep 437.

High Court rules on directors' duties - James Hardie and Fortescue cases

Written by Patrick Boardman, Partner and Jonathon Lees, Senior Associate
Tel 02 8273 9941 | 02 8273 9942
Email patrick.boardman@wottonkearney.com.au
jonathon.lees@wottonkearney.com.au

James Hardie

Introduction

The High Court held that seven former non-executive directors of James Hardie approved a misleading ASX announcement regarding the James Hardie Group's restructure in 2001, which separated its asbestos liabilities from its trading companies. The High Court also held that James Hardie's general counsel and company secretary (**Mr Shafron**) was acting as an "*officer*" when he failed to give adequate advice in relation to the misleading ASX announcement and limitations of an actuarial report.

In upholding the appeal of the Australian Securities and Investments Commission (**ASIC**) in ***ASIC v Hellicar & Ors*** [2012] HCA 17 (3 May 2012) and dismissing Mr Shafron's appeal in ***Shafron v ASIC*** [2012] HCA 18 (3 May 2012) the High Court has:

- reinforced the requirement for non-executive directors to take a diligent and intelligent interest in their independent assessment of information put to them, rather than merely relying on management;
- highlighted the probative value of approved board minutes;
- given guidance on ASIC's duties to conduct litigation fairly; and
- held that a person acting as a company secretary and general counsel acts as an officer of the company.

Facts

In 2001, the James Hardie Group restructured its business to "*ring fence*" its asbestos liabilities. Two subsidiaries with the greatest exposure to asbestos claims were separated from the Group and the Medical Research and Compensation Foundation (**MRCF**) was established to fund compensation to asbestos claimants.

At a James Hardie Board meeting on 15 February 2001 (**the Board Meeting**), the Board approved the

separation proposal. The minutes of the Board Meeting (**the Minutes**) record that the Board also approved a draft announcement to the ASX (**the draft ASX announcement**) outlining the separation proposal. Importantly, the proposal provided that the MRCF would have sufficient funds to meet all legitimate asbestos claims and was therefore "*fully funded*". The next day, a finalised ASX announcement was made (in a similar form to the draft ASX announcement, including the reference to "*fully funded*"). This announcement was ultimately shown to be incorrect as there were not sufficient funds to meet all claims.

Supreme Court of NSW decision

The Supreme Court of NSW originally ruled that the directors had approved the misleading ASX announcement by reason of their approval of the draft ASX announcement (see the Wotton + Kearney case note "*High Court Rules - James Hardie Directors Approved Misleading ASX Release*", dated May 2012).

Gzell J held that:

- the draft ASX announcement was approved at the Board Meeting;
- the draft ASX announcement was false and misleading because of the reference to the MRCF having sufficient funds to meet all legitimate asbestos claims, and being "*fully funded*";
- Mr Shafron failed to advise the Board about the limitations of the economic model supporting the MRCF's funding, and also failed to consider whether JHIL was required to disclose to the ASX a deed of covenant and indemnity between JHIL and its two subsidiaries (**DOCI**); and
- the nine directors and one officer had breached section 180(1) of the **Corporations Act 2001 (Cth)** (**Corporations Act**).

The seven non-executive directors argued that at the Board Meeting, they did not approve and would not have approved the draft ASX announcement, however Gzell J found that the draft ASX announcement was discussed and approved at that meeting, because the Minutes referred to that as having occurred and the Minutes were subsequently approved by all of the directors.

Court of Appeal decision

The Court of Appeal overturned Gzell J's findings against the seven non-executive directors, on the basis that ASIC had failed to discharge its onus of proof and establish that the draft ASX announcement had been approved at the Board Meeting. The Court of Appeal relied on the fact that:

- no witnesses were called who could specifically recall the approval of the draft ASX statement;
- ASIC failed to call JHIL's principal legal advisor, Mr Robb, who was present at the Board Meeting; and
- mistakes in the Minutes indicated that they may not be a reliable record of what had occurred.

However, the Court of Appeal upheld the finding that Mr Shafron had failed to advise the Board about the limitations in the economic models projecting future asbestos liabilities and about the Board's duty to disclose the DOCI.

High Court decision

ASIC v Hellicar & Ors

It was not disputed that the draft ASX statement was false and misleading, or that if the directors had approved it (as alleged by ASIC) the approval would have amounted to a breach of the directors' duties.

Accordingly, the issues before the High Court were:

- whether the Court of Appeal was correct in determining that the directors did not approve the draft ASX statement at the Board Meeting; and
- whether ASIC should have called Mr Robb to give evidence as part of its duty to conduct litigation fairly and, if it should have done so, the effect of that failure.

In relation to the first point, the High Court held that the ultimate issue was:

"*... having regard to the nature of ASIC's claims and the respondents' defences, the nature of the subject matter of the proceeding and the gravity of the matters which ASIC alleged, did ASIC establish, on the balance of probabilities, that (as the minutes recorded) the [draft ASX announcement] was tabled and approved by the board ...*".

In rejecting the directors' argument that they did not approve the draft ASX statement, the High Court relied heavily on the Minutes which were a formal and near contemporaneous business record and which, importantly, were approved by each director as being correct.

Along with Mr Baxter's evidence that he took the draft ASX announcement to the Board Meeting, the evidentiary effect of the Minutes was that the draft had been approved. Accordingly, without evidence to the contrary, ASIC had proved its case by tendering the Minutes.

In addition, all the directors maintained that they would not have approved the draft ASX announcement if it had been put before them. However, each director had ultimately been provided with a copy of the finalised ASX announcement (which referred to "*fully funded*") and not one of them had objected to its content.

The directors advanced three specific arguments, which they maintained inferred that the draft ASX announcement was not approved.

Firstly, the directors argued that because the draft ASX announcement was amended after the Board Meeting, this implied that it had not been tabled or approved by the Board at the meeting. The High Court disagreed, noting that the amendments were textual rather than substantive, and that both versions of the announcement conveyed identical misrepresentations regarding adequacy of funding.

Secondly, the directors proposed that the Minutes were an unreliable record because they were demonstrably inaccurate in some respects. As none of the inaccuracies related to the separation proposal or the draft ASX statement, the High Court ruled that merely because some parts of the Minutes were inaccurate did not necessarily imply that other parts were also inaccurate.

Thirdly, because ASIC did not call Mr Robb to give evidence the Court of Appeal was correct to conclude that ASIC had not proved its case. The High Court agreed that ASIC was under a duty to conduct litigation fairly; however, the relevant issue was the nature of the evidence Mr Robb was likely to have given, rather than the evidence he might theoretically have given. Further the High Court considered that the notion of unfairness required that the directors were either denied an advantage, or subjected to a disadvantage. The former had not been identified and the latter had not been established.

In addition, the effect of any unfairness arising from a failure to call a relevant witness could only ever raise the issue of a possible miscarriage of justice, which could require a new trial. It could not, as the Court of Appeal had found, justify discounting the cogency of other evidence ASIC had led at trial. In any event, the High Court concluded that

there had been no unfairness in not calling Mr Robb because there was no basis for inferring that Mr Robb would have given evidence favourable to the directors.

Shafron v ASIC

Mr Shafron argued that he was acting in his capacity as a general counsel rather than as a company secretary (and therefore not acting as an officer) when he advised the Board in relation to the restructure and the draft ASX announcement.

The High Court rejected Mr Shafron's submissions and held that because his job description was both company secretary and general counsel, all tasks were performed in that joint role and it was not possible to divide his duties and responsibilities. Further, section 180(1) requires an officer to discharge all of his duties with due care and diligence – not only statutory duties – so it was irrelevant if some of Mr Shafron's duties to advise JHIL arose from his position as general counsel.

In any event, the High Court ruled that Mr Shafron was also acting as an officer because he participated in making decisions that affected the corporation's whole business (or a substantial part thereof), which brought him within the definition of "*officer*" under section 9 of the Corporations Act. The High Court provided useful guidance on the statutory criteria for being classified as an "*officer*". Notably, it did not matter that Mr Shafron was not involved in making the ultimate decision, as he had sufficient participation in the decision-making process to be deemed an "*officer*".

Summary and effect

Although the High Court did not state this expressly, its endorsement of Gzell J's findings reinforces the importance of non-executive directors' duty to independently and properly assess information put before them, particularly regarding critical strategic announcements. They cannot blindly rely on advice from management which was also a central theme of the ASIC prosecution of the Centro directors (see the Wotton + Kearney case note on ASIC's prosecution of Centro, "*Blind Freddy or a Standard of Perfection*", dated June 2011.)

The judgement highlights that unless there is something more than inferential evidence to the contrary, approved board minutes will have substantial probative value as a business record of events that occurred at that board meeting. As such, prior to approving minutes, directors should ensure that the minutes accurately reflect and record the events of the meeting. This may mean directors have to take their own notes or request that board meetings be recorded, in order to resolve any disputes.

The High Court also gave guidance on ASIC's duties in bringing civil penalty proceedings. It confirmed that the failure to call a witness is not necessarily unfair and, in any event, does not impeach other evidence led at trial. However, ASIC's failure to call a witness may be a ground for a miscarriage of justice, depending on the facts.

A joint company secretary and general counsel will often be acting as an officer when giving legal advice to the company. Perhaps more significant is the High Court's finding that, by preparing draft documents for board approval, a general counsel may be participating in making decisions that affect the corporation's whole business or a substantial part thereof and may therefore be acting as an officer for the purposes of section 180(1) of the **Corporations Act**. This aspect of the decision has no doubt unsettled many in-house counsel, and could also extend to any executive undertaking equivalent preparatory tasks utilised in board decisions. This could significantly expand the number of people who may be deemed "*officers*" of a company and thereby subject to the relevant obligations and duties (including punitive provisions) of the **Corporations Act**.

Forrest v ASIC; Fortescue Metals Group Ltd v ASIC [2012] HCA 39

In October 2012, the High Court upheld an appeal by Andrew Forrest and Fortescue Metals Group (**FMG**) against the Full Federal Court's finding that they each breached the misleading and deceptive provision of the **Corporations Act**. The alleged breaches occurred when they disclosed to the market that binding "*contracts*" had been entered into with Chinese companies, for building, financing and transferring the railway, port and mine for the proposed Pilbara Iron Ore and Infrastructure Project in Western Australia.

In overturning the decision of Edmonds J, the Full Federal Court held that:

- the agreements with the Chinese companies were not binding contracts;
- no reasonable person could have considered them to be binding contracts;
- by stating that the agreements were binding contracts, Forrest and FMG were guilty of misleading and deceptive conduct, and breach of their continuous disclosure obligations; and
- the "*business judgment rule*" defence (which is available under the **Corporations Act** to a director who acts in good faith in the best interests of the company), was not applicable because noncompliance with the **Corporations Act** could never be a "*business judgment*".

The High Court held that:

- the statements were not misleading. In establishing whether the statements were misleading and deceptive, ASIC had to prove the effect of the statements on the intended audience, and that the effect was misleading; and
- the effect on the relevant audience – in this case the present and possibly future investors – had to be considered and read in that context (that is, not in strict legal terms). The statements would be read as a statement of what the parties understood they had done and what they intended to happen in the future.

Immediately following the decision, the Australian Securities Exchange (in conjunction with ASIC) published a new Guidance Note entitled "*Continuous Disclosure: Listing Rules 3.1 – 3.1B*" which highlights that:

- compliance with Listing Rule 3.1 is critical to the integrity and efficiency of the ASX market;
- relevant information must have a material effect on the price or value of the entity's security. On the issue of disclosure, a director should ask themself two questions:
    - Would the information influence my decision to buy or sell securities in the entity at their current market value?; and
    - Would I feel exposed to an action for insider trading if I dealt in the securities armed with that knowledge?
- a distinction between statements of fact and opinion should be made;
- "*immediately*" does not mean "*instantaneously*" but rather "*promptly and without delay*";
- if disclosure cannot be made promptly and without delay, a trading halt should be requested;
- confidentiality is not, per se, a bar to disclosure; and
- the old test of materiality of

earnings guidance (a variation of more than 10–15%) has been abolished. Instead, what constitutes a "*material difference*" between the guidance and the actual earnings requires consideration of several stipulated factors. Reference should also be made to accounting standards AASB 1031, which provides that:

- a variation in excess of 10% is material; and
- a variation of less than 5% is not material.

The need to establish reliance in a shareholder claim for misleading and deceptive conduct

Written by Patrick Boardman, Partner
Tel 02 8273 9941
Email patrick.boardman@wottonkearney.com.au

Introduction

One of the most important outstanding issues in shareholder class actions is the extent to which the shareholder has to prove reliance on the alleged wrongful conduct. In ***De Bortoli Wines Pty Ltd v HIH Insurance Ltd (in liquidation)*** [2012] FCAFC 28, the Full Federal Court considered this issue in the context of a claim for misleading and deceptive conduct (in contravention of section 52 of the **Trade Practices Act 1984 (Cth)** (**TPA**), which is now section 18 of the **Australian Consumer Law**).

The Full Court held that the fair inference of reliance utilised by De Bortoli Wines Pty Limited (**DBW**) must be weighed in light of all the evidence, and it did not relieve DBW from the need to establish its reliance on the impugned conduct or information. Accordingly, where the evidence rebutted the inference of reliance, DBW failed to establish that its loss was caused by the alleged conduct of HIH Insurance Ltd (**HIH**).

Background

In 2000, DBW acquired more than 19 million HIH shares in 66 separate transactions in a five-month period, at a total cost of $7,140,179.01. HIH was eventually liquidated and those shares became worthless.

DBW's claim

On 9 February 2009, DBW submitted a proof of debt to HIH's liquidators (**the liquidators**) for an amount equal to the cost of the shares. This proof of debt was submitted on the basis that the shares were acquired in reliance on misleading and deceptive information – provided directly or indirectly by HIH in breach of section 52 of the TPA – contained in:

- financial statements and reports released by HIH, as well as HIH media releases published by the Australian Securities and Investments Commission (**ASIC**) and the Australian Securities Exchange (**ASX**);
- advice given by third-party analysts (such as stockbrokers), based on the information provided by HIH to the public and the ASX; and
- representations made separately by an officer and a director of HIH at the time.

The liquidators' decision

While the liquidators admitted that some of the alleged representations were misleading and deceptive, they

rejected DBW's claim on the basis that there was insufficient evidence to establish HIH's liability. In particular, the liquidators considered that DBW could not establish that its loss was caused by reliance on HIH's alleged misleading and deceptive conduct.

The Federal Court proceedings

On 17 February 2010, DBW sought orders pursuant to section 1321 of the **Corporations Act 2001 (Cth)**, to set aside the liquidators' decision and have its debt admitted.

The remedy for a breach of section 52 of the TPA is damages pursuant to section 82, which requires DBW to establish that its loss was occasioned "*by conduct of [HIH]*". Accordingly, the pertinent issue was whether HIH caused the claimed loss to DBW.

Following a detailed review of relevant authorities – including the decisions in ***Digi-Tech (Australia) Ltd v Brand*** [2004] NSWCA 58 and ***Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd*** (2008) 73 NSWLR 653, Stone J held that for DBW to succeed in its claim, it must establish that it was induced to enter each transaction by the impugned conduct of HIH. Her Honour held that "*here reliance is critical to [DBW's] claim; DBW must show that it relied on the misleading information and that that information emanated from HIH*".

DBW placed great emphasis on inferred reliance, by reason of the fact that HIH engaged in misleading or deceptive conduct and that DBW purchased HIH shares. This inferred reliance arose from the long-recognised principle of Lord Blackburn[1] that:

"*...if it is proved that the defendants, with a view to induce the plaintiff to enter into a contract, made a statement to the plaintiff of such nature as would be likely to induce a person to enter into a contract, and it is proven that the plaintiff did enter into the contract, it is a fair inference of fact that he was induced to do so by the statement ...*".

