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OVERVIEW

I love a sunburnt country. A land of sweeping plains. Of ragged mountain ranges, Of drought and flooding rains… Her beauty and her terror – The wide brown land for me. (Dorothea Mackellar, 1906)

Most Australians had a terrible sense of déjà vu during the bushfires and flooding over the 2012/13 summer. Our memories were still fresh from the deadly 2009 Victorian bushfires and the catastrophes across Australia in 2010/11. However in terms of loss of life and property damage, thankfully the recent summer was far less destructive than those in our very recent past.

The 2010/11 season of catastrophes cost the insurance industry approximately AU$4.23 billion. Contrast that with the Insurance Council of Australia’s (ICA’s) estimated cost to the industry of our recent extreme events such as ex-tropical Cyclone Oswald, the Queensland and New South Wales floods and the Victorian and Tasmanian bushfires. As of early February, the ICA estimated the cost to be in the order of AU$670 million.

Those figures are not enough to reverse the pretty favourable industry statistics published by the Australian Prudential Regulation Authority in November 2012, which show net earned premium up and gross incurred claims down. Total industry net profit after tax in the year ended 30 September was AU$4.8 billion, a 37% improvement on the previous period. However as the table on page 5 shows, these dramatic improvements are largely driven by the spike created by the catastrophes in 2011/12 on short tail classes of business. The long tail classes, public and product liability and professional indemnity, have not contributed to the improvements. Net loss ratio for public and product liability was steady over the two years at 65 to 66%. Although the net loss ratio for professional indemnity deteriorated from 46% to 53%, it is still pretty healthy.
Class actions have been front of mind for the past 12 months. We have seen some very significant decisions and some notable settlements, which our editor surveys in her article on page 53. The Victorian bushfires have generated three class actions so far; one of which has already settled and sometime this year we will see a class action against the operators of the Wivenhoe Dam in South East Queensland.

Australia hit the international news when the Federal Court delivered a landmark decision against ratings agency, Standard & Poors, for giving a financial product a AAA rating. That decision is considered in an article on page 59 by Samantha Kelly and some of our international partners. This and a series of other class actions are the flow on effect of the Global Financial Crisis, whereby investors and shareholders seek to recoup their losses.

With the steady rise in class actions, litigation funders are playing a greater role in the litigation landscape. It has been very interesting watching the unfolding story of the regulatory oversight (or lack thereof) of that industry. Given the industry’s potential for large profits and the seeming unwillingness to take much risk, it is perhaps not surprising to see some criticism of the protection litigation funders enjoy.

Litigation funders are not the only protected species – so are lawyers! Australia has the dubious honour of being one of the last jurisdictions upholding advocates’ immunity, a situation unlikely to be reversed without legislative intervention. With several recent decisions, advocates’ immunity is alive and well. In August last year, Justice Bell of the Victorian Supreme Court found that a solicitor’s negligence caused a client significant loss. However, advocates’ immunity provided a complete defence, a situation the judge found “deeply troubling”. And in December 2012, the NSW Court of Appeal (Full Bench) unanimously found that advocates’ immunity applies in the widest of circumstances.

Directors and officers and their insurers received a nice Christmas present when the New Zealand Court of Appeal reversed the famous Bridgecorp decision. The court held that Bridgecorp was not entitled to a statutory charge over insurance money lawfully payable by the insurer to the directors to reimburse their existing liability to pay defence costs as opposed to a contingent liability for damages or compensation payable to Bridgecorp. The decision at first instance created a scramble in the directors and officers market to ensure policies protected an insured’s entitlement to defence costs.

I was pleased to see the High Court allowed the Vella appeal (Hunt & Hunt v Mitchell Morgan Nominees Pty Ltd & Ors [2013] HCA 10). This is a very important case for the insurance industry. At first instance, proportionate liability was held to apply, resulting in a negligent solicitor being liable for just 12.5%, with the fraudsters liable for the rest. The New South Wales Court of Appeal overturned the judgment, finding that the solicitor and the fraudsters were not concurrent wrongdoers. The solicitor was left holding 100% of the liability. The majority of the High Court reinstated the primary judge’s conclusion on apportioning loss between the solicitor and the fraudsters. Our full case note on the High Court decision can be found on our website and on our blog, Insurance Flashlight.

If you are interested in these issues, I recommend you bookmark Insurance Flashlight, which reports on these and many other issues throughout the year.

I hope you enjoy reading Insurance Review.

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COVER FOR STATUTORY PENALTIES

In recent years, there has been an expansion of policy coverage for claims concerning exposure to statutory liability. For a while, insurers have provided defence costs cover in regulatory actions, such as Australian Securities and Investments Commission (ASIC) proceedings, but rarely indemnified policy holders for statutory penalties.

It is now common for management liability policies to extend cover to their insured for penalties imposed under a statute for a civil offence. Common examples include offences under the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act) and the *ASIC Act 2001* (Cth).

However, whether insurers should extend cover under management liability policies for criminal fines where offences are dealt with by criminal courts is highly contentious. This article examines common coverage issues and examines the commercial and public policy considerations surrounding granting indemnity to an insured for criminal fines and penalties.

**POLICY COVER**

Management liability policies often express cover for statutory liability in terms that are difficult to understand. In determining whether cover should be granted for a claim involving statutory liability, there are often tricky exclusions and semantic distinctions to interpret and assess. These usually centre around the distinction between a “fine” and a “pecuniary penalty”.

Policies usually exclude cover for “fines and penalties” in the definition of “loss”. However, cover for statutory liability is usually contained in an automatic extension whereby the definition of “loss” is extended to include “statutory liability”, which is defined as “pecuniary penalties awarded against an insured for a civil offence”. The definition of “statutory liability” in relation to occupational health and safety claims and claims relating to the discharge or escape of pollutants is limited to strict liability offences.

Essentially, cover is usually provided for civil offences and pecuniary penalties, but cover for “fines” is excluded.

Policies limit cover for statutory liabilities that insurers are “legally prohibited from paying”. As a general rule, insurers have never provided cover for criminal offences as it is contrary to public policy. But does this mean insurers are “legally prohibited” from doing so? Can and should insurers cover penalties and fines for criminal conduct?

**CIVIL V CRIMINAL AND STRICT V ABSOLUTE LIABILITY**

The issue of policy cover for statutory liability turns on the classification of the relevant penalty or offence into the following categories:

- Civil pecuniary penalties
- Criminal fines and sanctions
- Strict v absolute liability offences.

The distinction between a “fine” and “pecuniary penalty” is often a difficult one to make. However, essentially a “fine” is imposed as a punishment for a criminal offence where the court has a back door to ferry offenders straight to jail. In contrast, “pecuniary penalties” are awarded by civil courts.

Therefore, in order to attract cover, a statutory liability claim must fall within the definition of a civil offence where the punishment is a pecuniary penalty, or in occupational health and safety and environment claims it must be an offence of strict liability.

The distinction at law between strict liability and absolute liability offences is that strict liability offences are subject to a defence of honest and reasonable mistake. There is no defence open to an insured for an offence of absolute liability, unless the enabling legislation provides one. The only qualification is that the offence is subject to the requirement of “reasonable practicability”. A good example of an absolute liability offence is a failure to maintain or provide a safe system of work under the *Occupational Health and Safety Act 2004* (Vic) (OHS Act), which is an indictable offence subject to a substantial fine (section 21). Therefore, absolute liability offences are often criminal in nature.

It is difficult to classify penalties under pieces of legislation such as the OHS Act and the *Environment Protection Act 1970* (Vic) as civil pecuniary penalties as they are prosecuted and determined within the criminal jurisdiction. These types of penalties are more correctly categorised as criminal fines. A criminal fine falls outside the cover provided by management liability policies due to the definition of “statutory liability” and persuasive policy considerations.
PUBLIC POLICY CONSIDERATIONS

Civil pecuniary penalties play a key role in promoting general and specific deterrence for regulatory bodies such as the Australian Competition and Consumer Commission and ASIC. Proceedings under the Competition and Consumer Act imposing pecuniary penalties for conduct that constitutes an unfair practice or is unconscionable are dealt with in the civil jurisdiction of the courts. Cover is usually granted for these types of proceedings, subject to the usual exclusions relating to intentional, reckless or grossly negligent conduct. This has important implications in the market due to the increase in regulatory proceedings. This is especially so for small businesses, which would go under if it were not for their insurer providing defence costs cover and cover for substantial pecuniary penalties (up to AU$1.1 million for each contravention, in relation to a body corporate under section 21 and 22 and section 224 of the Australian Consumer Law 2010 (Cth)). They could certainly not defend a regulatory action to judgment without statutory liability cover. Although there are some policy considerations against granting indemnity for civil pecuniary penalties (eg deterrence), it is clear from the wording of management liability policies that it is the intention of underwriters to provide such cover and they are not legally prohibited from doing so.

However, it is a different story for criminal fines. Criminal sanctions are imposed for a number of reasons, including retribution, deterrence and rehabilitation. It is not the intention of the criminal law for insurers to indemnify offenders for fines and penalties imposed as a result of an offence committed. If indemnity was granted then none of the aims of the criminal law could ever be achieved. Indemnity for a criminal offence can be seen as a “moral hazard” that negates the incentive of directors and/or companies to behave in accordance with the law.

A contract to indemnify an insured against criminal liability should be classified as illegal if the offence is one which can only be, or in fact is, committed with guilty intent. The position is less clear and is highly contentious where the offence is one of strict liability and the conduct of the offender is morally innocent.

It is certainly arguable that insurers are “legally prohibited” from providing cover for criminal fines, such as those imposed under the OHS Act, as to do so will undermine the fundamental public policy considerations that underlie the criminal law.

Despite this, in the current market, insurers have made commercial decisions to extend statutory liability cover to criminal fines (for example fines imposed for breaches of the OHS Act), unless the insured has behaved in a reckless manner.

CONCLUSION

Current management liability policies usually provide their insured with cover for civil pecuniary penalties. Arguably, cover can be provided for fines of a criminal nature. All cover is subject to the usual exclusions relating to intentional, reckless and grossly negligent conduct of the insured. Indemnity issues are often contentious relating to intentional, reckless and grossly negligent conduct of the insured. Indemnity issues are often contentious relating to intentional, reckless and grossly negligent conduct of the insured. Indemnity issues are often contentious relating to intentional, reckless and grossly negligent conduct of the insured. Indemnity issues are often contentious relating to intentional, reckless and grossly negligent conduct of the insured.

However, when you delve deeper there are complicated indemnity and public policy considerations at play that need to be carefully assessed to determine whether or not an insurer is “legally prohibited” from providing cover.

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DEVELOPMENTS IN PROFESSIONAL INDEMNITY

2012 saw the introduction of legislation requiring certain professionals to hold professional indemnity insurance. Insurers may wish to consider amending existing policies or writing new policies in anticipation of the amendments.

PROPERTY, STOCK AND BUSINESS AGENTS AMENDMENT (PROFESSIONAL INDEMNITY INSURANCE) REGULATION 2012 (NSW)

Anthony Roberts, the New South Wales (NSW) Minister for Fair Trading, released an exposure draft for the Property, Stock and Business Agents Amendment (Professional Indemnity Insurance) Regulation 2012 (NSW). The proposed Regulation seeks to introduce a requirement for persons licensed under the Property, Stock and Business Agents Act 2002 (NSW) to have and maintain a policy of professional indemnity insurance as a condition of the licence. The policy must provide cover for civil liability arising from specified situations, with a minimum cover of AU$1 million for any one claim and AU$3 million aggregate for all claims made during the policy period.

The amendments will affect real estate agents, stock and station agents, business agents, strata managing agents, community managing agents and on-site residential property managers. The closing date for submissions was 5 October 2012. There has been no subsequent update as to when the Regulation will commence.

CONVEYANCERS LICENSING AMENDMENT (APPROVED PROFESSIONAL INDEMNITY INSURANCE POLICY) ORDER 2012 (NSW)

On 24 May 2012, Anthony Roberts MP approved the policy of professional indemnity insurance (Number LPS011195725) of Vero Insurance Limited and Allianz Australia Limited from 1 July 2012 until 30 June 2013. Conveyancers must be insured...
under a policy of professional indemnity insurance (cl 6(1) Conveyancers Licensing Regulation 2006 (NSW)). The above policy will now be available to those conveyancers wishing to enter into new policies.

ARCHITECTS REGULATION 2012 (NSW)

On 1 September 2012, clause 13 of the Architects Regulation 2012 (NSW) introduced the NSW Architects Code of Professional Conduct. Clause 16 of the Code requires architects to hold and maintain a policy for professional indemnity insurance.

A failure to comply with this requirement constitutes unsatisfactory professional conduct for the purposes of the Architects Act 2003 (NSW) and may be grounds for disciplinary action under Part 4 of that Act.

CASE LAW

2012 saw the courts dealing with a variety of legal principles in the context of professional indemnity claims, including advocates’ immunity, loss of chance and causation. As expected, proportionate liability continues to be in focus. On 3 April 2013, the High Court allowed the appeal in Hunt & Hunt v Mitchell Morgan Nominees Pty Ltd & Ors [2013] HCA 10. The New South Wales Court of Appeal had held that the loss suffered by Mitchell Morgan due to Hunt & Hunt’s negligence was different from the loss suffered due to the fraudster’s conduct. The High Court rejected that reasoning, finding that the loss suffered by Mitchell Morgan was its inability to recover the lent money, which was caused by both Hunt & Hunt’s negligence and the fraudster’s inducement to enter into the transaction.

Further guidance on when proportionate liability applies

In The Owners Strata Plan 69312 v Allianz Australia Insurance Limited [2012] NSWSC 1477, the NSW Supreme Court found that a claim for indemnity under a policy of insurance is not an apportionable claim to which proportionate liability applies. In doing so, the court held that the insurer’s failure to indemnify did not involve a failure to take reasonable care within the meaning of section 34(1)(a).

In Commonwealth Bank of Australia v Hamilton [2012] NSWSC 242, the Commonwealth Bank of Australia (CBA) commenced proceedings against a solicitor for breach of a warranty of authority. The court held that the proportionate liability regime does not apply, as the claim being made by the CBA was not a claim for damages arising from a failure to exercise reasonable care. Moreover, the solicitor’s fraudulent conduct caused the damage, and so s 34A(1)(b) applied to exclude the proportionate liability provisions. The case is also noteworthy as the court, while determining contributory negligence could not be used as a defence given the type of action pleaded, nonetheless went on to assess that CBA was 35% contributory negligent due to various weaknesses in its practices and procedures.

In the decision of Curtin University of Technology v Woods Bagot Pty Ltd [2012] WASCA 449 (see page 63), the Supreme Court of Western Australia found that the proportionate liability regime does not apply to commercial arbitrations. Accordingly, practitioners and insurers need to keep in mind the forum in which they agree to hear a dispute.

Advocates’ immunity

The long standing defence of advocates’ immunity was upheld by the Supreme Court of Victoria in Goddard Elliot (a firm) v Fritsch [2012] VSC 87. The plaintiff sued his solicitor, barristers and accountant for, amongst other things, negligence and breach of contract. In their defence, the solicitor relied on “advocates’ immunity”, which protects advocates from suit in relation to in-court work and certain out-of-court work, which leads to a decision affecting the conduct of the case in court. The court apportioned liability 75% to the solicitor and 25% jointly to the two barristers (the barristers and accountant settled with the plaintiff prior to the hearing). However, consistent with High Court authority, the court further held that advocates’ immunity applied and that the solicitor had a complete defence to the claim. Costs were awarded in favour of the solicitor.

Likewise, in a strong judgment on 18 December 2012 (Donnellan v Woodland [2012] NSWCA 433), the NSW Court of Appeal confirmed that advocates’ immunity applies to “wasted costs” cases. It also gave strong indication that it applied in settled cases.

