POLICYHOLDER INSURANCE HIGHLIGHTS 2016

IN THIS ISSUE

01 Welcome

02 Restrictions on policy coverage may be overcome

03 Insurers can be sued directly by certain third parties

04 Policy wording an important part of early coverage strategy

05 Policyholders can be covered for their own negligence

06 'Professional services' exclusion clauses do not prevent coverage

07 Ambiguities in insurance contracts will not be resolved in favour of the Insurer

08 Consider 'double insurance' issues at the time of purchasing insurance to avoid unnecessary premium costs

09 Admission of liability by insurer can be withdrawn if circumstances change

10 Are your exclusion clauses relevant to your circumstances?

12 Courts will apply the 'golden rule' for calculating damages

13 Defect vs damage: what is excluded?

14 Insurance for cyber risks

16 Contacts – who can help?

17 Market recognition – awards and accolades

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WELCOME

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

The Court's decisions in 2016 have again reminded us that policyholders should be very careful not to compromise or walk away from difficult claims without specialist advice. We have seen claims which at first blush might seem difficult to make or fall outside the policy coverage – for reasons ranging from obvious restrictions on coverage to defective workmanship and a policyholder's own clear negligence – in the end covered by the relevant policies after the Courts weighed in on the claims.

We have also seen a number of D&O insurance policies litigated in the past year. More directors, officers and employees appear to be on the receiving end of formal investigations, which has resulted in heavier reliance on their company's D&O insurance. The recent D&O cases reiterate the importance for policyholders to ensure that they are aware of and comply with the terms of the policy and, importantly, that they prove the causal link between the insured event and the loss suffered.

Finally, as is often the case with insurance policies, the Courts continue to remind both insurers and policyholders that they will look first and foremost at the words of the insurance policy document when taking a position on policy coverage. It remains of the utmost importance to ensure the words on the paper reflect the intention of the parties and the agreement reached about coverage.

We have also included a brief update on two US cases dealing with cyber security breaches. As yet, there have been no reported cases on cyber insurance policies in Australia. However, given the rate at which cyber security breaches are occurring, and with the impending Australian legislation proposing to make reporting of data breaches mandatory, we expect it will not be long before cyber insurance litigation makes its way to Australia.

We hope that you enjoy this year's edition of the 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 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
- 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.

RESTRICTIONS ON POLICY COVERAGE MAY BE OVERCOME

Watkins Syndicate 0457 at Lloyds v Pantaenius Australia Pty Ltd [2016] FCAFC 150

Facts

In June 2013, an ocean-going yacht owned by Mr Phillips ran aground in Western Australia on its return from participating in a race from Fremantle to Bali.

Mr Phillips had insured the yacht with both Pantaenius Australia and Watkins Syndicate 0457 at Lloyds. The latter policy was written through Nautilus Marine Insurance Agency.

The race insurer (**Pantaenius**) paid the claim and sought to exercise the policyholder's rights in a subrogation claim for contribution from the insurer of the policyholder's current boat insurance policy (**Nautilus Policy**).

The Nautilus Policy covered the yacht for losses occurring within 100 nautical miles of the coastline but was subject to the following restriction:

> *'All cover provided by the policy will be automatically suspended when your boat clears Australian Customs and Immigration for the purpose of leaving Australian waters and will recommence when it clears Australian Customs and Immigration on return.'*

At the time of the accident, the yacht had cleared Customs on the outward voyage but had not yet cleared Customs on its return (despite having sailed back to within 100 nautical miles of the coastline).

The insurer under the Nautilus Policy therefore declined the claim on the ground that the accident occurred while the policy was suspended.

The decision

Pantaenius argued that section 54 of the *Insurance Contracts Act 1984* (Cth) should operate to overcome the restriction, as the restriction was a condition that had the effect of depriving the policyholder of cover due to an 'act or omission' which had not caused the loss and did not prejudice the insurer (since the claim would clearly have been covered had Customs been cleared on return).

The Federal Court at first instance and the Full Court of the Federal Court on appeal held that section 54 *did* apply to assist Pantaenius, finding that the act of clearing Customs at Fremantle to depart Australia, which suspended cover, was an 'act' within the meaning of the section 54.

The Full Court also confirmed that an insurer exercising subrogation rights to seek contribution from another insurer could also rely upon the assistance of section 54.

LESSONS FOR POLICYHOLDERS

This decision reminds policyholders and their broker advisors that they should not abandon or compromise a claim simply because it appears at first look that the loss is excluded or outside the conditions or restrictions in the policy.

Although the words of the policy are important, the *Insurance Contracts Act 1984* (Cth) contains statutory modifications to most insurance policies that may assist policyholders to produce a different outcome.

INSURERS CAN BE SUED DIRECTLY BY CERTAIN THIRD PARTIES

CGU Insurance Limited v Blakeley & Ors [2016] HCA 2

Facts

The liquidators of Akron Roads Pty Ltd (in liquidation) (**Akron**) commenced Court proceedings against three former directors of the company claiming compensation for loss pursuant to section 588M(2) of the *Corporations Act 2001* (Cth) for insolvent trading.

The directors made a claim for indemnity for the allegations under a professional indemnity policy they held with CGU Insurance Limited (**CGU**). CGU denied the claim on the ground that (according to CGU) the professional indemnity policy did not provide cover for the form of liability alleged in the claims made in the Court proceedings.

The liquidators became aware of the professional indemnity policy held by the directors and applied to the Supreme Court for:

- an order to join CGU as a defendant to the Court proceedings against the former directors; and
- a declaration that CGU was liable to indemnify the former directors under the policy in respect of any judgment obtained against them in the proceeding (subject to the policy limit).

CGU opposed the application, arguing that the liquidators were not insured under the policy and therefore had no right to pursue CGU simply because it was the directors' insurer.