This inference of reliance is rebuttable. Stone J held that any inferred reliance must be weighed in light of all the evidence and, in this case, the weight of that evidence rebutted any such inference. In regard to the evidence, Her Honour noted that:

- in cross examination, Mr De Bortoli (the managing director of DBW, who purchased the shares) could not recall when he read the relevant documents. Moreover, he confirmed that he did not make the yellow highlighting on the documents when he read the documents, but rather these had been made by his lawyers in 2009 after they had read the report of the Royal Commission into the collapse of HIH. Stone J concluded that "*in the absence of any contemporaneous notes or markings on the documents, his assertions that he paid particular attention to statements highlighted by his legal advisors almost nine years later cannot be regarded as reliable evidence ...*"; and
- when questioned about why he continued to buy HIH shares as the price plunged, Mr De Bortoli confirmed that he thought he knew better than the market and that he was backing his own judgment. Stone J found that those assertions were inconsistent with Mr De Bortoli's claim that he relied on HIH's representations.

DBW, while expressly disclaiming any reliance on the "*fraud on the market*" theory (as that theory has not been accepted in Australia), submitted that "*the HIH shares only had some market value and were able to be traded at all on the share market*" as a result of the

1 ***Smith v Chadwick*** (1884) 9 App Cas 187 at 196

representations by HIH, which were admitted to be false. In other words, DBW contended that had the true position been known, the shares could not have been traded at all. Stone J rejected this argument for two reasons: firstly, because there was no evidence to support the proposition, and secondly because "*it was clear from the evidence that Mr De Bortoli was betting against the market rather than relying on it*".

Thus, while DBW was able to establish HIH's misleading and deceptive conduct, the absence of cogent evidence of reliance on that conduct – and therefore the absence of any causal link between the impugned conduct and the loss – was fatal to DBW's claim.

The Full Federal Court decision

The essential issue in the appeal was whether Stone J erred in finding an absence of causation. DBW contended that Her Honour failed to give proper weight to the "*fair inference*" principle and that Stone J applied an unrealistic test in determining whether to accept Mr De Bortoli's evidence of reliance.

The Full Court held that it was unnecessary for it to determine whether the proper approach was to proceed on the basis of a rebuttable "*fair inference*" principle (as neither party contended that the principle did not arise). Instead, the crux of the appeal was whether Stone J had erred in finding that that inference was rebutted by evidence that DBW did not rely on the impugned information.

The Full Court identified five reasons for Stone J's finding of an absence of reliance.

- The evidence did not support a finding that DBW read the statements of HIH's profits and net assets prior to purchasing the shares, or in the event that it did, that evidence was overshadowed by the weight DBW gave to a HIH Director's (Mr Adler) purchase of shares.
- In purchasing shares from September onwards, when the market was falling, DBW "*knew better than the market*".
- It was open to Her Honour to find that due to the considerable negative media attention given to HIH from September onwards, Mr De Bortoli's credibility was undermined by his claim that he was unaware of the media reports.
- DBW's evidence of reliance was given at a very high level of generality. There was no evidence of how the statements in the accounts were understood or how they related to DBW's assessment of the value of HIH shares.
- The statements attributed to an employee and a director of HIH, to the effect that it was a "*profitable company*", were general statements to which little weight could be attached.

Conclusion

The Full Court held that in order to establish that a shareholder's loss is caused by any misleading and deceptive conduct, it is necessary for the shareholder to establish reliance on the impugned information or conduct. While the Full Court did not have to make a finding of whether the "*fair inference*" of reliance arose (as it was accepted by both parties), it is notable that it did not reject that inference, but rather held that it was clearly rebutted by the evidence in this instance.

The effect of the judgment is that a shareholder will have to adduce evidence of its particular reliance on the impugned conduct, and cannot merely rely on the "*fair inference*" of fact, otherwise it runs the risk of the company adducing its own reliance evidence in rebuttal. This could result in the shareholder being unable to

establish the necessary reliance to prove its case. However, if the Courts accept the "*fair inference*" principle, the onus of proof is effectively reversed, so that reliance is accepted unless cogent rebuttal evidence is established.

This in turn raises a number of further issues still to be addressed by the courts, namely the extent:

- of reliance required to establish a breach of continuous disclosure obligations;
- to which shareholders must provide individual discovery sufficient to allow proper consideration of a rebuttal defence; and
- to which indirect causation could be relied on (although this was expressly rejected by the NSW Court of Appeal in ***Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets Ltd*** [2008] NSWCA 206).

Further issues

The Full Court decision will be relevant to the current trial of a number of Group class actions arising out of the collapse of The Great Southern Group of Companies which involve claims for losses arising from alleged reliance on various representations contained in published prospectuses. Equally important will be the judgment in ***Woodcroft-Brown v Timbercorp Securities Ltd & Ors*** where, on the issue of reliance, Judd J held that a plaintiff relying on a contravention of the misleading or deceptive conduct provisions must establish:

- reliance on the alleged misleading or deceptive conduct or statement; and
- that the plaintiff would have acted differently if the material omission had been disclosed.

Two other associated judgments were delivered in 2012.

In ***National Australia Bank v Pathway Investments Pty Ltd & Anor*** [2012] SCA 168, the Court of Appeal held that National Australia Bank (**NAB**) was not entitled to discovery and particulars from 20 of the largest shareholder group members, in a shareholder class action relating to the adequacy of the bank's disclosure of its exposure to collateral debt obligations. While it appeared accepted that the initial hearing was on the issue of liability only (with issues of reliance and causation for group members' losses to be determined separately), NAB contended that the issue of reliance and causation went to the very heart of whether the matter could proceed as representative proceedings. The Court of Appeal did not agree in refusing NAB's application.

The Federal Court decision of ***Edmonds J in Meaden v Bell Potter Securities Ltd (ACN 006 390 772) No. 2*** (2012) 291 ALR 482 highlights the importance of reliance and causation to the notion of whether there is sufficient commonality for a class action to proceed. Edmonds J held that claims by 56 investors could not proceed as a class action, as there were differing reliance and causation issues, based on various oral representations and 10 separate reports over a 12-month period. This meant that there was insufficient commonality between the claims, so that one representative action would not determine common questions for all group members. Leave to appeal was refused ([2012] FCA 739). ■

Insurance Year in Review 2012
Reinsurance + Regulatory

A reinsured's right to a stay

Written by Catherine Osborne, Partner and Matthew Foglia, Special Counsel
Tel 02 8273 9930 | 02 8273 9905
Email catherine.osborne@wottonkearney.com.au
matthew.foglia@wottonkearney.com.au

Introduction

In ***Amlin Corporate Member Ltd & Ors v Oriental Assurance Corporation*** [2012] EWCA Civ 1342, the English Court of Appeal was asked to consider a reinsured's application for a stay of declaratory proceedings. The declaratory proceedings were brought by London reinsurers pending the outcome of a coverage dispute on the direct insurance policy.

Background

Sulpicio was the owner of a ferry that capsized and was lost in the Philippines in 2008 during Typhoon Frank. Oriental Assurance Corporation (**Oriental**) was the cargo liability insurer and was reinsured by various syndicates at Lloyd's (**the English reinsurers**) under an excess of loss reinsurance contract (**the Oriental policy**).

Both the reinsurance contract and the underlying Oriental policy contained the following typhoon warranty:

> *"Notwithstanding anything contained in this policy or clauses attached hereto, it is expressly warranted that the carrying vessel shall not sail or put out of Sheltered Port when there is a typhoon or storm warning at that port nor when her destination or intended route may be within the possible path of the typhoon or storm announced at the port of sailing, port of destination or any intervening port. Violation of this warranty shall render this policy void."*

The cargo owners sued the ferry's owner, Sulpicio, and also pursued a direct claim against Oriental as the cargo liability insurer (**the Philippines proceeding**). A key issue in the Philippines proceeding was whether Sulpicio was entitled to indemnity under the Oriental policy or whether the typhoon warranty would apply and void the policy.

The English reinsurers commenced declaratory proceedings in England seeking a declaration that they were not liable to indemnify Oriental under the reinsurance contract in relation to the loss, by reference to the typhoon warranty, in both the underlying policy and reinsurance contract (**the English proceeding**).

Oriental sought a stay of the English proceeding pending the outcome of the underlying Philippine proceeding. At first instance, Smith J dismissed Oriental's stay application on the basis that a stay should only be granted in rare and compelling circumstances and that such circumstances were not present. Oriental appealed.

The decision on appeal

The reinsurance contract contained a 'follow provision' in these words:

> *"To follow all terms, conditions and settlements of the original policy issued by the Reinsured to the Insured, for the period specified herein, in respect of sums and interests hereby reinsured..."*

On appeal, Oriental argued that reinsurance should be considered an exception to the normal rule that a stay should only be granted in rare and compelling circumstances because, by reference to the 'follow provision' the reinsurers should first wait for the reinsured to settle the claim before addressing the reinsurers' own liability for the loss.

The English Court of Appeal unanimously dismissed the appeal, rejecting Oriental's suggestion that reinsurance was a general exception to the normal rule regarding stays.

Implications

The Court of Appeal recognised that this decision placed the reinsured (Oriental) in a difficult position where it had to simultaneously argue:

- in the Philippines proceeding that the typhoon warranty applied; and
- in the English proceeding that the typhoon warranty did not apply.

Notwithstanding the potential for inconsistent verdicts affecting the reinsured, the English courts appear to be inclined to let reinsurance disputes proceed in the English courts before the underlying coverage disputes are concluded, which may or may not render the reinsurance dispute moot.■

Westport Insurance Corporation v Gordian Runoff Ltd [2011] HCA 37

Written by Catherine Osborne, Partner and Matthew Foglia, Special Counsel
Tel 02 8273 9930 | 02 8273 9905
Email catherine.osborne@wottonkearney.com.au
matthew.foglia@wottonkearney.com.au

In our 2010 Insurance Year in Review we reported on the 2010 decision of the NSW Court of Appeal in this matter. However, in October 2011 the High Court of Australia in ***Westport Insurance Corporation v Gordian Runoff Ltd*** [2011] HCA 37 reversed the Court of Appeal's decision and set aside the underlying arbitration award.

Background

Gordian Runoff Ltd (**Gordion**) provided Directors and Officers (**D&O**) insurance to the directors and officers of FAI Insurance Ltd (**FAI**) pursuant to an insurance policy that ran for seven years commencing in 1998 (**the Gordian D&O policy**). Gordian had reinsurance treaty protection with various reinsurers, including Westport; however, the reinsurance treaties did not cover any underlying contracts for a period longer than three years.

Various claims against FAI's directors and officers were notified to Gordian in 2001. The reinsurers denied liability on the basis that the Gordian D&O policy was outside the scope of the reinsurance treaties because it ran for more than three years. The terms of the reinsurance treaties required the coverage dispute to be arbitrated.

The coverage dispute was arbitrated in 2008. In the arbitration, Gordian relied on section 18B of the **Insurance Act 1902 (NSW)**, which limits the application of contractual exclusion clauses. The arbitrators held that the treaties only applied to policies of up to three years in duration, but nevertheless held that section 18B applied, so the reinsurance treaties applied to all claims made under the Gordian policy within three years of its inception.

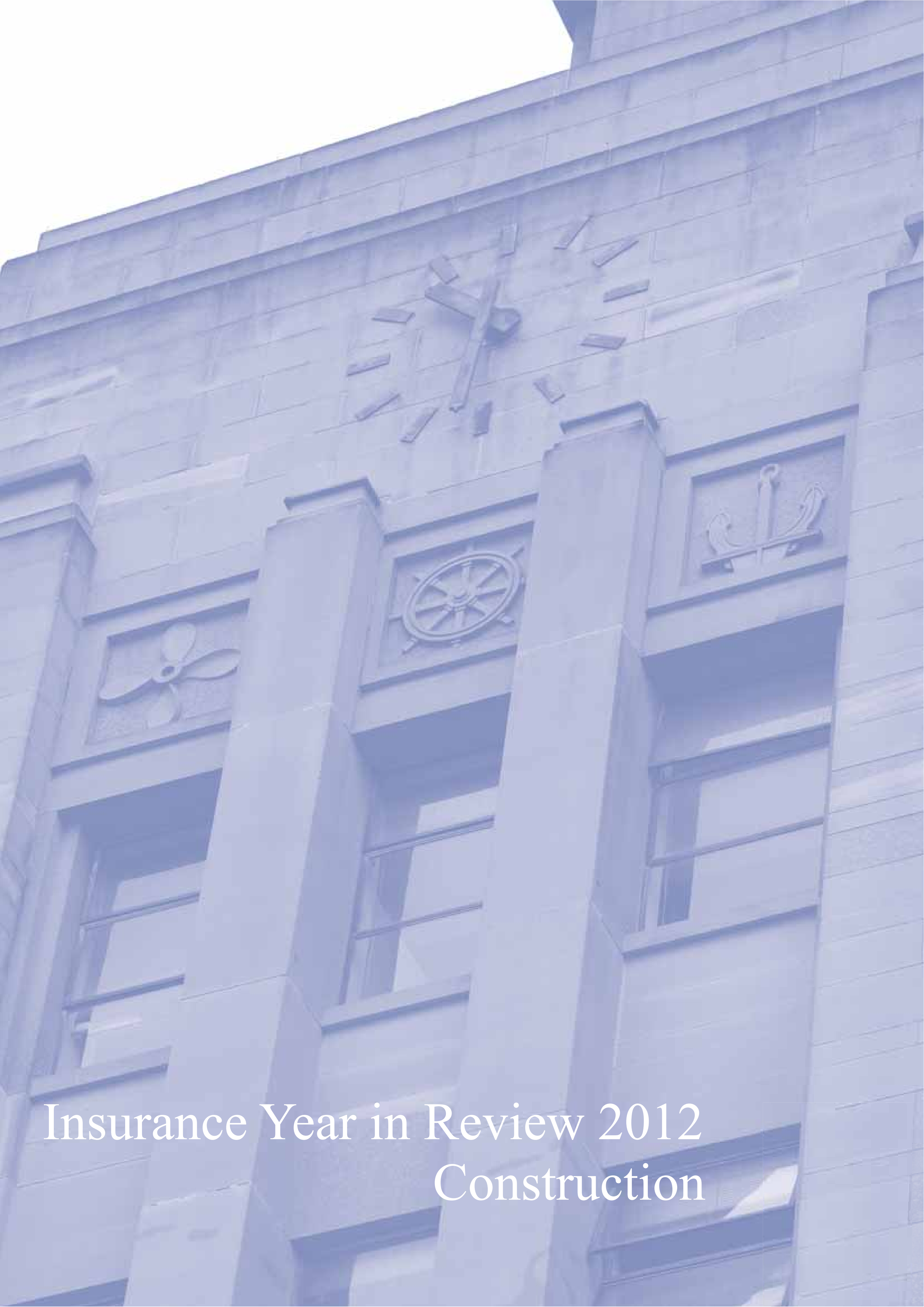
The reinsurers appealed to the Supreme Court under section 38(5)(b) of the **Commercial Arbitration Act 1984 (NSW)** on the basis that there was a "*manifest error of law*" on the face of the award. Einstein J allowed the appeal and overturned the arbitration award. In 2010 the NSW Court of Appeal allowed Gordian's appeal and reinstated the arbitration award.

The High Court decision

In October 2011 the High Court allowed the reinsurers' appeal. In doing so, it held that the provision of inadequate reasons by an arbitrator could be a "*manifest error*". In this regard, the High Court noted that having relied on section 18B of the Insurance Act in granting the award, the arbitrators were obliged to explain how all of the various elements of that section were satisfied, which they had failed to do.

Implications

The level of detail required in an arbitrator's reasons will vary depending on the nature of the issues and the particular circumstances of the dispute. ■



Insurance Year in Review 2012
Construction

A builder's duty of care to avoid causing economic loss owed by a builder to an owners corporation. Does it exist?

