HERBERT SMITH FREEHILLS

POLICYHOLDER INSURANCE HIGHLIGHTS 2018

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Introduction

Welcome to the fourth edition of Herbert Smith Freehills' Policyholder Insurance Highlights. In this publication we have pulled together the learning opportunities for insurance policyholders from the most relevant insurance cases decided over the past 12 months.

The key messages are:

- *The insurance market is hardening, particularly in the financial lines space (D&O and professional indemnity insurance):* in a hardening market, policyholders should generally expect to see escalation of premiums and extended delays and disputes about the payment of claims – and this is consistent with what we have been seeing, particularly over the last 6 to 9 months. This should be a timely reminder to policyholders that their interests in the event of a claim are not always aligned with the interests of their insurers and the adjusters appointed by insurers to assess and advise on the claim. Policyholders should likewise appoint advisors on the claim at an early stage to manage the flow of information, minimise the risk of misconceptions and maximise claim recovery. Following the Banking Royal Commission, the Commonwealth government is proposing changes to the Insurance Contracts Act 1984 (Cth) to allow ASIC to seek penalties of up to $210 million against insurers who breach their duty of utmost good faith. This is a welcome development since the current laws have no sanction for breach of that duty, which frequently arises in the context of claims.
- *Important decisions to be made about D&O insurance:* the meteoric rise of shareholder class actions as a regular feature of the Australian litigation landscape has had a significant, some would say catastrophic, impact on Australian (and to some extent international) D&O insurance markets. The situation has been exacerbated by the swell in class action activity arising from the Banking Royal Commission, and the anticipated increase in regulatory enforcement action which will follow in the years to come. As the Australian insurance market seeks to reduce its exposure to these risks, in some cases by withdrawing from the market altogether, capacity diminishes meaning premiums skyrocket and leave company directors with ever more difficult decisions around the purchase of D&O insurance (particularly Side C cover for securities class action risks).
- *Cyber insurance:* despite over 200 notifications following the introduction of the mandatory data breach reporting regime in Australia last year, there have been no reported Australian decisions regarding insurance coverage for cyber losses. However, with cyber insurance cases and incidents continuing to trend upwards in overseas jurisdictions, it is only a matter of time before they reach these shores. Cyber risk is now front and centre for Boards across Australia, as the true impact of a cyber breach becomes better understood. It is imperative that companies improve their understanding of these risks, and ensure their ability to respond (including their suite of insurance policies) is fit for purpose in the event of an incident.

We hope that you enjoy this year's edition of Policyholder Insurance Highlights. Please contact a member of our Insurance team (details at the back of this publication) if you would like to discuss any of the cases or how they may impact your business in more detail.

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Our insurance practice

Our global insurance and reinsurance practice advises insurers, brokers and policyholders on all aspects of insurance and reinsurance matters, whether corporate, regulatory or contentious claims.

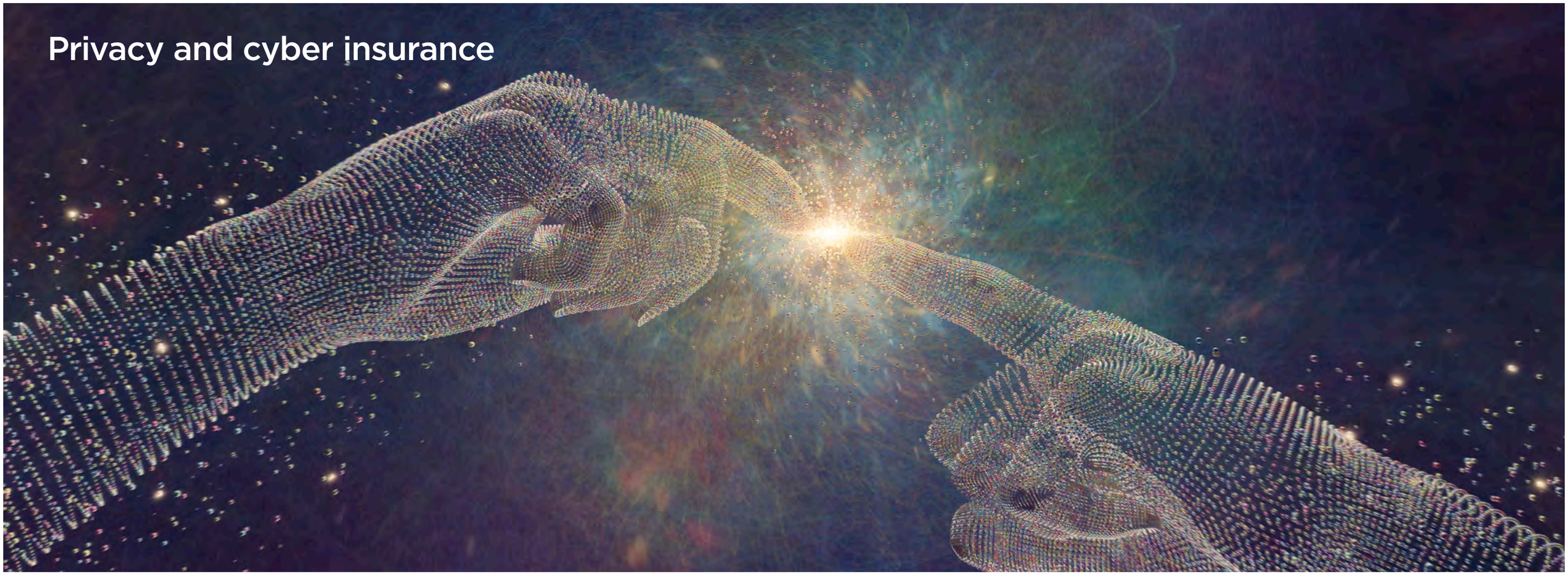
Herbert Smith Freehills' insurance practice in Australia is focussed upon representing the interests of our clients as policyholders in major claims.