The decision

At first instance, Justice Judd allowed the joinder of CGU to the Court proceedings and held that:

(a) the liquidators had a sufficient interest in the proceeds of insurance to allow them to apply for declaratory relief; and

(b) a justiciable dispute existed between the liquidators and CGU as a result of the denial of coverage to the directors.

His Honour referred to section 562 of the *Corporations Act 2001* (Cth) and the comparable provision in section 117 of the *Bankruptcy Act 1977* (Cth) (which set out a third party claimant's right to the proceeds of an insurance policy payable to an insured) and held that where a company in liquidation holds insurance for liability to third parties and a payment is received pursuant to that insurance, the liquidator must pay that money to the third party in priority to other payments.

CGU's appeal to the Court of Appeal failed and it was granted special leave to appeal to the High Court on the grounds that the Supreme Court allegedly lacked jurisdiction to entertain the claim by the liquidators against CGU.

The High Court upholds the decision

The High Court unanimously dismissed the appeal, confirming that a third party, such as a liquidator, can join a defendant's insurer and seek a declaration of rights under the insurance policy, provided that the third party has a 'real interest' in the performance of the policy and there is practical utility in the Court making the declaration.

The High Court agreed with the liquidators' submission that their real interest arose by virtue of section 562 of the *Corporations Act 2001* (Cth) and section 117 of the *Bankruptcy Act 1977* (Cth). If the liquidators made good their claim against the directors and established the liability of CGU to indemnify its insured, the proceeds of the policy would have been payable to them. The High Court held that this interest and denial of liability under the policy grounded a 'justiciable controversy' between the liquidators and CGU.

The Supreme Court of Victoria ultimately held that CGU was not liable to pay any amount under the insurance policy. The insured had failed to satisfy its duty of disclosure and made a misrepresentation to CGU, which entitled CGU to rely on the *Insurance Contracts Act 1984* (Cth) to reduce its liability to zero as it would not have issued the policy had it known the true circumstances.

LESSONS FOR POLICYHOLDERS

This case confirms that, in exceptional circumstances, a third party can join insurers of insolvent or potentially insolvent insureds to a proceeding and seek a declaration of rights under the insurance contract. The decision will allow certain third parties to pursue insurers of insolvent third parties directly, thus involving insurers at an earlier stage and providing an opportunity to leverage an earlier settlement via direct negotiations with insurers who will now be under threat of being joined.

POLICY WORDING AN IMPORTANT PART OF EARLY COVERAGE STRATEGY

Hird v Chubb Insurance Company of Australia Ltd [2016] VSC 174

Facts

In connection with the now infamous Essendon Football Club supplements scandal, James Hird received an interview notice as part of a joint investigation between the Australian Sports Anti-Doping Authority (**ASADA**) and the Australian Football League (**AFL**).

Mr Hird participated in the joint investigation, but subsequently brought an unsuccessful challenge to ASADA's power to conduct the investigation and to rely on the information it had collected.

Only after that challenge failed did Mr Hird then seek to recover his legal costs of the challenge from Essendon's D&O insurer, Chubb Insurance, on the grounds that the defence costs were incurred in response to a 'formal regulatory proceeding' or at least on account of a 'formal investigation' (which was defined in the policy to include inquiries).

The decision

Justice Hargrave of the Victorian Supreme Court found in favour of Chubb Insurance.

The Court accepted that the ASADA process fell within the policy's meaning of a formal investigation and (in Mr Hird's favour) that the cover for defence costs under the D&O policy could cover positive defence actions, such as challenging the conduct of the investigation during the interview process. The Court also agreed that the costs were 'reasonably incurred' as required by the policy because Mr Hird had a reasonably-based fear that his reputation and earning capacity would be adversely affected and he had positive legal advice as to his prospects of success.

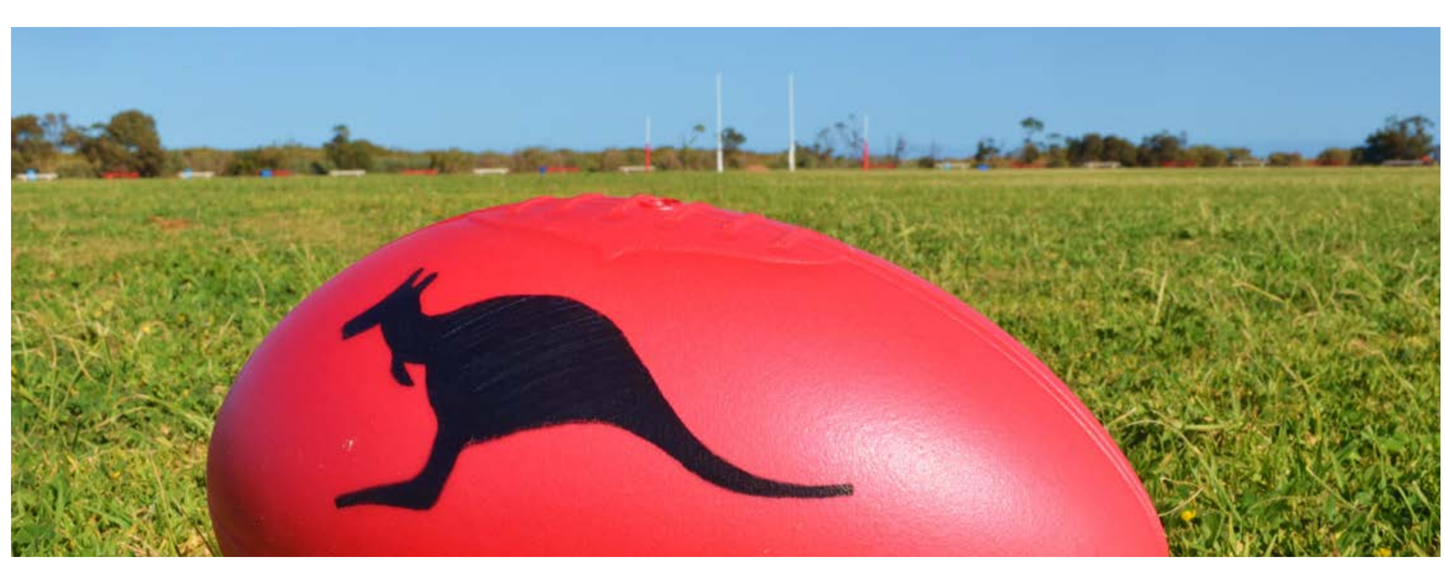
However, Mr Hird's insurance claim ultimately failed because the coverage was limited to those costs '*which an Insured Person incurs on account of the attendance and / or provision of documents or information ... at or to any Formal Investigation*'. In other words, Mr Hird had to demonstrate a causal link between the costs incurred and the requirement that he attend the interview.

