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Proportionate liability and contract certainty

Fred Hawke
CLAYTON UTZ

The current Australian proportionate liability regime — or perhaps I should say 'regimes' since once again we have significant variations in the way in which this reform has been introduced in various Australian states and territories — is proof for the insurance industry of the truth of the adage: be careful what you wish for because you might get it. Well, after more than a decade of lobbying and several false starts,[1] we now have proportionate liability governing damages claims for financial loss and property damage in all the major Australian jurisdictions, and it is going to be up to all of us with a stake in the system to make it work. Enough reservations have been expressed by enough highly respected and experienced commentators to give anyone pause.[2] Nevertheless, we are committed to this reform of the fundamental basis of damages liability and the philosophical justifications for it have not gone away, even if the liability insurance crisis which finally prompted its implementation seems now to be only a distant memory.

The current Australian proportionate liability regime — or perhaps I should say 'regimes' since once again we have significant variations in the way in which this reform has been introduced in various Australian states and territories — is proof for the insurance industry of the truth of the adage: be careful what you wish for because you might get it.

Introduction

The fundamental purpose of proportionate liability legislation, which as indicated was motivated at least in part by liability insurance considerations, was to remedy the perceived injustice of solidary liability where it had the effect of permitting a plaintiff to collect the full amount of its damage from *any* liable defendant whose tortious conduct had contributed to the plaintiff's undifferentiated loss, even in a minor degree, irrespective of the extent to which other tortfeasors might also have been found to have contributed to that loss. The plaintiff could recover in full from the 'deep pocket' defendant who had been found liable, leaving that defendant to recover in contribution claims from the others. Accordingly, the risk of the other tortfeasors (including, perhaps, the ones primarily responsible for the loss) being insolvent or inaccessible rested upon the paying defendant, rather than on the plaintiff. While this might be an acceptable situation from a public policy point of view in the case of personal injury actions, by 2002 it was becoming increasingly difficult to justify it in the case of economic loss and property damage claims, and commercial tort litigation generally.[3]

Proportionate liability, as is now well known, operates in principle by replacing the old common law rule of joint and several liability of civil wrongdoers with one which requires

the court to allocate liability for a loss between all of the 'concurrent wrongdoers' whose actions have caused or contributed to it, according to their respective shares of responsibility for it. The court, therefore, must carry out essentially the same exercise which it has always done in determining contribution proceedings between joint tortfeasors; however, it is now precluded from entering judgment against any concurrent wrongdoer for an amount in excess of the share of responsibility which it has apportioned to them. All very simple and difficult to argue with in principle; diabolically difficult and, as we shall see, riddled with potential unintended consequences in practice.

Most concerns which have been expressed about the practical application of the proportionate liability provisions, and their impact upon the cost and disposition of cases, seem to centre around the following considerations.

- There are questions of just what factors determine the extent of a defendant's responsibility for the plaintiff's loss, in an apportionable claim; in particular, the degree to which the parties to a contract involving the assumption of a duty of care or responsibility for breach of it by one party can pre-empt the apportionment by the terms of their contract. In other words, if the legislation does not permit the parties simply to contract out of its application, can they nevertheless, by the terms of their contract, define (as between themselves) what the respective degrees of responsibility of concurrent wrongdoers for a loss will be, in some or all circumstances? Must a court then take that contractual allocation of risk into account in determining what degree of responsibility for a plaintiff's loss it would be fair to apportion to a defendant, and what damages can therefore be awarded against that defendant?
- There is also the related question of whether indemnity provisions in contracts between tortfeasors are overridden by the legislation, where it prohibits a concurrent wrongdoer in an apportionable claim from being required to indemnify another for more than the first concurrent wrongdoer's apportioned share of responsibility. In other words, does the indemnity prohibition apply only to common law indemnities or does it also catch contractual ones?
- If the legislation permits contracting out, or does allow contractual allocation of risk provisions to influence the determination of a concurrent wrongdoer's appropriate share of responsibility for a loss, what effect does that have upon the response of general liability and professional indemnity insurance policies, in light of insurers' longstanding practice of excluding from coverage liabilities assumed by the insured under the express terms of a contact, where they would not have attached to the insured in the absence of that contract?
- What may be the procedural and evidentiary difficulties, and the consequent impact upon the cost and complexity of litigation and the court's management of cases, of such a radical shift in the underlying dynamics of litigation?

All these issues present far too much material to be canvassed in one article; however, there have now been cases addressing at least some of the issues and quite an extensive amount written.[4] There is also the experience of the building legislation cases to guide us, along with that of other jurisdictions. This article, therefore, will focus upon an aspect of proportionate liability regimes which is of particular interest to the writer: the question of their interaction with contract law and possible impact upon contract certainty in the allocation of risk and responsibility for losses under major commercial contracts, where concurrent wrongdoers may be involved in the contract performance.

While I will address this question specifically in the contract of the Victorian legislation, my comments will be applicable to a greater or lesser extent in other jurisdictions, except for NSW, WA and Tasmania where contracting out of the legislation is expressly permitted. In Queensland, contracting out is expressly prohibited (which may or may not affect a court's consideration of the issue) while the other states and the Commonwealth are silent on the point. The relevant Victorian provisions are found in Pt IVAA of the *Wrongs Act 1958* (Vic).

The legislation

The critical elements of the *Wrongs Act 1958* (Vic), as amended by the *Wrongs and Limitation of Actions Acts (Insurance Reform) Act 2003* (Vic), are as follows.

Section 24AE Definitions

'*apportionable claim*' means a claim to which this Part applies;

…

'*damages*' includes any form of monetary compensation;

…

Section 24AF Application of Part

(1) This Part applies to —

(a) a claim for economic loss or damage to property in an action for damages (whether in contract, tort under statute or otherwise) arising from a failure to take reasonable care; and

(b) a claim for damages for a contravention of Section 9 of the *Fair Trading Act 1999* [Vic].

(2) If a proceeding involves two or more apportionable claims arising out of different causes of action, liability for the apportionable claims is to be determined in accordance with this Part as if the claims were a single claim.