Loss of chance – causation and standards of proof

The NSW Court of Appeal provided further guidance as to the standards of proof applicable to loss of chance cases in Pritchard v DJZ Constructions Pty Ltd & Ors; Gillies & Anor v DJZ Constructions Pty Ltd & Ors [2012] NSWCA 196. The trial judge had awarded 100% damages against a solicitor for providing negligent advice. Damages were reduced by 30% on appeal. The decision is useful in deriving the following standards of proof:

- In determining whether a solicitor’s negligent advice caused loss or damage to a plaintiff, the court will consider past hypothetical questions, including the impact of receiving non-negligent advice. Those questions will be assessed on the balance of probabilities (ie over 50%).
- To determine how damages for loss of chance might be calculated where a solicitor has given negligent advice, the court will take degrees of probabilities/possibilities into account (ie could be less than 50%).
Gung ho clients and causation

In *Simply Irresistible Pty Ltd v Couper* [2012] VSCA 128, the Victoria Court of Appeal found in favour of a solicitor in an action for a failure to advise on the exercise of an option to repurchase property. The trial judge, with whom the Court of Appeal agreed, found that the solicitor had failed to properly advise the plaintiff on the option. However, it was held that the breach did not cause any loss suffered. In making its finding, the Court of Appeal held the plaintiff would have proceeded with its course of action regardless of what advice was given. The court stated that the question of causation could not be resolved by applying an objective test as to what a prudent client would have done if properly advised. Rather, it is the subjective state of mind of the particular client that is relevant. In this instance, the court relied on the factors listed by the trial judge in concluding that the plaintiff did not establish its loss was caused by the breach of retainer or breach of duty, and therefore was only entitled to nominal damages for breach of contract.

Contributory negligence and the Fair Trading Act revisited

In last year’s decision of *Perpetual v Milanex (in Liquidation)* [2011] NSWCA 36 (*Milanex*), the Court of Appeal held a defence of contributory negligence is not available for a claim for damages arising as a result of a breach (or contravention) of section 42 of the *Fair Trading Act 1987* (NSW) (misleading and deceptive conduct).

This year, the Court of Appeal arguably brought into question the correctness of *Milanex* in *Monaghan Surveyors Pty Ltd v Stratford Glen-Avon Pty Ltd* [2012] NSWCA 94. While the court did not ultimately need to decide the issue, it referred to *Milanex* and then noted common law position that contributory negligence is a defence to a cause of action even if it is based on breach of statutory duty. Interestingly, the issue was also raised in the previously mentioned case of *Commonwealth Bank of Australia v Hamilton*, although the court there similarly did not have to decide the issue. Given the remarks in both cases, we expect the issue will gain further attention in the future.

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FOCUS ON THE INSURING CLAUSE IN LIABILITY POLICIES

The insuring clause in a commercial policy of liability insurance will typically provide cover for “liability for any claim… in connection with (or similar words such as “in respect of” or “arising from” or “in the conduct of”) the insured business”.

This article looks at a series of recent legal decisions that have focused on two of the main triggers of cover in such insuring clauses:

- The identification of the types of claim covered
- The concept of connection to the insured business.

COMPENSATION

In commercial liability policies, the cover provided in the main insuring clause is generally restricted to claims for compensation. This limitation is most commonly found in the definition of “claim”. In some policies it may be contained in the insuring clause itself or in the definition of the “loss” covered. Two recent cases provide some guidance as to the way in which this limitation may operate in practice.

Hamcor Pty Ltd v The State of Queensland [2013] QSC 9

Hamcor was the owner of land that contained a chemical manufacturing plant operated by a tenant. In August 2005, the property was destroyed by a fire. Large quantities of water were used by the fire brigade to bring the fire under control. Those waters became contaminated with chemicals and contaminated the land and surrounding waterways.

The Environmental Protection Agency (EPA) issued a remediation notice and obtained orders requiring Hamcor to remove contaminated substances from the property and surrounding land and to clean relevant structures. Hamcor spent over AU$10 million complying with the notice and orders.

The Supreme Court of Queensland considered whether those costs fell for cover under the insuring clause of a policy covering public, pollution and products liability. The issue arose in the form of a stated case brought for separate determination by Hamcor’s broker, which had been sued for, among other things, failure to ensure that Hamcor was noted as an insured under the policy. The insuring clause covered “liability to pay compensation” for “claims… made against the insured”.

The court held that “the costs incurred by [Hamcor] in complying with the notices issued by the EPA, and the subsequent court orders are costs met by the respondents in respect of their own property. They do not constitute a liability to pay compensation in respect of a claim made against the insured. The fact that they arise as a result of action taken by a statutory authority is insufficient to allow them to be properly categorised as a liability to pay compensation in respect of a claim made against the insured”.

Kyriackou v Ace Insurance Limited [2012] VSC 214

In May 2007, the Australian Securities and Investments Commission (ASIC) commenced Federal Court proceedings seeking interlocutory and final relief against Mr Kyriackou and others. The proceedings related to Mr Kyriackou’s alleged involvement in an unregistered managed investment scheme. ASIC sought numerous forms of relief, including that Mr Kyriackou be restrained from promoting or advancing the relevant scheme.

Mr Kyriackou incurred substantial legal costs in defending the ASIC proceedings. In July 2008, ASIC discontinued the proceedings. Mr Kyriackou sought indemnity for such costs and expenses pursuant to a policy of professional indemnity insurance with ACE Insurance Limited (ACE). Mr Kyriackou’s claim was declined. He commenced proceedings against ACE.

The central question was whether the ASIC proceeding was a “claim” as defined.

The court interpreted “civil compensation” or “civil damages” to mean a claim for pecuniary redress for some actionable wrong, as that concept was considered in Kantfield Pty Ltd v Lockwood [2003] VSC 420 at [12] per Byrne J. The originating process and affidavits in the ASIC proceedings did not
Mr Newman’s claim on the policy was declined on the basis that no claim, as defined in the policy, had been made during the policy period. Mr Newman joined the insured to the proceedings commenced by Mrs Livesay. The central issue in the dispute between Mr Newman and his insurer was whether the letter was a “claim” as defined in the policy.

Claim was defined to include “any written demand... for compensation made against the insured but only in respect of the performance of professional services by the insured”.

The court held that the letter did contain a demand for compensation. In doing so, the court cited with approval the following passage from the judgment of Fryberg J [Junemill (in liq) v FAI (1997) QCA 261]:

“There is no formula which must be included in a claim by a third party. What is required, unless the policy expressly so stipulates, is a form of demand or assertion of liability, not a formal demand or assertion of liability. It must be remembered that the wording is a matter quite beyond the control of the insured.”

The court held that it was sufficient that the letter asserted an entitlement on the part of Mrs Livesay to recover for her personal injury claim “due to injury caused by dangerous fixture”. Even in the context of the other matters mentioned in the letter, it was clear that Mrs Livesay was making an assertion of liability on the part of Mr Newman. It was not necessary that the “compensation” sought be expressly identified. It was sufficient that the letter asserted the existence of a liability (which must implicitly involve a right to compensation).

IN CONNECTION WITH THE INSURED BUSINESS

The recent case of Rian Lane v Dive Two Pty Ltd [2012] NSWSC 104 concerned a scuba diving instruction business owned and operated by its sole director, Mr Todd. On 29 July 2006, Mr Todd was driving a boat owned by Dive Two when it collided with a fishing boat. Mr Lane, who was in the fishing boat at the time of the collision, commenced proceedings against Dive Two and Mr Todd, seeking compensation for his injuries.

Liberty Mutual Insurance Company (Liberty) issued a master policy issued to “PADI Asia Pacific and individual members, dive centres and resorts and others as agreed”. Dive Two, a member of the PADI Asia Pacific group, was noted as an insured under the policy. The policy was a combined general and products and professional indemnity policy. The cover provided under the policy extended to Mr Todd as a director of the company.

Liberty contended that it was not liable to indemnify the defendants because the claim did not arise “in connection with the insured business”.

DEMAND FOR COMPENSATION

In “claims made” policies, the insuring clause is triggered by a “claim” being made against the insured during the policy period. As such, the entitlement of an insured to indemnity under any particular policy will require the identification of precisely what constitutes a “claim” and when the claim was “first made”.

Sometimes that will be clear, such as when an insured receives a statement of claim out of the blue. In other cases, particularly where a client or customer makes a complaint, the question of whether that complaint constitutes a “claim” can be far more complicated. That was the situation considered by the Queensland Supreme Court in the recent case of Livesay v Hawkins [2012] QSC 122.

Mr Newman, the managing agent of a rental property, was sued by Mrs Livesay as a result of an accident in which a curtain pelmet came away from the bedroom wall and struck her on the head in April 2005.

The following day, Mrs Livesay and her husband, who were the tenants of the property, sent a long and rambling letter of complaint to Mr Newman. The letter raised 17 separate items of maintenance, which the tenants sought to have addressed. The letter also included the following comments:

■ “We are currently seeking medical advice and will advise you of our intentions on this matter;”

■ “As per the Tenancy Act and advice from the Rental Tribunal, Ray White Real Estate and the owners of a rental property will be held liable for any personal injury claims arising from damage caused to the tenants due to poor living conditions.”

■ “This does not include the Personal Injury Claim that we are currently entitled to due to injury caused by dangerous fixture.”

■ “We will take no legal action if this property is repaired effectively and promptly and made safe for living in. We state again, that we would be happy for the owners of this property to visit and meet us and inspect their property.”

At the time that Mr Newman received the letter, he was insured under a professional indemnity policy issue, which had a policy period of 24 July 2004 to 25 July 2005. Mr Newman did not notify the insurer of his receipt of the letter.

Mrs Hawkins commenced proceedings against Mr Newman in relation to the injury in September 2005. By that time the policy was no longer in force.
The “insured business” was defined as “scuba diving”, which was defined as “… principally incorporating class and water based learning activities and modules including first aid training and certification, including the determination of standards by the accrediting agency and all activities relating to training, instructing, observing and control of recreational scuba diving. This includes all activities relating to snorkelling, skin diving, swimming, recreational surface supplied air to a maximum depth of 10 meters, servicing hiring and repairing of equipment and sales of related products, tours of reefs by glass bottom boats (under 12 meters), transportations of people from one island to another, bird watching, guided tours of island when not diving, jungle and/or bush walking, fishing, underwater photography/video, whale watching, scuba doos, beach games”.

After the collision, Mr Todd told the police that the boat trip was for the purpose of a private function for his wife and her friends. Mr Todd later asserted that the trip was for marketing purposes or as a “thank you” to friends who had referred business. That evidence was rejected. As a result of that finding, the central issue in the dispute became whether the accident, which occurred in the course of a private boat trip, was “in connection with the insured business”.

Dive Two argued that because the term “insured business” was defined by reference to a list of activities, which included the activities that were being engaged in at the time of the accident, the claim fell within the insuring clause.

Her Honour held that the activities identified in the definition of “insured business” would only be covered where they were undertaken for business, rather than private, purposes. To find otherwise would be to ignore the fact that the parties have chosen to use the words “insured business” in the insuring clause.

Her Honour also rejected Dive Two’s argument that sufficient “connection” to the insured business could be established by the fact that the boat was owned by the company, that Mr Todd was the company’s usual boat skipper or that the boat was being operated in the general vicinity of the area in which diving excursions were generally undertaken by the company.

Her Honour stated that the necessary connection to the business must be “real and not merely tenuous”. However, the words “in connection with” were words of broad import and ought not be interpreted narrowly. In the event that Mr Todd’s evidence that the outing had a promotional or marketing purpose had been accepted, such connection would have been sufficient to attract cover.

CONCLUSION

The insuring clause in any liability policy is fundamental to the cover provided. As these recent cases show, there continues to be areas of uncertainty in relation to how these clauses operate. It is essential for insureds and brokers to understand the limitations inherent in the insuring clause of the policy and to ensure that the cover provided is sufficient to meet the insured’s needs. It is also important to remember that automatic and optional extensions and endorsements will often be subject to the insuring clause and must be read together with it. It is usual for such terms to be stated to be subject to all other policy terms and condition unless otherwise stated.

Finally, great care needs to be taken in considering the appropriateness of the description of the insured business. Where it is defined by reference to activities, great care needs to be taken to ensure that all relevant activities are included. Otherwise, the insured may not be fully covered.

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JOINING INSURERS TO PROCEEDINGS – SECTION 6

Australian courts have not yet had the opportunity to consider the “Bridgecorp” issue which has confronted the New Zealand courts in recent times (see our article on page 50). Given the high stakes involved, it is unlikely to go away, even after the New Zealand Court of Appeal sensibly preserved the interests of insureds.

In the meantime, we summarise the recent key decisions handed down in relation to section 6 (s 6) of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW) (LRMPA). These decisions reinforce the difficulties that plaintiffs may encounter in seeking to join insurers to proceedings pursuant to s 6.

ENERGIZE FITNESS PTY LTD V VERO INSURANCE LTD [2012] NSWCA 213

This was an appeal from a decision of RS Hulme J dismissing an application to join Vero Insurance Ltd (Vero) as a defendant to a proceeding pursuant to s 6(4) of the LRMPA. Vero was the liability insurer of Cal-Gym Manufacturing Pty Ltd (CG Manufacturing), the named insured of the policy in question and its subsidiaries.

The proceeding was issued by the plaintiff, who had been seriously injured in November 2006 at a gym owned and operated by the defendant, Energize Fitness Pty Ltd (Energize), while using a weightlifting aid known as the Smith Machine, which was alleged to be defective. Energize brought CG Manufacturing and Cal-Gym Equipment Pty Ltd (CG Equipment) into the proceeding on the basis that one of them had manufactured the machine. Energize subsequently applied to join Vero to the proceeding on the basis that it was the liability insurer of both CG Manufacturing and CG Equipment. By the time of the hearing of that application, both CG Manufacturing and CG Equipment were deregistered.

The primary judge held that leave will only be given to join an insurer under s 6 of the LRMPA where there is an arguable case against the insured, an arguable case that the policy responds and a real possibility that if judgment is obtained the insured would not be able to meet it. In relation to the first of those requirements, the primary judge held that there was insufficient evidence for there to be an arguable case that CG Manufacturing was the manufacturer of the machine, because the evidence was that the machine was manufactured in or around 1996, which was two years before CG Manufacturing was incorporated. It was held that there was no arguable case that CG Manufacturing was the manufacturer of the machine and therefore Vero, as insurer of that company, should not be joined to the proceeding.

In relation to CG Equipment, the primary judge held that there was no evidence that Vero insured CG Equipment or that CG Equipment was a subsidiary of CG Manufacturing and therefore Vero should not be joined.
On appeal, the Court of Appeal said that the decision to grant or refuse leave to proceed against an insurer under s 6(4) is discretionary. The Court of Appeal rejected the argument that the primary judge made an error of principle in not applying the test for summary dismissal of an action, because the questions involved in an application for summary dismissal and an application for leave under s 6 of the LRMPA are different. In an application for leave under s 6 of the LRMPA, the question is whether the court should permit a litigant to commence an action against a party who, in the absence of such leave, the litigant has no right to sue, whereas in an application for summary judgment the question is whether an action that a litigant has been able to commence without any need for leave of the court should be brought to an end. The Court of Appeal said that the essential question for the grant of leave in this case was whether there was an arguable case that the machine was manufactured on or after the date that GC Manufacturing was incorporated. It held that the primary judge’s view that there was no such arguable case was the correct view.

PERPETUAL TRUSTEES VICTORIA LTD V MALOUF [2012] NSWSC 1119

This decision concerned an application by the second defendant, Albert Malouf, to join his solicitor’s insurer, LawCover Insurance Pty Ltd (LawCover), to a cross-claim he was making against his solicitor, Mr Goldberg. The question for the court was whether the event giving rise to the claim occurred before inception of the applicable insurance policy.