Because Mr Hird had already attended the interview, and his motive in commencing and maintaining the application was held to be for fear of damage to his reputation and economic interests arising out of the show cause notices served by ASADA on the players, the defence costs were not incurred 'on account of' the investigation. Accordingly, Mr Hird could not establish the necessary causal link between the defence costs and the interview and he was unable to recover his costs.

LESSONS FOR POLICYHOLDERS

As with all events giving rise to a potential insurance claim, policyholders should check the policy wording and get advice early on how best to bring themselves within the parameters of the insurance coverage (and how to avoid stumbling across the risk of exclusions).

Had Mr Hird taken these steps as soon as he received an interview notice, his strategy in respect of the investigation – and potentially therefore the D&O policy outcome – may have been quite different.



POLICYHOLDERS CAN BE COVERED FOR THEIR OWN NEGLIGENCE

Matton Developments Pty Ltd v CGU Insurance Limited [2016] QCA 208

Facts

Matton Developments Pty Ltd (**Matton**) owned a crane which was being used to lift and place concrete tilt panels as part of the construction of a factory.

The crane's boom collapsed while the crane was being operated on a slope, with the boom extended, contrary to the operating guidelines of the crane's manufacturer. Matton made a claim for 'accidental damage' under its Contractors and Plant Insurance Policy issued by CGU Insurance Limited (**CGU**). The operator's evidence was that he expected the rubble onto which he was driving the crane to compress and level the slope. By the time he realised that would not happen, it was too late.

CGU declined the claim, alleging that the policyholder chose to negligently operate the crane on the slope contrary to both the applicable Australian Standards and the express manufacturer's guidelines (and so alleged the loss was not 'accidental').

The decision

At first instance, Justice Flanagan found in favour of CGU, dismissing the claim by Matton. His Honour noted that the 'accidental overload' clause in the policy covered 'accidental sudden and unforeseen' loss resulting from 'accidental overloading'. He held that the crane was not physically overloaded (carrying a load exceeding the weight capacity of the crane) but rather structurally overloaded due to it being operated on a slope in conjunction with carrying a 39.2 tonne load. In those circumstances, he held that the overloading and the loss was not 'accidental, sudden and unforeseen'. Accordingly, he held that the policy did not respond to the claim.

The Queensland Court of Appeal overturned the Supreme Court's decision. The Court of Appeal held that the term 'overloading' encompassed both physical overloading and structural overloading (carrying an acceptable load, but at an angle which caused the load to exert excessive force on the crane boom - which was the mechanism of overloading in this case). Therefore, the structural overloading of the crane did fall within the definition of 'overload' in the policy.

In reaching this conclusion, the Court of Appeal:

- adopted a broad meaning of 'overload' which took into account the dynamic and structural forces which might be encountered by the crane moving around the worksite; and
- read down the various exclusions relating to the use of the crane in breach of relevant Australian Standards and the manufacturer's guidelines, holding that otherwise the cover provided by the 'accidental overload' extension would have been illusory.

Further, a 2:1 majority of the Court of Appeal also determined that the structural overloading was *'accidental ... non-deliberate and clearly unintentional'* and the resulting damage was 'accidental sudden and unforeseen', overturning the decision of the trial judge.

While this conclusion relied on a number of specific factual findings, the majority proceeded on the basis that the *relevant perspective* for determining whether overloading or damage was accidental was the individual crane operator associated with the policyholder (subjective) as well as the perspective of a reasonable person in the position of the crane operator (objective). The majority considered whether the judgment of the crane operator and his colleague involved such a level of recklessness or risk-taking that it could not be found to be accidental, and concluded it did not.

Taking the various factual matters together—the crane operator's judgment that the rubble would compress and the crane could therefore be driven onto it and his failure to realise in time that the rubble was not compressing—meant the damage was an '*unlooked for mishap or an untoward event which was not expected or designed*' (ie accidental). Matton was therefore able to recover under the policy.

LESSONS FOR POLICYHOLDERS

While on first blush the facts of the claim suggested recklessness (which may have negated the 'accidental damage' cover in question), the decision by the Queensland Court of Appeal reinforces a number of key principles which tend to favour the position of a policyholder, namely:

- read construction of coverage clauses in insurance policies by reference to, amongst other things, the purpose of the policy and the object of the insurance transaction;
- negligence on the part of a policyholder will not, without more, prevent a policyholder availing itself of 'accidental damage' cover – demonstrating that an event was not accidental must be done by reference to all relevant circumstances, and can be a very difficult hurdle for an insurer to overcome.

Policyholders should of course take precautions to avoid loss, but when oversights and even negligence leads to loss, policyholders should not be afraid to press their insurance claims and contest any decision by the insurer to decline or discount the claim for the policyholders' own role in the loss.