(3) A provision of this Part that gives protection from civil liability does not limit or otherwise effect any protection from liability given by any other provision of this Act or by another Act or law.

Section 24AH Who is a concurrent wrongdoer?

(1) A concurrent wrongdoer, in relation to a claim, is a person who is one of two or more persons whose acts or omissions caused, independently of each other or jointly, the loss or damage that is the subject of the claim.

(2) …

Section 24AI Proportionate liability for apportionable claims

(1) In any proceeding involving an apportionable claim —

(a) the liability of a defendant who is a concurrent wrongdoer in relation to that claim is limited to an amount reflecting that proportion of the loss or damage claimed that the court considers just having regard to the extent of the defendant's responsibility for the loss or damage; and

(b) judgment must not be given against the defendant for more than that amount in relation to that claim.

(2) If the proceeding involves both an apportionable claim and a claim that is not an apportionable claim —

(a) liability for the apportionable claim is to be determined in accordance with this Part; and

(b) liability for the other claim is to be determined in accordance with the legal rules, if any, that (apart from this Part) are relevant.

(3) In apportioning responsibility between defendants in the proceeding the court must not have regard to the comparative responsibility of any person who is not a party to the proceeding unless the person is not a party to the proceeding because the person is dead or, if the person is a corporation, the corporation has been wound up.

It is important to bear in mind that there have been few cases on this new legislation. In interpreting it, we have to proceed largely from first principles and in light of the legislative intention, as evidenced by the Explanatory Memorandum and parliamentary debate. It is in this context that the likelihood of the *Wrongs Act* amendments being interpreted so as to override contractual risk allocation provisions in contracts must be determined, and the likely effectiveness of any possible countermeasures assessed.

It is quite true, as the title of the Bill itself[5] and the Premier's Second Reading speech make clear, that the intention behind this legislation was to mitigate the exposure of liability insurers, especially professional indemnity insurers, in the hope of curtailing the cost and enhancing the availability of such insurance, especially to professional service providers. Law reforms replacing solidary liability with proportionate liability have been an objective of insurers and other 'deep pocket' defendants, such as governments and major financial institutions, in various jurisdictions around the common law world for a number of years now.[6] It may confidently be assumed that the intention behind this legislation was to assist liability insurers, in cases not involving death or personal injury, by ameliorating the exposure of their insureds to liability.

As the Davis Report[7] foreshadowed, it is likely that such a change will indeed have a positive effect upon the cost and availability of professional indemnity insurance. Under a proportionate liability regime, insurers can confidently rate a professional's risk for professional indemnity premium calculation purposes by reference only to that professional's own claims experience history and the inherent risks of his or her profession, without having also to take into account the possibility of that professional being made jointly and severally liable for the incompetence of any other uninsured service providers with whom he or she may become involved on a project. The same applies, of course, to the risk assessments of government instrumentalities and major corporates who may also be involved in carrying out some of the activities of a project — the risks associated with their activities will be limited to their actual level of responsibility for the loss or damage caused. The risk of them nevertheless being impleaded even where that responsibility is minimal, and then being effectively fixed with liability for the entire claim merely because the parties responsible for most of it are without assets or insurance, is likewise eliminated. To that extent, the legislation may be assumed to be operating as intended.

The nature of the problem

The question which arises is, therefore, to what extent, in order to give effect to these objectives, it was

intended and is likely to be held that the legislation should operate to override or modify contractually assumed allocations of risk, as between joint venturers or arm's-length contracting parties, where the contract itself intends to prescribe those parties' respective degrees of 'responsibility' for a loss. Due to the nature of the coverage provided under professional indemnity insurance, it seems clear that to the extent that a contractual obligation to indemnify or to assume loss is coterminous with a tortious liability for breach of a duty of care, it will indeed be limited by the legislation and this is the clear intention, in order to reduce the exposure of liability insurers as indicated above.

Most insurers would be comfortable with a construction of the legislation limited to this, since liability policies generally exclude any liabilities assumed by the insured under the express terms of a contract, *unless those liabilities would have attached to the insured even in the absence of that contract*. In other words, while insurers do not normally distinguish between liabilities arising in contract,[8] tort or under statute, they only indemnify in respect of a contractual liability to the extent that it is coterminous with liability arising out of breach of a duty of care or, to use the language of the legislation itself, 'arising from a failure to take reasonable care'.

The difficulty for contracting parties, especially in the construction and engineering professions, is that except in the rare situations where a structure is state of the art, liability under a strict warranty to perform work:

- to the standard to be expected of a reasonably competent contractor; or
- to a design prepared to the standard expected of a reasonably competent engineer;

will in fact be coterminous with liability arising out of a failure to take reasonable care, by the very nature of the warranty given.

Arising from a failure to take reasonable care

In the case of an express warranty to perform works by a certain date, a failure to fulfil this will not necessarily arise out of any breach of duty of care on the part of the contractor giving it, or on the part of any other person involved in the works, and in that situation it would be possible to argue that a claim under the warranty fell outside the scope of s 24AF(1) and was not an 'apportionable claim' for the purposes of the legislation. There would be no 'concurrent wrongdoers' involved. Of course, in such a situation it is quite possible that the force majeure provisions of the contract would also apply, possibly absolving the contractor from liability in respect of the warranty claim in any event.

In a situation where a warranty to complete work on time was breached not as a result of any negligence on the part of the contractor giving it, but due to lack of reasonable care on the part of another contractor or subcontractor, an interesting question of construction of s 24AF(1) would arise. That is, of course, whether the words 'arising from a failure to take reasonable care' should be construed widely, to include the situation where the failure is that of a person other than the person against whom the damages claim for economic loss or property damage is being brought, or narrowly so that the Part only applies where the person against whom the claim under the warranty is brought is the same person whose failure to take reasonable care has given rise to the loss.

It is relevant to consider the actual terms of s 24AF, which reads as follows:

> *Application of Part*
>
> (1) This Part applies to —
>
> (a) a claim for economic loss or damage to property in an action for damages (whether in contract, tort under statute or otherwise) arising from a failure to take reasonable care; and
>
> (b) a claim for damages for a contravention of Section 9 of the *Fair Trading Act 1999*.
>
> (2) If a proceeding involves two or more apportionable claims arising out of different causes of action, liability for the apportionable claims is to be determined in accordance with this Part as if the claims were a single claim.
>
> (3) A provision of this Part that gives protection from civil liability does

> not limit or otherwise affect any protection from liability given by any other provision of this Act or by another Act or law. [Emphasis added.]