We work with corporate policyholders on a range of matters including:

- assisting policyholders with major claims, including advice on coverage, preparation of claims notifications and submissions, and claims advocacy to secure settlement of the claim using the full range of dispute resolution processes;
- advising clients in relation to issues flowing from critical business events including environmental incidents, property damage, personal injury claims, corporate manslaughter charges and health and safety investigations;
- representing insured directors and officers and major corporates in defending claims covered by their insurance policy where they have rights to nominate their choice of legal representation; and
- advising clients on insurance and risk in the context of major transactions, projects and insolvency.

We also advise brokers on the full spectrum of issues that emerge from the role of the broker, including defence of professional negligence allegations.

Privacy and cyber insurance



New laws for notifying breaches

In February this year, the Commonwealth introduced amendments to the Privacy Act 1988 (Cth) which required that entities subject to that Act (including private entities with annual revenue of more than $3 million) notify affected individuals and the Office of the Australian Information Commissioner of 'eligible data breaches'.

'Eligible data breaches' occur where:

- there has been unauthorised access or disclosure of personal information, or a loss of personal information that makes such unauthorised access or disclosure likely;
- this is likely to result in serious harm to one or more individuals. Serious harm can include physical, psychological, emotional, economic, financial and reputational harm; and
- the entity has not been able to prevent the likely risk of serious harm with remedial action.

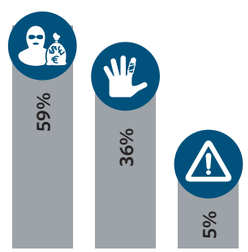
If a regulated entity suspects there has been an eligible data breach, it must carry out a reasonable and speedy assessment – usually within 30 days or less.

Data breaches in 2018

There have been a number of significant data breaches in 2018, with a particular media focus placed on Facebook. Beyond Facebook, some of the many large scale breaches in 2018 have included:

- **TSB:** an IT upgrade to TSB's online platform made the information of up to 2 million of its customers publicly accessible;
- **MyFitnessPal App:** an unauthorised party accessed the names, emails and passwords of more than 150 million users;
- **Exactis:** a database containing 340 million of the data aggregation firm's records was found to be inadvertently publicly accessible online;
- **MyHeritage:** a file was discovered on a private server which contained the email addresses of the approximately 340 million users who had signed up to the service prior to 26 October 2017;
- **AADHAAR:** a service on WhatsApp allowed users to purchase the AADHAAR information (Indian identification system details) or create a fake identity card of potentially any of India's 1.1 billion citizens; and
- **Marriott:** in Australia the personal details of half a million guests of the Marriott hotel chain were exposed by a possible hack in September.

The Commonwealth Government has also released statistics on notified data breaches between February and June 2018. These show that:



There were 242 notifications during that period (of which 59% were due to malicious or criminal attacks, 36% were due to human error and 5% were due to system faults)

35 related to more than 1,000 individuals and 1 related to more than 1 million individuals

Methods for malicious or criminal acts included phishing, brute-force attacks, ransomware, malware, social engineering, compromised and stolen credentials, rogue employees/inside threats and physical theft of materials

The top 5 industries affected were (in order): health service providers, finance, legal/accounting/management services, education and business and professional associations

Cyber – the overseas experience

Interactive Communications International, INC v Great American Insurance Co (No. 17-11712, 11th Cir. May 10, 2018).

Facts

The policyholder issued customers with 'chits', redeemable by calling a hotline connected to an interactive voice response computer system (IVRCS). The call triggered the following steps (in order):

- The customer's debit card was credited with funds
- The policyholder transferred money to a designated bank account
- The customer used the card and incurred a debt
- The bank transferred money from the bank account to pay the debt

A vulnerability in the IVRCS allowed fraudsters to redeem chits multiple times. This vulnerability was exploited to the value of USD11.4 million. The policyholder claimed on its 'Computer Fraud' policy which provided coverage for:

> "Loss of... money... resulting directly from the use of any computer to fraudulently cause a transfer... to a person..."

Decision

The Court held that the exploitation was a fraudulent act perpetrated through 'the use of a computer'. However, the loss had to result directly from the fraud – ie the loss had to follow straightaway, immediately and without intervention or interruption from the fraud.

The policyholder could prevent the release of funds prior to Step 4 (ie the transfer of money to pay a relevant debt). Therefore, while the fraud occurred at step 1, the loss occurred at step 4. As there were intervening acts (and potentially significant delay) between these steps, the loss did not 'result directly' from the fraud, so was not covered by the cyber policy.

St. Paul Fire & Marine Insurance Company v Rosen Millennium, Inc and Rosen Hotels & Resorts, INC. (D. Florida – Middle District), September 28, 2018.

Facts

The policyholder provided payment data security services at a hotel. Malware was discovered which potentially gave fraudsters access to the credit card details of customers.

The hotel owner wrote to the policyholder and alleged these circumstances were the policyholder's fault. This caused the policyholder to claim on its commercial general liability policy.

Decision

The Court held that, as the hotel owner had not yet made a claim, the policyholder's claim was limited to enforcing the insurer's duty to defend personal injury claims, which were defined to include "[m]aking known to any person or organization covered material that violate[d] a person's right of privacy."

> 'Making known' was held to mean the 'publication'.

But the Court held that the policy applied only to personal injuries resulting from the policyholder's business activities – not actions of third parties (ie the fraudster). Here, any publication of materials (and therefore any injury) would be caused by the actions of the fraudster and was therefore not covered.