The underlying proceeding arose out of a transaction in which Mr and Mrs Malouf signed several documents in the belief that they were providing short-term financial assistance to their son, Albert (the second defendant). However, the effect of the documents was that Mrs Malouf’s interest in the property was transferred to Albert (and therefore Mr Malouf and Albert became tenants in common) and a mortgage was granted over the property to the plaintiff. That mortgage secured a AUD$700,000 loan to Albert, which Albert on-lent to a third party. The third party, and then Mr Malouf and Albert, fell into default and the plaintiff sought to exercise its rights under the mortgage. As Mr Goldberg had ceased practise as a solicitor, Albert sought to join LawCover to the proceeding pursuant to s 6(4) of the LRMPA.

The case against Mr Goldberg was that he was negligent in failing to investigate the security properties adequately or at all and failing to obtain the consent of caveators with priority to the registration of a second mortgage over the security properties.

The relevant policy was a claims made policy providing run-off cover to Mr Goldberg for the period 1 July 2006 to 30 June 2007. There was no dispute that the claim was first made against Mr Goldberg in March 2007. As the court was bound by authority that s 6(1) does not give rise to a charge where the event that gives rise to a cause of action against the insured occurred before the inception of the relevant contract of insurance, the issue to be determined was when the event giving rise to the liability arose. Was it at the time of the sale of the final security property in October 2006.
The plaintiff, Mr Al Khaled, suffered injuries from electrocution while working as a cement renderer on scaffolding at a building site when the aluminium straight edge he was using came into contact with an energised power line. He issued proceedings against the developer of the building site and the companies that erected the scaffolding. The defendants each issued a cross-claim against Neatrule Cement Rendering Pty Ltd (Neatrule), a labour hire company that provided the plaintiff’s labour. Neatrule became the subject of a creditor’s voluntary winding up order and liquidators were appointed. At the time of the event in question, Neatrule held public liability insurance with Calliden and workers compensation insurance with Allianz.

Calliden initially conducted the defence on behalf of Neatrule under a reservation of rights and, while doing that, joined Allianz to the proceeding as a cross-defendant on the basis that it was obliged to indemnify Neatrule because the plaintiff was a worker or deemed worker of Neatrule.

After liquidators were appointed to Neatrule, the defendants sought leave to continue the cross-claims against that company. Calliden argued that the appropriate course was for leave to be granted to the defendants to institute fresh proceedings seeking relief under s 6 of the LRMPA. The defendants opposed such an order. The issue for the court was whether to grant leave to the defendants to continue the cross-claims.

Although the court was “very attracted to the idea that an order under s 6(4) should be made”, ultimately it held that the orders sought by the defendants should be made (ie to grant leave to the defendants under s 500(2) of the Corporations Act 2001 (Cth) (Corporations Act) to continue with the cross-claims). If the defendants were to bring claims directly against the insurers pursuant to s 6 of the LRMPA, that would involve instituting fresh proceedings and redrafting pleadings, which the defendants did not wish to do. The court did not wish to impose that burden upon the defendants.

The court acknowledged that there was some commercial risk that continuing the proceedings under s 500(2) may later lead to it being necessary for the defendants to bring further proceedings, but said that it was not for the court to protect the defendants from that risk. The preferable course was to maintain the status quo and allow the proceedings to continue as they had been. Therefore, orders were made that the defendants be granted leave under s 500(2) of the Corporations Act to continue each of the cross-claims against Neatrule.

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The failure of a low-value crop in a poor region can devastate families and communities. The cost of a funeral can mean a family goes hungry. Microinsurance can reduce the impact of events such as these. Notwithstanding the challenges that microinsurance presents, it has experienced massive growth in recent years and there is a lot of commitment to it from the global insurance community.

**WHAT IS MICROINSURANCE?**

Microinsurance is by no means a new phenomenon and has existed in different economies in various forms for some time. A briefing note published by the Munich Re Foundation states that “a product is generally defined as microinsurance if it is modest in premium and coverage and meets the following four criteria:

- **Target population:** The product targets the lower-income segment of the population, those who so far have been excluded from mainstream insurance offerings.
- **Business line:** Microinsurance can be found in all business lines, including life, accident and disability, health, property, agriculture (crop and livestock).
- **Sales:** Microinsurance may be supplied by various stakeholders and through a variety of channel types.
- **Affordability:** The premium amount is commensurate with the income level of the low-income sector.”

Microinsurance protects low-income people by insuring against a specific risk (or risks) common to individuals or communities in developing countries. In that way, the prefix “micro” does not refer to the scope or subject of the risk. Rather, it refers to the size of the premiums and potential pay-outs relative to those of the “regular” insurance policies often found in the more developed world.

**WHY IS MICROINSURANCE RELEVANT?**

Many low-income people in developing countries do not have access to adequate risk-management tools. They are therefore vulnerable to fall back – or fall deeper – into poverty when such uninsured risks eventuate. However, if these risks have been insured against, the potentially significant detriment to the individual, their family and the wider community will be reduced and could even be eliminated altogether.

Microinsurance is therefore vital to the protection of low-income people in developing countries where more common commercial insurance is not appropriate, as it would be uncommercial for an insurer to offer the cover and unaffordable for a consumer to purchase it.

**WHAT ARE THE DISTRIBUTION/Delivery Channels?**

Because microinsurance is designed to cover individuals over a vast geographic area, it is presented with issues in two phases of the insurance policy: inception and claims.

As outlined above, microinsurance is generally most needed in the poorest of areas. These are the areas with limited infrastructure for education, transport and telecommunications. Accordingly, microinsurers find it difficult to reach potential consumers to issue policies. Yet, even where they can, the consumers often lack an understanding of the concept of insurance and are reluctant to take out a policy. Other policyholders find it difficult to make a claim as they are unable to communicate their claim to the insurer. Some jurisdictions also require “wet signatures” for an insurance contract to be recognised. This can frustrate the process as consumers are required to physically travel to the insurer (or vice versa) to sign a policy or make a claim.

**WHAT ARE THE BENEFITS OF MICROINSURANCE?**

The presence of uninsured risks may mean that low-income people produce and/or consume in a less efficient manner. This could stifle income, productivity and/or standards of living on a wider – perhaps national – scale. Microinsurance makes it possible for low-income people to produce and/or consume more efficiently by enabling them to take more (calculated and appropriate) risks.

For example, without microinsurance, farmers may elect to grow crops that are more drought-resistant but have much lower yields in good seasons. However, if those farmers were insured against a bad harvest, they would be in a better position to grow crops that have high yields in good years and bad yields in years of drought. The spreading of risk by virtue of microinsurance would thereby promote greater potential returns; not only for the producing individual and their community but also for the economy as a whole, thanks to the increased production and sustainable consumption.
A CASE STUDY – FUNERAL MICROINSURANCE IN SOUTH AFRICA

Of all product offerings, funeral microinsurance seems to be one of the most common. In some ways, this is not surprising. The actuarial/underwriting issues are relatively straightforward and, unfortunately, a market clearly exists for it in poorer economies.

In South Africa, funeral microinsurance is provided by both independent insurers who are aligned with a single funeral parlour and larger insurers who are aligned with numerous funeral parlours through agencies or intermediaries. However, one of the keys to its market prevalence has been the ability of insurers to engage directly with the community via existing funeral parlours, rather than creating their own capital-intensive operations, which would most likely be met with scepticism and resistance from community members. Similarly, funeral microinsurance in South Africa is often written on the basis that benefits will be paid “in kind” (such as mortuary, transport and/or catering services), rather than in the form of a cash payment. This has also helped generate acceptance of the concept within the community, as the benefits go directly to the community and help to stimulate the local economy.

WHAT ARE THE ISSUES CURRENTLY FACING MICROINSURANCE?

Although the reach of microinsurance has expanded significantly, it remains unavailable to hundreds of millions of people. It needs massive expansion. The Munich Re Foundation states that it “requires the commercial insurance industry and professional mutual insurers”.

Most low-income people manage risk through more traditional or informal mechanisms. This may include borrowing from family or specialist loan organisations (at times at a prohibitively high interest rate), self-insurance or simple risk avoidance. However, despite the theory that such traditional or informal mechanisms are less effective at managing risk, especially in contrast to the more “modern” and “appropriate” method of microinsurance, microinsurance initiatives have had limited global success to date.

Where it has been made available, microinsurance has been hindered by various factors, including a lack of actuarial data, a lack of understanding of insurance principles, slow pay-out processes, low pay-out rates, inappropriate product design, obstacles associated with regional regulation, a mistrust of insurers, a lack of consumer protection or a general resistance by individuals to part with what little resources they have to secure a benefit that may never materialise.

The sheer geographic spread and cultural divergence of the issues facing the microinsurance industry means that the current issues will not be fixed overnight.

WHAT IS DLA PIPER DOING?

Throughout 2012, DLA Piper engaged with various international pro bono partners and clients in order to understand the issues that they are currently facing in relation to microinsurance.

As part of this exercise, in November 2012 DLA Piper Consultant, Michael Gill attended the 2012 Microinsurance Conference in Dar Es Salaam, Tanzania. That conference provided a forum for over 400 participants and experts on microinsurance to meet and exchange ideas and experiences, as well as discuss the challenges to implementing microinsurance initiatives globally. Michael met with a number of those experts to discuss how DLA Piper can best contribute to such microinsurance initiatives, including by partnering with various organisations.

DLA Piper is therefore continuing to engage in this growing global industry and is committed to partnering with other organisations in order to promote the livelihood and wellbeing of people in developing countries, particularly in the Asia Pacific region. In many ways, the effective implementation and penetration of microinsurance is vital to such development.

For more information in this area, or to discuss possible involvement in future microinsurance projects with DLA Piper, please do not hesitate to contact Michael Gill or Daniel Creasey.

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Created in 1960, the Association Internationale de Droit des Assurance (AIDA) is the peak international body for insurance law. The Australian chapter, the Australian Insurance Law Association (AILA), was created in 1983. In that year, DLA Piper Consultant, Michael Gill became AILA’s first chairman. Fast-forward 30 years, and Michael is enjoying his third year as AIDA president. In this role, his focus has been on revitalising existing chapters, such as Hong Kong and Poland, and establishing new chapters, such as Bulgaria, Croatia and Cuba. His sights are set firmly on Asia, where chapters in India, Malaysia, China and Thailand are either forming or are under consideration.

On 30 November 2012, Michael presented a paper at the AIDA Budapest Colloquium. Numerous representatives from around the world presented on their nation’s experience. Michael found he had a good story to tell about the Australian experience. Below is an edited excerpt from the paper he delivered, which was co-authored by DLA Piper’s James Morse and Emma van den Bok.

– Kerry Hogan-Ross, Editor

THE AUSTRALIAN EXPERIENCE

In 1991, the General Insurance Enquiries and Complaints Scheme (GIECS) was established in response to a demonstrated need for an independent, national body that could provide help to consumers who had disputes with their general insurance providers. Insurance Enquiries and Complaints Ltd (IEC) was incorporated in December 1993 as part of this self-regulation mechanism.

In November 2004, GIECS combined with the IEC to create the Insurance Ombudsman Service Ltd (IOS). The change was primarily brought about to increase accessibility and awareness, as well as to improve service to the community and stakeholders.

Today, Australia has the Financial Ombudsman Service (FOS). This commenced on 1 July 2008 and was formed through the consolidation of three schemes: the Banking and Financial Services Ombudsman, the Financial Industry Complaints Service and the IOS.

The FOS now provides dispute resolution services for over 80% of all disputes which arise in relation to the provision of financial services in Australia.

While some disputes still fall outside of the FOS’s jurisdiction, such as disputes concerning the level of a fee, premium charge or interest rate, the jurisdiction has increased and is likely to continue to do so over time. This is not only due to the fact that insurance claims and disputes have increased, but also because over time the industry has grown in confidence about the scheme.

Critically, the FOS operates on a “without prejudice” basis and is not bound by any legal rules of evidence. It proceeds with minimal formality and technicality.

When deciding a dispute and deciding whether a remedy should be provided, the FOS will do what it considers is “fair in all the circumstances”, having regard to legal principles, applicable industry codes or guidance as to practice, good industry practice and any previous relevant decisions of the FOS or a predecessor scheme (although the FOS will not be bound by these).

A Determination is a final decision and is binding upon the insurer if the claimant accepts the Determination within 30 days of receiving it. It is not binding on the insured and is cost-free to the insured. An insurer has extremely limited rights of appeal once the claimant accepts the Determination. However, a claimant who receives a Determination with which they are not content may commence court proceedings against the insurer in relation to that very same dispute.

It is therefore not surprising that there has been some criticism of the FOS, especially from insurers and particularly regarding its quasi-judicial nature.

Recently, in the judgment of Mickovski v Financial Ombudsman Service Limited & Anor [2012] VSCA 185, the court acknowledged that, in the face of increasing privatisation of governmental functions, there is a need for the availability of judicial review in relation to a wider range of public and administrative functions.

A similar concern is that because the FOS is not bound by legal precedent and is required to take other considerations into account (such as fairness and good industry practice), this can lead to a dichotomy whereby the same or similar disputes will be determined differently, depending on whether they are determined by the FOS or a court. This has the potential to create a system that allow parties to a dispute, usually claimants, to “forum shop”.

USING AND AVOIDING THE AUSTRALIAN COURT SYSTEM TO RESOLVE (RE)INSURANCE DISPUTES
Such concerns include those of a pro bono manager and partner at a leading Australian law firm, who stated that “the ever-increasing push for [alternative dispute resolution] is part of a wider reduction in access to court for people in our pro bono client base. A two-tiered justice system is developing where disputes worth more money receive the benefit of the rigour of the court system and the disputes that our clients are involved in are accorded such rigour less and less”.

But the question arises: is this inappropriate, or is it all just part of the cut and thrust of alternative dispute resolution?

There appears to be two distinct camps on this issue: one which believes that alternative dispute resolution processes should generally mirror that of the judicial system, and the other suggests that alternative dispute resolution processes should be encouraged to undertake innovative resolution activities that are separate and distinct to the judicial system.

The General Insurance Code of Practice binds all members of the Insurance Council of Australia and sets out the way in which consumers can expect an insurer to behave and the recourse that they may have in the event of a dispute. But I do not find this at all surprising. The concept of “balancing the interests” of all participants in the insurance industry, which has been central to Australia’s recent reforms (including those in relation to alternative dispute resolution) has universal appeal.

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IT PAYS TO THINK ABOUT CAUSATION

Several higher court decisions in 2012 have highlighted the importance of considering the crucial ingredient in negligence actions – causation.

The Court of Appeal’s decision in *New South Wales v Mikhael* [2012] NSWCA 338 (*Mikhael*) is one such case. In *Mikhael*, the plaintiff, a student, had been seriously assaulted by another student (T) at a state high school after class. There were warning signs about T’s violent behaviour: he had assaulted another student six weeks earlier and had had an argument with the plaintiff just before class had ended. The teacher on duty was not aware of the prior assault. The plaintiff argued the defendant breached its duty of care by failing to provide teachers with information as to the student’s propensity to violence, which would have alerted them to apply techniques to avert such incidents. The plaintiff was successful at trial, however the Court of Appeal overturned the decision, finding that although duty of care and breach of duty were established, the plaintiff had not established that the defendant’s failure to take steps to prevent the assault was a “necessary condition of the occurrence of the harm”, as required by section 5D(1) of the *Civil Liability Act 2002* (NSW), being the “but for” test.

The Court of Appeal found that while certain precautions should have been taken, the plaintiff had not proved that the assault would not have occurred had those precautions been taken.

The Queensland Supreme Court reasoned along the same lines in another assault case, but this time in an employment context, in *Serra v Couran Cove Management Pty Limited* [2012] QSC 130. In that case, the Supreme Court held that an employer did not breach its duty of care to the plaintiff employee by failing to investigate, reprimand or discipline a co-worker prior to an assault committed by the co-worker on the plaintiff.

However, even if there had been a breach of duty, the court would not have drawn a causal link between the breach and the assault. While there were several indicators that the co-worker’s behaviour could lead to a physical confrontation with the plaintiff, the court held that there was no basis in the evidence for concluding that any measures taken by the employer to reprimand, investigate or discipline the co-worker would have prevented him from assaulting the plaintiff anyway, stating “the conduct of criminal assailants is not necessarily dictated by reason or prudential considerations”. In fact, it was just as likely that a reprimand would have incited an attack rather than have prevented one.