The interpretation question needs to focus on s 24AF(1)(a), and there are two questions in interpreting it.

- The first is whether the focus is upon economic loss or damage to property 'arising from' a failure to take reasonable care, or whether it is the action for damages which must arise from such a failure in order for the Part to apply and the claim to become an apportionable one. The first interpretation of the subsection would arguably give it a wider field of operation, while the second would require a closer connection between the cause of action and the breach of duty, arguably a coterminous liability in tort and contract.
- The second question concerns the breadth of meaning to be ascribed to the words 'arising out of' in the context of this particular legislation and its objectives, as opposed to other areas of law where this phrase has been significant.

This is a point of some subtlety and it is not possible to state with confidence how a court would determine it. On the one hand, there is extensive case law dealing with the construction of phrases such as 'arising from', primarily in the context of insurance law and the doctrine of proximate cause, and it is generally accepted that the words have a wider meaning than the immediate basis of a cause of action.[9] On the other hand, consideration of the intention of the legislation as discussed above might prompt a court to prefer a narrower interpretation of the phrase in this context, restricting the application of the Part to a situation where the party liable on the warranty is also the party out of whose failure to take reasonable care the action for damages arises, since it is only in that situation that a professional indemnity insurer will be indemnifying and will benefit from the apportionment of liability.

Concurrent wrongdoers

Such an argument is consistent with the definition of 'concurrent wrongdoer' within the meaning of s 24AH. That section reads:

> *Who is a concurrent wrongdoer?*
>
> (1) A concurrent wrongdoer, in relation to a claim, is a person who is one of two or more persons whose acts or omissions caused, independently of each other or jointly, the loss or damage that is the subject of the claim.
>
> (2) …

In light of this definition, where an indemnity is obtained from a person not actually involved in the project, who has not been guilty of any acts or omissions in relation to it but whose liability arises only by way of the indemnity, it is clear that s 24AI(1) will not apply. It follows that indemnity obligations of external parties such as guarantors and insurers are not abrogated by the legislation. By the same reasoning, in the case of a contractual indemnity given by, for example, a prime contractor to the principal, if the prime contractor itself were not in any way at fault but was liable to indemnify against a loss only because it had assumed responsibility for the actions of all other contractors and subcontractors, then it would seem to be strongly arguable that in such a situation the prime contractor also would not be a 'concurrent wrongdoer' within the meaning of s 24AH and the proportionate liability regime in s 24AI would not apply.

Once again, this is not inconsistent with the purpose of protecting insurers since professional indemnity insurance of the prime contractor alone would not respond in that situation. The argument is also consistent with the existence of s 24AI(2), which contemplates both apportionable and unapportionable claims in the same proceeding. The proportionate liability regime is only to apply to the former.[10]

Monetary compensation

Another important issue in the construction of this legislation arises from the definition of 'damages' in s 24AF(1)(a), which in s 24AE is defined to include 'any form of monetary compensation'. This definition elides the distinction between an action for damages and an action for debt, and there can be no doubt that a claim for

liquidated damages under contract falls within the concept of 'monetary compensation'. By their very nature, liquidated damages must be compensatory in order to avoid being construed as unenforceable penalties.

It is also arguable that the phrase 'any form of monetary compensation' is apt to include a contractual entitlement to indemnity, where the entitlement 'arises out of' a failure to take reasonable care as discussed above. While it is possible to draw a conceptual distinction between compensating someone for a loss and indemnifying them against it, no reliance could be placed upon a court applying such a hair splitting distinction in the context of this legislation, at least not in a situation where the indemnity obligation was coterminous with a damages liability in tort, for the reasons outlined above.

It is possible, however, that in a scenario where a party's contractual indemnity obligations exceeded the liability which would otherwise have attached to them for their own breach of a duty of care, a court might be prepared to distinguish between an indemnity obligation and 'monetary compensation' and hold that the requirements of s 24AF(1)(a) had not been met. This argument is not inherently persuasive and would have to be run in tandem with the argument outlined above, that a claim under a contractual indemnity is not a claim in an action for damages arising from a failure to take reasonable care, and it is obviously stronger where the person liable under the contract to indemnify and the person whose breach of duty of care has proximately caused the loss or damage are not one and the same person.

Assumption of responsibility

A final and, in the writer's view, persuasive argument, to avoid undue interference by the proportionate liability provisions with contractual risk allocation, focuses upon s 24AI(1)(a). That subsection reads:

> *Proportionate liability for apportionable claims*
>
> (1) In any proceeding involving an apportionable claim —
>
> (a) the liability of a defendant who is a concurrent wrong doer in relation to that claim is limited to an amount reflecting that proportion of the loss or damage claimed that the court considers just having regard to the extent of the defendant's responsibility for the loss or damage.

Let us focus here on the words 'the court considers just having regard to the extent of the defendant's responsibility for the loss or damage'. 'Responsibility' must mean legal responsibility but the question is, is the court limited to considering only the extent to which the defendant's failure to take reasonable care has caused or contributed to the loss or damage, which it must have done for them to be a 'concurrent wrongdoer' or can the court, in deciding what the defendant's liability in relation to the apportionable claim should be, have regard also to any contractual assumption of responsibility to which the defendant may have committed itself?

It would not be inconsistent with the avowed purpose of the legislation, to mitigate the exposure of professional indemnity insurers, to construe the words 'the defendant's responsibility' to include a contractually assumed responsibility for the consequences of other persons' failure to use reasonable care and to indemnify a counter party against any loss or damage arising from that. The prospects of success of such an argument could be enhanced, it is suggested, by including in the relevant contract, whether as between joint venturers or between a principal and a prime contractor, an express stipulation that, for the purposes of s 24AI(1)(a), the party indemnifying has assumed responsibility for loss or damage which may have been caused or contributed to by concurrent wrongdoers. A suggested form of words for such a clause might be along the following lines:

> … it being agreed and understood that, for the purposes of Section 24A1 of the *Wrongs and Limitation of Actions Acts (Insurance Reform) Act 2003*, the Prime Contractor is entirely responsible for any failure to take reasonable care on the part of any of its sub-contractors.