The Commonwealth Government has released statistics on notified data breaches between February and June of 2018. These show that: there were 242 notifications during that period (of which 59% were due to malicious or criminal attacks).

Lessons for Policyholders

Although cyber fraud continues to result in significant losses for companies globally, policyholders still face uncertainty around whether they will be able to rely on their insurance to protect against the risk. Whether the policy is a general liability policy or a cyber insurance policy, individual courts around the world have adopted different approaches to determining whether there exists a sufficient causal connection between the fraudulent conduct and the loss. Intervening causes and actors continue to be decisive factors in deciding such cases.

In any event, policyholders would be well-advised to carefully consider their coverage against the increasing number of ways through which cyber fraud occurs. In particular, policyholders should consider whether their general liability policy is sufficient to cover losses from cyber fraud, or whether they would benefit from a specialist cyber insurance policy.

Breaking news

Just prior to publication, it was reported that the US-based food manufacturer Mondelez had issued proceedings against Zurich Insurance for non-payment of claims of approximately $100 million under a property insurance policy arising from the widely publicised NotPetya ransomware virus which affected a number of large organisations in mid-2017.

The claims relate to damage to Mondelez's servers and laptops which halted production at its facilities. It has been reported that Zurich is arguing the distribution of the virus was an 'act of war' and therefore excluded under the cyber policy. This is premised on various reports that the virus originated from the Russian military in the context of conflict between Russia and Ukraine. The outcome of this high-profile cyber case will inevitably cause policyholders to re-examine how robust their cover is, particularly in the context of the constantly evolving nature of cyber threats.

Advancing defence costs when fraud is alleged

Provisions which limit an insurer's ability to withhold advancement of defence costs unless and until a final adjudication of fraud may not assist a policyholder who is accused of pre-policy fraudulent non-disclosure.

Onley v Catlin Syndicate Ltd as the Underwriting Member of Lloyd's Syndicate 2003 [2018] FCAFC 119

Facts

The applicants, Mr Onley and Mr Cranston, were directors of a company which held an insurance policy that provided cover for management and professional indemnity liability. Fraudulent conduct was excluded, but the policy entitled the insured to an advancement of defence costs to defend fraud allegations unless and until a court had adjudicated the conduct to be fraudulent.

Criminal charges were brought against the applicants, alleging they had conspired to dishonestly cause loss to the Australian Taxation Office. The applicants claimed an advancement of their defence costs pursuant to an extension in the policy.

The relevant conduct which was the basis of the criminal charges began at least one month before the policy was taken out, and it was alleged the directors fraudulently failed to disclose the conduct because they knew it would impact the availability of insurance. The insurer denied liability on the basis of alleged fraudulent non-disclosure, and relied on its right under s28 of the Insurance Contracts Act 1984 (Cth) to void the policy.

The applicants argued that, as defence costs had to be advanced until underlying allegations of fraud were determined by the court, the insurer could not seek to rely on the alleged fraudulent non-disclosure to avoid the policy unless and until a court adjudication had occurred.

Decision

The Full Court of the Federal Court held that the insurer was entitled to seek to avoid the policy, and was not prevented or delayed from doing so by the advancement provision.

The Court noted that it would require the support of clear policy wording indicating insurers agreed to cover a risk and waive their rights under the Insurance Contracts Act 1984 (Cth) notwithstanding a breach of the insured's disclosure obligations – this policy did not expressly or impliedly waive the insureds' pre-contractual obligations of disclosure. Pre-contractual fraud is to be contrasted with post contractual conduct that would be covered so long as it isn't fraudulent.

Further, the Court held that public policy would not allow a policyholder to effectively prevent the insurer excluding liability for fraudulent conduct which induced the insurer to enter the contract. As such, the insurer's entitlement to rely upon its rights in respect of fraudulent non-disclosure under the Insurance Contracts Act 1984 (Cth) was not revoked or otherwise conditioned.

In respect of the argument that the charges of fraud had not yet been determined, the Court found that only a 'real or substantial ground' for alleging non-disclosure was required, which does not require 'all necessary proof' of the conduct. Of course, the allegation of fraudulent non-disclosure would need to be proved, but there was no requirement to advance defence costs in the meantime.

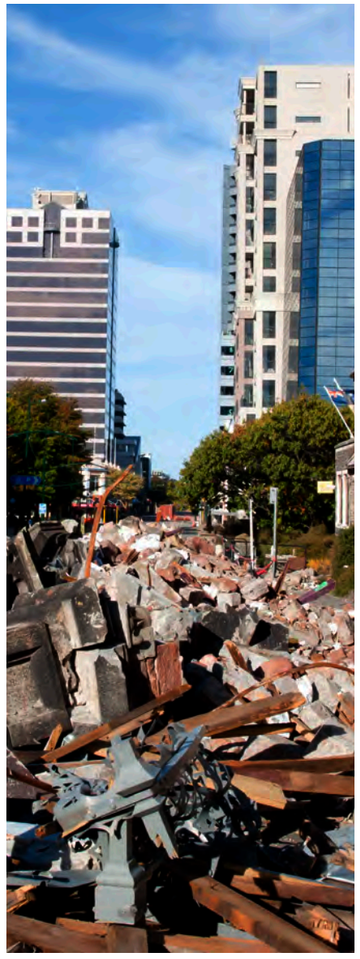
Lessons for Policyholders

Exclusions requiring a 'final determination' of fraudulent conduct grew out of a series of cases in the early 2000s arising out of major corporate collapses where policyholders would have been deprived of the opportunity to defend fraud allegations if insurers could decline cover whenever such an allegations were made. Given the likely increase in regulator activity, particularly following the Banking Royal Commission, and the prospect of criminal allegations, coverage for defence costs will be a vital lifeline to directors. Policyholder directors would be well advised to ensure that their deed of indemnity and insurance protections will provide them with appropriate cover, including the advancement of defence/ investigation costs, when they are most needed.