‘PROFESSIONAL SERVICES’ EXCLUSION CLAUSES DO NOT PREVENT COVERAGE

Chubb Insurance Company of Australia Limited v Robinson [2016] FCAFC 17

Facts

Reed Constructions Australia Pty Limited (**Reed**) was engaged by 470 St Kilda Road Pty Limited (**St Kilda**) to redevelop and construct commercial and residential premises. Under the construction contract, Reed was required to verify each of its payment claims by procuring one of its officers or employees to swear a statutory declaration in support of its claim. Reed was subsequently placed into liquidation and St Kilda took the view that Reed had made payment claims to which it had not been entitled.

A statutory declaration relating to disputed payment claims had been made by Glenn Robinson, the Chief Operating Officer of Reed, who was not a director of the Reed group of companies.

St Kilda commenced proceedings against Mr Robinson, and Mr Robinson sought indemnity under the D&O insurance of his employer, which was a policy issued by Chubb Insurance Company of Australia Limited (**Chubb**). Chubb declined the claim on the grounds that Mr Robinson’s action in making the statutory declaration was a professional service which was excluded from cover by the professional services exclusion clause in the D&O policy.

The decision

The primary judge held that Mr Robinson’s statutory declaration was not an act or omission in the rendering of professional services that therefore did not fall within the exclusion in the policy.

On appeal, the Full Federal Court upheld the decision of the primary judge, determining that the professional services exclusion clause should not extend to the discharge of routine managerial functions. The swearing of the statutory declaration was seen by the Court as the mere *‘routine compilation of factual material in order to secure a contractual payment’*, which fell short of being described as the rendering of a professional service.

In reaching this conclusion, the Court noted the following:

- the scope of a professional services exclusion clause under a D&O policy need not necessarily correspond to the scope of the commonly used insuring clause under professional indemnity insurance;
- to avoid inappropriately limiting the professional services exclusion, the exclusion *‘must relate to a narrower band of activity than the work that generally comprises or supports the delivery of building and construction activities’*; and
- professional services may be understood as meaning *‘services of a professional nature furnished by [the contractor] involving the application of skill and judgment by the person or persons who carried out the relevant activities ... being services which fall within the scope of a vocational discipline which is generally regarded as a profession’*.

It is also worth noting that evidence led by Chubb failed to satisfy the Court that ‘project management’ was generally regarded as a profession at the relevant time (2010-2011).

In any case, the Court held that Mr Robinson’s actions in making the statutory declaration would not have constituted the rendering of project management services, and hence would not have invoked the exclusion clause.

LESSONS FOR POLICYHOLDERS

This is another good news decision for policyholders as the Court has construed an exclusion clause narrowly in dismissing an attempt by an insurer to avoid coverage.

However, to avoid controversies, policyholders need to ensure an appropriate correlation between their D&O policy and professional indemnity coverage. They should not assume that all activities covered by professional indemnity insurance will be excluded from D&O insurance, or that what is excluded from one policy will be covered under the other.

Policyholders are encouraged to review their existing policies to ensure that they are not at risk of ‘falling between 2 stools’ or are not paying for double coverage over the same risk.

AMBIGUITIES IN INSURANCE CONTRACTS WILL NOT BE RESOLVED IN FAVOUR OF THE INSURER

Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400) [2016] FCAFC 15

Facts

Mr Todd was an authorised representative of The Salisbury Group Pty Ltd (**TSG**). TSG was one of the named insureds under a financial services errors and omissions insurance policy with a Lloyd's Syndicate led by Alterra (**Alterra**).

Clients of Mr Todd lost money as a result of purchasing investment products on Mr Todd's advice. They sued Mr Todd, TSG and another person. Some of the investment products recommended by Mr Todd were not on any approved product list applicable to, or adopted by, TSG.

The key coverage issue in the case was the breadth of the phrase 'financial planning' in the policy and in particular whether the phrase 'financial planning encompassing advice on approved investment products and life insurance products' limited coverage under the policy to losses arising from approved investment products.

Ultimately the Court was asked to consider whether it was obliged to interpret ambiguity in a policy of indemnity insurance in favour of the insurers.

The decision

The primary judge found that the policy did not respond to cover agreed losses suffered by clients of Mr Todd. This was on the basis that the reference in the insuring clause to 'advice on approved investment products' restricted the coverage to losses arising from advice about products on approved products lists.

This decision was reversed on appeal, with the Full Court noting that the insurers' interpretation would mean that the exclusion clause was broader than the insuring clause. The Full Court held that the policy covered Mr Todd.

Alterra sought to (unsuccessfully) persuade the Full Court that any ambiguity in cover ought to be resolved in its favour based on a series of High Court decisions to the effect that any doubt concerning the construction of contracts of guarantee and indemnity should be resolved in favour of the surety or indemnifier.

This submission was rejected on the grounds that the principle did not extend to insurance contracts, which were of a fundamentally different character and purpose. While the Court accepted that the notion of indemnity is present in many contracts of insurance, it nevertheless noted that:

- the object or purpose of a guarantee or indemnity is to make good the financial position of a creditor, while a contract of insurance has the object or purpose of sharing the risk, or spreading the loss, from a contingency; and
- the historical position of the surety (who typically accepts obligations gratuitously) could be contrasted with that of an insurer who accepts a premium to respond to a risk.

Chief Justice Allsop and Justice Gleeson concluded that:

> *'From the nature, character and purpose of insurance there is no reason, and no precedent, for according an insurer the tenderness accorded to guarantors and indemnifiers…'.*

Accordingly, insurance contracts remain to be interpreted according to ordinary principles.

LESSONS FOR POLICYHOLDERS

This decision affirms the long-established approach that contracts of insurance will be construed according to ordinary principles applied to the interpretation of contracts. Importantly, it makes clear that a contract of insurance has a fundamentally different character to a guarantee or indemnity and the principles that those forms of indemnity should be construed narrowly in favour of the party giving the indemnity do not apply to contracts of insurance. For example, the principle that ambiguity should be resolved in favour of the guarantor or indemnifier will not apply to contracts of insurance.