Other variations on this theme can

readily be envisaged, tailored to the needs of various forms of contract. Of course, the risk of such a provision enlivening the contractual assumption of risk exclusion, in a liability or professional indemnity policy, is easy to see.

That, however, is a problem which needs a separate solution and one on which a separate article is required.[11]

Conclusion

To summarise, the declared purpose of the legislation is to mitigate the exposure of liability (especially professional indemnity insurers) and a construction consistent with that purpose is likely to be given to it. The question is whether and to what extent that necessarily entails overriding

- the extent to which a court, in an apportionable claim, can take into account an express contractual assumption of responsibility by a concurrent wrongdoer, for the conduct of other concurrent wrongdoers, in determining what amount would be the just liability of the first concurrent wrongdoer under s 24AI(1)(a).

In light of the importance of these issues for major projects, it may be worthwhile for a number of key stakeholders to consider seeking to refer these questions to the Victorian Supreme Court upon a case stated, relating to the proper interpretation of Pt IVAA of the *Wrongs Act*. Assuming the possibility of a satisfactory outcome, upon which senior counsel's

… the declared purpose of the legislation is to mitigate the exposure of liability (especially professional indemnity insurers) and a construction consistent with that purpose is likely to be given to it.

parties' contractual allocations of responsibility, to the extent that these relate to uninsured risks. An external party to the project, such as an insurer or guarantor, who assumes those risks by contract will not be a concurrent wrongdoer for the purposes of the legislation and their contractual responsibilities will not be affected by it.

In the case of indemnities or hold harmless agreements given by persons who are involved in a project, and whose acts or omissions have caused or contributed to economic loss or property damage, the key questions are:

- the extent to which it can be argued that their contractual obligations do not 'arise from a failure to take reasonable care', for the purposes of s 24AF(1)(a), in a situation where they have contractually assumed more responsibility than the extent to which their own acts or omissions have caused the loss or damage; and

advice obviously ought to be obtained, this might be preferable to an immediate strategy of making major projects contracts subject to the law of a foreign jurisdiction, in the hope of avoiding the legislation altogether.

While that may well work, the difficulty is that applying the laws of foreign jurisdictions may have other unintended consequences, which the parties and their advisers could not anticipate at the time of contracting, and it would seem likely to increase the cost and complication of both the contractual negotiations and the resolution of any subsequent disputes.

As to the contractual liability exclusion insurance problem, one way of addressing this might be to shift the emphasis in risk management of major projects away from the traditional model of legal liability backed by liability or professional indemnity insurance, toward a form of two party, direct loss project insurance. This would entail sidestepping the entire

question of legal liabilities and the parties simply insuring directly their respective allocated risks in connection with a project. This might be more economically efficient, however, the cost and availability of such insurance would need to be explored.[12] The problem of uninsurable risks would remain, of course.

Finally, there remains the possibility of further legislative intervention. In evaluating the appropriateness and likelihood of that, however, it is pertinent to consider the fact that the proportionate liability reforms, although undoubtedly driven by insurance considerations, are for the benefit of all 'deep pocket' defendants including governments, not merely professional indemnity insurers. It is a legitimate question whether it is reasonable for a major contracting party such as the state to have the benefit of a proportionate liability regime in its capacity as a defendant, while avoiding its effects where it is a principal seeking to sheet home liability for project losses to a prime contractor. ●

Fred Hawke, Partner,
Clayton Utz, Sydney.

This is an expanded and updated version of the writer's paper entitled 'Proportionate liability legislation: toward restoring certainty in contractual risk allocation', presented at a Major Projects Conference in the Melbourne office of Clayton Utz in 2003. The author wishes to acknowledge and thank Ms Jane Warrington of Clayton Utz, Brisbane, and Mr Dominic Murphy, of the firm's Melbourne office, for their invaluable assistance with the preparation of this article. Any mistakes are entirely my own work.

Endnotes

1. The issue was canvassed extensively in the Davis Report as far back as 1996, long before the so-called 'insurance crisis' of 2002 which provided the catalyst for eventual implementation. See Commonwealth of Australia *Inquiry into the Law of Joint and Several Liability* Reports of Stages 1 and 2 (1994–95).

2. See, for example, the Hon Justice David Byrne 'Proportionate liability, some creaking in the super structure', paper presented to the Judicial College of Victoria, 19 March 2006.

3. It is worth noting that Victoria and some other jurisdictions have had proportionate liability in so-called 'building actions', being claims for loss or damage arising out of or concerning defective building work, for a considerably longer time: see *Building Act 1993* (Vic), Div 2 (specifically s 129).

4. See, for example, McDonald 'Proportionate liability in Australia: the devil in the detail' (2005) 26 *Australian Bar Review* 29; *Aquatec-Maxcon Pty Ltd v Barwon Region Water Authority (No 2)* [2006] VSC 117; BC200601653; *Wimmera-Mallee Rural Water Authority v FCH Consulting Pty Ltd* [2000] VSC 102; BC200001174; *NBD Bank v South Italy Tiling SA* [1997] SADC 3596; *Commonwealth Bank of Australia v Witherow* [2006] VSCA 45; BC200600995. See also Aghion D and Uren A G 'Proportionate liability: an analysis of the Victorian and Commonwealth legislative schemes', paper delivered to the Commercial Bar Association, 18 August 2005.

5. Wrongs and Limitation of Actions Act (Insurance Reform) Bill 2003 (Vic).

6. Hawke F 'Proportionate liability: the enquiry into the law of joint and several liability Parts 1 & 2' (1997) 20(5) *Australian Insurance Institute Journal* 26 and (1998) 21(1) *AIIJ* 14; the Davis Report, above note 1. See also Davis *Draft Model Provisions to Implement the Recommendations of the Enquiry into the Law of Joint and Several Liability* (July 1996) and the references cited in those publications.