Home work assignment

The rights of an assignee of an insurance claim may not be the same as those of the original owner.

Xu & Anor v AIG New Zealand Ltd [2018] NZCA 149



Facts

The Barlows' (Owners) property was damaged in the 2010 and 2011 Christchurch earthquakes. The Owners held insurance against loss caused by such damage under a policy underwritten by IAG New Zealand Ltd (IAG). The policy required claims to be settled by IAG on the basis of either an indemnity payment or paying the actual cost of the owners restoring the property to the property's pre – damage condition (replacement benefit).

The Owners claimed under the policy but then sold the property to Ruiren Xu (Purchasers) before the claim was settled. The Owners assigned their rights in respect of their claim under the policy to the Purchasers. The question on appeal was whether the Purchasers could claim the replacement benefit under the policy.

Decision

The New Zealand Court of Appeal confirmed the position established in its decision in Bryant v Primary Industries Insurance Co Ltd [1990] 2 NZLR 142 – ie that purchasers who are assigned the owner's insurance claim are entitled to indemnity value but not to full reinstatement costs on the basis that:

- the right to the replacement benefit under the policy is personal to the insureds, being the Owners. The Owners' right to the replacement benefit was extinguished by the sale. Consequently the Owners could not assign to the Purchasers the right to receive the benefit;
- an insurer should not be held liable to a stranger to the insurance contract whose moral character it has not been able to assess and who may seek to profit from the loss. The Purchasers were 'strangers' to the policy; and
- IAG's policy was consistent with these principles. For example, the insured was defined as 'the Barlows', not 'the Barlows or their assignees', and the replacement benefit was expressed to be payable if 'you restore your Home' – in other words, it was conditional on the Barlows restoring their home and incurring the cost.

Lessons for Policyholders

The assignment of rights under insurance policies can raise some complex issues and the making of such an assignment (and its potential implications for coverage) requires careful consideration. Generally, an assignee of an insurance claim (whether in a property or liability context) should exercise caution around the value of that assigned claim, noting that this is a New Zealand decision and this issue has not been directly addressed by an Australian Court.

Don't assume your liability isn't covered

The policyholder was entitled to cover, despite allegations of non-disclosure and an exclusion for contractually assumed liability, because (despite it not being specifically disclosed) the existence of the indemnity was apparent from a letter in the insurer's possession, no further questions were asked by the insurer, and in any event the policyholder would have been liable anyway on bases other than the indemnity.

QBE Underwriting Ltd as managing agent for Lloyds Syndicate 386 v Southern Colliery Maintenance Pty Ltd [2018] NSWCA 55

Facts

- Southern Colliery Maintenance warranted in a "Special Services Agreement" with Endeavour Coal that its labour hire services would be performed by appropriately qualified and trained personnel with due care and skill. It also indemnified Endeavour for any breaches of the Agreement, its own negligence and liability arising from the injury of one of its own employees.
- An injured employee claimed against Southern Colliery (as his employer) and Endeavour (as occupier of the site). Endeavour cross-claimed seeking indemnity or contribution from Southern Colliery, alleging negligence and breach of various warranties given in the Agreement. The cross claim was advanced on three bases, being:

  the indemnity in the Agreement;

  damages for breach of the warranties in the Agreement;

  contribution/indemnity as a joint tortfeasor.

Southern Colliery was covered under its worker's compensation policy for its liability to its employee, but claimed under its public liability insurance for its liability to Endeavour. QBE declined cover, but Southern Colliery successfully recovered at trial. QBE appealed.

Decision

QBE raised two defences to the claim, both of which failed. First, QBE argued that the policy excluded liability assumed under the terms of a contract, unless the insured would have been liable absent such terms (this form of exclusion for contractually assumed liability is fairly standard). The Court found that Endeavour had established breaches of the contractual obligations in the Agreement, including a failure to provide properly trained employees that would exercise due care and skill, so Southern Colliery's liability would therefore have existed absent the indemnity. The exclusion therefore did not apply.

Secondly, QBE argued that Southern Colliery had failed to disclose the existence of the indemnity in the Agreement when it applied for the policy, which QBE alleged was material to QBE's decision to insure. However, a letter in QBE's possession referred to a counterparty in another claim seeking an indemnity from Southern Colliery and to the existence of the Agreement. The Court held that the disclosure duty will be satisfied if the policyholder discloses sufficient information such that the underwriter is in a position to determine if further information should be sought. Disclosing less than all of the information known by the policyholder did not detract from this position. Here, the letter was sufficient to put QBE on notice of the indemnity, and it was held to be then incumbent upon QBE, if it wished to know more, to seek out the terms of that indemnity, which it failed to do, thereby waiving compliance with the duty of disclosure.

Lessons for Policyholders

As a general proposition, insurers bear the burden of proving that an exclusion applies and the terms of that exclusion will likely be construed narrowly – specifically in the context of contractually assumed liability exclusions, all bases upon which the policyholder is said to be liable will be relevant to its application.

Similarly, where insurers allege a non-disclosure, it is important to consider all the information provided to them (including potentially in relation to claims and previous renewals of the policy) to determine whether they were 'on notice' of an issue and therefore waived their right to further information if they failed to ask follow-up questions.

Don't walk away from a difficult claim

Deliberate acts by a policyholder can still be covered as wrongful acts – it doesn't have to be an unintentional wrongful act.