In *Strong v Woolworths Ltd* [2012] HCA 5 (*Strong*), there was a lack of direct evidence as to how long a chip had been lying on the floor. The High Court therefore drew inferences from the available evidence to support a finding of causation.

In *Strong*, the plaintiff was an amputee whose crutch slipped on a (once) hot chip, causing her to fall. The accident occurred during lunchtime in an area for which Woolworths was responsible. The plaintiff alleged Woolworths was negligent in failing to have an inspection and cleaning regime in place that would have detected and removed the chip. There was no question that Woolworths did not have an effective system in place.

The Court of Appeal relied on the inference that the chip was likely to have been deposited on the floor at lunchtime. It followed that even if there was a periodic inspection and cleaning regime, the chip could have been dropped after the last inspection and therefore would not have prevented the plaintiff’s fall.

The High Court overturned the Court of Appeal’s decision on the basis that the evidence did not support the Court of Appeal’s finding on causation. Proof of the causal link and an occurrence requires consideration of the probable course of events had the omission not occurred. The High Court, noting that hot chips are eaten not just at lunchtime, concluded the chip could have landed on the floor at any time since the opening of the shopping centre that morning. Therefore, a system of inspection and cleaning every 20 minutes in the area would have detected and removed the chip in that wide period of time.

The Victorian Court of Appeal considered the question of causation in the context of allegedly negligent legal advice. In *Simply Irresistible Pty Ltd v Couper* [2012] VSCA 128, the plaintiff sued its legal advisors, alleging they had failed to advise the plaintiff in relation to exercising an option that later lapsed, depriving the plaintiff of any benefit had it exercised the option. The plaintiff argued that had it been properly advised, it would have exercised the option. The Victorian Court of Appeal agreed with the trial judge in this instance to say that whilst the legal advisors failed to properly advise the plaintiff on the option, that negligence did not cause the loss
suffered by the plaintiff, as it was clear the plaintiff held an “unshakeable view” about their ability to exercise the option that overrode any legal advice they would have received.

Relevantly, the Court of Appeal stated that the question of causation could not be resolved by applying an objective test as to what a prudent client would have done if properly advised. Rather, it is the subjective state of mind of the particular client that is relevant.

The message from these cases is that even with the return to the more straightforward “but for” test, causation remains a difficult issue for both plaintiffs and defendants and it is hard to predict. Strong is a perfect example of that – the Court of Appeal found unanimously in favour of the defendants and the High Court overturned that decision six to one.
A JUDGMENT IS NOT ALWAYS A JUDGMENT

A person who has suffered damages as a result of a tort and brings separate actions against tortfeasors liable in respect of the same damage cannot recover more than the amount of damages awarded by the judgment first given. On 13 December 2012 in Newcrest Mining Limited v Thornton [2012] HCA 60, the High Court found the limit on recovering damages in successive actions does not apply where the “judgment first given” is a consent judgment filed to give effect to an agreement to settle the first action. The decision will allow plaintiffs to settle an action with one tortfeasor via a consent judgment and use the settlement proceeds to potentially fund subsequent actions against the remaining joint tortfeasors.

BACKGROUND

Michael Thornton alleged he was injured on 16 February 2004 while working at a mine occupied by Newcrest Mining Limited (Newcrest Mining). Initially, Mr Thornton did not claim damages from Newcrest Mining, and instead claimed workers compensation payments from his employer, Simon Engineering (Australia) Pty Limited (Simon Engineering). He later commenced an action against Simon Engineering in the District Court of Western Australia, claiming damages for negligence. Mr Thornton’s action against Simon Engineering was settled by way of a consent judgment for AU$250,000 plus workers compensation and costs. Simon Engineering paid the settlement sum to Mr Thornton in full and the judgment was discharged.

A year later, Mr Thornton commenced a separate and new action against Newcrest Mining and three other defendants in the District Court. In this second action, he claimed damages against the defendants relating to the same work accident and the same injuries.

SUMMARY JUDGMENT

Newcrest Mining applied for summary judgment in light of the settlement of the first action. The District Court granted the application on the basis Mr Thornton had already been awarded damages for the same injuries, and therefore could not be awarded damages again. When reaching this decision, the District Court found that at no time prior to the settlement of his claim against Simon Engineering did Mr Thornton expressly reserve his rights to pursue a claim against any other tortfeasor.

COURT OF APPEAL DECISION

Mr Thornton appealed the summary judgment decision to the Court of Appeal. The appeal focused on the interpretation of s7(b) of the Law Reform (Contributory Negligence and Tortfeasors’ Contribution) Act 1947 (WA) (Law Reform Act), which is designed to preclude plaintiffs from being awarded damages for the same injury in successive actions. This section relevantly provides that sums recoverable under judgments given in successive actions “shall not in the aggregate exceed the amount of the damages awarded by the judgment first given”. The question before the Court of Appeal was whether Mr Thornton had been “awarded” damages in his first action against Simon Engineering when the consent to judgment was entered. The Court of Appeal held that a payment further to a consent judgment was not an award of damages. As such, the court found there was nothing to stop Mr Thornton from bringing his further claim against Newcrest Mining. In doing so, the Western Australian Court of Appeal reached the same conclusion as the New South Wales Court of Appeal in Nau v Kemp & Associates [2010] NSWCA 164, which considered the interpretation of a similar provision in the Law Reform (Miscellaneous Provisions) Act 1946 (NSW) and which was handed down two months after the District Court had entered summary judgment against Mr Thornton.

HIGH COURT APPEAL

In the appeal, the High Court was asked to consider whether the restrictions on recovering damages in multiple actions under the Law Reform Act (and its equivalent legislation in
New South Wales, Queensland and the Northern Territory) only applied to damages awarded by a court following a judicial assessment or if the provisions have broader application and applied to a judgment entered by a court by the consent of the parties.

In support of the appeal, Newcrest Mining challenged the construction of s7(1) of the Law Reform Act and the findings of the Court of Appeal on the basis it prompted multiplicity of actions. In doing so, it contended that a judgment delivered by a trial judge based on agreements between the parties to all or part of the elements required to quantify damages prior to trial could not be superior to, and should have the same effect as, a judgment entered by consent of the parties. Newcrest Mining also submitted the findings of the Court of Appeal could allow plaintiffs to adopt a scattergun approach to litigation against potential tortfeasors, with the knowledge that a consent judgment would be no bar to further pursuing other defendants and seek to improve their position with each defendant.

Mr Thornton disagreed and submitted the interpretation of the phrase “damages awarded by the judgment first given” must require judicial determination on the question of damages recoverable for the damage or injury.

The majority of the High Court (comprising Chief Justice French and Justices Heydon and Bell) found a consent judgment, which merely gives effect to the settlement and cannot amount to an award of damages for the purposes of s7(1) of the Law Reform Act because there had been no judicial determination of liability and no consequent award of damages. Instead, a consent judgment gives legal effect to the parties’ settlement agreement and does not confine the plaintiff’s common law right to recoup the full amount of their loss against several concurrent tortfeasors.

**IMPLICATIONS**

The decision challenges the previously perceived benefit of using consent judgments as a mode of settlement of court proceedings. While this was seen in the past to be a proper and effective means of recording full and final settlement of an action against a particular defendant and end all further potential claims against that defendant, defendants who resolve claims against them by consent judgments are now exposed to being joined as third parties in subsequent actions the same plaintiff commences against separate tortfeasors, and having to pay more than they originally settled for.

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IS ACTIO PER QUOD STILL AVAILABLE IN AUSTRALIA?

If you think *actio per quod* is a spell taught at Hogwarts, you better read on.

A couple of the issues before the High Court in *Barclay v Penberthy* [2012] HCA 40 (delivered 2 October 2012) have kept very few litigators awake at night in recent decades, but were of critical importance to the parties:

- Is *actio per quod servitium amisit* (*per quod*) still available in Australia? Yes.

Two other critical issues in the case were:

- Whether a party was ‘vulnerable’ in the sense that it could bring a claim for pure economic loss. Yes, with a strong dissent from Heydon J.
- Whether a party could argue a cause of action, *per quod*, which had not been pleaded or argued properly, or at all, in the courts below. Yes, with a strong (and again, with respect, compelling) dissent from Heydon J.

BACKGROUN

On 11 August 2003, a twin-engine aircraft crashed near Jandakot Airport in Western Australia due to the failure of its right engine on take-off. Two passengers were killed. The remaining three passengers and the pilot survived. All passengers were employees of Nautronix Limited (Nautronix), a marine communications technology company, which had chartered the aircraft from Fugro Spatial Solutions Pty Ltd (Fugro). The aircraft had been especially modified for the purpose of conducting testing of Nautronix’s technology and for carrying the Nautronix employees directly involved in the testing.

The pilot, Mr Penberthy, was employed by Fugro. He was found negligent at first instance for the decisions he made in flight after the engine failed, which contributed to the accident. Another contributing factor was a faulty replacement bearing in the right engine. The bearing had been designed locally by Mr Barclay, an approved aeronautical engineer, and installed approximately three years before the accident. Its specifications were different to the original bearing installed by the aircraft manufacturer. At first instance, Mr Barclay was also found to be negligent for the design specification of the faulty bearing.

There were three issues examined on appeal to the High Court:

- First, Nautronix brought actions for damages against Fugro and its pilot, Mr Penberthy, in negligence and in contract. The damage claimed was in the nature of pure economic loss. The issue was whether Mr Penberthy (and Fugro vicariously) owed a duty of care to avoid the pure economic loss flowing from the loss of services of the three injured employees.
- Second, Nautronix brought a claim in negligence for pure economic loss flowing from the loss of the two deceased employees. The issue was whether the rule in *Baker v Bolton*, which would preclude an action where the tort resulted in death, should be overruled.
- Finally, Nautronix brought an action in *per quod* against Fugro, Mr Penberthy and Mr Barclay for the loss of its employees’ services. The issue was whether the principle of *per quod* continued to remain part of the common law, and if so, what the measure of damages was.

HIGH COURT DECLARES TO ABOLISH PER QUOD

The court unanimously held that the action *per quod* still forms part of the common law of Australia and that, if it was permissible for Nautronix to argue the cause of action, the defendants would be liable. The majority held that the action was available. Heydon J considered it impermissible to allow the action *per quod* to be pleaded, given the way the proceedings ran.

The principle of *per quod* can be traced to medieval times. It allowed a master to claim for the loss of his servant, in which it was said he had a quasi-proprietary interest, so long as the tortfeasor acted negligently or intentionally towards the servant. The appellants submitted that *per quod* should be absorbed into the law of negligence and should now not constitute a distinct cause of action.
In negligence generally, no liability arises for breach of a duty of care unless damage is suffered by the person to whom the duty was owed. The appellant argued that an action per quod is an exception to this general rule because the tortfeasor does not owe a duty to the person trying to recover. With the developments of the law of negligence, it was argued this exception should not constitute a separate cause of action and should instead be subsumed by the law of negligence.

The court disagreed that an action per quod is an exception to the general rule of negligence. It is wholly distinct from negligence because a duty of care is owed to the employee and not the employer. A breach of the duty to the employee is the foundation of a claim in negligence. But if the employer is to recover, he must pursue a separate cause of action that is not grounded in principles of proximity of damage resulting from breach of duty of care.

An action per quod provides a remedy where there is a wrongful invasion of the employer’s quasi-proprietary right held concerning the services his servant is obliged to provide to him. An infringement of that right entitles the master to recover damages.

For these reasons, the majority declined to subsume the principle of per quod into the general law of negligence.

Heydon J added further support to the majority’s refusal to abolish an action per quod. His Honour considered that per quod had not been pleaded at trial and that, therefore, it could not be argued on appeal. However, His Honour stated that the action per quod could not be “absorbed back” into general principles of negligence because it was older than the tort of negligence and did not derive from it. If it is antiquated and anomalous in today’s society, His Honour stated that this is for the legislature to resolve.

Heydon J finally considered that it would be inappropriate to abolish per quod as a cause of action on the present appeal because it had never been pleaded at trial. To do so would be to deal with a hypothetical question.

**BAKER V BOLTON RULE**

Nautronix claimed damages for pure economic loss for the loss of the services of the three injured employees. This is a significant part of the quantum of what is sought to be recovered in the litigation. It further sought to claim for losses suffered as a result of the two deceased employees. To do so, it argued that **Baker v Bolton** should be overruled.

The rule in **Baker v Bolton** states that “the death of a person cannot constitute a cause of action giving rise to a claim for damages”. The plaintiff argued that the rule made it “cheaper to kill than to maim” and that it was an inappropriate principle considering changing societal conditions.

The court decided that there was considerable authority, both in Australia and overseas, that endorsed the rule in **Baker v Bolton**. It would be a significant step to overrule it, especially in view of the High Court’s decision in **Woolworths Ltd v Crotty** (1942) 66 CLR 603, which affirmed the rule. The court considered that it is for the legislature to alter the scope of the rule.

**PLEADING POINT RE PER QUOD**

An interesting procedural point arose in the case. Of all the issues, per quod took up a significant amount of the High Court’s deliberation. This cause of action is not mentioned in Murray J’s judgment (the trial judge), and is opaquely referred to in the Court of Appeal’s judgment. Why? Because it wasn’t pleaded or argued in the courts below.

As Heydon J commented: “...actio per quod servitium amisit was distinctly raised for the first time only in (the High) Court.”

All High Court judges agreed that a cause of action can be legitimately raised for the first time in an appeal, provided there is no specific injustice to the other parties. The plurality found that there was no such injustice here. Heydon J, dissenting, found that evidence concerning the relationship between Nautronix and its personnel could have been given at trial, which may have defeated the per quod claim.

This case is strong authority for the proposition that where it is not injustice to the parties, a new or expanded pleading can be introduced at the appeal stage.

**LIABILITY UNDER PER QUOD**

As discussed above, the court found that an action per quod still exists in Australia. The plurality further found that Nautronix was entitled to rely on the action in this litigation. Mr Barclay and Mr Penberthy were found to be liable to Nautronix in the action per quod. The tort was established for the loss of services of the employees of Nautronix who were injured in the plane crash. This did not constitute a finding of negligence against Mr Barclay and Mr Penberthy as far as Nautronix is concerned. Per quod is a tort but does not form a part of the law of negligence. The court also very narrowly reduced the scope of the entitlement to recover damages for loss of services.

**PURE ECONOMIC LOSS**

At first instance, Nautronix claimed damages for pure economic loss as against Mr Barclay and Mr Penberthy, such loss arising from the injuries to its key personnel in the accident. To succeed, Nautronix needed to establish that either or both Mr Barclay and Mr Penberthy owed it a duty of care and further that it was “vulnerable” in that it could not protect itself from the foreseeable harm of their negligence.
The trial judge, Murray J (see Cifuentes v Fugro Spatial Solutions Pty Ltd [2009] WA SC 316 of 322), found that Mr Barclay did not owe Nautronix a duty of care, because Mr Barclay could not have foreseen Nautronix’s losses. As designer of the specifications of the defective part, Mr Barclay’s duty of care was limited to the passengers on the plane and the owners of the plane.

Murray J found that Mr Penberthy did owe a duty of care and that Nautronix was vulnerable. The finding against Mr Penberthy was undisturbed by the Court of Appeal and the High Court. Heydon J dissented. Heydon J found that in the absence of evidence that Nautronix could not have negotiated a warranty, it had not proved that it was vulnerable. His Honour said: “The sole answer of Nautronix was that there was no evidence that it could have negotiated for itself ‘a watertight contractual warranty’ from Fugro. But that impermissibly reverses the burden of proof.”

The Court of Appeal overturned the finding in favour of Mr Barclay and found him liable for Nautronix’s pure economic loss. Interestingly, even though the Court of Appeal found unanimously against Mr Barclay on this point, it was considered so weak that it was abandoned by Nautronix by the time of the High Court appeal so that Barclay succeeded in being found to have no liability to Nautronix for the significant pure economic loss claim.