7. The Davis Report, above note 1, Report of Stage 2.

8. For example, under the terms of a retainer.

9. If the policy states that the insured is covered against losses 'arising out of' the insured perils, there is no requirement that the loss be proximately caused by the peril: *Government Insurance Office (NSW) v R J Green & Lloyd Pty Ltd* (1966) 114 CLR 437; *SGIC v Stevens Bros Pty Ltd* (1984) 154 CLR 552; *Dickson v Motor Vehicle Insurance Trust* (1987) 163 CLR 500; *Transport Accident Commission v Jewell* [1995] 1 VR 300 at 306 (Tadgell J); also *Clover, Clayton & Co Ltd v Hughes* [1910] AC 242 at 245.

What is in required where 'arising out of' is used is that there be some 'non-coincidental nexus' between the peril and the loss: *Lamont, Hodkinson and Jorgenson v Motor Accidents Board* [1983] 1 VR 88 at 96 (Tadgell J); *Transport Accident Commission v Hoffman* [1989] 1 VR 197 at 201 (Young CJ and McGarvie J).

If the word 'directly' appears before 'arising out of' (as it does in many motor accident insurance statutes following *Dickson v Motor Vehicle Insurance Trust* (1987) 163 CLR 500), the effect of the expression is changed. The added requirement then is a 'direct and sufficient non-coincidental nexus': *Transport Accident Commission v Treloar* [1992] 1 VR 447 at 452 (McGarvie and Gobbo JJ); *Transport Accident Commission v Jewell* [1995] 1 VR 300 at 307–08 (Tadgell J).

10. See, for example, *Aquatec-Maxcon Pty Ltd (ACN 002 250 482) v Barwon Regional Water Authority* [2006] VSC 117; BC200601653 (Byrne J) and extensive related litigation. This case presents a classic scenario of how proportionate liability legislation may be expected to complicate commercial litigation, specifically an action to recover a liquidated sum under a contract which was confused by apportionable claims against various professionals also involved in the works.

11. See, for example, Mann, Giblett and Hawke 'Proportionate liability', paper to be presented at the Risk Management Institution of Australasia Annual Conference 2006.

12. Construction Performance Bonds have traditionally been provided by insurers, so there is nothing conceptually difficult about such a proposal. It would, however, need a significant commitment on the part of the insurance industry to make it work and both the allocation and rating of the major risks on a two party basis would need to be revisited, as the limiting factor of breach of a duty of care would no longer apply.

Court of Appeal confirms heart attack decision

Alph Edwards
TURKS LEGAL

In the August 2006 issue of the *Australian Insurance Law Bulletin*, I discussed the case of *Larwint Pty Ltd v Norwich Union Life Australia*,[1] a Victorian Supreme Court decision dealing with a dispute as to whether the plaintiff had suffered a heart attack as defined under his trauma insurance policy: see Edwards A 'When is a heart attack a heart attack? Diagnostic criteria must be met to qualify for trauma benefit' (2006) 21(9) *ILB* 144.

The court found that the plaintiff had not suffered a heart attack as defined under the policy. The plaintiff appealed and the Court of Appeal has now dismissed his appeal, confirming the reasoning of the trial judge.[2]

The facts and the lower court decision

The plaintiff sued the life insurer in respect of a heart attack benefit which the insurer had refused to pay on the life of the life insured. 'Heart Attack' was defined in cl 14 of the policy as:

> Means death of a portion of heart muscle as a result of inadequate blood supply to a relevant area. The basis for diagnosis shall include:
>
> (i) electrocardiographic changes associated with the myocardial infarction; and
>
> (ii) elevation of cardiac enzymes consistent with the myocardial infarction.
>
> If in the policyowners [sic] opinion the above tests are inconclusive we will, at our discretion, consider other appropriate tests.

The life insured had sustained a death of a portion of his heart muscle as a result of inadequate blood supply, which was diagnosed by the presence of elevated cardiac enzyme levels consistent with a heart attack. An electrocardiogram, however, failed to show any associated electrocardiographic (ECG) changes.

The issue was whether a heart attack must be diagnosed on the basis of *both* ECG changes and the elevation of cardiac enzymes in order to fall within the description of the defined event.

The plaintiff argued that the final sentence of the definition meant that any properly diagnosed heart attack should be covered, not just heart attacks diagnosed by the listed criteria. Any other interpretation would deprive the clause of 'practical sense'.

The lower court dismissed the claim, finding that the heart attack definition is a composite one. It includes the requirements as to the basis for a diagnosis listed in the definition as well as the outcome of any exercise of the defendant's discretion contemplated by the last sentence of the clause.

Appeal

The leading judgment was given by Ashley J, with whom President Maxwell and Chernov J agreed.

Ashley J dismissed the appeal on the basis that the second sentence of cl 14 required that the basis for a diagnosis of heart attack must include ECG changes associated with a myocardial infarction *and* the elevation of cardiac enzymes consistent with a myocardial infarction.

According to Ashley J, this view was supported by the following.

- Every part of cl 14 'must be given work to do'. In this regard, the second and third sentences of the

definition prescribe how the occurrence of heart attack may be established under the clause. These sentences 'are not to be ignored'.
- The third sentence of cl 14 allows the insurer, in certain circumstances, to consider tests other than those mentioned in the second sentence of the clause in determining whether a heart attack had occurred and in effect expanded the circumstances in which a heart attack may attract indemnity. This put paid to the appellant's submission that an insurer could simply ignore other tests which demonstrated that a heart attack had been suffered.
- The effect of the second sentence in cl 14 is that while a diagnosis of heart attack might be based on a multiplicity of considerations, nonetheless, to satisfy the requirements of that sentence, positive results are required of both the ECG and cardiac enzyme tests. In this regard, the 'and' appearing between (i) and (ii) of the second sentence of cl 14 should be given a conjunctive application.
- The purpose of the policy was to give indemnity not where a person suffers a heart attack in lay or medical parlance, but where a person suffers a heart attack as defined.