Certain Underwriters at Lloyds' subscribing to Contract Number NCP106108663 v Aquagenics Pty Limited (in liq) (2018) 352 ALR 131

Facts

A local council engaged the policyholder, Aquagenics, to design and construct a water treatment plant, including conducting pre-commissioning works. A dispute arose as to whether those pre-commissioning works had been properly carried out – Aquagenics maintained that they had, such that commissioning could commence. The dispute could not be resolved. Aquagenics walked off the construction site and never returned.

The local council successfully brought arbitration proceedings against Aquagenics for the $1.3 million cost of engaging another party to conduct the pre-commissioning works. Aquagenics sought to recover the arbitration award under its professional indemnity insurance policy – on the basis that the arbitral award resulted from a 'claim… arising out of [a] wrongful act committed… in the course of [Aquagenics'] professional activities'. The claim was successful at trial. The insurer appealed.

Decision

The Full Court unanimously approved the trial judge's decision and ordered that the claim be paid. The key aspects of note are as follows:

The Court refused to restrict the cover provided by the policy's insuring clause, particularly where that would effectively require the implication of an additional word into the clause.

Insurers argued that the use of 'wrongful act', 'error' and 'omission' in the cover meant that the conduct giving rise to the claim had to be 'unintentional' and the policy did not cover deliberate acts such as Aquagenics' 'commercial' decision to leave the site. The Court rejected these arguments:

- the ordinary meaning of 'act, error or omission' can involve deliberate conduct, and to limit those terms in the way suggested by the insurer would be inconsistent with the remainder of the policy – for example, the policy exclusions suggested that the insuring clause was not intended to cover only inadvertent or unintentional acts; and
- any untoward width of operation of the phrase 'act, error or omission' argued by the insurer was addressed by operation of the policy exclusions and by the requirement that the relevant act must have been committed 'in the course of professional activities'.

Aquagenics' decision to cease work in connection with the contractual dispute did arise 'in the course of [Aquagenics'] professional activities'.

The decision which provided a basis for Aquagenics' assertion that pre-commissioning works were complete was informed by a consideration of commissioning and pre-commissioning questions that involved professional expertise and skill on the part of Aquagenics.

As such, Aquagenics' refusal to take further steps under the contract on the basis that pre-commissioning works had been completed was committed in the course of the professional activities of a water treatment engineer.

It was incorrect to characterise the decision as 'commercial' – Aquagenics' position was that it could not conduct any further work until the local council had fulfilled its contractual obligations concerning commissioning works.

Lessons for Policyholders

This decision represents another practical, common-sense approach to policy construction which appropriately preserves the commercial purpose of the policy - this should similarly be the lens through which policyholders view policy construction disputes with their insurer. It would be a deeply uncommercial outcome if a court concluded that a professional indemnity policy did not cover deliberate, albeit negligent, acts and omissions.

Professional integrity

Specific policy endorsements rank higher that standard exclusions where there is some conflict over what is covered.

Pacific International Insurance Co Ltd v Walsh (2018) 20 ANZ Insurance Cases 62–171

Lessons for Policyholders

Generally, principles relating to the construction of insurance contracts tend to produce a more favourable outcome for policyholders than insurers. While this will not overcome all coverage issues which may arise, careful attention must be paid to the whole policy wording and the commercial context for the policy, as these may support a more favourable (and often common-sense) outcome for the policyholder.

Facts

The policyholder, Walsh, prepared a report for a homeowner stating that a balcony rail (subsequently found to be defective) was 'structurally sound and in fair condition'. The homeowner's daughter was subsequently injured after falling from the balcony. The policyholder was successfully sued for negligence in the preparation of the report and ordered to pay damages to the homeowner and her child.

Pacific Insurance declined to indemnify the policyholder on the ground that the policy excluded liability caused by or arising out of the insured's provision of, or failure to provide, any professional advice or services. At trial, the Court held that the exclusion did not apply. Pacific Insurance appealed the decision.

Decision

The NSW Court of Appeal dismissed both main arguments raised by Pacific Insurance:

Did the Policy cover the advice provided in the report?

Pacific contended that the words 'this policy covers all inspections/reports as requested in your proposal unless excluded in your Premium Advice' bore a very narrow meaning which restricted cover to only those certain types of reports listed in the insurance renewal proposal form.

The Court rejected this argument, holding that this was:

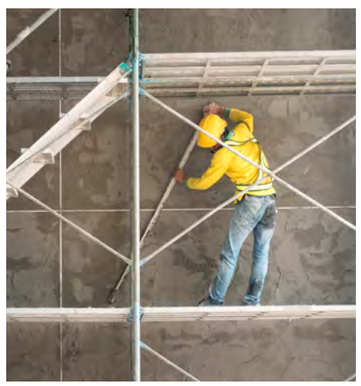
- not a natural meaning of the words 'all inspections/reports as requested in your proposal'; and
- difficult to reconcile with the 20 species of cover listed in the proposal form.

Pacific further contended that a policy requirement that building inspection reports include a recommendation for annual inspections to take place indicated that the policyholder was not covered for reports about a building's structural integrity. Again, the Court rejected this argument – the policyholder's obligation to include a particular recommendation in a report of itself said nothing about whether other content of the report was insured.