Written by Gabrielle Levette, Senior Associate
Tel 02 8273 9936
Email gabrielle.levette@wottonkearney.com.au

Introduction

Owners corporations often bring negligence claims against builders for defective works on common property. The circumstances in which this cause of action in negligence arises has been the subject of considerable debate. Two recent decisions in the Supreme Court of NSW provide clarity as to the duty of care to avoid economic loss that is owed by a builder to an owners corporation.

The Star of the Sea decision

In ***Owners Corporation Strata Plan 72535 v Brookfield*** [2012] NSWSC 712 McDougall J considered whether Brookfield, as a builder, owed a common law duty of care to the owners corporation with respect to alleged defective work.

The plaintiff was the owners corporation of a strata title development known as "Star of the Sea" at Terrigal in NSW, which comprised 52 residential lots. Brookfield designed and constructed the development pursuant to a contract with the developer, Hiltan. The owners corporation alleged that there were defects in the common property and commenced proceedings against Hiltan and Brookfield, claiming that Hiltan and Brookfield had breached warranties implied by section 18B of the **Home Building Act 1989 (NSW)** (**HBA**) as well as breaching a common law duty of care.

With respect to the allegations of negligence against Brookfield, the owners corporation submitted that it was relevantly vulnerable so as to create a duty of care. The owners corporation submitted that this duty of care was owed because ownership of common property was foisted on it without any opportunity to consider whether or not to accept the burden, and because it did not have the benefit of having previously inspected the common property.

McDougall J did not accept the owners corporation's submissions and found that Brookfield did not owe a duty of care because:

- owners corporations have the benefit of statutory warranties pursuant to section 18B of the HBA;
- the legislature had considered and made clear provisions under the HBA covering the liability of a builder or developer to the owners corporation or subsequent purchasers;
- courts should be slow to impose additional obligations in circumstances where the owners corporation has the protection of statutory warranties (which arguably dispose of any "*vulnerability*" that may otherwise potentially give rise to a duty of care); and
- the imposition of any such duty of care, particularly on a developer, would be very onerous and would increase project costs.

The Chelsea decision

McDougall J subsequently handed down a further decision on the duty of care owed by a builder to a commercial corporation in ***Owners Corporation Strata Plan 61288 v Brookfield Multiplex Limited*** [2012] NSWSC 1219 (**the Chelsea decision**).

In this case, the plaintiff was the owners corporation of a strata title development at Chatswood in NSW. The development operated as serviced apartments available for public letting. Brookfield Multiplex Limited (**Brookfield**) entered into a contract with the principal developer, Chelsea Apartments, to design and construct a complex that formed part of the development. The contract with Chelsea Apartments contained detailed provisions relating to the quality of services Brookfield was to provide.

The owners corporation claimed that there were defects in the common property of the serviced apartments and sued Brookfield for the cost of the rectification, alleging that Brookfield had breached a common law duty of care. The owners corporation did not have the benefit of the warranties implied by the HBA because the development did not fall within the definition of a "*dwelling*" to which the HBA applies.

McDougall J found that the owners corporation did not make good its case that Brookfield owed it a duty of care because:

- the duty of care alleged by the owners corporation did not fall within any established category of duty of care shown in the authorities;
- the decision in ***Bryan v Maloney*** (1995) 182 CLR 609 could not be relied on because:
  - the decision in that case – that the builder owed a duty of care to a successor in title to the person for whom the house had been built – depended on the fact that the builder owed a duty of care to the earlier proprietor; and
  - because Brookfield and Chelsea Apartments had negotiated their rights and obligations in full, there was no reason to intervene by imposing a general law duty of care; and
- the owners corporation did not have the benefit of statutory implied warranties under the HBA. The legislature had put in place a regime to protect those who buy defective residential property, and had decided, as a matter of policy, to exclude developments constructed for commercial purposes. In other words, the owners corporation was inviting the Court to go where the legislature had not.

The Chelsea decision confirms that a builder does not owe a subsequent commercial owners corporation a duty of care to take reasonable steps to

avoid economic loss, in circumstances where the contract sets out the rights and obligations of the parties to that contract.

Implications

As a result of the decisions outlined above, the prospect of an owners corporation successfully bringing a claim in negligence against a builder of commercial or residential units has narrowed considerably. Notwithstanding, this area of law may change if the decisions are appealed or as a result of the NSW Government's current review of the HBA. ■

The High Court's review of the doctrine of contractual penalties – implications for the building industry

Written by Mark Hughes, Senior Associate
Tel 02 8273 9812
Email mark.hughes@wottonkearney.com.au

Introduction

On 6 September 2012 the High Court of Australia delivered its judgment in ***Andrews v Australia and New Zealand Banking Group Limited*** [2012] HCA 30, in which the Court reviewed the doctrine prohibiting the imposition of contractual penalties.

In a decision that has implications beyond the banking industry, the Court determined that the equitable prohibition against contractual penalties applies not only in circumstances where there has been a breach of contract; it can also be used to prohibit an outcome that could be regarded as a penalty for conduct or circumstances that are not a breach of contract.

Background

The decision arises from class action litigation commenced by customers of the Australia and New Zealand Banking Group Limited (**ANZ**), in which a large number of customers have sought compensation and reimbursement of fees and imposts they were charged by ANZ.[1]

ANZ and other financial institutions had imposed fees – such as honour fees (charged upon successful presentation of a cheque), dishonour fees (charged upon a cheque being dishonoured on presentation) and non-payment fees (charged when a periodic payment is not made due to insufficient funds in the customer's account) – on retail and business deposit accounts. It also charged over limit fees (charged when a customer exceeds the credit limit on a credit card account) and late payment fees (charged when a customer fails to make a minimum repayment by the specified date) in respect of consumer and commercial credit cards. All of these fees were identified in the litigation as "*exception fees*".

In the first instance decision of the

1 A number of similar or identical class actions against other banks are also pending. The decision has obvious wide-ranging implications for the banking industry.

Federal Court[2], in an interlocutory determination of a separate question before the final trial, Gordon J determined that a late payment fee was a fee payable upon breach of contract and was therefore capable of being characterised as a penalty. That part of the decision was not appealed.

His Honour held that the customer was not charged the balance of the exception fees for breaching any contractual obligation, nor were the circumstances in which the fees were charged an event that the customer had an obligation or a responsibility to avoid. As such, the fees were not capable of being characterised as a penalty.

This decision was the subject of an appeal before the High Court.

Contractual penalties

Following the earlier decision of the NSW Court of Appeal in ***Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd*** [2008] NSWCA 310, the doctrine against contractual penalties had previously been understood as one limited to circumstances involving a breach of contract and did not extend to circumstances that did not involve contractual breaches.

Disputes about contractual penalties can frequently arise in construction matters in relation to liquidated damages clauses.

Typically, if completion of a project is detailed beyond a contractually identifiable date for completion (which is invariably a breach of contract) the delaying party will be required to pay liquidated damages, often calculated at an identified daily rate. To the extent that those liquidated damages are disproportionate to the actual cost to the owner or developer (for example, because they grossly exceed additional finance costs or interest on delayed settlements) there has never been any conceptual difficulty in characterising those claims as penalties. Further, a contractual statement that the liquidated damages are a genuine pre-estimate of damages and not a penalty will not prevent scrutiny by the Court.

Decision of the High Court

The reasoning of the High Court involves a detailed historical analysis of the long-standing equitable prohibition against contractual penalties, and of the concept of contractual bonds (such as modern performance guarantees), which is where the doctrine has its origins.

The Court drew distinctions between a contractual term that can be characterised as a "*condition*" and the word "*condition*" as it applies to bonds, pointing out that the word has a substantially different meaning in each application. A well understood meaning for the term "*condition*" in an ordinary contract is "*an important, vital or material promise, the breach of which will repudiate the contract.* In contrast, an obligation under a bond may be said to be conditional on the occurrence of a particular event and the term "*condition*" in the context of a bond is used in the sense of a trigger, not to mean a breach of contract or breach of condition.

Ultimately, the Court found that in the absence of a breach of contract – or an obligation or responsibility on the part of a customer to avoid a certain occurrence upon which the relevant fees were charged – those fees could still be characterised as penalties.

The High Court has not determined whether exception fees are actually penalties; that is a matter to be determined in the final trial of the

2 ***Andrews v Australian and New Zealand Banking Group Limited*** [2011] FCA 1376 per Gordon J

class action. Rather, the High Court has removed the barrier to those fees being characterised as penalties, opened the concept of certain contractual terms, obligations or performance bonds – which are not invoked merely by breach of contract and may arise in the ordinary performance of a contract – being characterised as penalties.

Interestingly, the Court also discussed the distinction between contractual terms that might attract the penalty doctrine and those that merely give rise to a further consensual obligation. Referring to and quoting from earlier authorities[3], the Court gave an example involving land leased for agistment purposes but instead tilled to grow crops. Depending on the form of obligations chosen by the parties, this conduct may be a breach of their agreement for which damages are payable, or a matter that generates further consideration – for example, if the lessee tills the land and plants crops, the lessee shall pay the lessor a further identified fee per acre. The distinction is that further consideration is consensually payable for the additional benefit received.

It is not beyond the realm of possibility for such terms to find their way into construction agreements.

Implications

Building contracts – particularly those involving large and complex projects – often contain a variety of contractual terms and obligations that, on the now expanded understanding of penalties, may well be characterised as contractual penalties. The provision and exercise of bank and performance guarantees are obvious examples.

Litigation in relation to penalties is difficult, costly and uncertain, especially now that the class of issues contractors can consider as potential penalties has been greatly expanded.

While the High Court has expanded the basis for determining potential penalties, it has also offered a potential solution to parties to find alternative means of dealing with adverse circumstances. Parties to building contracts will need to give careful thought to drafting clauses (not merely liquidated damages clauses) that might offend the expanded doctrine against contractual penalties. ■

3 ***MGM Pty Ltd v Greenham*** [1966] 2 NSWR 717 and ***French v Macale*** (1842) 2 Drury & Warren 269

Does proportionate liability apply in arbitrations? The Supreme Court of Western Australia has its say

Written by Paul Spezza, Partner and Michael Fung, Solicitor
Tel 02 8273 9909 | 02 8273 9819
Email paul.spezza@wottonkearney.com.au
michael.fung@wottonkearney.com.au

Introduction

The introduction of proportionate liability across various Australian jurisdictions over the last decade has given rise to a number of issues requiring clarification. One such issue is whether proportionate liability applies to disputes the subject of arbitration.

The Full Court of the Supreme Court of Tasmania touched on this question in ***Aquagenics Pty Ltd v Break O'Day Council*** [2010] TASFC 3 but did not reach a final view. The Supreme Court of Western Australia has now considered this issue in ***Curtin University of Technology v Woods Bagot Pty Ltd*** [2012] WASC 449.

Facts

Woods Bagot Pty Ltd (**Woods**) and Curtin University of Technology (**Curtin**) were involved in a construction dispute, which was to be resolved by arbitration pursuant to the **Commercial Arbitration Act 1985 (WA)** (**CAA**).

Beech J was asked to consider whether Part 1F of the **Civil Liability Act 2002 (WA)** (**CLA**) – which provides that the liability of concurrent wrongdoers in apportionable claims is subject to the principles of proportionate liability – applies to commercial arbitration proceedings being arbitrated under the CAA.

Decision

Beech J limited his judgment to the statutory construction of Part 1F. His Honour did not address whether there was an implied or express term of the arbitration agreement that could invoke the operation of Part 1F – that was an issue reserved for the arbitration proceedings.

Beech J determined that Part 1F does not apply to arbitrations because:

- the natural and ordinary meanings of the words "*court*", "*action for*

damages" and "*judgment*" do not naturally encompass arbitrations. For example, where a court should be interpreted as including an arbitration, express words (absent from Part 1F) are used to indicate this intention;
- if Part 1F was to apply to arbitrations, the legislature would have explicitly defined "*court*" and "*action*" to include arbitrations;
- there is no provision expressly extending the operation of Part 1F to arbitrations; and
- the philosophical basis of arbitration is voluntary, unlike the compulsory basis of the court process. This means an arbitrator cannot compel the joinder of a party alleged to be responsible for the damage if that party refuses to consent to the arbitration. The absence of such a power risks causing injustice or hardship to a claimant, who may have to initiate proceedings before a different tribunal. This may put the claimant at risk of obtaining conflicting judgments from an arbitrator and a court.

In *obiter*, Beech J considered that, depending on and subject to the terms of the arbitration agreement, an implied term may make Part 1F of the CLA applicable to arbitrations. This could occur as long as the implied term was consistent with the parties' intentions in the arbitration agreement. However, His Honour did not comment on whether there is any such implied term in this case.

Implications

Although Beech J's judgment did not specifically comment on whether an implied or express term of an arbitration agreement would render Part 1F applicable, this decision has potentially widespread implications. The judgment is therefore relevant to:

- parties bound by contract who will need to determine what method of dispute resolution should be included in contracts, particularly where a party might assume a greater liability exposure than it would otherwise;
- the legislature, given the possible dilution of a statutory intention to limit a defendant's liability to an amount proportionate to its degree of fault rather than its financial capacity to meet an adverse judgment against it; and
- insurers, whose exposures might appreciably increase if their insured agreed to have a dispute determined by arbitration (where proportionate liability may not apply) as opposed to in a court or tribunal (where proportionate liability would likely apply). ■

Parties soon to lose the right to present their own case – proposed amendments to expert evidence in Victoria

Written by Nick Lux, Partner and
Connor Burdon-Bear, Solicitor
Tel 03 9604 7902 | 03 9604 7903
Email nick.lux@wottonkearney.com.au
connor.burdon-bear@wottonkearney.com.au

The Victorian Government intends to reform the **Civil Procedure Act 2010 (Vic)** (**the Act**) by introducing the **Civil Procedure Amendment Bill 2012 (Vic)** (**the Bill**).

The Bill is currently before the Legislative Council, having been passed in the Legislative Assembly. The Bill will commence on 1 May 2013, subject to proclamation prior to that date.

The Bill aims to "*reduce costs and delays for persons involved in civil litigation in Victoria, and improve the effectiveness of the civil justice system*". To achieve this aim, the Bill seeks to amend the Act in relation to costs, expert evidence and certification requirements.

We have focused on the proposed amendments to expert evidence and certification requirements.

Proposed amendments to expert evidence

When the Bill reaches assent, parties will be required to obtain direction from the relevant Court (except the Magistrates' Court, unless the rules of that court specify it is required) as soon as practicable, not only if they intend to adduce expert evidence at trial, but also if they become aware they may adduce expert evidence at trial.

The proposed changes provide courts with wide-ranging powers regarding expert evidence including:

- ordering the use of a single joint expert to be engaged by the parties;
- ordering experts to give evidence concurrently;
- ordering experts to participate in a conference to narrow the issues in dispute and to prepare a joint

expert report, similar to the expert conferences and Scott Schedules currently utilised by the Victorian Civil and Administrative Tribunal;
- ordering that expert witnesses be permitted to ask questions of any other expert giving concurrent evidence;
- enabling the court to question an expert witness; and
- ordering a court-appointed expert.

Importantly, parties will be prohibited from adducing any expert evidence if a single joint expert or court-appointed expert has been engaged. As a result, parties that engage an expert in support of issuing a claim may never be allowed to adduce that evidence, losing support for their claim and wasting costs.

The Bill also has the potential to oversimplify proceedings. On rare occasions in construction matters it may be appropriate to engage a single building inspector to assess defects in a property; however, the majority of cases require the expertise of multiple experts.

In addition, the Bill will adversely affect the ability of parties to assess liability, ascertain matters of causation and, importantly, present their own case by adducing expert evidence in support of their position.