The judgment of Ashley J also dealt with the appellant's application for leave to add an additional ground of appeal at the hearing of the appeal. In a nutshell, the appellant sought leave to allege that the trial judge had erred in not finding that a benefit should have been paid in accordance with the third sentence of cl 14.

Ashley J refused to grant this leave on the basis that the appellant had not raised an argument based on the third sentence of cl 14 on the pleadings or before the trial judge and on the basis that there was no 'factual basis which could enliven such a claim'.

Further, allowing the appellant to raise the matter now would likely cause the respondent prejudice on the basis that had it known the third sentence cl 14 was in play, it would have investigated a number of relevant factual questions.

While refusing leave, Ashley J noted that in failing to raise an argument under the third sentence under cl 14, the appellant had deprived itself of an alternative way of making a claim on the policy and of pursuing the present proceedings.

His Honour also noted that questions will arise as to whether it was open to the appellant to reformulate its claim (under the third sentence of cl 14) and if necessary bring proceedings in the event such a claim is rejected. No view was offered by his Honour on these issues.

Implications

The Court of Appeal has confirmed the lower court's finding that both a positive ECG test and elevated cardiac enzymes were essential elements of the heart attack definition in this policy. In terms of construction, this seems to be the only logical conclusion the Court of Appeal could reach.

It was also made clear by the Court of Appeal that the purpose of the policy was to respond when a person suffers a heart attack as defined, not a heart attack as is generally understood in lay or medical parlance.

With respect to this issue, and turning to the wider implications of this decision, insurers need to be aware of the potential for a gap to arise between a medical condition as it is understood in everyday and medical usage and as it is defined in a policy, and ensure that marketing materials accurately reflect the cover being offered. To do otherwise could potentially expose an insurer to the type of trade practices action contemplated by Hodgson J in *MLC v O'Neil*.[3] ●

Alph Edwards, Partner, Turks Legal, Sydney.

Endnotes

1. [2006] VSC 187; BC200603566.
2. *Larwint Pty Ltd v Norwich Union Life Australia Ltd* [2007] VSCA 21; BC200700921.
3. [2001] NSWCA 161; BC200103010.

Multiple insurers and leading insurer's clauses

Raylee Hartwell and **Jason Symons**
KENNEDYS

On 11 January 2007, Chesterman J of the Supreme Court of Queensland delivered a decision that examined the purpose and ambit of a leading insurer's clause contained in a contractor's floater policy of insurance: *Thiess Pty Ltd v ERC Frankona Reinsurance Ltd* [2007] QSC 0004; BC200700014. The court found that the clause bound all underwriters that issued the policy to the agreements made by the leading insurer, including the acceptance of a claim by the leading insurer.

Background

The contractor's floater policy in question indemnified Thiess Pty Ltd (Thiess) against losses arising out of the conduct of its business as a civil engineering contractor. The policy was issued by three underwriters: AXA Global Risks (UK) Ltd (AXA), ERC Frankona Reinsurance Ltd (ERC) and GIO Insurance Ltd (GIO). Under the policy, underwriters' risk was to be borne 45 per cent each by AXA and ERC and 10 per cent by GIO.

Clause 17 of the policy provided:

> *Leading insurer's clause*
> It is understood and agreed by all Insurers hereon that notification to or from or agreements effected with the Leading Insurer, AXA Global Risks (UK) Ltd, in all matters relating to this Policy shall be binding on all Insurers except in respect of the relevant agreements required under Condition 5 applicable to Sections A and B.

Thiess made a claim under the policy for losses which occurred during the construction of the Pacific Motorway. AXA paid Thiess $364,002.98, being its 45 per cent proportion of Thiess' loss. A short time later, GIO paid the plaintiff $80,889.55, being its 10 per cent proportion of Thiess's loss. However, ERC refused to pay Thiess's claim.

Thiess commenced proceedings seeking a declaration that ERC was bound to pay its proportion of the loss in accordance with the policy. It also sought judgment for that amount, together with interest. Thiess argued that ERC was bound by AXA's acceptance of the claim and the leading insurer's clause obliged ERC (as it did GIO) also to accept the claim and to pay its proportion of the loss. ERC argued that the leading insurer's clause did not apply to claims made under the policy and their settlement by an insurer or, in the alternative, the clause did not bind ERC to pay a claim that did not fall within the ambit of the cover under the policy.

The court found that the clause bound all underwriters that issued the policy to the agreements made by the leading insurer, including the acceptance of a claim by the leading insurer.

Decision

In delivering his judgment, Chesterman J noted:[1]

> The commercial purpose of clauses such as clause 17 is clear enough. The presence of more than one subscribing underwriter to the policy means that the insured … has made three separate contracts of insurance, one with each of the insurers. The contracts are in identical terms save for the individual proportions of the risk each insurer took. What the parties to such an arrangement intended to achieve is that for all practical purposes there should be one contract which, if the circumstances so fell out, would lead to one claim rather than separate claims upon separate insurers. To avoid a multiplicity of communications and differences of opinion between insurers the leading insurer clause is meant to achieve unanimity of opinion and action in dealings between insured and insurers.

His Honour then contrasted cl 17 with leading insurer's clauses founded in other cases.[2] His Honour noted that the other clauses specified with particularity the respects in which the lead insurer may bind the following insurers and, by contrast, the authority of the lead insurer was expressed in cl 17 in general terms. His Honour also found that it was of some significance that there was one express exception: the agreements referred to in condition 5 of sections A and B of the policy (which were irrelevant to the facts of this matter). His Honour said (at [24]) that:

> The existence of the exception in clause 17 has this relevance, that it shows that the generality of the language of the clause is not to be cut down by implications. The draftsman made it clear what class of agreement relating to the policy made by the lead insurer would not bind the others.

His Honour then addressed the submissions put forward by ERC.

ERC's submissions

ERC's first submission was to the effect that cl 17 did not expressly refer to claims settlements at all and, if the parties had intended that co-insurers should be bound to claim settlements made by the lead insurer, the clause would have said so expressly. This was rejected on the basis that (at [25]–[26]):

- the clause did not specify some subject matter that the lead insurers might bind the co-insurers; and
- the clause recited generally that the insurers are to be bound by notification given to or by the lead insurer and agreements effected by it 'in all matters relating to the policy'.