### FINDINGS ON PURE ECONOMIC LOSS

<table>
<thead>
<tr>
<th>Court</th>
<th>Party</th>
<th>Duty of Care Owed to Nautronix?</th>
<th>Was Nautronix Vulnerable?</th>
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<tbody>
<tr>
<td>WA Supreme Court</td>
<td>Mr Penberthy</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Mr Barclay</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>WA Court of Appeal</td>
<td>Mr Penberthy</td>
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</tr>
<tr>
<td></td>
<td>Mr Barclay</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>High Court</td>
<td>Mr Penberthy</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Mr Barclay</td>
<td>Claim abandoned before hearing</td>
<td></td>
</tr>
</tbody>
</table>

### COMMENTARY

The damages available for the cause of action have been severely limited by the decision in Barclay v Penberthy.

The court held that damages for an action per quod extend only to the cost of replacing the employee less the wages that would have been paid to the injured employee. This is a limited right to recover for loss of services.

The court quoted the principle set out in the New Zealand decision Attorney-General v Wilson and Horton Ltd [1973] NZLR 238, which stated that, because “a wrong done to the master is an interference with his right to the services of his servant, the damages recoverable should be measured exclusively by the consequences which follow from that interference.” The damages should “not be widened to include all consequences which follow merely from the fact that the servant was injured.” The court further examined the case law in this area and concluded that lost profits resulting from an employee’s injuries cannot be recovered in an action per quod.

Thus, employers should bear this limited utility in mind when considering damages claims for loss of the services of their employees.

### CONCLUSION

As a result of this decision we would not be surprised to see the occasional action per quod pursued where legislation has not abolished the right to do so. With the additional limitation on the right to recover damages for this tort, there should be no fear of floodgates.

We think that allowing the per quod claim to be argued in the High Court without it being ventilated in the courts below could potentially lead to more cases being decided on appeal on issues that may fall outside the pleadings – provided there is no prejudice to the other parties.

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In December 2012, the High Court gave some useful guidance in common law qualified privilege in its decision in *Papaconstuntinos v Holmes a Court* [2012] HCA 53. Just when can a person make defamatory allegations against another person and make out the qualified privilege defence?

When Peter Holmes à Court and Russell Crowe proposed to buy a controlling interest in the South Sydney District Rugby League Football Club (Club), Mr Tony Papaconstuntinos (Mr Papa) was a vociferous opponent of the plan. He was also a director of the Club and an employee of the Construction, Forestry, Mining and Energy Union (CFMEU).

Mr Holmes à Court reviewed the Club’s accounts and conducted a due diligence of the Club’s operations. The results of these investigations caused him to write a formal letter of complaint to the CFMEU, which related a series of facts concerning Mr Papa and his son Jamie, who was formerly employed by the Club as an assistant coach. The letter noted that Jamie was paid approximately AU$60,000 for his services when the normal rate was closer to just AU$4,000 and that Jamie’s employment was terminated when the overpayments were discovered. The letter suggested that the overpayments were made as “a reward for other activities, or a method of channelling funds to the CFMEU, or indeed to Mr Tony Papa”. The letter went on to say that the salary was paid by construction companies that were sponsors of the Club. At first instance, the trial judge observed that these companies may have had a motive for keeping the CFMEU happy and found the facts were “inherently suspicious”.

The letter clearly contained defamatory imputations. In upholding Mr Holmes à Court’s defence of common law qualified privilege, the plurality found that the maker of the statement does not have to establish some “pressing need” to publish the statement. Rather, the defence requires reciprocity of duty and interest – the maker has a duty or interest in making the statement and the recipient has a duty to hear or an interest in hearing it. Mr Holmes à Court established that he had an interest in making the statement and the CFMEU had a duty to hear or an interest in hearing it.

The other 2012 High Court decision handed down was *Harbour Radio v Trad* [2012] HCA 44, which addressed a number of issues, the primary one being “reply to attack” qualified privilege.

The High Court had to decide whether the reply to the attack by 2GB had (as a matter of law) to be reasonably proportional to the attack, similar to the requirements of the criminal defence of self-defence, or alternatively whether the reply simply had to be relevant to the subject matter, with anything outside that being outside the “umbrella” of the privilege. The majority decided that it was an issue of relevance and not proportionality and all but two of the imputations were relevant and therefore privileged. Heydon J dissented and found that 2GB was motivated by malice (the majority refused leave to seek to cross-appeal out of time on the issue of malice, so it was not addressed by the majority).

Given that two imputations were not privileged, the High Court referred the matter back to the Court of Appeal to consider the defence of contextual truth for these two imputations and if found not to succeed, to remit the matter to the trial judge to decide damages on those two imputations. The case has therefore provided some certainty around the precise requirements for the defence of “reply to attack” qualified privilege.
Another developing area of law is the statutory restriction on certain corporations in suing for defamation. Since 2005 (uniform Defamation Acts) companies cannot sue unless they have less than 10 employees or contractors or are not-for-profit companies. Those acting for such organisations are bringing more imaginative actions such as injurious falsehood or misleading conduct, each of which has its own challenges. In this case, McCallum J found that as the plaintiff (which was a company with less than 10 employees) was a non-trading company and therefore had no reputation to be damaged and could not succeed in such an action.

BENNISON V O’NEIL [2012] NSWSC 360

A local councillor sued a member of the public who had allegedly defamed him whilst making submissions during a council meeting of Sydney’s Lane Cove Council. In fact, the defendant accepted the denial by the plaintiff of the allegation and withdrew the allegation at the very same meeting. Therefore, it was held that the allegation had been completely neutralised by the withdrawal (known as bane and antidote) of the allegation and the statement of claim was therefore struck out.

Finally, set out to the right are two damages awards to take note of.

HABIB V RADIO 2UE & ANOR [2012] NSWDC 12

Three broadcasts were made that the plaintiff was dishonest in trying to get a disability pension even though he ran in the City to Surf race and that he attempted to deceive Centrelink by seeking such a pension and was therefore a welfare cheat. Damages awarded after all defences failed were AU$70,000 for the first broadcast, AU$25,000 for the second plus aggravated damages of AU$25,000 and AU$25,000 for the third broadcast.

CLARKE V COLES SUPERMARKETS AUSTRALIA PTY LTD [2012] NSWDC 107

This case involved claims for defamation, injurious falsehood, assault, intimidation, harassment and wrongful imprisonment, which involved an accusation of non-payment for goods that was directed at the plaintiff in Coles Supermarket to the effect that the plaintiff had consumed, without first paying for (and had therefore stolen) raw prawns from the supermarket. All actions were rejected except defamation and defences of truth and qualified privilege were rejected. Damages awarded were AU$50,000, including AU$10,000 for aggravated damages.
2012 was a much quieter year in Canterbury, at least in seismological terms. The last earthquake of any magnitude was in December 2011. The dwindling sequence of aftershocks has given insurers and builders confidence to move ahead with the settlement of claims by reinstatement. It is also fuelling increasing frustration by policyholders at the slow pace with which building is occurring.

The Canterbury Earthquake Recovery Authority (CERA) made a series of announcements over the course of the year, zoning properties into red and green. Those zoned red are subject to the Crown offer to purchase, at 2007 rating values, with the threat of compulsory acquisition for those not wanting to sign up.

Properties zoned green can be redeveloped. However, the green zone has been sub-divided into three sub-categories depending on the extent of land damage. These range from Technical Category (TC) 1, where the houses can be built with ordinary foundations, through to TC3, where the local authority requires geo-technical investigation and specialist foundation design.

Unsurprisingly, issues have arisen between the owners and insurers of TC3 properties. A particularly difficult issue is in determining what cover is provided by the Earthquake Commission (EQC) for damaged land. All properties with policies of fire insurance automatically have cover for land provided by the EQC. That cover is capped at the value of the land damaged by earthquake.

The EQC is showing reluctance to meet the cost of land repairs. Its view seems to be that insurers should bear the cost of foundations as part of the house repair. That ignores the fact that repairing the land by compacting and strengthening it would mean ordinary foundations would suffice. Insurers are taking assignments of the rights policyholders have against EQC to test this point.

Insurers have had to deal with houses in the hill suburbs subject to the threat of damage by falling rocks. That has brought into question whether policies that cover physical loss are triggered. We are aware some insurers are treating such houses as total losses on the basis that the owners are prohibited from living in them and there is no short or medium term prospect of them being able to return.

Policyholders with houses in the Residential Red Zone continue to argue that the fact they are not able to repair their properties means they have suffered total losses, irrespective of the actual damage suffered. Insurers are holding the line that houses that are not actually destroyed should not be treated as such. That position is to be tested by the High Court in a case scheduled for hearing in March 2013.

Intractable cases are moving inexorably towards the courts and the Ministry of Justice is fast-tracking earthquake-related litigation to hearing. One case that has been heard – *Turvey Trustee Limited v Southern Response Earthquake Services Limited* [2012] NZHC 3344 – involved the issue of reinstatement of an old house with period features. The owner wanted replacement on an identical basis. The court took a pragmatic and reasonable approach. Plaster ceilings and cornices could be replaced with polystyrene equivalents. Hardwood floors and other features that were painted could be replaced with softwood. Exposed and polished floors had to be replaced with something equivalent, though the owner had to accept that the precise wood may not be available in 2012.

Insurers have seen an upsurge in claims being prosecuted by claims management companies. Our expectation is that as the pace of construction increases, and homeowners can see progress, these companies will have a harder time attracting clients.
The UK High Court decision on 8 February 2013 in AIOI Nissay Dowa Insurance Company Limited v Heraldglen Limited and Advent Capital (No 3) Ltd [2013] EWHC 154 removed any uncertainty in the reinsurance market by upholding an arbitration tribunal’s decision that the terrorist attacks of 11 September 2001 on the Twin Towers of the World Trade Center (WTC) amounted to two “events” for the purposes of aggregation under a whole account catastrophe XL reinsurance wording.

The underlying losses principally arose from settlements for property damage/personal injuries claims made by the liability insurers of American Airlines (for flight AA11, which crashed into the North Tower), United (for flight UA175, which crashed into the South Tower) and the two security companies responsible for screening passengers on each flight. The issue was whether the losses arising from each act of hijack of the aircraft were one or two events under the reinsured’s outwards XL reinsurances.

The case was reinsurer AIOI’s appeal from an arbitration award dated 26 January 2012 made by a tribunal consisting of Ian Hunter QC, David Peachey and Richard Outhwaite. AIOI contended that its liability under the outward XL reinsurances was on a one-event basis, whereas Heraldglen had presented its claims to AIOI as two separate occurrences arising out of two separate events. The outward XL reinsurance contracts were subject to London Standard Wording 351, which provided that “each and every loss or accident or occurrence or series thereof arising from one event”.

The tribunal had decided that the losses arising were caused by two separate occurrences arising out of separate events. The High Court upheld this finding on the basis that the tribunal had (i) correctly applied the law; (ii) had regard to all materially relevant matters; and (iii) did not take into account impermissible considerations.
In reaching this conclusion, the tribunal had evaluated the “four unities” test set out in the Dawson’s Field arbitration and adopted by Rix J in Kuwait Airways Corporation v Kuwait Insurance Co:

- The circumstances and purposes of the persons responsible
- Cause
- Timing
- Location.

In relation to each of these:

- The tribunal acknowledged that the hijackings were the result of a coordinated plot paid for by Al Qaeda, but observed that it was clear from the authorities that a conspiracy or plan cannot of itself constitute an occurrence or an event for the purposes of clauses in reinsurance contracts that refer to each and every loss, occurrence or event.

- The tribunal was not satisfied that there was any basis, at least in the context of analysing unity of cause, for concluding that there was any factor amounting to an event of sufficient causative relevance to override the conclusion that two separate hijackings caused separate loss and damage. There were two separate causes because there were two successful hijackings of two separate aircraft.

- The tribunal considered that there were clearly similarities in the timing of the events from the commencement of the flights to contact with the North and South Towers, but these were not such as to lead to the conclusion that there was either one occurrence or two occurrences arising out of one event. So far as timings were concerned, there were two occurrences and two events: infliction of personal injury and death started in the case of each aircraft shortly after they were hijacked and continued until at least the collapse of each of the North and South Towers, a period of 134 minutes in the case of Flight 11, and 72 to 76 minutes in the case of Flight 175.

- The tribunal held that each tower was a separate building, albeit connected by a single mall. They did not stand or fall together. If only one of the hijackings had succeeded, only one tower would have been destroyed. The fact that both towers were destroyed was attributable to the fact that there were two successful hijackings directed at separate buildings forming part of the WTC.

The decision will be welcomed as it confirms the view taken by the majority of the market and removes any uncertainty as to the number of events.

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TRANSPORT: A NEW ZEALAND PERSPECTIVE

From a legal perspective, in 2012 the New Zealand maritime scene has been dominated by the consequences of the grounding of the Rena at Tauranga on 5 October 2011. An environmental oil pollution disaster was threatened but largely averted, but that grounding has proved to be the most costly maritime event in New Zealand’s history.

On a different topic, transport operators and their insurers averted changes in the law that would have seriously impacted upon New Zealand’s domestic legislation governing carriage of goods, though some changes will be made.

Lastly, while the courts have not been busy with transport matters, of international interest, the law was clarified in relation to enforcement of possessory liens by reference to English and Singaporean authorities.

RENA – A YEAR ON

The master and second officer of the Rena were prosecuted under the Maritime Transport Act 1994 (NZ) (Maritime Transport Act) for operating a ship in a manner which caused unnecessary danger or risk, and also under the Resource Management Act 1991 (NZ) (RMA) for the oil pollution. However, the most serious charge was that of perverting the course of justice arising from their alteration of the ship’s documents and computer system to try and make it look as though the accident had not occurred as a result of their poor navigation. In May, upon guilty pleas, they were each sentenced to seven months’ imprisonment, but served half the term and were released in September. The ship owner was also prosecuted under the RMA but its guilty plea was deferred until the anniversary of the grounding, and it was fined NZ$305,000 for its part in the incident.

Meanwhile, the clean-up costs were finally estimated at NZ$47 million. As we reported last year, the limitation of liability under the Convention of Limitation of Liability for Maritime Claims 1976 (1976 Convention), as enacted in New Zealand, meant that any liability on the part of the carrier was limited to about NZ$12 million. The 1996 International Maritime Organization (IMO) Protocol would have applied a limit of about NZ$28 million, but had not been enacted. Early in the year, the ship owners constituted a limitation fund under the 1976 Convention in London. While falling short of the money spent, to its credit, the Crown negotiated payment by the ship owners of a sum equivalent to the value of the fund in London: NZ$27.6 million with a possibility of over NZ$10 million more if the ship owners gain a resource consent to leave part of the wreck on the reef, rather than remove it.

Meanwhile, on 30 August the Marine Legislation Bill was introduced to Parliament. That is an omnibus Bill dealing with numerous matters, including enacting the higher limits applying under the 1996 IMO Protocol. It will also enable a simple mechanism for applying any future higher limits under the Convention and avoid the need for Parliamentary intervention to do that – which appears sensible, given competing priorities for Parliamentary time.

Of interest, the amendments create a greater limit of liability than that which ordinarily applies under the 1976 Convention. They do that by enacting the International Convention on Civil Liability for Bunker Oil Pollution Damage 2001, but with a twist. Clause 25 in the Bill is to amend the Maritime Transport Act to say that the limits of liability for claims for pollution damage must not be aggregated with other claims that arise on that occasion.

The purported effect of the amendments is to create an additional liability for ship owners for bunker pollution, over and above the limits of liability under the 1976 Convention and the 1996 IMO Protocol.

The Bill does not require a limitation fund to be constituted in New Zealand as a precondition of invoking limitation of liability, which might be seen by some as opportunity missed.