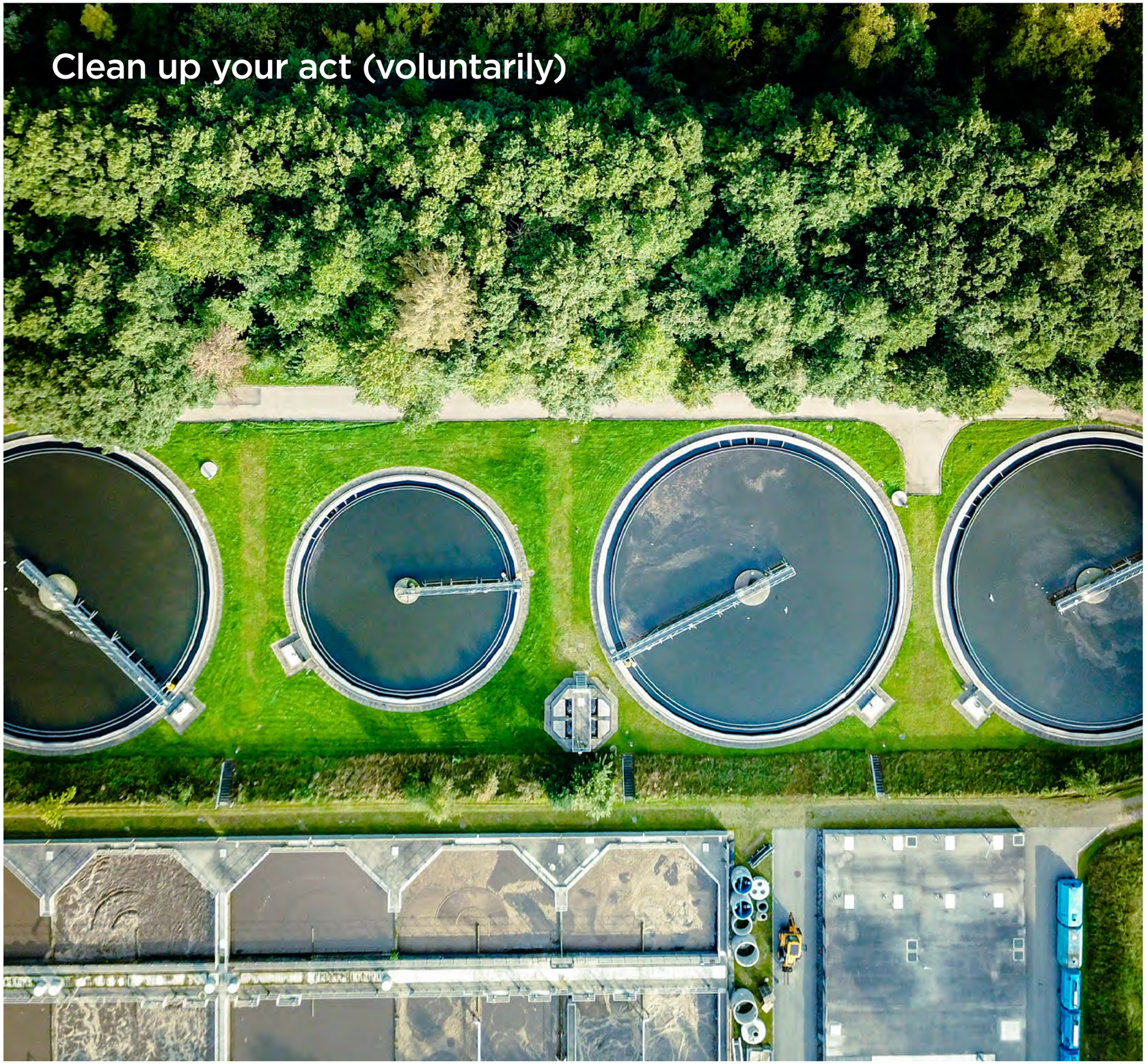
Moreover, a policy condition required reports to include advice about the structural inadequacy of certain structures, which was analogous to structural integrity, and this indicated that such advice was insured.

Even if it was covered, did a 'professional advice' exclusion apply?

Pacific also contended that the policyholder's advice constituted 'professional advice or services' which were specifically excluded by the policy. The Court rejected this argument, reasoning that this construction would lead to a conflict with an endorsement requiring a building inspection report to recommend that people take care not to overload external timber structures, including verandahs. It could not be the case that the policy required certain advice to be given and simultaneously excluded liability for the provision of that advice. Further, a separate clause provided that, where an endorsement conflicted with an exclusion, the endorsement applied. The Court said that where important questions of construction involve a conflict between exclusions and provisions in the policy schedule and endorsements, weight should be given to any provisions directed to the very issue of creating a hierarchy between those provisions.



Clean up your act (voluntarily)



The costs of 'voluntary' compliance with a statutory obligation to remediate may well be a legal liability within the character of that covered by a typical general liability policy.

Marketform Managing Agency Ltd v Amashaw Pty Ltd (2018) [2018] NSWCA 70 (11 April 2018)

Facts

Petrol had leaked from a service station operated by the policyholder, causing an explosion in a nearby water sewer and contamination in other underground services. The policyholder responded quickly and 'voluntarily' undertook works to rectify the damaged sewer, addressing both its statutory obligations and its civil liability to the sewer main's owner.

The liability insurer declined the claim for the remediation costs, alleging that the costs of compliance with statutory obligations were not covered. At first instance, the policyholder successfully recovered the costs of remedying the damage (but not the cost of works to prevent future leakages) on the basis that the policy covered liability arising out of damage resulting from pollution (which expressly included 'nuisance'), despite the fact that the policyholder also had a statutory obligation to remediate the damage. The insurer appealed, but failed.

Decision

The Court of Appeal upheld the policyholder's entitlement to cover, and dismissed the following main arguments by the insurer:

Did the policyholder breach a duty of disclosure to the insurer?

The insurer argued that, if the policyholder had disclosed two technical reports regarding contamination at the service station, it would not have taken on the risk at all, and could therefore reduce its liability to nil. Those reports supported an ongoing belief that (1) contamination at the policyholder's premises was the result of historical leaks and spills which was not out of the ordinary having regard to the earlier use of the site and (2) other factors (such as a climatic or geological change) were unlikely to shift the onsite contamination to neighbouring properties. The Court concluded that a reasonable person in the policyholder's position could not be expected to know that the reports would be relevant to the insurer's underwriting decision.