ERC's next submitted that there was a 'demarcation' in cl 17 between matters relating to the policy, its terms, conditions, mechanics and administration on the one hand (which the clause covered),[3] and claims on the other (which the clause did not cover). That submission was rejected on the basis that (at [27]–[28]):

- the submission did not explain why cl 17 did not, or could not, apply to the settlement of claims made by an insured and addressed to, as the policy itself requires, the insurer's nominated broker and adjuster; and
- there was nothing in the 'brief expression' of cl 17 which marked a distinction between those matters which may, and those matters which may not, be dealt with by the lead insurer on behalf of the co-insurers, save for the express exception.

ERC's further submission to the effect that, if claims and their settlements were not excluded from the operation of cl 17, a following insurer might be held liable to contribute to a loss which does not in fact fall within the ambit of the policy was also rejected.[4] His Honour noted (at [30]):

> The predicament bemoaned by [ERC] is a consequence of the agreement it made with the lead insurer and the insured. This is no reason for perturbation. In the event that a leading insurer improperly settles a claim by the insured, whether negligently or dishonestly, the co-insurer will have the remedy against it.[5]

Further, Chesterman J noted (at [30]):

> Moreover a co-insurer can protect its position as against the leading insurer's impropriety in handling claims by express agreement.

ERC's final submission was that if cl 17 'is broad enough to cover claims

settlements it cannot … be broad enough to bind following insurers beyond the terms of their respective policies of insurance … had the parties intended this result it would have been a simple matter to state so expressly'. This submission was also rejected on the basis that it was the same as its first submission set out above and could be met by the same answers and the commercial purpose of cl 17 (see at [31]–[32]).[6]

His Honour then concluded (at [33]–[34]):

> [ERC's] submissions require reading into the clause words of limitation that the parties did not employ. They exclude from the operation of the clause a class of dealings which the parties did not think it necessary to mention.
>
> There is no warrant for reading into clause 17 words which are not there and which would cut down the generality of its effect which was surely intentional. [ERC's] submission would severely curtail the effect and effectiveness of clause 17. [ERC] does not point to any provision of the policy which is inconsistent with the generality of expression found in clause 17 and which might require it to be curtailed to make sense of the policy as a whole, or to any other circumstance which would suggest that the plain words of the clause should not be allowed to mean what they say.

The court then looked at whether AXA's acceptance of Thiess's claim was an 'agreement effected with [AXA] in [a matter] relating to the policy' as required by the terms of cl 17. His Honour found that there could be 'no doubt' that Thiess's claim for indemnity related to the policy.[7] His Honour also found that AXA's acceptance of the claim was an agreement effected by the leading insurer relating to the policy.[8] Accordingly, ERC was found to be bound by the agreement made by AXA and his Honour:

- declared that ERC was bound by the leading insurer's clause; and
- gave judgment for Thiess against ERC for the sum of $364,0002.98 (being its 45 per cent proportion of Thiess's loss) plus interest. ●

Raylee Hartwell, Partner, and Jason Symons, Solicitor, Kennedys, Sydney.

Endnotes

1. *Thiess v ERC Frankona Reinsurance* at [14]–[17], citing Sir John Megaw in *Irish Shipping Ltd v Commercial Union Assurance Co plc* [1991] 2 QB 206 at 230–31 and at [18]–[22] citing Mance J in *Roar Marine Ltd v Bimeh Iran Insurance Co* [1998] 1 Lloyd's Rep 423 at 427 and 430.

2. The leading insurer clause in *Irish Shipping* provided:

> All extensions, reductions or cancellation of risks or of conditions, all fixing of premiums, all settlements of claims or contestations whatsoever and in general all dispositions of whatsoever nature taken by the leading underwriter, will be binding upon all underwriters and carry with them the unanimous consent of all the underwriters of this contract.
>
> All co-insuring underwriters hereby expressly authorise the leading company to sign policies or endorsements for their account and hereby undertake to consider documents so signed as having been signed by themselves.
>
> The undersigned insurance companies declare themselves liable for their respective share for all decisions taken against the leading company.

The leading insurer clause in *Roar Marine* provided:

> It is agreed with or without previous notice to follow leading British Underwriters in regard to agreements, alterations, extensions, additions, endorsements and cancellations and attaching and expiring dates, and also in regard to all decisions, surveys, the providing of bail and settlements in respect of claims and returns, but excluding ex gratia and without prejudice settlements.

3. The matters regarding the policy, its terms and conditions, mechanics and administration that ERC submitted that the clause addressed included (see at [27]):

- an assignment being binding on the insurers;
- an agreement in respect of a particular contract being covered;
- an agreement that a particular entity be added as a named insured;
- the identity of the loss adjuster to be used;
- an agreement as to when notice is to be given;

- alterations to the terms and conditions regarding alteration of a material fact; and
- alteration of the insured risk under the policy or an extension of the time for which cover is provided.

4. At [29] and [30], noting that the point was also made and rejected in *Roar Marine*, above note 1.

5. Citing Hirst J in *Barlee Marine Corporation v Mountain* [1987] 1 Lloyd's Rep 471 at 475:

> Underlying the whole relationship between the leading underwriter and the following underwriters ... is the former's manifest duty of care.

His Honour also noted that the Court of Appeal in *Bonner v Cox* [2006] 2 Lloyd's Rep 152 at [95] thought the question was still an 'open' one.

6. At [32], his Honour noted that:

> It is to give business efficacy to the contract of insurance that the co-insurers agree to be bound by the leading insurer. The purpose of the clause is to create, in effect, one policy of insurance rather than separate ones with individual insurers. To achieve that efficiency, and the business it will generate, the following insurers agree to 'follow the leader'. By clause 17 they gave the lead insurer, AXA, authority to act on their behalf in dealings with the insured and agreed to be bound by the agreements made by AXA in that regard. They gave up the right to decide for themselves whether, e.g. a claim should be accepted, and for how much.