CARRIAGE OF GOODS ACT AMENDMENTS

Early in the year, changes were proposed by the Consumer Law Reform Bill to extend statutory guarantees for consumers to domestic carriers, even though there is already a well-developed and longstanding legal code that applies to domestic carriage in New Zealand.
Following submissions to the Parliamentary Select Committee, the revised Bill no longer tinkers with the Carriage of Goods Act 1979 (NZ), with the Committee recognising that this would have unintended consequences. The limit of liability to NZ$1,500 per unit of goods also remains unaltered.

Instead consumers will have a new right of redress against the supplier of goods that are to be delivered, rather than a right of recovery against the carrier.

**BABCOCK FITZROY LTD V THE SHIP “THE M/V SOUTHERN PASIFIKA” [2012] NZHC 1007**

The Global Financial Crisis has highlighted the importance to creditors of establishing their right to priority over others in line to be paid. Ship repairers can retain possession of a ship as security for unpaid repairs, but a recent case in the High Court at Auckland highlights the importance of adopting the correct process to secure payment in priority to other secured creditors. In this case sense prevailed to enable the repairer to recover on arrest and sale of the ship, in priority to the bank, but old English case law had to be distinguished to achieve that.

The established position in admiralty law is that the holder of a possessory lien over a vessel will not lose its right to have unpaid repair costs reimbursed if a third party (such as a mortgagor) commences litigation against a vessel (The “Tergeste” [1903] P 26 (CA)). However, in order to retain priority, the lien holder must be in possession of the vessel at the relevant time. On arrest, the admiralty registrar only assumes custody of the arrested ship, while the possessory lien holder continues to maintain possession and the claim is then paid out by way of a notional lien against the ship’s sale proceeds.

In this case, Babcock had undertaken repairs to the ship, had maintained possession and so had a possessory lien, but then had the vessel arrested. The question was whether by the process of arrest Babcock had surrendered possession of the ship and so its possessory lien.

Priestley J considered the Singaporean authorities cited by Babcock to be compelling. One of these cases was The “Dwima 1” [1996] SGHC 83, a dispute between a ship repairer (the possessory lien holder) and a mortgagee. The court noted that although the plaintiffs parted with possession of the ship for the purpose of the sale, the parting of possession was without prejudice to their possessory lien, and it indicated that the plaintiffs did not intend to abandon their possessory lien. Other cases that also supported the right of a repairer to enforce a statutory in rem right against the sale proceeds included The “Opal 3” ex “Kuchino” [1992] 2 SLR 585 and Pan-United Ship Yard Pte Ltd v Chase Manhattan Bank (National Association) [1999] 1 SLR (R) 703. He decided Babcock was entitled to ask the court for an order that its possessory lien be preserved by a notional lien over the sale proceeds of the vessel and as a result would have priority over the sum owing to the mortgagee.

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DLA Piper has an exclusive alliance with DLA Phillips Fox in New Zealand.
In July 2010, the Australian Government introduced new provisions providing relief in relation to unfair contract terms in consumer contracts into the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) (Act No. 44 of 2010 inserting ASIC Act Part 2, Division 2, Sub-Division BA ss12BF to 12BM; similar provisions were also introduced into the *Australian Consumer Law* dealing with contracts that are not relating to financial products or services).

At the time, those provisions were not applied to contracts of insurance. However, the Government continued to work with key stakeholders, including consumer groups and the insurance industry, to consider whether, and if so how, the unfair contracts legislation would be applied to insurance.

On 20 December 2012, the Assistant Treasurer, David Bradbury announced that the Government will legislate to protect consumers from unfair terms in insurance contracts. The proposed unfair contract terms laws for insurance will be introduced into the *Insurance Contracts Act 1984* (Cth) (IC Act). While they will be based on the provisions in the ASIC Act, the new provisions will take account of the unique features of insurance contracts.

But given the substantial protections already found in the IC Act, are the unfair contract terms provisions really necessary to protect consumers from unfair terms? How will the unfair contract terms provisions interrelate to the more directly tailored protections already found in the IC Act? And will the provisions restrict the right of insurers to decide on the scope of cover they are willing to provide and price the policy accordingly?

**THE UNFAIR CONTRACT TERMS PROVISIONS OF THE ASIC ACT**

The provisions apply to standard-form consumer contracts that are either a financial product or a contract for the supply, or possible supply, of financial services. A consumer contract is a contract where a supply is made to an individual for personal, domestic or household use or consumption (see s12BF (3) of the ASIC Act). A term in such a contract that is unfair is rendered void by the ASIC Act.

A term will be unfair if:

- It would cause a significant imbalance in the parties’ rights and obligations arising under the contract
- It is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term
- It would cause detriment (whether financial or otherwise) to a party if it were to be applied and relied on.

In determining whether a term is unfair, a court must take into account:

- The extent to which the term is transparent (in the sense that it is presented clearly, legibly, in plain language and readily available to the consumer)
- The contract as a whole.

The onus of proving that the term is reasonably necessary to protect the legitimate interests of the party advantaged by the term falls on that party.

The ASIC Act provides a “grey list” of the types of terms that may be unfair. That list highlights that the concept of reciprocity of rights and obligations is central to the concept of fairness. As such, the “grey list” includes a range of terms that give significant rights to one party (but not the other) in relation to termination, penalties, variation (including any right to vary the price) or limitations to that party’s performance. The grey list also targets provisions that impose limitations upon a party’s rights to sue or which affect the evidentiary burden.

The unfair contract terms provisions of the ASIC Act do not apply to terms that:

- Define the main subject matter of the contract
- Set the upfront price payable
- Are required or expressly permitted by Commonwealth, state or territory legislation. Importantly, in the context of this article, the unfair contract terms provisions of the ASIC Act do not apply to contracts of insurance.
APPLICATION OF UNFAIR CONTRACT TERMS TO INSURANCE

While the Government has not yet publicly released draft legislation (exposure draft legislation will be released this year), draft legislation has been discussed with key stakeholders on a confidential basis, including consumer advocates and the insurance industry.

The Treasurer’s announcement gives some indication of the form of what is proposed:

1. The provisions will be based upon the ASIC Act provisions but tailored to take account of the unique features of insurance contracts.

One important aspect of the ASIC Act provisions that is likely to be retained is the definitions of “standard form” and “consumer contract”. That is, the provisions will only apply where the insured is an individual who has purchased the policy for personal, domestic or household purposes. The range of policies affected is therefore likely to be similar to (but not necessarily co-extensive with) those policies that are “prescribed contracts” under the IC Act.

It is also likely that the new provisions will maintain the key concepts of “significant imbalance” and “legitimate interest”. The concept of “imbalance” generally involves the weighing of the benefits conferred on the seller or supplier by a term of the contract against the countervailing benefits conferred on the consumer, in each case considering the context of the contract as a whole. The concept of “legitimate interest” would require the insurer to prove that the term was necessary to protect its commercial interest as the issuer of the policy.

2. The provisions will apply to terms governing the scope of and limitations in cover.

The Treasurer’s press release states “the worst nightmare for many people facing a traumatic moment in their lives is finding out they will not have their insurance claims paid because the fine print in a contract unfairly favours the insurance companies” and “consumers deserve to know that insurance companies won’t simply take their premiums and hide behind unfair terms to leave them high and dry when it comes time to pay out a claim”.

This indicates that any “subject matter” exception to the provisions will be either amended or construed narrowly such that the “subject matter of the contract” will not be “cover”. There may be some aspects of cover, however, that are so central to the policy that they are regarded as forming part of the “subject matter of the policy” (which is excluded from the reach of the unfair contract terms provisions in the ASIC Act). Depending on the drafting adopted in relation to insurance, this distinction may raise similar issues for the definition of “standard form” under the IC Act.

It is not clear how the concepts of “significant imbalance” or “legitimate interest” would apply to coverage terms where the product has been priced by the insurer based on the scope of risk that the insurer is prepared to accept.

3. If a term is found to be unfair, the principal remedy will be that “the insurer cannot rely on that term”. However, the court may also order “other remedies”.

This is to be distinguished from the principal remedy under the ASIC Act by which an unfair term is “void”. The distinction is an important one. If a grant of cover in a policy of insurance was drafted in such a way that it was “unfair”, the result that the term was “void” would not benefit the insured. It remains to be seen what “other remedies” it is proposed a court could order. Perhaps a court may have some power to vary or rewrite a term to excise that part of the term that is considered “unfair”.

4. ASIC will have a range of enforcement powers to administer these new laws.

This statement suggests that a finding that a term is “unfair” may have regulatory as well as legal implications. It is also likely that ASIC will have powers to take proceedings to have a term declared unfair.

5. The new regime will provide for an adequate transition period, and will apply to all new and renewed insurance contracts entered into after commencement.

6. At this stage, the amendments will apply to general insurance only. Further consideration will be given to the application of unfair contract terms laws to life insurance contracts in the future.

BUT DOESN’T THE IC ACT ALREADY ADDRESS ANY UNFAIRNESS?

Insurers have questioned whether there was any need for the unfair contracts terms legislation to be applied to insurance contracts. Most, if not all, of the issues that have historically caused an imbalance of rights between insurers and insureds have already been made the subject of more specifically targeted remedies or relief under the existing provisions of the IC Act.

It is difficult to see what work the unfair contract terms provisions have left to do in a number of the areas already governed by the IC Act. For example, the following issues, which might otherwise be thought to be the province of the unfair contract terms provisions, are comprehensively dealt with in the IC Act in a manner that is both fair and certain:

- Circumstances in which an insurer may cancel a policy (section 60 IC Act)
- Notice required to be given by an insurer where it seeks to cancel the policy (section 58 IC Act)
The need for “transparency” in relation to non-standard or unusual terms (sections 35 and 37 IC Act)

Notice to be given by an insurer where it does not intend to offer renewal of the policy (section 58 IC Act)

Conditions which, where breached, provide the insurer with rights that are out of proportion to the prejudice suffered by the insurer (section 54 IC Act).

Notwithstanding that, consideration of the “grey list” provided at section 12BH of the ASIC Act gives some guidance to the types of terms in an insurance policy that might be considered to be unfair and are not currently the subject of specific remedy or relief by the IC Act (though arguably a sufficient remedy is provided by the duty of utmost good faith at ss 13 and 14 of the IC Act). Thus, applying the above tests, a term in an insurance contract may be unfair where:

- The term allows an insurer to determine an issue relevant to coverage “in its absolute discretion”
- The term requires the insured to establish a matter relevant to coverage to a particular standard different to, or possibly greater than, the usual balance of probabilities eg “to the satisfaction of the insurer”
- The term prevents an insured from cancelling the contract at any time or for any reason (but preserves for the insurer the rights of cancellation in the IC Act)
- The term provides for a “minimum premium” or allows the insurer, in the event of cancellation by the insured, to retain premium greater than the pro rata proportion plus a reasonable estimate of the insurer’s processing costs.

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On 10 September 2003, the then Australian Federal Government announced that it would be undertaking a comprehensive review of the *Insurance Contracts Act 1984 (Cth)* (the Act). Its first act was to set up a Review Panel of Alan Cameron and Nancy Milne. The Review Panel published its report in two stages, the final stage of which was delivered to Government in June 2004. DLA Piper (then known as Phillips Fox) followed these developments closely. It was the only law firm to make submissions to every stage of the initial panel review. Since then, we have been involved on behalf of clients in numerous rounds of consultation on various draft versions of the proposed reform legislation, including both public Exposure Drafts and confidential drafts on which the Government sought to consult with key stakeholders, including the Insurance Council of Australia, the National Insurance Brokers Association and consumer groups. Throughout that process, the form of the legislation has varied, with some of the recommendations of the Review Panel being revised in the implementation while others were abandoned altogether.

On Thursday 14 March 2013, the Insurance Contracts Amendment Bill 2013 (the Bill) was introduced by the current Federal Government into the House of Representatives. Finally, it looks like the amendments will make it into law.

Overall, the Bill introduces a number of well-directed amendments to the Act, which should further improve the operation of an Act that has operated well for over 25 years.

As the Parliamentary Secretary to the Treasurer, the Honourable Mr Rippol stated in the Second Reading Speech:

“Although many of the amendments are technical adjustments to the Act rather than significant changes to the framework of the Act, as a package they will operate to streamline and clarify requirements while maintaining appropriate consumer protections”.

The Bill does not introduce any provisions relating to unfair contract terms. Those reforms will be the subject of separate legislation. The Government has announced that Exposure Draft legislation dealing with those proposed amendments will be released soon.

### ULTIMST GOOD FAITH

There are amendments to section 13 of the Act to:

- Make a breach of the duty of utmost good faith a breach of the Act, without carrying a penalty or amounting to an offence
- Extend the duty of utmost good faith to apply as between third party beneficiaries and the insurer, but only after the contract is entered into
- Grant powers to the Australian Securities and Investments Commission (ASIC) to deal with a breach of the duty of utmost good faith in relation to the handling or settlement of claims (as if such failure was a failure to comply with a financial services law).

### BUNDLED CONTRACTS

The Bill changes the treatment of bundled contracts under the Act. The effect of the amendments are that, where a single policy includes cover of the type usually found in exempt contracts and other cover to which the Act would apply, each of the above covers will be “unbundled” – that is, treated as if they were contained in separate contracts of insurance. Accordingly, only that part of the bundled cover which directly falls within the s9(1) exception will be exempted from the Act. All other aspects of cover will continue to be governed by the Act. However, where a workers compensation policy includes cover for both statutory workers compensation liabilities and common law liabilities, such covers will not be unbundled. That is, both aspects of cover will be exempt from the operation of the Act.
ELECTRONIC COMMUNICATIONS

The Bill amends the Act to enable the service of any notice or document required by the Act to be effected electronically in compliance with the provisions of the Electronic Transactions Act 1999 (Cth) (Electronic Transactions Act). The Electronic Transactions Act will be amended to remove the current exemption of the Act. This simple, but long overdue, change will significantly increase the efficiency and reduce the cost of insurers doing business.

ASIC

The amendments grant ASIC express power to intervene in proceedings arising under the Act and extend ASIC’s right to bring representative proceedings to allow such proceedings to be brought on behalf of third-party beneficiaries as well as insureds.

GENERAL DUTY OF DISCLOSURE

The Bill contains amendments to the general duty of disclosure contained in section 21 of the Act such that the subjective/objective test of “reasonable person in the circumstances” shall be applied, having regard to non-exclusive factors, including the nature and extent of the insurance cover to be provided under the relevant contract of insurance, and the class of persons to whom that kind of insurance cover is provided in the ordinary course of the insurer’s business.

DUTY OF DISCLOSURE FOR ELIGIBLE CONTRACTS OF INSURANCE

The amendments will see the introduction of a new disclosure regime to apply at the renewal of an eligible contract of insurance. Under this new regime, the insurer may either ask one or more specific question relevant to the insurer’s underwriting decision, or provide a copy of the insured’s previous disclosures and request the insured to either disclose any changes or inform the insurer that there have been no changes.

If the insurer does either, or some combination of the above, then it is taken to waive the duty of disclosure in relation to any other matter. If the insured correctly answers any specific question asked and/or informs the insurer of any changes to previous answers, then it is taken to have complied with the duty of disclosure. If the insured does not respond to a request to inform the insurer of changes to previous disclosures, it is taken to have informed the insurer that there has been no such change.

THIRD-PARTY BENEFICIARIES

The Bill introduces a number of reforms in relation to third-party beneficiaries, including:

- Extending to third-party beneficiaries the same rights as an insured to give notices under s41 – requiring an insurer to elect whether to extend indemnity to the third-party beneficiary or waive any contractual prohibition on the making of any admission or entering into any settlement or compromise
- Clarifying section 48(2), which deals with the defences available to an insurer for claims by third-party beneficiaries, so as to make it clear that the insurer may raise, as against the third-party beneficiaries, a defence based upon the conduct of the insured (such as non-disclosure or breach of conditions)
- Conferring on third-party beneficiaries the same rights as an insured in relation to subrogation
- Extending s51 rights, by which a person with a claim against an insured can proceed directly against the insurer where the insured is dead or cannot be found, so that such rights also apply for claims against third-party beneficiaries.