CONSIDER 'DOUBLE INSURANCE' ISSUES AT THE TIME OF PURCHASING INSURANCE TO AVOID UNNECESSARY PREMIUM COSTS

Lambert Leasing Inc. v QBE Insurance (Australia) Ltd [2016] NSWCA 254

Facts

A partnership purchased an aircraft from Lambert Leasing Inc (**Lambert**) which it leased to Lessbrook Pty Ltd (**Lessbrook**). In May 2005, the aircraft crashed causing the death of the two pilots and 13 passengers on board. The relatives and dependants of the deceased brought proceedings in the United States against Lambert and the partnership (amongst others) (**US Proceedings**).

A claim was initially advanced (and indemnified) for defence costs, and ultimately a settlement was reached in respect of the US Proceedings under one insurance policy (the **Global policy**). Subsequently, Lambert and the Global policy insurer became aware of, and claimed under, a second potentially applicable insurance policy issued to Lessbrook which identified Lambert as an Additional Insured (the **QBE policy**).

Both insurance policies contained 'other insurance' clauses which purported to reduce the insurer's liability where another insurance policy covered the same risk. QBE relied on the 'other insurance' clause in its policy to deny the claim.

The decision

The key issues in relation to the 'other insurance' clauses in the Global policy and QBE policy were (1) whether section 45 of the *Insurance Contracts Act 1984* (Cth) applied to the policies such that the 'other insurance' clauses were ineffective; and (2) if not, what the consequences were for Lambert's claims under each policy.

The Court of Appeal held that for section 45 of the *Insurance Contracts Act 1984* (Cth) to apply to render the 'other insurance' clause ineffective, Lambert must have entered into the relevant policy (ie have been the party who contracted with the relevant insurer). Here, it held that Lambert had not 'entered into':

- the QBE policy, primarily because being named as an Additional Insured (together with 19 other parties) in the QBE policy (as opposed to 'the Insured') made it clear Lambert was a third party beneficiary of the policy; and
- the Global policy, primarily because on its proper construction, the correct inference to draw was that subsidiaries held an insurable interest but were not contracting parties.

Another factor the Court considered relevant was that there was no evidence (for either policy) that Lambert: (1) was involved in any way in the negotiation of the terms of the contract; or (2) paid for any part of the premium.

As a result of this finding, QBE's 'other insurance' clause was effective and, since Global had fully indemnified Lambert, there was no loss or liability which Lambert could claim from QBE.

LESSONS FOR POLICYHOLDERS

Failure to carefully consider 'double insurance' issues at the time of purchasing insurance can lead to inefficient use of premium and unrecoverable costs associated with a coverage dispute. At the very least, a policyholder should seek to establish at an early stage of any claim or loss all of the potentially applicable insurance policies, as this will inform the insurance claim strategy and maximise the available coverage.

ADMISSION OF LIABILITY BY INSURER CAN BE WITHDRAWN IF CIRCUMSTANCES CHANGE

Mobis Parts Australia Pty Ltd v XL Insurance Company SE [2016] NSWSC 912

Facts

Mobis Parts Australia Pty Ltd (**Mobis**) sought recovery under a local property damage and business interruption insurance policy (issued by XL) (**Local Policy**) in respect of damage to its warehouse after a large amount of hail accumulated on the roof which caused it to collapse. The local insurance policy formed part of a global insurance program led by XL, which included cover for Mobis under a global master policy (**Master Policy**).

In May 2015, Mobis pressed XL for indemnity under the Local Policy.

In June 2015, XL admitted liability in respect of the loss on the basis of 'known facts and circumstances' and by reference to the terms of the policy. This was premised, in part, on a preliminary report from a consulting engineer retained by XL which concluded that: (1) the original structural design of the warehouse complied with the requirements of the various Australian Standards; and (2) the collapse of the warehouse was a direct result of the hail storm during which the hail stones, water and ice on the roof greatly exceeded the minimum design loads required under the Australian Standards.

XL subsequently appointed a separate independent expert to assist it in the proceedings, who formed the view that the warehouse design did not comply with the relevant Australian Standards (in contrast to the earlier report). XL sought to amend its Commercial List Response to rely on a policy exclusion for 'faulty or defective design or materials'. Mobis opposed the amendment on the basis that: (1) XL had earlier admitted liability under the policy and should not be permitted to withdraw that admission; and (2) Mobis had suffered prejudice as had it known that XL would rely on the defective design exclusion, it would have claimed under the Master Policy which contained a narrower form of exclusion.

The decision

Justice Bergin found that the receipt of the new expert report which came to a different conclusion to the preliminary expert report was a change to the 'known facts and circumstances' which existed at the time XL admitted liability and, particularly given the proceedings were at a relatively early stage, granted XL leave to amend. In reaching this conclusion, Justice Bergin noted that:

- at the time of admitting liability, XL was investigating a large claim in urgent circumstances and in light of a preliminary expert report. In complying with its obligations of utmost good faith, XL admitted liability to the extent that it saw fit, reserving its position and qualifying its admission based on the facts and circumstances known at that time; and
- the commercial community depends upon insurers dealing with claims promptly and as a matter of practicality. Accordingly, such qualified admission by an insurer may be preferable to a declination of a claim.

LESSONS FOR POLICYHOLDERS

It is not uncommon for insurers to grant conditional coverage under an insurance policy, subject to broad reservations of rights by reference to known facts and circumstances and the policy wording. This is obviously preferable to protracted delay in granting any coverage at all. However, policyholders must remain wary that the coverage decision may be subsequently reversed by insurers. If this occurs, the burden will be on the insurer to show at a later stage that circumstances have changed if it wishes to retract the admission of liability.

ARE YOUR EXCLUSION CLAUSES RELEVANT TO YOUR CIRCUMSTANCES?