It is yet to be seen how restricted the use of expert evidence will become; however, our concern is that parties will lose the ability to realise the true prospects of their claims, consequently hindering the early resolution of disputes.

Overarching obligations certification – insurers' ability to 'step in'

Interestingly for insurers, the Bill also seeks to amend the overarching obligations certification requirements. Currently a named party to the proceeding must make the overarching obligations certification. The Bill seeks to amend this requirement in circumstances where "*a party has no meaningful control over the conduct of a civil proceeding by virtue of a ... contract of insurance, the person in control by virtue of the ... contract of insurance may make the overarching obligations certification*".

The Bill specifically states that the insurer may make the certification. The second reading speech highlights that this provision is intended to address situations where insurers issue recovery actions in the name of their insureds.

While this may be beneficial in circumstances where it is difficult to contact the insured, it does not negate the need for legal practitioners to ensure they have sufficient instructions to file a pleading and to make the corresponding proper basis certification.

Furthermore, if an insurer was to 'step in' and make the overarching obligations certification, it could show their hand to the other parties, who could alter their litigation strategies upon becoming aware that an insurance interest is involved.

Subject to how the courts use them, the proposed amendments that the Bill seeks to make have the potential to dramatically change the shape of litigation in the future. ■

Insurance Year in Review 2012
Property / Industrial Special Risks

Delayed notification and prejudice – court quantifies a lost opportunity to investigate

Written by Phillip Wotton, Senior Partner and Rebecca Craig, Solicitor
Tel 02 8273 9939 | 02 8273 9805
Email phillip.wotton@wottonkearney.com.au
rebecca.craig@wottonkearney.com.au

Introduction

In ***Milton Keynes Borough Council v. Michael Nulty (deceased) and ors*** and ***National Insurance and Guarantee Corporation Limited v. Michael Nulty and ors*** [2011] EWHC 2847 (TCC), the English High Court considered the impact of an insured's late notification of a claim on the insurer's liability. In this case prompt notification of the claim was not a "*condition precedent*" to the insured's liability, but it was a "*condition*" of the policy. Accordingly, the Court had to value the prejudice suffered by the insurer (if any) due to the late notification.

Background

On 2 April 2005, Mr Nulty attended a recycling centre (**the Centre**) owned by Milton Keynes Borough Council (**the Council**) to urgently repair a fault with a machine. Mr Nulty took a cigarette break and 15 minutes later the Centre's fire alarm was activated. The fire brigade attended the Centre, extinguished the fire and left the Centre. However, at midnight on 3 April 2005 a second fire broke out at the Centre, which caused around £4.5million of damage to the Centre and its contents.

After interviewing Mr Nulty and conducting forensic investigations, on 10 October 2006 the Council's solicitors sent a letter to Mr Nulty alleging that he started the fires at the Centre by carelessly discarding his cigarette. Mr Nulty did not reply. On 30 October 2006 the Council's solicitors sent Mr Nulty a further letter warning him that there was a significant risk that he would be sued. On 10 November 2006 Mr Nulty gave notice of the claim to his professional liability insurer, National Insurance and Guarantee Corporation Limited (**NIG**).

Mr Nulty's insurance policy contained a notification clause, which stated that

"*the Insured shall, on the happening of any incident which could result in a claim under this Policy, immediately notify and send written confirmation to* [NIG]". NIG initially reserved its rights under the policy due to the "*very late reporting*" before ultimately denying indemnity.

The Proceedings

The Council commenced proceedings against Mr Nulty for losses caused by the fires (**the liability dispute**). As Mr Nulty died in December 2010, his defence was conducted by NIG, without prejudice to NIG's position on indemnity. NIG argued that the fires were caused by an electrical fault or arson.

NIG commenced separate proceedings against Mr Nulty alleging that by failing to give prompt notice of any circumstance likely to give rise to a claim, Mr Nulty was in breach of his obligations under the policy. NIG claimed that the delayed notification seriously prejudiced its ability to defend the liability dispute, since it lost the opportunity to promptly investigate the cause of the fires and to gather evidence that would demonstrate that Mr Nulty did not cause the fires (**the coverage dispute**).

The Decision

The liability dispute

In the liability dispute, Edwards-Stuart J considered three possible causes of the first fire and held that on the balance of probabilities:

- Mr Nulty caused the first fire; and
- the first fire caused the second fire.

As such, Mr Nulty was liable for the damage resulting from the fires.

The coverage dispute

The requirement to give notice of a claim was a "*condition*" of the policy. This meant that delayed notification of a claim might reduce – but would not automatically exclude – NIG's liability.

When considering NIG's entitlement to reduce its liability, Edwards-Stuart J relied on dicta from ***Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp*** [2005] 2 Lloyd's Rep 517, where Manch LJ stated that:

> "*If* [the insurer] *can prove serious consequences, then these will often be capable of quantification, in one way or another, even if only as losses of a chance or opportunity, and can be set off against the claim.*"

NIG submitted that the prejudice suffered as a result of the delay should reduce its liability entirely or alternatively by 50%. NIG claimed that its ability to defend the liability dispute was seriously prejudiced because if it had been notified of the circumstances in April 2005 it would have immediately instructed forensic fire investigators to investigate the cause of the fires.

While unconvinced by NIG's argument, Edwards-Stuart J accepted that "*it is self-evident that a cold trail always puts an investigator at a disadvantage*" and accepted that the 19-month delay in notification meant that NIG lost the opportunity to prove that Mr Nulty was not the most likely cause of the fires. While recognising that valuing NIG's loss of opportunity was "*fraught with difficulty*", Edwards-Stuart J held that by reason of the delay NIG was entitled to reduce its liability to Mr Nulty by 15%.

Comment

This case is a useful reminder of the importance of promptly notifying an insurer of circumstances that may give rise to a claim. While delayed notification is unlikely to exclude cover entirely (particularly if the **Insurance**

Contracts Act 1984 (Cth) applies and if the policy includes a "*deeming clause*" for circumstances notified during the policy period) the insurer may still have grounds to reduce its liability to reflect the prejudice suffered as a result of the delay.

If notification is delayed, an insurer will need to show that it was prejudiced by the delay. That prejudice may be reflected in the loss of opportunity to investigate the cause of the loss, particularly in circumstances where, as in this case, the cause was disputed. In that situation, the lost opportunity to investigate promptly could be significant.

Playing with fire – the onus of proof and exclusion clauses

Written by Michael Bath, Special Counsel and Jack Geng, Solicitor
Tel 02 8273 9953 | 02 8273 9910
Email michael.bath@wottonkearney.com.au
jack.geng@wottonkearney.com.au

Introduction

When an insurer is seeking to rely on an insured's alleged misconduct to trigger an exclusion clause, the insurer carries the burden of proving, on the balance of probabilities, that the misconduct occurred and that the misconduct falls within the terms of the exclusion clause. In ***Jonathan Smyth v St Andrew's Insurance Plc*** [2012] EWHC 2511 (QB), the High Court of England and Wales reaffirmed that it is a difficult burden to satisfy, particularly where the alleged misconduct constitutes criminal behaviour.

The facts

A fire started at Mr Smyth's (**the insured**) house, inside a tenant's room. The tenant accused the insured's partner of starting the fire after a drunken argument between the insured's partner and the tenant. The insured's partner was subsequently arrested by the police in relation to the fire, but was ultimately not charged.

The insured made a claim under his building policy, which was issued by St Andrew's Insurance (**the insurer**). The policy contained a vandalism exclusion that excluded cover for any damage caused by the insured or the insured's family.

The insurer denied indemnity on the basis that the fire was deliberately started by the insured's partner and therefore subject to the policy's vandalism exclusion.

The proceedings

The insured commenced proceedings in the High Court of England and Wales against the insurer, seeking damages following the insurer's refusal to grant indemnity for the claim. It was common ground that once the insured proved that a valid policy was in force during the relevant period, and that the fire was an insured peril, the burden of proof shifted to the insurer to demonstrate that an exclusion clause operated to exclude cover.

It was not disputed that the house was insured property or that fire was an insured peril. It was also accepted that the insured's partner fell within the definition of the insured's *"family"* for the purpose of vandalism exclusion. The principal issue was whether the insured's partner started the fire,

triggering the vandalism exclusion.

The case involved the typical conundrum in civil cases where one of the potential causes of the loss involves criminal conduct. As a civil case, the relevant standard of proof is the balance of probabilities; however, where one of the potential causes of the loss involves serious criminal conduct, that cause is arguably subject to a higher standard of proof. Deputy High Court Judge Randall QC resolved the conundrum by following the House of Lords decision in ***Re B (Children) (Care Proceedings: Standard of Proof)*** [2009] AC 11, which held that the more serious the allegation, the less likely a court should be to consider the allegation true, and the stronger the evidence it should require to establish the alleged misconduct. His Honour, quoting from Lord Hoffmann's speech in ***Re B***, accepted that:

> *"the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability.*
>
> ...
>
> *There is only one rule of law, namely that the occurrence of the fact in issue must be proved to have been more probable than not. Common sense, not law, requires that in deciding this question, regard should be had, to whatever extent appropriate, to inherent probabilities".*

Causation is a question of fact. His Honour approached the question from the starting premise that:

> *"on a common-sense view of inherent probabilities it is less likely that someone (particularly a resident and partner of the owner) would deliberately start a fire in the basement of a house, than that a smoker would carelessly discard or accidentally dislodge a lit cigarette".*

After considering all of the facts and expert evidence, His Honour held that there was insufficient evidence to conclude that the insured's partner started the fire and that there was no other compelling evidence to displace *"the common-sense view of inherent probabilities"*. Accordingly, the insurer's reliance on the vandalism exclusion failed and the insured was entitled to indemnity.

Comments

In situations where an insurer is seeking to decline indemnity based on the insured's alleged misconduct, the onus is on the insurer to show, on the balance of probabilities, that the conduct being asserted falls within the terms of the exclusion clause.

This case demonstrates the inherent difficulties faced by insurers, particularly when seeking to rely on an exclusion clause in situations involving allegations of serious misconduct by the insured. In these situations, an insurer bears the onus of proof and must also provide sufficiently compelling evidence that, on the balance of probabilities, the alleged misconduct in fact occurred. It is a high evidentiary hurdle and one not easily overcome. ■

Accidents and inadvertence – insurer's defence to a third party's claim under the policy

Written by Faith Geraghty, Senior Associate
Tel 02 8273 9964
Email faith.geraghty@wottonkearney.com.au

Introduction

The Supreme Court of NSW decision in ***Rail Corporation v Vero Insurance Limited*** [2012] NSW SC 632 reaffirmed that ordinary principles of contractual interpretation apply when considering insurance policies and applying section 51 of the **Insurance Contracts Act 1984 (Cth)** (**ICA**).

Background

Vero was the insurer of a motor vehicle third-party property damage policy (**the policy**) issued to Mrs Phyllis Jefferies. In May 2004, Mrs Jefferies was killed when her car collided with a train belonging to Rail Corporation New South Wales (**RailCorp**). RailCorp commenced proceedings against Vero for Mrs Jefferies's liability in damages pursuant to section 51 of the ICA, which provides that:

> *"(1) Where:*
>
> *(a) the insured under a contract of liability insurance is liable in damages to a person (in this section called the third party);*
>
> *(b) the insured has died or cannot, after reasonable enquiry, be found; and*
>
> *(c) the contract provides insurance cover in respect of the liability;*
>
> *the third party may recover from the insurer an amount equal to the insurer's liability under the contract in respect of the insured's liability in damages."*

RailCorp sought to recover:

- the costs of repairs to the train and rail infrastructure; and
- alternative transport costs (that is, the amount spent in supplying alternative transport to passengers following the collision while the track was not in use).

Vero denied that it was liable to RailCorp for those costs.

The decision

Both parties accepted that the requirements in sections 51(a) and

(b) of the ICA were satisfied. However, Vero disputed that section 51(1)(c) of the ICA applied because the policy did not respond and provide cover for Mrs Jefferies's liability.

Vero argued that to be found liable for the costs claimed by RailCorp, the Court must find that, in accordance with the relevant term of the policy, Mrs Jefferies was legally responsible to pay compensation for "*loss or damage to property owned or controlled by someone else*" as a result of an accident. Vero alleged that the incident was not an "*accident*" because Mrs Jefferies committed suicide and therefore deliberately caused the incident.

Vero also sought to rely on a policy exclusion, which provided that Vero was entitled to refuse to pay claims where it had been established that the insured "*intentionally*" caused the "*loss, damage or legal liability*".

The term "*accident*" was not defined in the policy so the Court held that it must take its ordinary and usual meaning. The Court applied the meaning cited in ***Australian Casualty Company Limited v Federico*** (1986) 160 CLR 513, being:

> "*Something which happens without intentional design ... an unexpected and unintended mishap.*"

The Court held that:

- there was insufficient evidence to conclude that Mrs Jefferies committed suicide;
- the incident occurred "*without intentional design on the part of Mrs Jefferies*" and therefore was an "*accident*" within the ordinary and usual meaning of that word; and therefore
- the policy responded and provided cover for Mrs Jeffries's liability.

Exclusions

Vero also sought to rely on several policy exclusions, which provided that the policy did not respond where the vehicle was being used for:

- an unlawful purpose; or
- an illegal activity.

Having determined that the incident was an accident and due to Mrs Jefferies' inadvertence, the Court held that neither of the exclusions applied.

Measure of damages

Having determined that the policy did respond, the Court then considered the extent to which the policy covered the damages claimed. The NSW Office of Transport Safety Investigations conducted an assessment of RailCorp's repair costs, and the parties accepted this assessment. However, RailCorp also sought to recover the costs it incurred in providing alternative transport.

Vero submitted that because the policy only provided cover for "*loss or damage to other people's property*", Rail Corp's claim for alternate transport costs should not be included because those costs were for consequential pure economic loss.

The Court was satisfied that the claim for alternative transport costs was not covered by the policy because it was not directly related to the damage to the property; it came from RailCorp's decision to provide alternate forms of transport for passengers. ■

New Zealand earthquakes and successive claims for multiple events

Written by Kristine Vale, Senior Associate and Bonny Daniell-Smith, Solicitor
Tel 02 8273 9951 | 02 8273 9840
Email kristine.vale@wottonkearney.com.au
bonny.daniell-smith@wottonkearney.com.au

Introduction

It is just over two years since Christchurch was rocked by the first in a sequence of earthquakes and aftershocks that are still troubling the region today. Several major earthquake events – in September 2010, December 2010, February 2011, June 2011 and December 2011 – caused extensive property damage.

Since September 2010, the insurance market has faced vast and complex issues unlike anything seen before. These various issues are explored in the article 'More on New Zealand earthquakes' on page 138 of this publication.

Determining indemnity under insurance policies has been complicated because in many cases multiple events occurred within a single policy period and property sustained damage in more than one of these events.

The High Court of New Zealand in ***Ridgecrest NZ Ltd v IAG New Zealand Ltd*** [2012] NZHC 2954 (**Ridgecrest**) recently provided some guidance on this issue, in considering whether an insurer was required to indemnify an insured for the estimated (but not incurred) cost of repairing a building that was damaged in early earthquakes and subsequently rendered a constructive total loss by another earthquake in June 2011.

Background

The insured property was a commercial building in Christchurch. There were four earthquake events within the policy period, and each caused damage to the building. After the first two events, repair costs were estimated and partial repairs were carried out, funded by the insurer. Those repairs were not completed.

The building sustained extensive damage in the third event: the February 2011 earthquake. There was some disagreement between the insured and insurer as to whether the building was beyond economic repair. In any event, both parties agreed that following further damage caused by an earthquake on 13 June 2011, the building was irreparable.

The insurer paid $1.984 million, being

the policy limit for any one claim. In its view, that payment discharged its obligations under the policy. The insured disagreed and sought to recover the total estimated repair costs for the damage caused by the three preceding earthquakes, even though those repairs were not carried out.