SUBROGATION

The Bill repeals the existing provisions of the Act dealing with subrogation and inserts a new regime, by which the person who funded the recovery has a priority over the proceeds of the recovery to the extent of its payments and the costs of the recovery action with the balance will be paid to the non-funding party. Where the proceedings are jointly funded, the parties’ relative entitlements are calculated on a pro rata basis in proportion to the parties’ contribution to the funding of the recovery action. The new provisions are subject to any other agreement to the contrary, either contained in the policy or entered into subsequent to the loss.

CONCLUSION

The amendments contained in the Bill are proposed to commence in a staggered fashion. Some amendments will commence upon Royal Assent. Others will commence six months, 12 months or 30 months later. Some provisions will only apply to contracts entered into after commencement of the amendments. Generally, those provisions which require insurers to change their procedures or documentation are subject to the later commencement dates. The provisions dealing with the duty of disclosure will not commence until a period of 30 months after the Act receives Royal Assent. However, insurers may choose to opt into the new disclosure regime in relation to the renewal of eligible contracts earlier.

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WORKERS COMPENSATION PREMIUMS HOLD STEADY IN WAKE OF REFORMS

Due to changes introduced by the New South Wales (NSW) State Government, the anticipated surge in workers compensation premiums has been avoided. The Workers Compensation Legislation Amendment Act 2012 (Act), which received assent on 27 June 2012, was designed to reduce WorkCover NSW’s deficit, lower insurance premiums for NSW employers and fix some inequities in the system, in particular for seriously injured workers. The amendments drastically change the face of the NSW Workers Compensation Scheme and are likely to significantly impact key players within the scheme, including employers, workers and insurers.

An independent investigation into WorkCover’s ailing financial position revealed a AU$4.1 billion deficit, which was increasing at a reported AU$9 million a day. NSW employers’ premiums were 20% to 60% higher than competitive states (including Queensland and Victoria). As a result of the reforms, the expected 28% rise in premiums will not be implemented.

How have the savings been achieved?
The key reforms include:

- Schedule 9 of the Act permits the entry of “new insurers” into the NSW Workers Compensation Scheme. While not expressly stated, these “new insurers” could include specialised insurers to underwrite specific industry classes, who will take all of the risk in an industry (eg Coal Mines Insurance).

- Based on the Victorian model, the Act aims to reduce significantly entitlements to weekly payments so that all but “seriously injured workers” have a closed period of entitlements to either two years or five years.

- The Act seeks to increase benefits for “seriously injured workers” who are totally unfit for work, up to the Commonwealth retirement age.

- Based on the South Australian model, the Act intends to restrict journey claims to very limited circumstances where there is a real and substantial connection between the employment and the accident or incident.

- The Act will limit payment of medical expenses to 12 months after the date of claim for an injury, or 12 months after the cessation of weekly payments (previously afforded a lifetime entitlement).

- The Act has also introduced a new process to assess a worker’s capacity (thereby entitlements to weekly benefits) by way of Work Capacity Assessments.

Other important changes include:

- Restricting a worker’s ability to dispute an insurer’s decision to reduce weekly payments

- Abandoning a worker’s entitlement to compensation for pain and suffering

- Restricting entitlements to lump sum compensation to one claim only, thus abandoning deterioration claims

- Abandoning common law claims in negligence for nervous shock to non-workers

- Reducing a worker’s right to claim for heart attack and stroke injuries, unless work significantly increased the risk of injury

- Relaxing the criteria to commute a claim.

It is important to recognise that the Act will not apply to police officers, paramedics and firefighters.
KEY IMPACT ON EMPLOYERS/INSURERS

One would expect that, with the implementation of the reductions in entitlements, workers compensation premiums will remain static with only marginal increases. Employers will still need to comply with the various requirements relating to procedural matters – reports of injury, notices of claim and the like.

The new laws, while controversial and unpopular amongst some groups, have gone a long way to align NSW with competitive states, including South Australia, Queensland and Victoria, and help to provide a scheme that is affordable, efficient and financially sustainable.

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SECTION 151Z RECOVERY EXPANSION AND UNCERTAINTY

Section 151Z (1)(d) of the Workers Compensation Act 1987 (NSW) (WCA) provides an employer with a right to indemnity from a third party. The indemnity allows the employer or its insurer to recover compensation payments from a person liable to pay damages for the same injury for which compensation was paid. The last decade has seen an increase in the importance of recovery claims as employers have become increasingly aware of the entitlement to recovery and the potential effect of successful recovery on their workers compensation insurance premiums.

Two 2012 decisions of the New South Wales (NSW) Court of Appeal, United Airlines Inc v Sercel Australia Pty Ltd [2012] NSWCA 24 (United Airlines) and Izzard v Dunbier Marine Products Pty Limited [2012] NSWCA 132 (Dunbier Marine), are of significance to recovery claims. The first has expanded the potential of employers and workers compensation insurers to claim recovery from airlines for injury to workers during flight. The second has introduced potential uncertainty into the assessment of the amount of the recovery sought under the indemnity.

RECOVERY CLAIMS SET TO TAKE OFF

In United Airlines, the NSW Court of Appeal considered whether the two-year time bar imposed by the Warsaw Convention (Convention) on claims for damages arising from international carriage by aircraft applied to a claim for recovery by an employer.

In 2005, an employee of Sercel, Mr Aurora, was a passenger on a United Airlines flight from Sydney to Houston, Texas. He sustained personal injury when the aircraft braked heavily on landing. Aurora made a claim for workers compensation in New South Wales, which was paid by Sercel. Sercel sought indemnity from United Airlines under Section 151Z (1)(d).

United Airlines argued that Sercel’s claim for indemnity was out of time as it had not been brought within two years, as required by the Convention. The operation of the Convention and subsequent protocols has force of law in Australia through the operation of the Civil Liability (Carriers’ Liability) Act 1959 (Cth) (CL Act).

The trial judge rejected United Airlines’ submissions. United Airlines appealed.

The issues in the Court of Appeal were:

- Whether the action for recovery brought under section 151Z, which is expressly recognised by section 37 of the CL Act, was time-barred by operation of Article 29 of the Convention
- Whether Sercel was prevented from bringing recovery proceedings in NSW as the event on which the recovery claim was based occurred in Texas, there being no cause of action available to Sercel in Texas.

The Court of Appeal concluded that the two-year time bar did not apply to a claim for recovery under section 151Z. In coming to that view, President Allsop, who delivered the lead judgment, found that:

- The time bar imposed by Article 29 of the Convention applied to a right to damages
- The action under section 151Z(1)(d) was an action under a statutory indemnity, not a claim for damages
- The liability of the person to pay damages to a worker (one of the elements of the recovery action) is to be assessed at the time of the act or omission giving rise to the injury, regardless of whether the recovery proceedings were brought within any limitation period applicable to a claim for damages by the worker against that person
- The only limitation period applicable to the claim under section 151Z(1)(d) was the date six years from the date of each payment of compensation. That limitation period arises pursuant to section 14(1)(d) of the Limitation Act 1969 (NSW)
- Section 37 of the CL Act is not affected by the two-year time bar under Article 29, as: “Neither type of liability or right (being the right to indemnity or contribution recognised by section 37) is for damages or for primary liability, though… both are, or are likely to be conditioned on the existence of the liability of the carrier to the passenger for injury of death”.

Addressing the second issue, the court held that it is irrelevant whether the worker was outside NSW when the injury occurred. The approach to choice of law issues taken in Regie Nationale Des Usines Renault SA v Zhang (2002) 210 CLR 491 (that the applicable choice of law to international
torts was the law of the place where the injury occurred) was not applicable, as it concerned the rules for determination of the applicable law for torts. As the action by Sercel was not an action in tort, but a claim for statutory indemnity governed by the law of NSW, that indemnity applied to permit recovery of compensation paid in accordance with the operation of the NSW statute, unaffected by the law of Texas.

The decision is of significance to employers and their insurers as it establishes a potential entitlement to recovery in claims that were previously thought to be statute-barred. It also provides clarification to entitlement to bring recovery proceedings in claims where a NSW employee is injured outside the jurisdiction, in circumstances creating a liability in a third party to pay damages, subject to issues of enforcement of any judgment obtained against that party.

ASSESSMENT OF PERMANENT IMPAIRMENT – BACK TO THE FUTURE

Dunbier Marine Products, which manufactures boat trailers, had a contract with RBI Haulage Pty Limited (RBI) to transport its boat trailers from Melbourne to its Sydney depot by road. RBI’s driver, Mr Izzard, drove a truck loaded with trailers to Sydney. While attempting to unload the trailers, Dunbier’s Sydney depot manager, Mr Buckley, was injured when a steel perimeter frame used to support the trailers during transport fell on him.

Mr Buckley brought proceedings against Mr Izzard and RBI, claiming damages for breach of duty of care owed to him. As part of their defence to the proceedings, Mr Izzard and RBI argued that Mr Buckley’s injuries had been contributed to or caused by the negligence of Dunbier and that any judgment recoverable by Mr Buckley should be reduced in accordance with section 151Z(2)(c) of the WCA. Mr Izzard and RBI also claimed contribution from Dunbier under section 5 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW).

Section 151Z(2) provides for the reduction in the damages awarded to a plaintiff based on the proportion of the responsibility of the plaintiff’s employer. The amount of the reduction is adjusted by the operation of paragraphs (b) to (d) to take account of the reduced liability of the employer under Division 3 of Part 5 of the WCA (work injury damages provisions), which limit the damages that can be awarded to a worker against his or her employer to past and future economic loss and loss of superannuation.

As Mr Buckley had not sued Dunbier, Mr Izzard and RBI argued that their liability to Mr Buckley should be reduced by the liability of Dunbier, as Mr Buckley’s employer, in accordance with section 151Z(2)(c).

The trial judge found Mr Izzard and RBI were liable in negligence to Mr Buckley but that Dunbier, if sued, would have had no liability to pay damages to Mr Buckley. Mr Izzard and RBI appealed.

On appeal, Dunbier argued that it was not liable to pay damages to Mr Buckley, as the threshold requirement of section 151H of the WCA had not been met. Section 151H provides that no damages may be awarded against the employer unless the injury to the worker results in a degree of permanent impairment that is at least 15% (assessed under AMA5 and the WorkCover NSW Guidelines).
An assessment of the degree of permanent impairment is a prerequisite to bring work injury damages proceedings against an employer. As Mr Buckley had not sued his employer, there was no Medical Assessment Certificate (MAC) assessing the degree of permanent impairment obtained in accordance with the provisions of the Workplace Injury Management Act 1998 (NSW) (WIM Act).

The NSW Court of Appeal found:

- As Mr Buckley had not sued his employer, the question of what damages the worker would have been entitled to recover from his or her employer was a hypothetical one, to be answered by reference to the circumstances existing at the time of the accident.
- The approach is analogous to professional negligence proceedings where there is a need to assess what would have been likely to occur at a notional trial of the plaintiff’s proceedings. (A similar approach is adopted in the notional assessment of the worker’s damages in recovery proceedings pursuant to section 151Z(1)(d) of the WCA.)
- In carrying out that task, the court was required to make a finding, on the balance of probabilities, as to whether the worker would have been able to establish that a medical assessment of his injuries would have revealed a degree of permanent impairment of at least 15%.
- Except in a case of catastrophic injury, the court would be required to consider the relevant medical evidence and the operation of the NSW WorkCover Guidelines in making its finding about the degree of permanent impairment.

This approach is a departure from the generally accepted view that the potential liability of an employer in relation to the questions of contribution and the defence under section 151Z(2)(c) of the WCA were governed by the existence of a MAC and the degree of whole person impairment it certified.

**The effect of Dunbier Marine on recovery claims**

The court’s approach to the determination of an employer’s liability has potentially significant implications for the assessment of claims for recovery under section 151Z.

Section 151Z(2)(e) provides for a modified form of recovery where a worker takes or is entitled to take proceedings for damages against his or her employer and does not do so, or does not accept satisfaction of judgment against the employer. In that event, the recovery amount is limited to the excess (if any) of the amount of compensation paid, over and above the amount of contribution that could have been recovered from the employer as a joint tortfeasor or otherwise (remembering that the amount is limited by operation of sub-section 151Z(2)(d) to the work injury damages liability of the employer).

Thus, where the employer has a liability to pay damages to the worker, the amount of the recovery will be reduced or eliminated entirely, due to the operation of the modified recovery under section 151Z(2)(e) where the court finds the degree of whole person impairment exceeds 15%.

The decision in *Dunbier Marine* means that a plaintiff employer in recovery proceedings can no longer rely on the absence of a MAC to argue that the modified recovery does not apply. Further uncertainty arises as the status of an existing MAC might no longer be conclusive evidence of the worker’s degree of permanent impairment. For example, where a MAC assesses a worker as having a degree of whole person impairment less than 15%, the approach dictated by *Dunbier Marine* arguably allows the court to look at all of the medical evidence, in addition to the MAC.

Section 326 of the WIM Act states that an assessment certified in a MAC is “conclusively presumed to be correct as to the following matters in any proceedings before a court… with which the certificate is concerned”. Those matters include the degree of permanent impairment of the worker as the result of an injury and whether the impairment is permanent. However, as *Dunbier Marine* characterised the question of the entitlement of a worker to recover damages from his or her employer, where the worker has not sued the employer as a hypothetical one, there must be some doubt as to whether a MAC is conclusive for the purposes of assessing the modified recovery under section 151Z(2)(e).

What is clear is that the Court of Appeal’s decision has the potential to introduce considerable uncertainty into proceedings for recovery under section 151Z. In all recovery actions where the employer has a potential liability, particular care will need to be taken to assess the likelihood of a finding of liability in the employer and the potential for medical evidence to establish a permanent impairment of 15% or greater. The number of recovery actions where those issues arise is likely to increase as the proportion of recovery cases with liability issues increases following the restrictions imposed on “journey” claims by the 2012 amendments to NSW workers compensation legislation.

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MEDICAL INDEMNITY TRENDS AND DEVELOPMENTS

CLAIM TRENDS

In August 2012, the Australian Institute of Health and Welfare released the latest in a series of reports on medical indemnity claims in the public and private sectors. The report examined claims made, current or finalised, in the 2010-11 period.

Errors in procedure represented the highest proportion of claims (nearly 26%), followed by errors in diagnosis (20%) and errors in treatment (16%). In terms of medical specialties, procedural errors contributed to the bulk of claims against gynaecologists (67%), general surgeons (58%) and orthopaedic surgeons (61%). Diagnostic errors were the most common source of claims against emergency physicians (51%).

The data also revealed a statistically significant increase in large claims. While claims settling for over AU$500,000 accounted for 2% to 3% of settled claims in the previous reporting period, the percentage nearly tripled to 8.7% during 2010-11.
COMMON LAW DEVELOPMENTS

In October 2012, the High Court granted special leave to appeal against the New South Wales Court of Appeal’s decision in Wallace v Kam [2012] NSWCA 82. The decision concerned whether a doctor is liable to a patient who has suffered an injury as a result of an inherent risk of a procedure if the patient would not have consented to undergo that procedure if he or she had been warned of a risk of different injury that never actually eventuated.

Dr Kam had performed a lumbar fusion and pedicle screw fixation on Mr Wallace. Mr Wallace suffered local nerve damage as a result of the surgery, which was an inherent risk of the procedure.

The trial judge found at trial that Dr Kam had negligently failed to warn Mr Wallace of the risk of the local nerve damage (which he suffered) and had also failed to warn him of a 5% risk of paralysis (which he never suffered). However, Mr Wallace could not prove that he would have declined the surgery had he been warned of the risk of local nerve damage. While Mr Wallace would not have agreed to the surgery if he had been warned of the 5% risk of paralysis, the trial judge decided that, because Mr Wallace had not suffered paralysis, Dr Kam’s failure to warn him of the risk of paralysis was not causally relevant to his loss. Mr Wallace’s claim was therefore dismissed.