OZ Minerals Holdings Pty Ltd v AIG Australia Ltd [2015] VSCA 346

Facts

On 20 June 2008, two mining businesses, Zinifex Limited and Oxiana Limited, merged. As a result of this merger, Oxiana, which was re-named OZ Minerals Limited (**OZ Minerals**), became the sole shareholder of OZ Minerals Holdings (the former Zinifex) (**OZ Minerals Holdings**).

In February 2014, a representative proceeding was brought against OZ Minerals for breaching disclosure requirements and for a series of misrepresentations which allegedly occurred before the merger. OZ Minerals sought contribution from OZ Minerals Holdings, which then claimed indemnity from its insurer, AIG Australia Ltd (**AIG**).

AIG denied indemnity, arguing that the claim was excluded because the claimant (OZ Minerals) owned more than 15% of the defendant, so the claim allegedly fell within the Major Shareholder exclusion clause in the policy which stated:

> *'The Insurer shall not be liable to make any payment under this policy in connection with any Claim brought by any past or present shareholder or stockholder who had or has:*
>
> *(i) direct or indirect ownership of or control over 15% [or] more of the voting shares or rights of the Company or of any Subsidiary...'*

The issue was this: when did one consider the Major Shareholder criteria? Was it:

(a) when the wrongful act occurred (in 2008, when the entities were unrelated); or

(b) at the time of the claim (in 2014, when one owned 100% of the other); or

(c) both of the above?

OZ Minerals Holdings argued that the policy wording was ambiguous and should be interpreted to only exclude claims by a shareholder holding the threshold percentage of shares at *both* the time of the wrongful act and at the time of claim (ie option (c) above). AIG argued that the policy wording clearly excluded claims by a major shareholder which held the relevant shares either at the time of the wrongful act or at the time of the claim (options (a) or (b)).

The decision

The Supreme Court and Court of Appeal both accepted AIG's submissions and held that the claim was excluded by the Major Shareholder exclusion clause.

The trial judge reiterated that it was necessary to construe the policy in accordance with the usual contractual principles and that it was not

the Court's task to search for ambiguity in a contractual term. The Court must consider what reasonable people would have understood the words to mean, having regard to all of the words of the agreement.

Having regard to these principles, His Honour preferred the construction put forward by AIG that satisfaction of either limb would mean the exclusion applied.

1) First, AIG's construction was grammatical. OZ Minerals Holdings' interpretation relied on reading *'had or has'* as '*had and still has*', which His Honour found to be inconsistent with how the policy dealt with past and present tenses.
2) Second, AIG's construction accorded with the structure of the policy. The policy was a 'claims made' policy rather than an 'occurrence based' policy. A wrongful act on its own is insufficient to trigger indemnity; the policy required both a wrongful act and a claim, the latter within the policy period.
3) Third, AIG's suggested commercial rationale was objectively reasonable. While the overarching purpose of the policy was to provide cover to the company's directors and officers, His Honour found that the insurer should be protected from co-operation between a major shareholder as claimant and the insured to maximise the loss claimed by the insured.

The Court of Appeal agreed, and reinforced the principle that the Court will construe an exclusion clause by reference to the language in the clause and its clear and unambiguous meaning.

LESSONS FOR POLICYHOLDERS

The wording of an exclusion clause is of vital importance to the Court when determining whether an individual is covered under an insurance policy. In the case of D&O insurance, it is common to exclude claims brought by major shareholders and it is necessary for policyholders to review the exclusion clauses carefully.

COURTS WILL APPLY THE 'GOLDEN RULE' FOR CALCULATING DAMAGES

Amcor Flexibles Group Pty Ltd v AIG Australia Limited [2016] FCA 1428

Facts

Amcor Packaging Australia Pty Ltd and a related entity (together **Amcor**) entered into an acquisition agreement (**Acquisition Agreement**) for the purchase of shares in Aperio Group Pty Ltd (Aperio) and its subsidiary Packsys Holdings (NZ) Limited (**Packsys**). The Acquisition Agreement contained a number of warranties and completed in May 2012.

It was subsequently discovered that Packsys had breached the warranties in failing to disclose a 20% price reduction and an inability to perform one of its contracts. The liability was covered under a buyer's warranty and indemnity insurance policy held by Amcor with AIG Australia Limited (**AIG**). AIG accepted liability under the policy to indemnify Amcor for the loss, but disputed the quantum claimed.

The decision

In determining a preliminary issue on the appropriate measure of damages Chief Justice Allsop of the Federal Court reiterated the 'golden rule' that damages for breach of contract are to place the plaintiff in the position it would have been had the contract been performed as agreed (ie if the warranties given by Aperio had been true). Chief Justice Allsop noted that both parties' proposed accounting methodologies 'over-complicated' the issue and had lost sight of this core principle.

His Honour reasoned that Amcor had agreed to pay $238 million for Aperio and Packsys on the basis of the truth of the warranties. If the warranties had been complied with, and full disclosure had been made, the 20% price reduction and Packsys' inability to perform the additional contract would have been disclosed and if such disclosure had been made, the purchase price would have been reduced.

Given this, Amcor's loss was held to be the difference between the counterfactual lesser purchase price and the agreed price of $238 million (after accounting for any price premium Amcor may have agreed to in order to secure the deal). The true value of Aperio's shares at the time of purchase or assessment and what has happened with the business since completion were irrelevant to this assessment.

The Court again returned to fundamental principles in highlighting that if it proved impossible to determine the lesser purchase price, 'it may well be' that Amcor's damages should be assessed in terms of loss of chance.

LESSONS FOR POLICYHOLDERS

Amcor and AIG have been ordered to attend mediation mindful of this guidance, and, if an agreement on quantum cannot be reached by 28 February 2017, the matter will be referred to a referee for assessment. This outcome reflects the adoption of a practical and commercial approach to decision-making, which cuts through complexity by focussing on core legal tenets and utilising case management avenues to resolve disputes quickly and effectively.

DEFECT VS DAMAGE: WHAT IS EXCLUDED?