Key policy terms

The policy required the insurer to pay:

- the estimated cost of reinstating the insured assets to the condition they were in immediately before the damage occurred ("*old for old basis*") (**C1**); and
- where the insured has restored or replaced the insured building, the cost of "*new for old*" reinstatement or replacement of the insured assets (**C2**).

The policy covered successive losses and the limit of $1.984 million was expressed to be payable in respect of each "*happening*" or loss event within the policy period.

There are two other important features of this policy: first, it did not include terms governing the reinstatement of cover as many policies in the market do; second, the insurer's obligation was to pay quantified repair costs, as opposed to incurred repair costs.

Construction of the policy

The Court held that under the terms of the policy the insurer bore the risk of multiple "*happenings*" throughout the policy period, and that C1 and C2 were not mutually exclusive. Those terms left the insurer open to liability on successive claims, for sums exceeding the limit of liability on a single claim.

The Court noted that where, as in this case, the limit of liability is per "*happening*" or loss event, ordinarily the full sum insured is available in relation to each claim and the insured is not required to increase its coverage after each claim to reinstate the level of cover. The policy is not brought to an end by a total loss of the insured asset, as it is conceptually possible for the building to be reinstated prior to the expiry of the policy period and further claims made.

Frustration saves the day

Despite the above, the Court held that the doctrine of frustration could be invoked to alter the outcome otherwise required by the terms of the policy. To do so, the insurer must show that without the default of either party:

> *"a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract."*

Here, the Court determined that the insurer's obligations in relation to the earlier earthquake claims were frustrated by the later complete destruction of the building.

The insurer had (contrary to the terms of the policy) proceeded to discharge its liability to meet the claims after the first and second earthquakes, by arranging to have the damage repaired. The insured had accepted this course of action. These circumstances effectively gave rise to a variation of the insurer's obligations under the contract. The varied terms only required the insurer to pay the cost of repairs or (in certain circumstances) replacement of the asset.

Had the insured insisted on paying repair or replacement costs as provided under the policy wording, the subsequent destruction of the building would not have rendered performance impossible, because the quantity surveyors had already estimated the costs.

Alternatively, the Court held that a term could be implied into the policy, to the effect that the scope of the insurer's liability for subsequent loss events during the policy period would not require it to pay sums greater than was necessary to effect repairs that could not be undertaken before the building became irreparable.

Conclusions

While the terms of the policy in Ridgecrest were unique, the judgment is encouraging as it shows a willingness by the courts to construe policy terms consistent with the general principle that an insured should not recover more than its ultimate net loss.

This decision is limited to the interpretation of an individual policy in its own commercial context. It should therefore not necessarily be viewed as having broad precedential value for insurers. Nevertheless, the decision is noteworthy in exposing the potential for insurers to be exposed to a liability exceeding the policy limit where there are successive occurrences such as the recent Christchurch earthquakes.

At the same time, it reveals a willingness by the New Zealand courts, when dealing with earthquake claims, to apply legal principles in a manner that will not expose insurers to liability exceeding the insured's actual loss.

Flood insurance update

Written by John Dillon, Senior Associate
Tel 02 8273 9806
Email john.dillon@wottonkearney.com.au

Introduction

In the aftermath of the 2010–2011 floods in Queensland and Victoria, the Federal Government commissioned the Natural Disaster Insurance Review Panel (**the Review Panel**) to conduct an independent inquiry into flood insurance in Australia.

Based on the Review Panel's November 2011 report, the Commonwealth Government published a consultation paper that canvassed a number of key areas aimed at improving the availability and affordability of flood insurance. The legislative response to the Review Panel's report, the **Insurance Contracts Amendments Act 2012 (Cth)** (**ICAA**), passed both houses of Parliament and received Royal Assent in April 2012. Regulations giving effect to the ICAA were made in June 2012. A standard definition of "*flood*" is now law.

Background – the Review Panel proposals

The Review Panel proposed a number of significant changes to flood insurance including:

- introducing a mandatory offer of flood cover for all home building and home contents insurance policies, with consumers able to opt out of flood coverage;
- introducing the following standard definition of "*flood*" for all insurance policies:

  "Flood means the covering of normally dry land by water that has escaped or been released from the normal confines of:

  (a) Any lake, or river, creek or other natural watercourse, whether or not altered or modified; or

  (b) Any reservoir, canal, or dam."

- having insurers provide a one page 'Key Facts Sheet' (**KFS**) to all their customers, to allow quick and easy access to and understanding of the basic terms of their insurance policy, including key areas of coverage and exclusions;
- introducing a system of premium discounts available to consumers living in flood-prone areas, with the discounts to be phased out over time; and
- establishing a flood risk reinsurance pool to fund these discounts.

The ICAA

The ICAA, which came about after the Review Panel delivered its 47 recommendations, amends the **Insurance Contracts Act 1984 (Cth)**. The ICAA introduced a legislative framework for establishing regulations that:

- define the "*prescribed contracts*" to which the ICAA and its regulations

apply;
- provide a standard definition of "*flood*"; and
- specify the form and content of a KFS for prescribed contracts.

In addition, the ICAA provides that:

- an insurer must clearly inform the intending insured, in writing, whether a prescribed contract covers flood loss or damage before the contract is entered into;
- if a prescribed contract includes "*flood provisions*" (that is, provisions that cover loss or damage for one or more flood events) the contract is taken to provide cover in respect of "*flood*" as defined by the regulations; and
- if the flood provisions in a prescribed contract provide different amounts of cover in respect of different flood events, the highest amount of cover will apply in respect of any flood event.

The Regulations

The **Insurance Contracts Amendment Regulation 2012** (**Regulations**) introduced on 18 June 2012 gives effect to the standard definition of "*flood*" and adopts the definition recommended by the Review Panel. The standard definition applies to "*prescribed contracts*" of insurance, including home building and contents, "*small business*" (as defined in the Regulations) and strata title insurance policies. It does not apply to:

- prescribed contracts entered into before 18 June 2012;
- the operation of a prescribed contract where the flood event occurred prior to 18 June 2012; or
- contracts arranged by an insurance broker in the course of providing financial advice.

Importantly, insurers can still choose whether to include flood cover in a policy – it is not a mandatory cover. Only if an insurer elects to offer flood cover must it adopt the standard flood definition.

The Regulations also provide for a two-year transitional period, which is intended to provide insurers with sufficient lead time to update the contents of their product disclosure statements and policy documents, retrain staff, and implement any necessary systems changes. However, the Regulations allow insurers to immediately adopt the standard flood definition if they choose.

The details of the specific content of the KFS are yet to be prescribed. Prototypes of the KFS will be submitted for consumer testing before the final content, format and structure of the KFS is settled and prescribed in future regulations.

Implications

Some of the key outcomes of the proposals, the ICAA and the Regulations are as follows:

- Insurers are not required to provide mandatory flood cover, and home building and contents insurance itself remains optional. It is still up to consumers to determine their own insurance needs.
- Where flood cover is offered in high-risk areas, consumers are still likely to face significant premiums. This is one of a number of issues raised by the Review Panel that the Federal Government chose not to address. The matter was to be considered further following a consultation process conducted throughout 2012.
- Disputes are still likely to arise as to whether damage was caused by stormwater or floodwater. The standard definition of "*flood*" may assist but disputes will still occur.
- The standard definition of "*flood*"

provides some certainty and enables insurers to consider the definition so they can more precisely determine the economic cost of offering flood insurance and the additional premium that flood cover should attract.

- The requirements to produce a KFS and to ensure that intending insureds are "*clearly informed*" as to whether a prescribed contract covers flood loss or damage are an additional compliance burden for insurers. While the information likely to be required in the KFS should be relatively easy to extract from a product disclosure statement, this will still result in extra compliance costs. ■

Cold comfort for insurers – what is real and personal property?

Written by Julie Bowker, Senior Associate
Tel 02 8273 9802
Email julie.bowker@wottonkearney.com.au

Introduction

In ***Commonwealth of Australia v Vero Insurance Limited*** [2012] FCA 826, the Federal Court of Australia considered whether an ultimate net loss insurance policy (**the UNL policy**) issued by Vero Insurance Limited (**Vero**) covered remediation costs and other associated costs arising from damage caused by a fuel oil spill at Casey Base Station in the Australian Antarctic Territory.

Background

Comcover, a self-managed insurance fund, was established to provide insurance cover to fund members, being certain Commonwealth agencies. The Australian Antarctic Division (**the AAD**) is a fund member.

Comcover issued the AAD with a schedule of cover for the period 1 July 1999 to 20 June 2000, which included cover for the fund member's property. The Comcover Manual:

- included an insuring clause in relation to property loss, destruction or damage which stated that:

  > "*property means the Fund Member's real and personal property ... which is in your possession, care, custody or control, or your responsibility*";

- defined "*property*" as:

  > "*all tangible real, or tangible personal property excluding watercraft more than 15 metres in length, and aircraft*"; and

- provided that in the event of property loss, destruction or damage, Comcover would pay the actual replacement value of property lost, destroyed or damaged.

Vero (then Royal & Sun Alliance Insurance Australia Ltd) issued the UNL policy on 13 July 1999. The insured was noted as "*The Commonwealth of Australia through its self-managed fund known as Comcover*". The insuring agreements included an agreement by Vero "*to indemnify Comcover for its liability or responsibility to reimburse Fund Members for any claims*".

A fuel oil spill occurred at Casey Base Station between 9pm on 19 July 1999 and 8.30am on 20 July 1999. Comcover initially declined cover but, following representations by the Australian Government Solicitor, on 21 June

2005 Comcover advised the AAD that it accepted the oil spill as an insured event.

Comcover sought an indemnity from Vero under the UNL policy for its liability to the AAD. Vero declined indemnity on the basis that there was no loss, destruction or damage to real property owned by the AAD. Vero submitted that since the AAD did not own Antarctica (or any part of it), the insuring clause was not activated and Comcover was not obliged to accept the AAD's claim. Vero said it was not therefore required to indemnify Comcover.

The Commonwealth commenced proceedings against Vero, seeking a declaration that it was entitled to indemnity under the terms of the UNL policy, as well as other relief. The Court was asked to consider:

- whether there was damage to real or personal property in the possession, care, custody or control of the Commonwealth; and
- whether the Commonwealth's claim was statute barred.

Was there damage to real or personal property in the possession, care, custody or control of the Commonwealth?

Yates J considered that since a Commonwealth agency such as the AAD is not capable of owning property in its own right, the real and personal property referred to in the insuring clause of the Comcover Manual must be a reference to property owned by the Commonwealth.

Furthermore, the Comcover Manual provided cover for loss or damage to "*Fund Member's real and personal property ... which is in your possession, care, custody or control, or your responsibility*". Yates J therefore considered that the contaminated land was potentially within the scope of the Comcover Manual as the Casey Base Station was Commonwealth land for the purpose of domestic law, and it was administered and controlled by the AAD as an emanation of the Commonwealth.

Notwithstanding that conclusion, Yates J stated that the insuring clause had to be considered having regard to all provisions and within the context of the Comcover Manual as a whole. He held that since the liability created by the insuring clause was directed at the replacement value or cost of repair of property which was lost, destroyed or damaged, the nature of the real or personal property covered was buildings or items which could be replaced or reinstated by repair, not land. Yates J therefore held that the contaminated land was not "*real or personal property*" within the insuring clause of the Comcover Manual and the Commonwealth's claim failed.

Was the claim statute barred?

Although it was not necessary for him to do so, Yates J went on to consider limitation.

It was common ground between the parties that the applicable limitation period was six years from the date the cause of action accrued, as provided by section 14 of the **Limitation Act 1969 (NSW)**. Three dates were suggested as being when the Commonwealth's cause of action accrued:

- 20 July 1999, the latest possible date of the fuel oil spill;
- 21 June 2005, when Comcover notified the AAD that indemnity would be provided; and
- 31 January 2008, when Comcover made an instalment payment to the AAD, which resulted in total payments being made in excess of the in-house retention and the fund member's excess.

Yates J held that the earliest date of loss

for the purpose of the Commonwealth's claim was 21 June 2005, when Comcover notified the AAD that it accepted the fuel oil spill as an insured event. Since the proceedings were commenced on 14 June 2011, the claim was not statute barred.

Comments

Given the broad definition of "*property*" in the Comcover Manual, which includes "*all tangible real, or tangible personal property*", at first glance the Court's decision appears harsh. However, when considered with regard to the well-recognised principle that contractual terms must be read in the context of the contract as a whole, the Court's decision appears to be correct.

This case is a further example of how courts consider the scope of insuring clauses. It highlights that in cases where there is ambiguity concerning the nature of property covered, the courts will consider the policy wording as a whole and will seek guidance from the character of the liability or responsibility assumed by insurers. Only in the rare cases where ambiguity cannot be resolved by reference to the policy wording will the courts allow parties to introduce evidence of the parties' intentions. ■

Federal Court revisits privilege over loss adjusters' reports

Written by Michael Bath, Special Counsel and Gabrielle Levette, Senior Associate
Tel 02 8273 9953 | 02 8273 9936
Email michael.bath@wottonkearney.com.au
gabrielle.levette@wottonkearney.com.au

Introduction

In ***Ensham Resources Pty Limited v AIOI Insurance Company Limited*** [2012] FCA 710, the Federal Court revisited and reaffirmed the principle applicable as to when a loss adjuster's report will be protected by legal professional privilege.

Facts

In 2008, heavy rainfall caused a river and creek to overflow and breach earth levees, which in turn caused certain pits at a mine owned by Ensham to be inundated with water. Ensham made a claim under its industrial special risks insurance policy with AIOI Insurance Company Limited (**the insurer**) for loss and damage suffered. The insurer retained a loss adjuster to investigate the claim, and solicitors to provide legal advice.

The solicitors recommended that they retain the loss adjuster directly to protect privilege over any reports produced. The insurer agreed and the solicitors' retainer letter to the loss adjuster indicated that:

- the solicitors had been instructed to advise on the policy response and to deal with certain issues that were likely to be contentious between the parties;
- a number of issues were likely to lead to a dispute about the policy response;
- any dispute over policy response was likely to result in litigation; and
- the loss adjuster's reports should be prepared on a privileged and confidential basis and in anticipation of future litigation.

The insurer ultimately denied indemnity for the claim and Ensham commenced proceedings to recover its loss. In doing so, Ensham sought discovery of all of the loss adjuster's reports. The insurer claimed privilege over some of the loss adjuster's reports on the basis that they were prepared for the dominant purpose of providing assistance or advice in relation to anticipated litigation. Ensham disputed the insurer's claim and argued that the reports were prepared to enable the insurer to determine whether to grant indemnity, for reserving issues and/or to comply with any reporting requirements, and that they therefore did not attract privilege.

The decision

In considering the insurer's claim, the Federal Court reaffirmed the following

general principles governing legal professional privilege:

- The person claiming the privilege bears the onus of establishing that at the time the document was produced, litigation was reasonably contemplated.
- The test of whether litigation is reasonably contemplated is an objective one. It does not require the solicitor to believe that litigation is absolutely certain, but it must be more than mere speculation.
- The party claiming privilege must also establish that the material was prepared for the dominant purpose of providing assistance or advice in relation to the anticipated proceedings.
- The "*dominant purpose*" means the ruling, prevailing or most influential purpose. The fact that material has been sent to a solicitor to enable them to provide advice will not be determinative.
- To determine the dominant purpose, the Court must inquire into the state of mind of the solicitor for the party claiming privilege, not the loss adjuster or the insurer.
- If a document has two or more purposes of equal significance, the document cannot be said to have a dominant purpose.

The Court acknowledged that statements in the solicitors' correspondence revealed a deliberate attempt to attach legal professional privilege to the loss adjuster's reports. However, the Court did not consider that such statements were persuasive, nor could they attach privilege to otherwise unprivileged documents.