7. At [36], where his Honour also noted that:

> Something more essential to a policy of insurance than a claim for indemnity under it cannot be imagined. The same can be said of the insurer's payment by way of indemnity pursuant to the policy. It is clear, then, that the claim and the payment by AXA and GIO were matters relating to the policy.

8. At [37]–[45], citing, inter alia, *Newton, Bellamy & Wolfe v State Government Insurance Office (Qld)* [1986] 1 Qd R 431, *Lindsay v Smith* [2002] 1 Qd R 610 and *Lubovsky v Snelling* [1944] KB 44. The court noted that 'an insurer's acceptance of an insured's claim necessarily connotes agreement' and 'an insurer's acceptance of its insured's claim does away with the potential uncertainties and their capacity to generate costs which the insurer may have to bear, if the claim is litigated, and replaces them with the insurer's intimation (or promise) that it will pay the claim. There is, in accepting a claim, an element of compromise, or of admission that the insured is entitled as a matter of contractual right to the indemnity contained in the policy. The consideration is the benefit to the insurer that it will not be liable to pay the insured's, and its own, costs of an action, and the detriment to the insured of forbearing to sue for the proceeds of the policy.' Further, the court noted: 'the acceptance of the claim is in form and substance an agreement. Moreover it will normally amount to a contract, legally binding on the parties.'

insurancebrief

Private health insurance legislation commences

1 April 2007. A legislative package which will provide the framework for reforms to private health insurance announced by the federal government in April 2006 has received Royal Assent and commenced on 1 April 2007. The central piece of legislation is the *Private Health Insurance Act 2007* (Cth).

According to the Explanatory Memorandum, the Acts intend to:

- clarify and simplify the legislative regime for private health insurance so that organisations can offer private health insurance products with the minimum compliance requirements necessary to achieve the government's policy objectives and protect the interests of consumers;
- allow private health insurance to provide and include in risk equalisation arrangements benefits for outpatient and out-of-hospital services, including chronic care management for conditions such as diabetes and asthma, and disease prevention programs;
- require insurers to provide standard product information to help people compare policies and to understand their entitlements;
- eliminate Lifetime Health Cover penalties for fund members who have retained their hospital cover for more than 10 years continuously;
- provide for the transition from the current regulatory regime;
- repeal redundant parts of the *National Health Act 1953* (Cth) and amend a range of other Acts to reflect the new regime;
- impose application and listing fees on the sponsors of prostheses; and
- amend the Acts imposing levies on private health insurers.

Source: Explanatory Memorandum to the legislative package. ●

New prudential standards and guidance for life insurance industry

29 March 2007. The Australian Prudential Regulation Authority (APRA) has released final prudential standards and guidance on risk management and business continuity management for the life insurance industry, including friendly societies.

The standards, developed in consultation with the industry, provide a set of principles-based requirements for risk management and business continuity management. Institutions have the flexibility to develop their own approaches to meet the requirements in order to best suit their particular circumstances.

The package contains:

- Prudential Standard on risk management (LPS 220);
- Prudential Practice Guides on:
  - — risk management;
  - — asset and liability management;
  - — conflicts of interest under s 48 of

the *Life Insurance Act* (durites of directors to policyholders);
— operational risk; and
— insurance risk and reinsurance management; and
- Prudential Standard (LPS 232) and Prudential Practice Guide on business continuity management.

The two new prudential standards come into effect from 1 January 2008 instead of 1 July 2007, as previously proposed. The extended implementation date will allow life companies to meet the requirements of the standard in an orderly way, without unnecessary cost. Individual life companies can approach APRA to seek additional transition arrangements if necessary. ●

Source: APRA media release no 07.13 (29 March 2007).

US/Europe: Holocaust-era insurance claims finalised

20 March 2007. The International Commission on Holocaust Era Insurance Claims (ICHEIC) announced its claims and appeals processes have concluded, having distributed over US$30 million in awards to more than 48,000 Holocaust survivors and their heirs.

'I full recognise that no amount of compensation can redress the suffering inflicted during the Holocaust,' said ICHEIC Chair Lawrence Eagleburger. 'Nevertheless, I believe that ICHEIC has achieved its foal of bringing a small measure of justice to those who have been denied it for so long.'

Established in 1998, ICHEIC was charged with expeditiously addressing, at no cost to claimants, the issue of unpaid insurance policies issues to victims of the Holocaust. It conducted an extensive worldwide outreach campaign to encourage claimants to file, and more than 70 European insurance companies and partner entities participated in the process. ●

For further information, visit <www.icheic.org>.

Insurance and climate change conference: 17–18 May

The Australian Insurance Law Association is holding an insurance law intensive on 17–18 May 2007 entitled 'Insurance Climate Change: What's the Forecast?'. The conference is being held at the Sheraton Noosa Resort in Queensland.

This conference will examine emerging issues for negligence law and insurance law in the context of our changing legal and physical environment.

Speakers and topics include:
- risk management and insurance issues in the Aerotropolis: Dr Brad Bowes, Brisbane Airport Corporation;
- agribusiness claims: Daniel Best, Partner, Carter Newell;
- the resources sector: Rob Evans;
- alliance contracting: Ian Briggs, Partner, Minter Ellison;
- construction site accidents: Richard Douglas SC, Barrister at Law;
- civil liability legislation: Michael Mills, Partner, Freehills;
- the effect that allegations of illegality or dishonesty have on liability or directors' and officers' cover: Professor Martin Davies, Professor of Maritime Law, Admiralty Law Institute; and
- an update on the expert rules: John Griffin QC. ●

For further information, including registration, visit <www.starwoodmeeting.com/StarGroupsWeb/booking/reservation?id=0703019179&key=7AC2F>.

IOS national conference: 10–11 September

The Insurance Ombudsman Service will hold its national conference, provisionally entitled 'Great Expectations — Managing Consumer Perceptions: the Industry Challenge' on 10–11 September 2007 at the Park Hyatt Hotel, Melbourne. Further details to come. ●

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CUSTOMER RELATIONS: 1800 772 772 GENERAL ENQUIRIES: (02) 9422 2222 FACSIMILE: (02) 9422 2404 DX 29590 Chatswood
www.lexisnexis.com.au darren.smith@lexisnexis.com.au

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