Acciona Infrastructure Canada Inc. v Allianz Global Risks US Insurance Company, 2015 BCCA 347

Facts

Acciona Infrastructure Canada (**Acciona**) held a Construction Insurance Policy (**Policy**) with Allianz Global Risks US Insurance Company (**Allianz**) to cover the risks of construction of a hospital facility.

The Policy contained a reasonably common defective workmanship or design exclusion based on the London Engineering Group 2/96 Model (LEG2) which read as follows:

> *'The insurer shall not be liable for:*
>
> *All costs rendered necessary by defects of material workmanship, design, plan, or specification, and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.'* (**Defects Exclusion**)

During construction, Acciona discovered that some of the concrete slab floors were over-deflecting, resulting in the formation of a concave recession in the centre of the slab and credit card-sized cracks. Rectification of the slabs involved grinding down higher areas and filling in lower areas with filler and associated work, such as load testing and cleaning.

Acciona claimed indemnity under the Policy for approximately CA$15 million in rectification costs. Allianz denied the claim on the grounds that the Defects Exclusion applied, so none of the costs were covered.

The decision

The trial judge found in favour of the policyholder, finding that only the preventative or avoidance costs – which at trial were found to be nil – were excluded from coverage by the Defects Exclusion. Importantly, the trial judge held that the defect triggering the Defects Exclusion was limited to defective workmanship in the framing and shoring during construction, which resulted in the (consequential) damage to the slabs, which were not themselves defective.

Allianz's appeal was unanimously dismissed by all 3 judges of the British Columbia Court of Appeal. The Court of Appeal accepted that the correct framework for considering the Defects Exclusion was a sequential analysis, as follows:

1) there must be a finding of damage under the Policy;
2) the total cost to rectify the damage must be determined; and
3) from this recoverable cost, the Defects Exclusion only operates to exclude the costs of repair to *remedy the defect itself,* calculated at the point just before any consequential damage is caused.

The Court of Appeal accepted the trial judge's interpretation of the Policy as excluding the costs necessary to rectify a defect in the workmanship *immediately* before that defect caused (consequential) damage to the insured property.

Accordingly, the Defects Exclusion did not exclude the cost of rectifying the slabs, as that was consequential to the excluded defective workmanship in the framing and shoring up during construction. Had that work been done properly, it would not have cost any extra, and the consequential damage flowing from the defective work would have been avoided.

LESSONS FOR POLICYHOLDERS

There have not been any reported decisions containing judicial consideration of the LEG2 Defects Exclusion in Australia or the United Kingdom. Drawing the line between where the defect ends and damage begins under the LEG2 Defects Exclusion is a difficult and often controversial coverage issue. While Acciona is not binding on Australian courts, it is favourable to policyholders and may be persuasive in guiding the approach that should be taking to the exclusion – the key, it seems, is being able to identify what was originally the defective work or design, what is consequential upon that defect, and how much extra would it have cost to rectify the defect immediately before the consequential damage occurred.

INSURANCE FOR CYBER RISKS

As the risk of cyber security breaches increases, so too do the number of insurance products available to policyholders to help protect against this risk.

There have been two recent cases in Arizona, USA which have considered what cover may be available to victims of cyber security breaches. Although not binding in Australia, these cases provide an interesting insight into how the US is dealing with this growing issue.

Travelers Indemnity Co. v Portal Healthcare Solutions (4th Cir (Arizona) 24 March 2016)

The District Court of Arizona had to consider whether a traditional commercial general liability insurance policy would respond to a cyber-security breach.

Portal Health Care Solutions (**Portal**) was sued in a class-action complaint which alleged that Portal engaged in conduct which resulted in the patients' private medical records being on the internet for more than four months. Portal sought cover under its general liability insurance policy held with The Travelers Indemnity Company of America (**Travelers**) on the basis that the policy covered loss because of injury arising from the '*electronic publication of material that ... gives unreasonable publicity to a person's private life*' (the language found in the 2012 Policy) or the '*electronic publication of material that... discloses information about a person's private life*' (the language found in the 2013 Policy).