Notwithstanding those statements, the Court accepted that:

- the consequences of the flood were catastrophic for Ensham and there was a real possibility that the costs of remedial measures would exceed the policy limits; and
- at the time the loss adjuster was retained, the solicitors considered that cover for the failed levees (which ultimately caused the inundation and loss) would likely become a contentious issue.

Given that evidence, the Court held that:

- when the loss adjuster's reports were being prepared, there existed a real prospect of litigation and the solicitors foresaw that litigation; and
- the loss adjuster's reports were prepared for the dominant purpose of providing advice in relation to litigation, and were therefore protected by legal professional privilege.

The appeal

On 21 December 2012 the majority of the Full Federal Court (Lander and Jagot JJ) refused Ensham's application for leave to appeal the primary judge's decision. In the minority judgment, Buchanan J allowed Ensham's application but accepted the primary judge's reasons and dismissed the appeal.

Implications

The decision is a useful reminder of the general principles relevant to when a loss adjuster's report will attract privilege. It also reinforces the status quo: that statements indicating that a report will be prepared for the purposes of litigation are typically insufficient to establish a valid claim for privilege. An insurer will need to demonstrate, based on the evidence available at the time the report was prepared, that litigation was reasonably contemplated and that its solicitors had turned their minds to that fact. ■

More on New Zealand earthquakes

Written by Adam Chylek, Partner and Kristine Vale, Senior Associate
Tel 02 8273 9940 | 02 8273 9951
Email adam.chylek@wottonkearney.com.au
kristine.vale@wottonkearney.com.au

The earthquakes that rocked Christchurch in September 2010 and February 2011 – and the catastrophic consequences that have since cascaded throughout the Shaky Isles – have exposed a difficult clash between commerce and law, which will inevitably change the way insurance is placed in this part of the world. One thing is clear: the region has never seen an insurance event quite like it, and some tough lessons have been learned.

For almost 18 months, Wotton + Kearney has had a team of lawyers picking through the colossal range of legal issues raised by the Christchurch earthquakes. While the scale of claims work from natural catastrophes over recent years has been boggling – bushfires, floods, cyclones – there has never been such a brutal disparity between expectation and entitlement as manifested in Christchurch. It is hard to escape the sense that many of the policies in the market were never designed to deal with catastrophes with this level of complexity. That isn't surprising to anyone who has worked in property or energy insurance.

The Australasian market generates a myriad of wordings, many of which have now been asked to respond to earthquake-related losses. Some are capable of performing, others are not. There are enormous differences in policy language, ranging from plain English and language directed at small to medium enterprise, to bespoke programmes prepared for global corporate insureds – many of which are still derived from the classic Mark IV Industrial Special Risks wording, and some unfortunate cut-and-paste versions of it. These differences have made it clear to insurers that there is no one answer or global fix to any particular policy problem. That creates a challenge when insurers, as they so valiantly do, seek to mobilise and coordinate catastrophe responses. Getting on the ground and providing an immediate presence is critical, but the differences in policy wordings make a consistent industry-wide approach challenging.

The breadth of policy responses is so vast that all insurers have been lumped into the same basket. And even though the reaction from the insurance industry has been powerful and at times impressive, critical progress has often stagnated because of paralysis in the rebuilding and reinstatement process. Local and central governments have intervened quickly and magnanimously, but plenty of insurers have taken an ego hit due to unfavourable press coverage.

Some criticisms have been justified but, as often occurs, many horror stories have been exaggerated.

We act for many of the significant players in the market and have watched the evolution of legal troubles in Christchurch. Many threshold policy problems regenerate with every significant catastrophe. Others are earthquake specific. Our work has focused on large-scale commercial buildings, infrastructure assets, significant academic and health services, body corporates, retail facilities and the hotel industry.

Local and home-office executives regularly ask us to identify some of the key lessons to be learned from the Christchurch catastrophe and to make recommendations for change. This list of lessons and recommendations is a long one.

- Building legislation in New Zealand has been in a state of perpetual uncertainty since the earthquake on 22 February 2011. While the building code and local council policies have undergone some change, the significant changes are yet to come. 'Code compliance' issues have impeded many recovery and reinstatement projects, and the lack of certainty has crippled many insureds. Councils have imposed new standards during the rebuilding process that generally do not reflect the entitlements under insurance policies. There is currently a large uninsured cost of rebuilding in Christchurch.
- Many insureds have found that they chose grossly inadequate levels of insurance for both material damage and business interruption, leading to systemic underinsurance.
- The transition between indemnity (actual cash) value and reinstatement is often unclear in policy language. The complexity of the language around reinstatement means that many insureds do not fully appreciate the circumstances in which they are entitled to sums greater than indemnity value – that is, when an insured actually undertakes repairs or rebuilds.
- Many policies provide insureds with generous and sensible alternatives to repairing or reinstating damaged property, including 'greenfield' site options, and the ability to apply funds to other unrelated capital expenditure. Some policies are silent on these benefits. This can create a potential disparity between two commercial insureds depending on the policy wording: one building owner gets the benefit, the other doesn't.
- One of the significant features of the Christchurch earthquakes is the extent to which land has been affected by lateral spread and liquefaction. Most (if not all) policies exclude costs to remediate land; however, in many cases the land remediation is inextricably linked to reinstating the building.
- Immediately after the major earthquake on 22 February 2011, public authorities established a cordon around Christchurch's central business district, preventing access to all buildings and services within this area (later known as the 'red zone'). At the time this zone was established, the industry did not expect that it would still be in place today. The size of the 'red zone' has gradually reduced, but tracts of the CBD are still cordoned off.
- The 'red zone' is unique to Christchurch and has generated rather unusual – and unanticipated – policy responses, particularly for business interruption losses. This has been manifested in a number of ways, but one of the most problematic issues is determining what "*triggered*" the business interruption loss. Was it the damage to the building, the prevention

of access or both? Insureds in the 'red zone' who have not sustained damage, or have suffered only minor damage, have found that their losses might be adjusted under a contingent business interruption clause. These clauses are usually sublimited and generally not designed to cover an extended period of exclusion. The issue is further complicated depending on whether an insured has cover for gross profit or gross rentals. While the adjustment methodology is the same under each item of cover, the application of the trends clause and the contractual relationship between insureds and their tenants often means the outcome is vastly different. The lack of real and current economic data needed to analyse business interruption claims has hampered the adjustment process.

- Policy and programme structures have come under heavy scrutiny, with particular focus on the adequacy of building data used to underwrite risks; whether asset schedules form part of the policy and guide policy limits; and whether policy benefits that are captured in separate items of cover can be "*stacked*".
- The multiple earthquake events have generated debate around reinstatement of policy limits and how to properly allocate damage to each individual event. While there is now some level of sophistication in New Zealand to allow insurers to more accurately undertake this allocation, it remains a difficult process.

Environmental and political pressures overlay these policy issues. Christchurch faces a long rebuild. There are many actors, each with a role to play in the recovery and rebuilding process. There is a fascinating and at times robust interaction between the Insurance Council of New Zealand, the Canterbury Earthquake Recovery Authority, local and central governments, insureds, insurers and brokers.

The devastation in Christchurch has propagated a number of legal issues that have had an impact on policy entitlement. Naturally, many insureds have had to temper their expectations about policy coverage. The series of events has also generated almost unprecedented interest and inquisition from reinsurers. What is surprising is the stunning absence of litigation on key insurance issues. Deals are being done every day in New Zealand – for many hundreds of millions of dollars – and the percolating principles of good faith seem to be guiding negotiations. It is fair to say that an event like this in Australia would by now have seen a voluminous suite of case law to rival the obsession with late notification and section 54 of the **Insurance Contracts Act 1984 (Cth)** in the 1990s.

Maybe those Kiwis are onto something… ■

Insurance Year in Review 2012
Trade + Transport

Insurers should always question authority

Written by Andrew Moore, Partner and Anglea Winkler, Solicitor
Tel 02 8273 9943 | 02 8273 9983
Email andrew.moore@wottonkearney.com.au
angela.winkler@wottonkearney.com.au

Introduction

The NSW Court of Appeal decision in ***Herde v Oxford Aviation Academy (Australia) Pty Ltd*** [2011] NSWCA 385 makes it clear that insurers may not always have the authority to settle a claim on behalf of an insured.

Background

Mr Herde made a claim under his insurance policy with QBE for damage to his aircraft caused when another aircraft owned by Oxford Aviation Academy (Australia) Pty Ltd (**OAA**) crashed at Bankstown Airport. QBE exercised its subrogation rights and made a claim against OAA's insurer, Hemisphere. QBE and Hemisphere reached a settlement whereby Hemisphere agreed to pay the sum of $73,408 for the property damage. Hemisphere failed to pay the settlement sum and Herde commenced proceedings in the District Court against OAA in respect of the outstanding $73,408.

At first instance, the trial judge granted summary judgment against OAA on the basis that:

- summary judgment should only be granted where the defence was:
  - so obviously untenable that it could not possibly succeed; or
  - manifestly groundless;
- there was no triable issue; and
- the evidence was *"really clear cut"* and *"compelling"*.

OAA appealed the District Court's decision on the basis that Hemisphere was not entitled to enter the deed of release on its behalf.

Court of Appeal decision

The sole issue for the Court of Appeal to consider was whether Hemisphere had authority to enter into the release on behalf of OAA. Mr Herde argued that Hemisphere did have the authority to settle on behalf of OAA, relying on clause 5 of the policy, which stated that:

"[Hemisphere] shall be entitled (if they so elect) at any time and for so long as they desire to take absolute control of all negotiations and proceedings and in the name of [OAA] to settle, defend or pursue any claim".

The Court of Appeal held that:

- clause 5 was not an obvious source of authority for Hemisphere to enter into the release;
- summary judgment should not have been granted;

- it was arguable that Hemisphere had acted without authority; and
- the matter should go to trial.

Implications

This case is a prudent reminder for insurers seeking to settle subrogated recovery claims that they should ensure other insurers have the relevant authority to settle claims.

The narrow construction of promissory warranties in contracts of marine insurance

Written by Nick Lux, Partner and Aisha Lala, Solicitor
Tel 03 9604 7902 | 03 9604 7916
Email nick.lux@wottonkearney.com.au
aisha.lala@wottonkearney.com.au

Introduction

The recent English decision of ***Elafonissos Fishing And Shipping Company v Aigaion Insurance Company SA*** [2012] EWHC 1512 illustrates the narrow construction given to a promissory warranty in the context of a marine insurance policy. The outcome indicates the need for clear and direct language in order for underwriters to safely rely on a breach of a warranty to discharge them from the promise to indemnify.

Facts

The defendant underwriters, Aigaion Insurance Company SA (**Aigaion**) insured the fishing vessel *Agios Spyridon* (**the vessel**) under a time policy from August 2006 to August 2007. The vessel operated out of the port of Mahajanga, Madagascar, and regularly fished the surrounding waters in the fishing season from February to November. The vessel was then laid up from November to February, during the cyclone season.

The insured's policy contained a term that the vessel was "*warranted laid up from 1/11/06 until 28/2/07 BDI in the Port of Mahajanga*".

On Christmas Day 2006, a cyclone struck Mahajanga. Heavy seas caused the vessel to break free from its mooring and collide with the port infrastructure, causing damage to the vessel (**the incident**).

The claim

The vessel's owners, Elafonissos Fishing and Shipping Company (**Elafonissos**), claimed under the policy for the damage to the vessel as a result of the incident. Underwriters denied liability on the basis that Elafonissos was in breach of the warranty that the vessel would be laid up at the time of the Incident. Elafonissos issued proceedings against Aigaion, seeking indemnity for the damage to the vessel.

Breach of warranty

Aigaion alleged that at the time the cyclone hit, the vessel was inappropriately manned and/or the

engines were not operational.

Underwriters argued that the true construction of the phrase "*warranted laid up ... in the Port of Mahajanga*" meant that between 1 November 2006 and 28 February 2007, the vessel was required to comply with the regulations of the Port of Mahajanga. Aigaion alleged that those regulations required the vessel to have:

- four crew members on board including a master and a chief engineer; and
- operational main and auxiliary engines.

However, Aigaion was not able to produce any evidence of the port regulations.

The decision

There was significant dispute between the parties over the factual circumstances of how the vessel was manned and operated at the time of the loss. The Court ultimately found that Aigaion could not make out the factual basis for the alleged breach of the warranty. It held that at the time the cyclone struck:

- the vessel was manned by the chief engineer and at least two other crew members; and
- the state of the engine was largely a matter of speculation, as neither party had satisfied the Court as to whether it was, or was not, operational.

Blair J held that:

- as a matter of law, the express warranty could not be construed as implying further requirements to comply with port regulations – it simply meant what it said; and
- failing to provide evidence of the port regulations, Aigaion was unable to support the breach of warranty allegation.

Implications

This decision is a useful reminder that if underwriters want to rely on promissory warranties under a contract of marine insurance, the terms of the warranty need to be clearly stipulated. The warranty, if at all ambiguous, will be construed in favour of the insured.

The relevant clauses of the English and Australian **Marine Insurance Acts** (sections 33(3) and 39(3) respectively) are identical, so this decision may be persuasive in Australia. In Australia, section 39(3) of the **Marine Insurance Act 1909 (Cth)** (**MIA**) provides that a warranty is a "*condition which must be exactly complied with*", whether it is material to the risk or not. A breach of warranty by the insured discharges the insurer from all further liability from the date of the breach.

Promissory warranties are often described as draconian and harsh in their operation and courts have been creative in reading down their effects in favour of insureds[1]. A reform was proposed in 2001[2] to prevent insurers avoiding cover where the loss was not proximately caused by or attributable to the breach – similar to the effect of section 54 of the **Insurance Contracts Act 1984 (Cth)** on conditions of non–marine insurance policies. There has, however, been no legislative change since the proposed reform in 2001. Strict compliance with express warranties in marine insurance policies that are subject to the MIA remains the status quo in Australia. ■

---

1 See for example, ***Allison Pty Ltd t/ as Pilbara Marine Port Services v Lumley General Insurance Ltd*** [2006] WASC 104 where the insured successfully argued the proximate cause was not the failure to moor the vessel on cyclone-proof mooring but the cyclone itself – despite the insured's actions being in breach of an express warranty.

2 Australian Law Reform Commission, *Review of the Marine Insurance Act 1909*, Report No 91 (2001).

Australian jurisdiction rules the seas – Federal Court finds foreign law and arbitration clause has no effect in Australia

Written by Faith Geraghty, Senior Associate
Tel 02 8273 9964
Email faith.geraghty@wottonkearney.com.au

Introduction

In ***Dampskibsselskabet Norden A/S v Beach Building and Civil Group Pty Ltd*** [2012] FCA 696 the Federal Court considered the provisions of the **Carriage of Goods by Sea Act 1991 (Cth)** (**COGSA**) in relation to its interpretation of:

- a voyage charterparty as a sea carriage document; and
- the Australian Courts' jurisdiction vis á vis foreign law and arbitration clauses in charterparties.

Background

The case concerned a voyage charterparty, in which Dampskibsselskabet Norden A/S (**DKN**) (as disponent owner) chartered a vessel from Beach Building and Civil Group Pty Ltd (**Beach Civil**) (as charterers) for the carriage of a cargo of coal from Australia to China.

A dispute arose between the parties about the demurrage payable under the charterparty regarding delays to the vessel at the loading and discharge ports. Since the charterparty provided that all disputes in relation to the charterparty should be arbitrated in London and subject to English law, the dispute was referred by DKN to arbitration in London. The arbitrator agreed to determine two preliminary issues, being:

- the Arbitrator's jurisdiction to hear an arbitration concerning a dispute arising out of the charterparty; and
- the identity of the charterer which, according to DKN, had been incorrectly named on the charterparty.