What was the relevant damage and was it insured?

The insurer also argued there was no 'Damage' that was covered by the policy – however, the Court held that the presence of petrol in a sewer was capable of constituting an actionable nuisance to the sewer main's owner, which was within the policy definition of 'Damage'. Such a nuisance occurred when the sewer main's owner became aware of the risk associated with the presence of contaminants in the relevant sewer – which meant that the occurrence of 'Damage' fell within the policy period.

Lessons for Policyholders

This decision represents a common-sense, practical outcome – had the insurers won on appeal, policyholders would be advised to sit back and wait for a claim following an incident so as to avoid arguments about whether its insurance cover has been triggered. Responsible corporate citizenship should be encouraged without placing liability coverage at risk.

While policyholders should always consider their specific risk profile and, if relevant, take out contamination specific insurance policies, the key takeaway for policyholders is to be aware that coverage for cleaning up pollution damage to third party property might be available under a general liability policy. Do not simply accept the view that a statutory obligation to remediate is not a legal liability within the character of that covered by a typical general liability policy.

Insurance and class actions

Australian D&O insurance market developments

As we foreshadowed in last year's Policyholder Insurance Highlights publication, 2018 has been a tumultuous year for the Australian D&O insurance market. Primarily, this has been driven by the continued prevalence of shareholder class actions, to which D&O insurers are exposed through "Side C" or Securities (shareholder class action) Claim cover. In terms of some high-level statistics:

50% of class actions commenced are shareholder class actions

Filings have increased steadily in the last 5 years

Most, if not all, of those claims are backed by a litigation funder

Average settlement amounts are around $50 million, not including defence costs

While speculative, Australian D&O insurers have almost certainly been heavily exposed to defence costs and settlement amounts in recently commenced, as well as historical, class action proceedings. Again, as foreshadowed, 2018 has seen the D&O market react to these historical and ongoing exposures by increasing deductibles and premiums, reducing the size of policy limits and, in some cases, withdrawing from the D&O Side C market altogether. There is also growing speculation as to whether Side C cover remains a viable product in the Australian insurance market. Indeed, the ongoing existence of Side C cover and the more general impact of shareholder class actions on the D&O insurance market in Australia has been the subject of commentary and submissions in the context of the Australian Law Reform Commission's inquiry into class actions and litigation funding in Australia.

While some consider that the existence of Side C cover will increase the risk of a company being the subject of a shareholder class action, this is rarely the case except in situations where the target defendant company is in financial distress. However, the existence of Side C D&O insurance (even where that existence is unclear or not known) is increasingly referred to by litigation funders and plaintiff firms to provide economic justification for commencing a claim, and avoid the suggestion that the class action is a claim by one group of a company's shareholders at the expense of another (ie current shareholders do not suffer a loss of value when the company's liability is covered by insurance). This may have made it more easy in the past for institutional investors to sign up to participate in proceedings on behalf of their clients.

However, the very real possibility that Side C D&O insurance may cease to exist, be purchased or respond to anything other than the upper part of a significant claim (because of a large deductible) raises some potential issues going forward.

First, institutional investors may have to give increasing consideration to the economic logic of joining a class action and how it interplays with their duties to clients. In short, if the company's liabilities are not being funded by the insurer, the class action will erode the value of the company in which they remain invested, which calls into question the holistic financial impact of the claim on past and/or current shareholders.

Secondly, although shareholder class action claims against individual directors are considerably more difficult and burdensome to prosecute, it may be that such claims receive increased focus to access potentially available insurance, either to meet economic viability issues raised by institutional investors, or where financially distressed companies are potential defendants but do not have Side C cover.

Associated with these issues, there may well be an increase in the frequency with which copies of relevant insurances are sought at an early stage of class action proceedings, or possibly prior to proceedings being commenced.

Impact on Boards

The issues outlined above also raise ongoing considerations for Boards in relation to the purchase of D&O insurance. The decision on the purchase of Side C insurance (and the terms of that insurance) is effectively a decision as to how much of the potentially significant financial risk arising from a shareholder class action, should it arise, a company is prepared to carry on its balance sheet. That must be weighed against the cost of obtaining such Side C insurance. In making this decision, directors are subject to their usual Corporations Act 2001 (Cth) duties, and may have available a "business judgment" defence. However, to rely on such a defence, the directors must, amongst other things, have informed themselves about the relevant subject matter. For Side C insurance, this would likely include a reasonable understanding of:

- the shareholder class action litigation landscape;
- the risk profile of the company from an operational and governance perspective;
- ways in which the risk could be managed through internal governance controls;
- the terms of cover offered; and
- the price and availability of Side C insurance, as well as the approach taken by other companies in the market, based on advice from an insurance broker.

Relevant case law developments

This year has seen the use of the Civil Liability (Third Party Claims Against Insurers) Act 2017 (NSW) (introduced in January 2018) to seek to join insurers to proceedings. Based on the reported cases this year (particularly Rushleigh Services Pty Ltd v Forge Group Ltd (in liq) [2018] FCA 26) concerning a shareholder class action the following main principles can be ascertained:

More than proof of the mere existence of an insurance policy is required – there must be some evidence to show the policy covered the risk, or was in place at the time of the risk;

Even where insurers claim that certain exclusion clauses apply, provided there is an arguable claim against their application, leave can be granted to join an insurer to a proceeding;

In exercising the discretion to grant leave, weight should not be given to either the additional costs which the insurers may have to incur in defending the claim, nor whether they are well-placed to defend the claim (ie whether they are strangers to the proceedings);

A refusal under s 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW) (which was previously used to seek access to insurance proceeds by way of charge) does not necessarily preclude a claimant from seeking leave under the new Act.