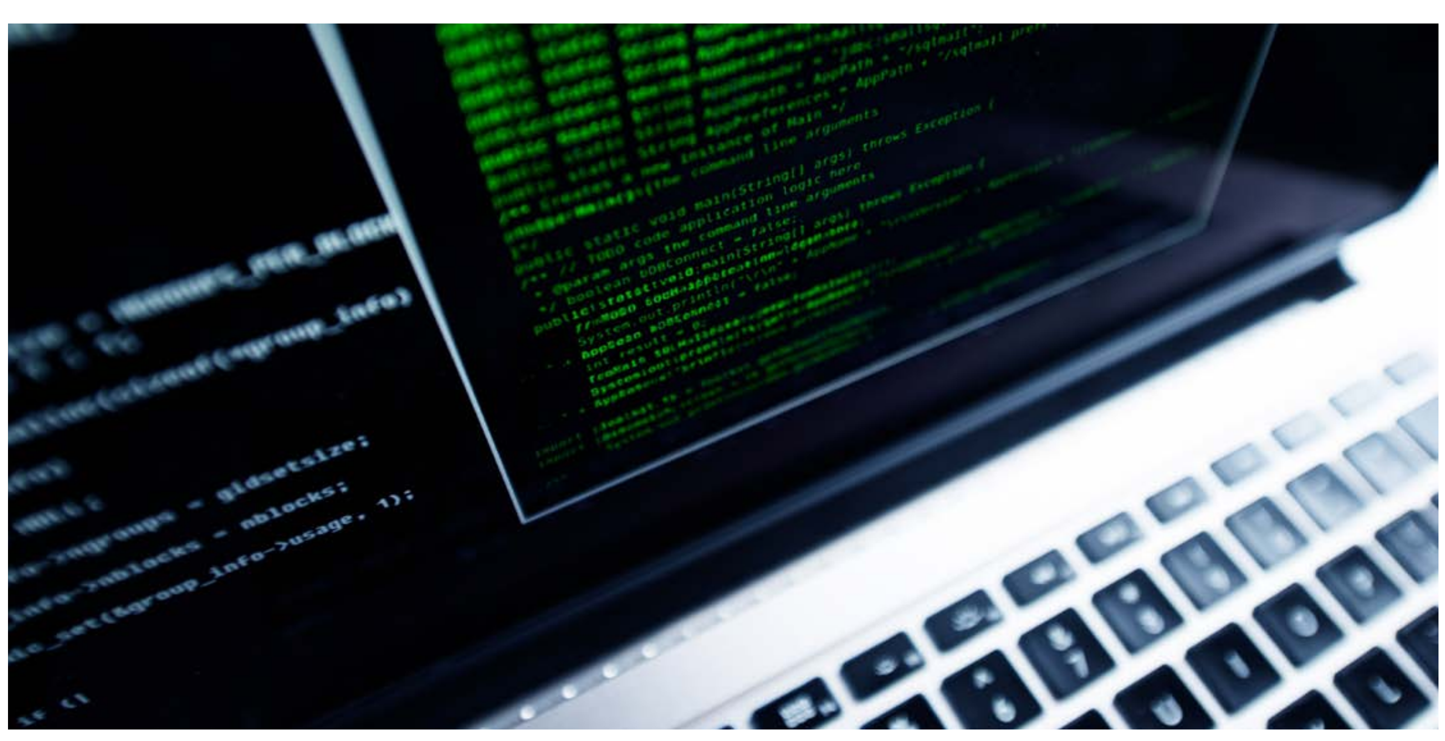
Travelers sought a declaration from the Court as to whether it was required to indemnify Portal. The Court found in favour of Portal, holding that the handling of patients' data amounted to 'publication' under the policy.

Travelers appealed. However, the District Court upheld the decision, reminding insurers that they must use '*language clear enough to avoid ... ambiguity*' if there are limits to the cover the insurer is providing.

LESSONS FOR POLICYHOLDERS

This case shows a willingness of the US Courts to hold that a commercial general liability policy will respond to losses arising out of cyber breaches. However, the case also reinforces the importance of ensuring the wording of the policy is clear.

In any event, we expect that most commercial general liability insurance policies in Australia are unlikely to include coverage as broad as was included in the Travellers' policy.



P.F. Chang's China Bistro, Inc. v Federal Insurance Company (D. Ariz. May 31, 2016)

In a second case decided in Arizona, P.F. Chang's China Bistro, Inc. (a restaurant chain) sought cover under a Cyber Security Policy by Chubb (**Policy**) which it held with Federal Insurance Company (**Federal**).

In this case, the insured had entered into an agreement with a third party to process credit card transactions, which was a common practice for restaurants. In June 2014, the insured learned that hackers had obtained and posted on the internet nearly 60,000 credit card numbers belonging to its customers. The third party was required to pay approximately US$2m to MasterCard, which the insured reimbursed under the third party agreement.

The insured then claimed reimbursement for the US$2m from Federal under the Policy. The Policy provided that Federal was to cover loss suffered by P.F. Chang for any '*Loss…on account of any Claim…for Injury*'. Injury included privacy injury, such as the unauthorised access to personal records. However, Federal declined cover (in part) on the grounds that the credit card numbers which were the subject of the data breach were not part of the third party's records (but rather the records of the issuing bank) then there could be no 'Injury' as the records were not personal records.

The Court found in favour of Federal, agreeing that the Policy did not respond to that part of the loss.

LESSONS FOR POLICYHOLDERS

This case reinforces the difficulties in obtaining cover for specific emerging risks under general policies of insurance. Policyholders need to ensure they have properly and diligently assessed the cyber risks they might face in the course of their business, to ensure they obtain the correct insurance.

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MARKET RECOGNITION – AWARDS AND ACCOLADES

AUSTRALIAN LAW FIRM OF THE YEAR
CHAMBERS ASIA PACIFIC AWARDS 2016

BEST LAW FIRM AND BEST PROFESSIONAL SERVICES FIRM (REVENUE >$200M)
FINANCIAL REVIEW CLIENT CHOICE AWARDS 2013, 2014 AND 2015

BAND 1 IN DISPUTE RESOLUTION GLOBAL-WIDE
CHAMBERS GLOBAL AWARDS 2016

RANKED AS 1 OF 8 TOP FIRMS GLOBALLY FOR CONTENTIOUS INSURANCE CLAIMS
SPOTLIGHT TABLE OF CHAMBERS INSURANCE: CONTENTIOUS - GLOBAL-WIDE AWARDS 2016

BAND 1 IN, 'DISPUTE RESOLUTION - AUSTRALIA'
BAND 2 IN, 'INSURANCE: POLICYHOLDER - AUSTRALIA'
CHAMBERS ASIA PACIFIC AWARDS 2016

BAND 1, 'DISPUTE RESOLUTION'
ASIA PACIFIC LEGAL 500 2007–2016
BAND 2, 'INSURANCE'
ASIA PACIFIC LEGAL 500 AWARDS 2016

A significant number of our partners were named amongst the 'Best Lawyers' in the field for Insurance, including Mark Darwin, Peter Holloway, Michael Vrisakis, Ken Adams and David Cooper.

BEST LAYWERS INTERNATIONAL 2016

"The lawyers work hard on client relationships and have excellent depth and experience in the contentious, litigious and regulatory spheres. They are very sensible, practical and easy to work with."

"The team gives solid, straightforward advice and quality service."

"The advice is always second to none and is always presented in a commercially useful manner."

"They set the bar higher than any other firm in terms of excellence, legal rigour, preparation and client service."

"It's one of the top firms in Australia in terms of technical skill, but what stood out for me was the excellent project management of the case. They were outstanding."

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