Although Beach Civil agreed to allow the arbitrator to determine these preliminary issues, it contended that the London arbitration clause in the charterparty was invalid and unenforceable by reason of section 11 of COGSA:

> *"11. Construction and jurisdiction*

(1) All parties to:

(a) a sea carriage document relating to the carriage of goods from any place in Australia to any place outside Australia; or

(b) a non-negotiable document of a kind mentioned in subparagraph 10(1)(b)(iii), relating to such a carriage of goods are taken to have intended to contract according to the laws in force at the place of shipment.

(2) An agreement (whether made in Australia or elsewhere) has no effect so far as it purports to:

(a) preclude or limit the effect of subsection (1) in respect of the bill of lading or a document mentioned in that subsection; or

(b) preclude or limit the jurisdiction of a court of the Commonwealth or of a State or Territory in respect of bill of lading or a document mentioned in subsection (1); or

(c) preclude or limit the jurisdiction of a court of the Commonwealth or of a State or Territory in respect of:

(i) a sea carriage document relating to the carriage of goods from any place outside Australia to any place in Australia; or

(ii) a non negotiable document of a kind mentioned in subparagraph 10(1)(b)(iii) relating to such a carriage of goods ..."

The arbitrator determined that:

- he had jurisdiction to decide the disputes between the parties arising out of the charterparty;
- the name of the charterers was incorrectly recorded in the charterparty and it should have mentioned Beach Civil; and
- Beach Civil should be ordered to pay DKN US$824,663.18.

DKN applied to the Federal Court of Australia for orders recognising the arbitrator's awards (which were made in England) pursuant to section 8 of the **International Arbitration Act 1974** (**Cth**) (**the Act**) which states:

"8. Recognition of foreign awards

(1) Subject to this Part, a foreign award is binding by virtue of this Act for all purposes on the parties to the arbitration agreement in pursuance of which it was made.

(2) Subject to this Part, a foreign award may be enforced in a Court of the State or Territory as if the award were a judgement or order of that Court.

(3) Subject to this Part, a foreign award may be enforced in the Federal Court of Australia as if the award were a judgment or order of that Court."

Beach Civil resisted DKN's application on the same grounds as those it argued in relation to the arbitration: that since the charterparty was a sea carriage document, section 11 of COGSA meant that the London arbitration clause had no effect and that only the Australian Courts had jurisdiction in relation to any dispute under the charterparty.

The decision

Foster J confirmed that the critical question to be resolved was whether the charterparty was a "*sea carriage document*" within the meaning of section 11(1)(a) of COGSA or a "*non-negotiable document*" within the meaning of section 11(1)(b) of COGSA. If the charterparty was either of those documents then the London arbitration clause had no effect and arbitrator's awards could not be enforced against Beach Civil.

Foster J ruled in favour of Beach Civil. His Honour found that this conclusion was consistent with section 2C of the Act, which provided that "*nothing in this Act affects: ...(b) the operation of sections 11 or 16 of the Carriage of Goods by Sea Act 1991*".

Although there is no definition of "*sea carriage document*" in COGSA, His Honour relied on Article 1(1)(g)(iv) of the amended International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading (**the Hague Rules**), which defines a sea carriage document as:

"(1) a bill of lading; or

(2) a negotiable document of title that is similar to a bill of lading and that contains or evidences a contract of carriage of goods by sea; or

(3) a bill of lading that by, law, is not negotiable; or

(4) a non-negotiable document (including a consignment note and a document of the kind known as a sea waybill or the kind known as a ship delivery order) that either contains or evidences a contract of carriage of goods by sea."

Foster J recognised that while that definition does not apply to COGSA itself, the amended Hague Rules do have force of law in Australia and therefore "*assume some significance in COGSA 1991*".

In its submissions, DKN argued that the original enactment of COGSA referred to "*any bill of lading or document related to the carriage of goods from any place in Australia*" and that this expression supported its argument that charterparties are not sea carriage documents within the meaning of COGSA.

Foster J disagreed and referred to the decision of Caruthers J in ***Sonmez Denizcilik ve Ticaret Anonim Sirketi v MV "Blooming Orchard" (No 2)*** (1990) 22 NSWLR 273 (followed by Hill J in ***BHP Trading Asia Limited v Oceaname Shipping Limited*** (1996) 67 FCR 211 at 235) to support his conclusion that charterparties are deemed to be sea carriage documents. In Foster J's view it was clear from the various amendments to maritime legislation since 1997 that the legislature intended to widen the definition of "*sea carriage document*".

His Honour noted that his findings were contrary to the Supreme Court of South Australia's decision in ***Jebsens International (Australia) Pty Ltd v Interfert Australia Pty Ltd*** [2012] SASC 50 (***Jebsens***). That case involved similar circumstances: a dispute in relation to unpaid freight claims under a voyage charterparty was submitted to arbitration in London. In ***Jebsens***, Anderson J held that the voyage charterparty was not a "*sea carriage document*" within section 11 of COGSA or within the meaning set out in the amended Hague Rules. He stated that:

"COGSA in its current form deals with the rights of persons holding bills of lading or similar instruments. A charterparty is a document of a different genus. A charterparty is not a sea carriage document simply because it is a document containing a contract for the carriage of goods by sea. The charterparty is the relevant document, not the bill of lading. The arbitration was concerned with the charterparty."

Foster J did not go into detail about how his findings differed to those of Anderson J, save to point out that he respectfully disagreed with Anderson J for the reasons explained in the judgment.

DKN has appealed Foster J's decision.

Implications

This case casts serious doubt over the ability to enforce foreign maritime arbitral awards in Australia, which was the principal aim of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. It will no doubt encourage those drafting arbitration clauses in sea carriage documents to include Australia as an arbitration seat if they consider there is a likelihood that enforcement will be required in Australia. ■

London court sinks non-disclosure defence

Written by Andrew Moore, Partner and Anglea Winkler, Solicitor
Tel 02 8273 9943 | 02 8273 9983
Email andrew.moore@wottonkearney.com.au
angela.winkler@wottonkearney.com.au

The UK Commercial Court decision in ***Sealion Shipping & Anr v Valiant Insurance Co*** [2012] EWHC 50 (Comm) sets a high bar for insurers to reach when attempting to prove material non-disclosure or misrepresentation.

Background

The owners of the vessel *Toisa Pisces* made a claim under their hull and machinery policy for 82 days' loss of hire as a result of a motor breakdown. The insurer refused to provide indemnity on the basis that:

- the owners had not disclosed that there had been two previous hull claims, not just one in 2004 which had resulted in an off-hire period of 10 days; and
- the broker's statement that there was an *"excellent hull record"* was a misrepresentation.

In the alternative, the insurer relied on a defence in the policy that the breakdown was caused by the owners' negligence, arguing that prudent owners would have made modifications to the motor following the incident in 2004.

The decision

The Court found in favour of the insured and held that the insurer could not avoid the policy for non-disclosure or misrepresentation. The undisclosed 10-day off-hire period in 2004 was not material in the context of the 21 day excess period.

The Court found that the broker's reference to the *"excellent hull record"* was a statement of opinion made in good faith rather than a statement of fact.

The Court also found that the insured was not negligent. Having regard to the concept of aggregation, the Court agreed that there was no technical connection between the three hull claims; rather, one breakdown had led to another, so there was only one *"occurrence"* and one deductible.

Implications

Failure to disclose prior losses of the exact kind for which indemnity is then sought is often found to be material non-disclosure. However, in this case the Court looked favourably on the insured, considering whether the non-disclosed fact would negatively influence the judgment of a prudent insurer in a commercial context. The outcome may have been different if the vessel had been off-hire for a longer period, or if the previous occurrences had occurred more recently and were closer in duration to the excess period. ■

Recent legislative shipping reforms and their impact

Written by Nick Lux, Partner and Suzanne Craig, Solicitor
Tel 03 9604 7902 | 03 9604 7921
Email nick.lux@wottonkearney.com.au
suzanne.craig@wottonkearney.com.au

The **Coastal Trading (Revitalising Australian Shipping) Act 2012 (Cth)** (**the Act**) commenced operation on 1 July 2012.

The purpose of this Act, as its name suggests, is to promote a viable shipping industry in Australia. Between 1995 and 1996, there were 55 registered ships in Australia's trading fleet. That number declined to 22 between 2010 and 2011, and it was widely considered that unless some action was taken, there would be no Australian registered vessels operating within the next five years. Further, foreign-flagged vessels were receiving favourable cost structures in comparison to Australian licensed vessels under the old permit system.

The legal background

According to the Act's explanatory memorandum, the decline in Australia's trading fleet stems from "*the failure of Australian shipping policy to keep pace with global changes in the industry, as well as the regulatory and competitive settings faced by the domestic industry*". Therefore, the objectives of the Act include:

- maximising the use of Australian vessels in coastal trading;
- promoting competition;
- supporting the long-term growth of the Australian shipping industry; and
- improving efficiency and reliability within the industry.

"*Coastal trading*" is the commercial activity of transporting passengers and/or cargo between ports around Australia. The Act introduces a three-tier licensing system for access to coastal trade, under which:

- a general licence provides unrestricted access to engage in coastal trading in Australian waters for a period of five years;
- a temporary licence provides authorisation to carry out voyages authorised by the licence for a period of 12 months; and
- an emergency licence provides authorisation to engage in coastal trading in identified emergency situations for a period of up to 30 days.

General licences are only granted to vessels registered in the Australian General Shipping Register. This means the vessel must be an Australian-owned ship and the seafarers working on the vessel when it is engaged in coastal trading must be Australian citizens or

holders of certain approved visas. It is an offence to engage in coastal trading without a licence.

The Minister of Infrastructure and Transport has the power to issue these licences. The Act sets out the factors that are relevant to the Minister's exercise of discretion in determining whether or not to vary a licence, and how a decision of the Minister can be challenged.

Interpreting the new Act

Robertson J of the Federal Court gave the first judicial guidance on the new Act on 16 November 2012, in the case of ***CSL Australia Pty Ltd v Minister for Infrastructure and Transport (No 3)*** [2012] FCA 1261.

In this case, CSL Australia Pty Ltd (**CSL**) sought to challenge a varied temporary licence being issued to Rio Tinto Shipping Pty Ltd (**Rio Tinto**), which allowed Rio Tinto to carry out four voyages between 11 October 2012 and 1 February 2013. CSL had earlier applied for an interlocutory injunction to prevent Rio Tinto from undertaking these four voyages.

CSL was the holder of a transitional general licence. CSL had offered freight rates for the four voyages to transport aluminium from various Australian ports to the Bell Bay Terminal in Tasmania. That offer had been rejected and other vessels were appointed to conduct the voyages. CSL sought judicial review of the grant of the varied licence to Rio Tinto on 10 separate grounds.

Robertson J rejected CSL's application for judicial review and its submissions that in granting the temporary licence the Minister for Infrastructure and Transport's delegate (**the delegate**) had failed to interpret the objects of the Act.

Robertson J found that "*promoting a viable Australian shipping industry is not the only or dominant object of the Act so as to make any other considerations legally impermissible*" [at 137] and that the delegate had not misconstrued "*the object of the Act ... by taking account of the economic interests, profitability and the costs of the shipper/receiver of the cargo*" [at 135].

Therefore, although the Act does attempt to promote the Australian shipping industry, it does not seek to do so at the exclusion of all economic or other interests. His Honour found that:

"*it is not possible to discern from the six express objects of the Act a single or primary purpose to the achievement of which every exercise of a discretion under the Act must bend*" [at 94].

Comments

This judgment provides some policy guidance for the determination of temporary licence applications by the Department of Infrastructure and Transport.

Insurance Year in Review 2012
Accident + Health

Income protection – avoidance for fraudulent non-disclosure or misrepresentation

Written by Charles Simon, Partner and Alexis King, Solicitor
Tel 02 8273 9911 | 02 8273 9932
Email charles.simon@wottonkearney.com.au
alexis.king@wottonkearney.com.au

In the recent decision of ***Syddall v National Mutual Life Association of Australasia Limited*** [2011] QSC 389, the Supreme Court of Queensland considered an insurer's entitlement to avoid an income protection policy due to fraudulent non-disclosure and misrepresentation of income, occupation and medical history.

Background

When taking out income protection cover in 1993 and 1995, Mr Syddall stated that his principal occupation was computer programming. On 16 January 2001, he made a claim on the policy for a back injury allegedly suffered while roofing a house in November 2000. In the claim form, Mr Syddall described his occupation as self-employed plumber and nominated computers as his hobby. The insurer made interim disability payments to Syddall while his claim was being determined.

On 3 May 2001, the insurer declined the claim on the basis that Mr Syddall was fit to perform the duties of a computer programmer.

In July 2006, Mr Syddall commenced proceedings in the Supreme Court of Queensland. As a result of further information that came to light during the proceedings, the insurer sought to:

- avoid the policy under section 29(2) of the **Insurance Contracts Act 1984 (Cth)** (**ICA**) due to misrepresentation of income and occupation in the 1993 and 1995 applications, and non-disclosure of a history of psychiatric illness including admission to a hospital psychiatric unit in 1990; and
- establish that Mr Syddall made a fraudulent claim and it was therefore entitled to refuse paying the claim pursuant to section 56 of the ICA.

The decision

Avoidance under section 29(2) of the ICA

Due to the significant disparity between the information Mr Syddall provided on his application forms and the information contained in his taxation and medical records, the Court ruled that the insurer was entitled to avoid the policy pursuant to section 29(2).

The Court described Mr Syddall's representations as "*demonstrably and completely untrue*" and as being made purely for the purpose of obtaining the benefit of the policy.

The Court heard evidence that Mr Syddall would not have been entitled to the type of policy he was issued had he disclosed his secondary occupation of plumbing in circumstances where the policy was only available to clerical workers.

Fraudulent claim

The insurer also sought a declaration pursuant to section 56 ICA that it was entitled to refuse to pay the claim because the claim was fraudulent.

The Court recognised the difficulty in proving that an insured has dishonestly misrepresented the extent of his or her disability to the point that a claim upon the policy is fraudulent. It is not sufficient to show that the claimant has exaggerated the disability; rather, the insurer must show that the claimant has made false statements with an intention to deceive the insurer.

Mr Syddall wore a neck brace to more than 20 court appearances between 2006 and 2010. At trial he gave evidence that he could not lean forward, put weight on his shoulders, walk for more than a short distance or travel for long periods in a car, and that he sometimes had to be moved by ambulance.

Surveillance obtained by the insurer over the course of several years painted quite a different picture. Eight surveillance DVDs were shown at trial, including footage of Mr Syddall sliding head first down a waterslide with his young son on his back, shaking his head vigorously from side to side and swimming with his children for over an hour. It also showed Mr Syddall removing his neck brace after leaving court on several occasions. On one occasion he threw his neck brace into the backseat of his car before driving away.

The Court found that Mr Syddall did not have "*anything like the level of physical disability which he has sought to portray in this case*" and at worst suffered an aggravation of some mild pre-existing condition.

The Court found that Mr Syddall's claim was made and pursued dishonestly and therefore fraudulently. The insurer was entitled to refuse to pay the claim under section 56 of the ICA. The claim was dismissed and Mr Syddall was ordered to pay the insurer's costs on an indemnity basis.

Implications

The case serves as a useful reminder of the onus placed on an insurer when considering fraudulent life insurance claims under section 29(2) of the ICA and/or seeking to avoid claims under section 56 of the ICA.

While the onus is considerable, it is not insurmountable. The case demonstrates the extent of evidence the insurer needs to compile and the utility of surveillance evidence when considering whether an insured person is temporarily or permanently disabled.