In addition, the New South Wales Supreme Court has recently handed down a decision on the operation of aggregation clauses in the context of class actions. In Bank of Queensland Ltd v AIG Australia Ltd [2018] NSWSC 1689, the Bank was the subject of a customer class action relating to its alleged failure to question suspicious transactions initiated by a financial planner on behalf of those customers as part of a Ponzi scheme. The Court held that there was an insufficient logical or causal connection between the various acts and omissions underlying the claims for them to be aggregated together for the purpose of applying a single $2 million deductible. As a result, each individual claim fell below the policy deductible and no recovery could be made under the policy for the settlement sum of $6 million. Some caution should be exercised in relation to this decision and its application to securities class actions, where there is frequently a common act or omission underlying the cause of action in relation to each group member (eg a failure to disclose material information or misleading and deceptive conduct).

Nevertheless, it would be prudent for policyholders to review their D&O, professional indemnity and public liability insurance wordings to ensure they will appropriately respond to a class action.

ATE insurance

Finally, after the event (ATE) costs insurance continues to be a common feature of litigation funding arrangements for class actions, and continues to be offered as part of the package for a defendant's security for costs to avoid the traditional payment into Court. However, the policies are rarely able to overcome the issues raised by the Court in Petersen Superannuation Fund Pty Ltd v Bank of Queensland Limited [2017] FCA 699 (see Policyholder Insurance Highlights 2017), and some form of direct indemnity to the defendant is therefore required. With the possible advent of contingency fees which have been recommended by the Victorian Law Reform Commission and may similarly be the subject of a recommendation by the Australian Law Reform Commission, there may be an emergence of forms of insurance or risk transfer products to support those contingency fee arrangements, including damages based agreement (DBA) insurance which is used in overseas jurisdictions.

All in the family (when agents arrange insurance for principals)

An agent with responsibility to renew insurance for a principal (a scenario which applies to a company's risk managers and brokers) must disclose matters known to both the principal and the agent.

Allianz Australia Limited v Taylor & Anor (2018) 20 ANZ Insurance Cases ¶62-173

Facts

Ms Post was the registered owner of a vehicle, had responsibility for the finance contract and was named as the sole insured in the policy with Allianz. Her daughter, Ms Taylor, was a 'nominated driver' under the policy, drove the vehicle and was responsible for all expenses concerning the running, maintenance, registration and insurance of the vehicle.

Ms Post's driving licence was suspended for three months, unbeknownst to her. Ms Taylor knew of her mother's licence suspension but did not disclose this to Allianz.

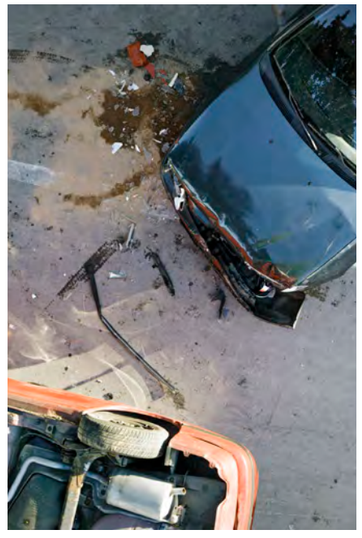
Ms Taylor made a claim after the vehicle was involved in a collision, but Allianz refused cover for non-disclosure, based on unchallenged evidence that, had the mother's suspension been disclosed, Allianz would not have renewed the policy. The Magistrate found that, although Ms Taylor had not disclosed her mother's licence suspension, there was no agency relationship between her and her mother. As a result, the Magistrate held there was no non-disclosure and that the insurer was bound to indemnify. The insurer appealed.

Decision

The insurer succeeded on appeal.

First, the Court found that the daughter was the mother's agent. Even though the daughter was acting in her own interest in renewing the insurance contract, it did not flow that there was no legal agency relationship. The knowledge of the daughter as the agent was the knowledge of the mother as the principal by virtue of (i) the task of renewal being delegated to the daughter, and (ii) the daughter having authority to act and exercising a power to affect her mother's legal relations with Allianz. The mother had consented to the daughter acting on her behalf to bring about the existence of the insurance policy under which the daughter would take an interest – so the daughter was both a beneficiary and agent.

Secondly, a matter 'known to the insured' under s 21 of the ICA includes a matter known to the insured's agent. The Court considered the authorities addressing the question of whether knowledge has to be personal to an insured. In Lindsay v CIC Insurance Ltd (1989) 16 NSWLR 673 it was established that where a person delegates all matters of insurance to an agent, the knowledge of both the agent and the proponent must be disclosed. Applying this principle to the domestic context in which it arose, the Court found that it operated in the same way. In light of that, Allianz was entitled to refuse indemnity.



Lessons for Policyholders

While this case occurred in a domestic context, it is a timely reminder of the agency and knowledge issues which can arise in a commercial context. Corporate policyholders invariably place their insurances via their risk manager and through a commercial broker, whose corporate knowledge of the business and operations (again, through claims and potentially their sources) will be attributable to the client. Policyholders should have robust systems in place for collecting and verifying disclosable information and similarly systems in place to understand any knowledge which may be held exclusively by the broker. We query whether the outcome would have been different had the daughter not known of the mother's licence suspension, or if the policy had contained a non-imputation clause.

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Market recognition – awards and accolades

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AUSTRALIAN LAW AWARDS 2018

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AUSTRALASIAN LAW AWARDS 2016 - 2018

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LEGAL 500 2019

BAND 1 DISPUTERESOLUTION
AUSTRALIAN CHAMBERS ASIA-PACIFIC 2016 - 2019

BAND 2 INSURANCE POLICYHOLDER AUSTRALIA
CHAMBERS ASIA-PACIFIC 2016 - 2019

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