Interest and the importance of original policy documents in life insurance cases

Written by Charles Simon, Partner and Alexis King, Solicitor
Tel 02 8273 9911 | 02 8273 9932
Email charles.simon@wottonkearney.com.au
alexis.king@wottonkearney.com.au

Two separate courts have recently had cause to consider factors governing interest under the **Insurance Contracts Act 1984 (Cth)** (**ICA**) in life and total and permanent disability (**TPD**) cases.

Facts

Public Trustee v Lumley Life Ltd & Ors [2012] QSC 61 (***Public Trustee***) concerned Davinda and Julie Dhother, a husband and wife who had purchased a life insurance policy from Lumley in December 1999. Tragically, in January 2001 Mr Dhother killed his wife. In 2003, the Public Trustee obtained an order to administer her estate including the benefits of the policy being paid to the couple's children.

Lumley repeatedly made requests for original policy documents. However, it was not until August 2008, five years later, that the Public Trustee provided the original policy document to Lumley and Lumley promptly paid the claim.

In ***Summers v The National Mutual Life Association of Australasia (No 2)*** [2012] TASSC 9 (***Summers***) the claimant made TPD claims in respect of injuries suffered in 1993 and 1997.

The insurer ceased to pay insurance benefits on 20 January 2000 when the Financial Industry Complaints Service (**FICS**) determined that no further benefits were payable. However, on 13 April 2000, the insurer received a progress claim from the insured. The insurer relied upon the determination of the FICS and did not make any further payments to the insured.

Section 57 of the ICA provides that interest begins to accrue once it becomes unreasonable for the insurer to withhold payment to the insured. Both cases concerned claims for interest, and the question of when it became unreasonable for an insurer to withhold payment.

Decisions

In ***Public Trustee***, the Supreme Court of Queensland held that Lumley was right to refuse payment of the benefit until it received the original policy document. The Court held that a life insurance policy of this type is a valuable document, which can be assigned by endorsement and used like a Certificate of Title, as a deposit with a financial institution, to provide security for a loan. Accordingly, the Court held that an insurance company is entitled to require the production of the original in order to ensure that the policy has not been assigned, before it is obligated to make a payment. As such, the claim for interest failed.

In ***Summers***, the Tasmanian Supreme Court held that by 13 April 2000, the insurer must have been on notice that the insured had not accepted the FICS determination and was indeed pressing his entitlement to benefits. The Court ruled that three months from the date of the FICS determination was a reasonable period for the insurer to investigate the claim, so interest began to run on 13 July 2000.

While the insurer had argued that it was reasonable for it to rely on the FICS determination when denying further payment to the insured, this decision continues a line of authority that a court can exercise discretion about the time within which an insurer ought to reasonably conduct enquiries. This is a question of fact to be determined having regard to all the circumstances of the case. However, courts have made it clear that an insurer's reliance on obtaining legal or loss-adjusting advice, however good or bad that advice is, will not assist when determining this period of time.

Implications

The decisions in ***Public Trustee*** and ***Summers*** underline how important it is for insurers to:

- require the production of the original policy document, to ensure that the policy has not been assigned; and
- take a proactive and considered approach to managing TPD claims, to avoid potentially large claims for interest. A proactive approach might include:
    - following up with an insured or Trustee after receiving the initial advice that a claim will be made; and
    - conducting early investigations rather than responding to material provided by an insured or Trustee.

Seeking asylum

Written by Catherine Osborne, Partner
Tel 02 8273 9930
Email catherine.osborne@wottonkearney.com.au

Introduction

2012 was marked by considerable political and public debate as to how the Australian Government should deal with the ever-increasing number of people seeking asylum in Australia.

At Wotton + Kearney, we saw a marked increase in the number of referrals from the Public Interest Law Clearing House (**PILCH**), to assist some of these people in appealing against Independent Merits Review (**IMR**) Board decisions as to whether they are entitled to the protection under the *1951 Convention relating to the Status of Refugees* as amended by the *1967 Protocol relating to the Status of Refugees* (**the Convention**).

The lawyers at Wotton + Kearney who do pro bono work do so for their own personal reasons. Generally speaking, it is fair to say that each of us who do that work do it because it is an opportunity to give something back to those so much less fortunate than ourselves. It is an opportunity to help people in need by allowing them to have legal representation.

The case of Mr S

One of the highlights of our pro bono program in 2012 was our victory for 'Mr S', who was successful at first instance in appealing the findings of the IMR Board in relation to his application for asylum.

In March 2012, the Federal Magistrates Court handed down its decision, ruling that the IMR's recommendation that Mr S did not satisfy the criteria of a refugee and therefore was not entitled to claim asylum in Australia were not made in accordance with the law.

The Minister appealed, and in September 2012 Gilmour J in the Federal Court of Australia dismissed the appeal and ordered the Minister to pay our costs to be taxed if not agreed. Mr Paul Menzies QC and Ms Brenda Tronson of Counsel appeared for Mr S in the appeal.

Background

Mr S is a Tamil from the north of Sri Lanka. He fled his home in May 2010 due to political unrest and fear for his own life. He claimed that the Sri Lankan government had killed all four of his brothers on account of their support for the Liberation Tigers and Tamil Eelam (**LTTE**) and other groups opposed to the government. He described a life of danger and fear.

Mr S and his family had been put into a camp for about six months in 2008–09, during which time he was required to assist the LTTE by letting them use his fishing boat to transport goods. As a consequence, he was classified as an LTTE associate. He sold his fishing boat to people smugglers in exchange for a boat trip to Australia. Once here, Mr S remained in a detention centre until January 2012 when he was released into

community detention.

The IMR Board decision

The Independent Merits Reviewer (the Reviewer) who conducted the IMR of Mr S's case determined that:

- Mr S's fear of persecution as defined under the Convention was not well founded; and
- Mr S was not someone to whom Australia owed protection under the Convention.

An IMR is part of a process conducted under administrative arrangements established by the Minister for Immigration and Citizenships (**the Minister**) Department. The Reviewers are appointed by the Minister and their function includes reporting their assessment and recommendation to the Minister for his or her consideration.

The Minister is not obliged to take a Reviewer's assessment or recommendation into account by virtue of section 46A(7) of the **Migration Act 1958 (Cth)**. Although a Reviewer's recommendation is not an administrative decision, the assessment and review must be procedurally fair and must address the relevant legal question or questions (***Plaintiff M61/2010E v Commonwealth of Australia*** [2010] HCA 41 at [77]).

Mr S's appeal

At first instance the Federal Court Magistrate held that the Reviewer had not taken into account Mr S's claims of fear of harm at the hands of the Sri Lankan authorities. The Federal Magistrate found that there was an error of law because the Reviewer had focused on the outcome of Mr S's likely interrogation in Sri Lanka, rather than considering what would happen to Mr S during the interrogation.

The Minister's appeal

The Minister appealed on grounds, amongst others, that the Reviewer was not required to consider whether the process of questioning of Mr S upon his arrival in Sri Lanka would expose him to a risk of serious harm amounting to persecution.

The Minister argued that in the Reviewer's statement, he had considered and made findings in relation to whether the process of questioning of Mr S would expose him to a risk of serious harm amounting to persecution, and that the Federal Magistrate had erred in failing to find that so.

The Minister also argued that the findings were based on a number of incorrect assumptions.

Gilmour J highlighted two issues in the appeal, namely:

- whether the Reviewer asked himself a "*wrong question*" in considering Mr S's claims of fearing harm at the hands of Sri Lankan authorities for being a suspected supporter of the LTTE; and
- whether the Reviewer failed to consider an element of Mr S's claims: that he had a well-founded fear of persecution by reason of his general involvement with the LTTE.

The Federal Court decision

His Honour found that it was plain enough in the context that Mr S was describing his fear that were he to return to Sri Lanka, he would be questioned as someone suspected of supporting or having an association with the LTTE. This fear emanated from the accepted facts that two of his brothers had been killed and two more were detained and then disappeared, all at the hands of the Sri Lankan army.

His Honour noted:

- Mr S's actual assistance to the LTTE, which would be known to the authorities;
- the fact that Mr S came from an area once under the control of the LTTE;
- the recent detention and interrogation of Mr S's son, who was asked about Mr S's whereabouts; and
- the established practice of torture and ill treatment of those merely suspected of an involvement with the LTTE.

Gilmour J held that the Reviewer focused on the likely outcome of the possible detention and interrogation of Mr S on his return to Sri Lanka, rather than considering the process of interrogation to which he would be subjected and the risk of serious harm amounting to persecution before he could convince the authorities that he was not an active LTTE member or supporter, notwithstanding his family's connections with the LTTE and his own role.

Gilmour J stated that the question the Reviewer should have asked in light of Mr S's claims and the information about Sri Lanka before him, was whether Mr S was at risk of serious harm from state authorities by reason of his imputed political opinion if he was "*suspected*" of having links or an association with the LTTE. Gilmour J noted that the Reviewer asked the wrong question, namely, whether Mr S would be at risk of serious harm from state authorities assuming he was not an active member of the LTTE.

Gilmour J found that the Minister had assumed that an interrogation on Mr S's return to Sri Lanka would begin with the assumption that Mr S was "*not an active member or supporter of the LTTE*". His Honour said that this was the wrong starting point and that it contained a false premise. His Honour said the starting point was in fact whether the Sri Lankan authorities would suspect that Mr S had links or an association with the LTTE, and that, on the material before him, the Reviewer would have concluded that the authorities would have held such suspicions.

Gilmour J also cited the USA Department of State 2010 "*Human Rights Report on Sri Lanka*" and the Amnesty International Report 2011 "*The State of the World's Human Rights re Sri Lanka*".

His Honour noted that there were widespread reports in the country information provided to the Reviewer of torture of detainees merely suspected of supporting the LTTE. The reports detail that killings and disappearances continue to be a problem and that the government searches for and detains LTTE sympathizers or operatives.

The various tortures described in these reports are barbaric. Methods of torture include beatings, electric shock, burning, suspension by wrists or feet in contorted positions, blows to the ears, abrading knees across rough cement, genital abuse, asphyxiation with plastic bags containing chilli pepper mixed with gasoline, and near drowning.

Gilmour J said that Mr S had connections with the LTTE in a way that had been explained to the Reviewer and that he had departed illegally from Sri Lanka as a result. Gilmour J noted the Sri Lankan Prime Minister had made it clear that the Sri Lankan Government wanted access to people such as Mr S.

The Minister's appeal was dismissed with costs.

Comments

Although we were able to help Mr S seek judicial review of the IMR decision, he will now have to submit to a further IMR, after which he may or may not be afforded refugee status under the

Convention.

It is a long, hard road for the asylum seekers who place all their hopes on a successful IMR outcome and/or the process of judicial review of those decisions. Only after reading the transcripts of interviews with these asylum seekers, speaking with them through translators and compiling the evidence for the proceedings can we appreciate the enormity of the horrific experiences these people have endured and may continue to endure if they do not meet the criteria for protection. ■

Reflections on our Cambodian house building project

Written by Heidi Nash-Smith, Senior Associate
Tel 02 8273 9975
Email heidi.nash-smith@wottonkearney.com.au

On 11 November 2012, a team from Wotton + Kearney – Chief Operating Officer Andrew Price, partner Nick Lux, senior associate and Pro Bono Co-ordinator Heidi Nash-Smith, lawyers Aisha Lala and Angela Winkler, and HR advisor Karen Pritchard – travelled to Cambodia to build 12 houses for a Cambodian community in partnership with the Tabitha Foundation Australia. The Foundation was established in 2002 to support the work of Tabitha Cambodia (**Tabitha**).

This project was part of *Community Footprint*, Wotton + Kearney's pro bono and corporate social responsibility program, which was established in January 2012.

I have been to Cambodia once before, seven years ago. I was deeply touched by the people I met then and what I learnt about Cambodia's recent troubled past. Returning to Cambodia allowed me to rediscover a truly remarkable country and to experience firsthand the efforts of people trying to make a difference. One of those people is Janne Ritskes, who founded Tabitha in 1994.

Tabitha is a non-profit organisation that seeks to help suffering families in Cambodia. Its aim is to reach out to impoverished communities and help them to address their own needs in a holistic and sustainable way. Tabitha helps achieve community development by encouraging personal savings; providing employment and income by teaching and selling traditional handcrafted items; and co-ordinating volunteers to build houses for families that cannot afford homes. Tabitha runs a number of programs in Cambodia, all focused on improving the lives of impoverished communities.

The Wotton + Kearney team visited Tabitha's operations in Phnom Penh and met with Janne and her staff.

House building

Our team set out for a village located in the Kompong Chhnang region, about a two-hour bus trip out of Phnom Penh. Along the dirt track near the village, there were many distinctive green 'Tabitha houses' – evidence that Tabitha had already contributed a great deal to the communities in this region.

Building the houses was hard work, particularly in the heat and high humidity. The Cambodian builders had already built the house structure and so our role was to nail on the floorboards and put up the walls. Although the team could work quite independently when nailing floorboards, putting up the walls was a combined effort. The walls are constructed using long sheets of metal which are then nailed to wooden beams. We often worked in groups

of three or four people, comprising Wotton + Kearney team members and Cambodian builders and villagers, working together to secure each sheet to the frame.

One of the things that really struck me about the Cambodian people was the sense of community and family. All the men in the village pitched in to help build each house – it didn't matter who the house would ultimately belong to. The children in the community all played together, the mothers working together to supervise them. Everywhere I looked, both in the regional districts and in Phnom Penh, there was evidence of a strong family unit.

Once the 12 houses were completed, there was a formal handover ceremony. Each team member handed the families moving into the houses a blanket – a house-warming gift provided by Tabitha. It was very moving to witness the joy and excitement of each family, knowing they would soon be moving into their new home and the difference it would make to their lives.

The journey to Cambodia

The team's journey to Cambodia did not start and end during that week of building. We started talking about the possibility of undertaking the project – and whether it was achievable –in January 2012. Back then it seemed like a pretty tall order. How would the team raise a minimum of $20,000 (the amount needed to build 12 houses)? Would the project receive the support of colleagues, family and friends?

Our collective enthusiasm for Cambodia, the work of the Tabitha Foundation and the house building project drove the initiative. It wasn't long before three of our team members – Andrew Price, Angela Winkler and I – signed up with a couple of other Wotton + Kearney runners to complete the Sydney Half Marathon and kickstart the fundraising.

The team raised more than $9,000 for the house-building project – a great beginning!

Following the success of the Half Marathon, the Sydney team members organised a fundraising dinner, auction and raffle at Manta Restaurant in Woolloomooloo. More than 50 people attended the dinner and again helped raise more than $9,000. The event was extremely well supported and the team was able to secure auction lots including a painting by renowned Sydney artist Jo Bertini, and a private dinner for 10 cooked in the winning bidder's home by La Grillade's head chef.

We raised a further $3,000 at a cocktail evening at MARS Gallery in Port Melbourne, hosted by the team's Melbourne contingent.

With the support of colleagues, clients, family and friends, the team ultimately beat the $20,000 fundraising target and raised a total of $21,789 for Tabitha. These funds purchased the materials to build the 12 houses and made a lasting difference to the village we visited.

Benefits of the house building project

Participating in the project was a very rewarding experience for the whole team, from a cultural, physical and emotional perspective. By witnessing firsthand the great work Tabitha does, and meeting the people directly benefiting from our fundraising efforts, we personally invested in Tabitha and will continue to support its efforts.

To everyone who supported this project, and on behalf of the Wotton + Kearney team and all the families who have benefited from your generosity – thank you!

You can find more information about the Tabitha Foundation Australia and its work at: www.tabitha.org.au/cms/. ■

Sydney

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

Melbourne

Tel +61 3 9604 7900
Fax +61 3 8414 2852

Level 6
550 Bourke Street
Melbourne VIC 3000
Australia

DX 182 Melbourne

Email melbourne@wottonkearney.com.au

www.wottonkearney.com.au