On appeal, Mr Wallace argued that his injury was caused by Dr Kam’s negligent failure to warn of him of all the material risks associated with the surgery. Mr Wallace contended that if he had been warned of both risks, particularly the risk of a catastrophic outcome of paralysis, he would not have undergone the surgery. The Court of Appeal dismissed the appeal and affirmed the trial judge’s finding that Dr Kam was not liable as a result of failing to warn Mr Wallace of a risk that did not materialise.

A successful High Court appeal has the potential to substantially increase the number of claims that can be made against health care providers. It raises the potential for plaintiffs to “shop” for risks they were not warned of but would nonetheless have been significant in their decision making, even though the risk never eventuated. However, based on the recent trend in the High Court’s decisions involving medical negligence cases, insurers probably need not take steps at this stage to rate their premiums based upon the potential for the appeal being allowed.

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DIRECTORS AND OFFICERS LIABILITY

Last year in this publication we speculated that the agenda for directors and officers and their insurers in 2012 was likely to be dominated by the fallout from the sovereign debt crisis in Europe and the impact that could have on the availability of capital worldwide. At the time of publication, European governments are still working hard to manage this issue and the direct impact on directors and officers (D&O) insurance and director liability and exposure in Australia, beyond a general slowdown in the economy and business confidence, has been limited. There remains healthy capacity to write D&O insurance in Australia and rates remain competitive.

From a claims perspective, the environment remains active but stable.

Looking back, 2012 will be remembered for a number of key decisions on director liabilities, Australia’s biggest class action settlement and further legislative reform. We touch on some of those highlights below.

KEY DECISIONS

James Hardie

In November 2012, the New South Wales Court of Appeal handed down its penalty decision against former non-executive directors, the former company secretary and general counsel of James Hardie Industries (James Hardie) for their breach of duties by approving James Hardie’s release of a misleading statement to the Australian Securities Exchange. That followed the High Court’s decision earlier in 2012 imposing liability on the seven former James Hardie Directors. The Court of Appeal rejected appeals from seven former James Hardie Directors (James Hardie’s former Chief Executive, Peter MacDonald was not part of the appeal) to scrap any penalties and disqualifications that were originally recommended by the judge in the first instance decision. The Court of Appeal ordered:

- An increase to the fine imposed on Peter Shafron (former company secretary and general counsel) from AU$50,000 to AU$75,000 and the retention of his seven-year ban as a company director
- A reduction of disqualification to act as company directors for the US-based directors, namely Martin Koffell and Michael Gillfillan, of about one year and 11 months. These directors were fined AU$20,000 each.

Australian Wheat Board (AWB)

Another case that has given some guidance as to the range of penalties courts will impose on directors was the penalty cases against former directors of AWB.

In December 2007, the Australian Securities and Investment Commission (ASIC) commenced several penalty proceedings in the Supreme Court of Victoria against six former directors and officers of AWB. The proceedings arose from investigations conducted by ASIC following the completion of the inquiry into certain Australian companies in relation to the United Nation’s (UN’s) Oil-For-Food Programme that had been established by the Australian Government.

Earlier this year, the Supreme Court of Victoria ordered that AWB’s former Managing Director, Andrew Lindberg pay a pecuniary penalty of AU$100,000 and be disqualified from managing corporations until 14 September 2014 after finding that he had breached his duties as a director of AWB. In May 2012, Mr Lindberg had admitted to four contraventions of section 180(1) of the Corporations Act 2001 (Cth) (Corporations Act) arising from the AWB’s supply of wheat to Iraq under the UN’s Oil-For-Food Programme and subsequent inquiries conducted by AWB in relation to that supply. The penalties imposed by the court reflected the joint submission made by ASIC and Mr Lindberg as to the appropriate penalty for the admitted contraventions. Justice Robson said that the contraventions did not involve deliberate wrongful acts, dishonesty or moral turpitude but that Mr Lindberg had nonetheless “failed to perform his duties as a reasonable director or officer would in this situation”.

Later in 2012, ASIC’s civil penalty action against AWB’s former Chief Financial Officer, Paul Ingleby also proceeded. Mr Ingleby acknowledged that he had contravened section 180(1) of the Corporations Act. The court heard a joint submission made by ASIC and Mr Ingleby that the appropriate penalty for the admitted contravention ought to be a pecuniary penalty of AU$40,000 and that Mr Ingleby be disqualified from managing corporations for a period of 15 months.
In August 2012, Justice Robson found that Mr Ingleby had contravened section 180(1) of the Corporations Act and ordered that he be disqualified from managing corporations until 31 December 2012 and pay a pecuniary penalty of AU$10,000. ASIC has now appealed that decision.

**Forrest v ASIC; Fortescue Metals Group Limited v ASIC**

Also in 2012, the High Court handed down the long-awaited (and unanimous) decision in Forrest v ASIC; Fortescue Metals Group Limited v ASIC [2012] HCA 39. It found that announcements that Fortescue had signed “binding contracts” with Chinese entities to build and finance an iron ore mine, railway and port in the Pilbara were not misleading or deceptive.

Consequently, it held that Fortescue had not contravened its continuous disclosure obligations, and that its Chairman, Andrew Forrest had not contravened his duties as a director. It ordered that the appeal by Fortescue and Mr Forrest be allowed with costs.

Significantly, in considering whether the announcements were misleading, the High Court determined that it is appropriate to consider how investors would have interpreted the announcement, rather than to ask the lawyer’s question of whether the agreements were enforceable in an Australian court. The High Court indicated that an accurate summary of a contract is sufficient disclosure for the purposes of making an investment decision.

**CLASS ACTIONS**

Class actions have become big business in Australia. The rise in shareholder activism, fuelled by more aggressive superannuation funds, proxy advisers and possibly (as some have suggested) anti-business media, suggest that more investor class actions are to be expected in coming years.

Increasingly, institutional investors are participating in class actions.

This year, the Centro class action settled for what was described as Australia’s largest settlement of a shareholder class action (reportedly AU$200 million). That class action involved two Centro entities, their former officers and auditors. The claims related to statements made by the Centro entities in their 2007 accounts that they had no interest-bearing current liabilities. Some months after those accounts were released, the Centro entities made announcements indicating that they had misclassified in their accounts and that they were having difficulties refinancing AU$7 billion worth of debt that was becoming payable. Following these announcements, the price of Centro securities fell sharply. The action involved allegations that the relevant listed entities had breached their continuous disclosure obligations and engaged in misleading and deceptive conduct. The matter involved six class actions concerning three separate groups of class members. The matter settled 10 weeks into trial.

Another notable settlement was the National Australia Bank class action for AU$115 million. That settlement is still subject to court approval. The class action involved allegations that the bank was too slow to reveal its AU$1.2 billion exposure to complex financial securities backed by US mortgages during the 2007 and 2008 subprime collapse.

There is a pipeline of ongoing class actions, including the bushfire class actions, the ABC Learning class action, the bank fees class actions, class actions in relation to immigration detention claims and a possible class action against the Church of Scientology in Australia for the recovery of unpaid or underpaid wages. There also appear to be plans for a class action relating to the Queensland floods at some stage.

Although the class action industry is growing in Australia, some say its foundations are tenuous. Of the 30 or so shareholder class actions filed in Australia, not one has run all the way to judgment. As a result, no Australian judge has ever ruled on critical elements, such as how damages are calculated. In the absence of any judgment on that issue, class actions are being settled commercially, given the uncertainties and costs, reputational and other risks involved. Some say this works to the advantage of plaintiff lawyers and litigation funders. Otherwise, the market participants watch with interest to see whether any of the upcoming class actions will run to final judgment.

**LEGISLATIVE REFORM**

Two key pieces of legislative reform that impact directors and are part of the Council of Australian Government’s (COAG’s) Schedule of Reforms have progressed this year. They are the harmonisation of occupational health and safety laws, and reforms around personal criminal liability on directors for corporate fault.

COAG has reported that both these reforms are at risk because either not all Australian governments have passed required reforms on schedule, or reforms are not being passed in a uniform manner.

In relation to personal liability on directors for corporate fault, a number of states have now passed laws to give effect to COAG’s agreed reforms to harmonise statutory offence provisions applying to directors and officers.

COAG has agreed a number of principles for director liabilities, which aim to create a system whereby directors and officers are no longer strictly and criminally held liable for offences by a corporation unless they acted as an accessory, for example by aiding and abetting in that particular offence. This is a positive development for directors and their insurers, but any benefits of COAG’s reforms will be diluted by an inconsistent application of the agreed principles across Australia.
LOOKING AHEAD

The perception that the peak of the mining boom has passed and the general global economic uncertainty has negatively impacted business confidence in Australia. This year will no doubt be a challenging year for directors.

Some issues we consider may receive attention in 2013 will include:

■ The ongoing investigation into the directors’ role in the collapse of the non-bank lender Banksia, as well as a review of guidelines applicable to non-bank lenders

■ Boardroom gender equality, in light of comments from Equal Opportunity for Women in the Workplace Agency Director, Helen Conway’s suggestion of the introduction of quotas on boards and in executive positions within four years if voluntary targets do not succeed

■ Executive remuneration. Reforms in 2011 gave shareholders a stronger say over executive pay through the “two strikes” rule. During the annual general meeting season that year, 108 “first strikes” were reportedly recorded against companies. The Government has now released new proposed amendments to the Corporations Act that would require, amongst other things, companies to report whether, in certain circumstances, they have clawed back remuneration and if not, explain why not. These changes, if passed, will be controversial.

■ Cyber risks. Businesses are recognising the importance of adequate infrastructure and risk-management initiatives to protect themselves from cyber risks. There are a number of insurers that have introduced tailor-made insurance products for these liabilities. Shareholders will expect directors and their boards to take these risks seriously and to take steps to ensure companies adequately manage these risks.

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On 15 September 2011, the extent of cover available for defence costs under a directors and officers (D&O) policy was thrown into doubt by the New Zealand High Court in Steigrad & Ors v BFSL2007 Ltd & Ors HC Auckland CIV-2011-404-611. The High Court relied on section 9 of the Law Reform Act 1936 (NZ) in deciding that the former Bridgecorp directors could not rely on their D&O policy to meet the cost of defending civil and criminal claims against them. Several Australian states have similar legislation.

In the High Court, Lang J held that the charge created by section 9 applies to the entire sum insured available for both liability and defence costs cover. Thus, where the potential liability the insured is facing to a claimant exceeds the sum insured, the charge exhausts the sum insured and nothing is left to pay defence costs in the meantime.

Just before Christmas 2012, the New Zealand Court of Appeal overturned this decision due to the unfair effect it has on the insured. It found it to be irrelevant that the payment of the defence costs depletes the funds available to meet a claimant’s claim, should it succeed. This is a necessary consequence of the policy’s structure and is consistent with an insurer wishing to avoid its contingent liability under the policy by incurring defence costs first to avoid the insured’s alleged liability to the claimant.

In the D&O policy before the court, there was a single aggregated sum insured, from which defence costs and third-party liability were to be met. The Court of Appeal was of the view that if these two insurer obligations were in two separate policies then a charge would not apply to the defence costs policy. The fact of combining the two distinct liabilities into one policy and having a single sum insured does not change the principle that section 9 does not apply to the defence costs cover. Section 9 does not operate to provide a charge over insurance money that will not be payable in settlement or discharge of that liability.

The Court of Appeal also held that section 9 cannot interfere with a contractual arrangement between an insurer and the insured as section 9 is merely a procedural mechanism enabling a claimant to directly access funds payable by an insurer under a policy to meet the insured’s liability to the claimant. The section must take effect subject to the terms of the contract, meaning that the charge is subject to the limit of indemnity for legal liability to claimants. The amount of funds available for indemnity must be determined after the insurer’s liability to meet defence costs under the policy is determined. If the insured is deprived of the right to reimbursement of defence costs under the policy, then this cover would be rendered useless in practice.

This reversal of the High Court’s decision will come as a relief to some. We wait with interest to see if the claimants will seek leave to appeal this decision in New Zealand’s highest court, the Supreme Court.

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OFFERS OF COMPROMISE

It is often said that the issue of costs is of primary importance in litigation. However, 2012 saw the issue of costs become one of increasing uncertainty for litigants in New South Wales (NSW). This is in large part due to differing judicial opinions on the application of rule 20.26 of the Uniform Civil Procedure Rules 2005 (NSW). This rule relates to offers of compromise and provides, in general terms, that such offers must be “exclusive of costs”.

In Old v McInnes and Hodgkinson [2011] NSWCA 410 (Old), the NSW Court of Appeal found that the relevant offers were not “exclusive of costs” because they provided that the offeror would also pay the offeree’s costs. In that way, rather than being “exclusive of costs”, the offers included an offer to pay costs. Such a “plus costs” offer was therefore invalid.

The matter was then revisited in Vieira v O’Shea (No.2) [2012] NSWCA 121 (Vieira), where the (differently constituted) NSW Court of Appeal again considered the effect of a “plus costs” offer. This time, the court found that the mere reference to costs was not sufficient to take the offer outside the rules unless the reference operated inconsistently with the rules. Such a “plus costs” offer was therefore valid.

Since that time, numerous judges have aligned themselves with the views expressed in Old. Numerous others have preferred the views in Vieira. The only aspect of certainty – is one of inherent uncertainty. One of the cases that followed Vieira, a decision of Justice Garling in Rail Corporation NSW v Vero Insurance [2012] NSWSC 632, is presently on appeal. The Court of Appeal will therefore have the opportunity to set things straight.

As the Honourable Justice M J Beazley AO (who is of the view that Old represents the law as it presently stands in NSW) says:

“[I]t must be conceded, however, that the proliferation of inconsistent statements on a matter of practice and procedure, but which has such a substantial impact on the parties, is unsatisfactory and should be addressed by the Rules Committee of the Courts”.

We presume that there is almost unanimous agreement that this uncertainty should be resolved, forthwith. We understand that the Uniform Rules Committee is reviewing the matter in conjunction with the NSW Bar Association.
THE JURY IS OUT

Back in 2011, a jury in a Supreme Court of Victoria asbestos proceeding awarded a plaintiff suffering from mesothelioma the sum of AU$730,000 for pain and suffering damages. This verdict created significant shockwaves around Australia, given that most state courts still assess pain and suffering damages in similar cases at under AU$300,000 (and significantly under AU$300,000 in some states).

This verdict was appealed, and on 22 December 2011 in Amaca Pty Ltd v King [2011] VSCA 447 (King), the Court of Appeal of the Supreme Court of Victoria upheld the damages verdict. The Court of Appeal was not persuaded, despite acknowledging the significant gap between this damages award and pain and suffering damages awards in other states, that the sum of AU$730,000 for pain and suffering was beyond what a reasonable jury properly instructed and with all due attention to the evidence could award.

The King verdict again raises the question as to whether juries are the most appropriate mode of trial in a modern society looking both for consistency from its courts and access to cost-effective litigation. This is a question no less pertinent now than when posed following the High Court decision of Swain v Waverley Municipal Council [2005] HCA 4, also known as the Bondi bodysurfing case.

In some states and territories, trial by jury has been abolished, whilst in other states and territories the right to trial by jury is heavily restricted. On the other hand, in Victoria an injured plaintiff has an unfettered right to trial by jury, unless there are compelling grounds to order otherwise. Traditionally, the complexity of the litigation needs to be such that a judge is satisfied that either a jury would not cope with the forensic issues that lie at the heart of the litigation, or that the mechanics of the trial would become too unwieldy.

In one notable instance (the 2004 Supreme Court of Victoria case of Ballerini v Berrigan Shire Council & Anor), the trial judge ordered trial by judge alone on application by the plaintiff, despite the plaintiff having previously requested trial by judge and jury, and the defendants seeking to retain the jury.

The King verdict prompts the following question: why should damages awards for the same injury or loss be potentially greater in Victoria than elsewhere simply because of access to juries? In 2001, the High Court effectively abolished forum shopping in John Pfeiffer Pty Ltd v Rogerson, confirming that plaintiffs’ claims are governed by the law of the state in which the injury or loss occurred. A resident of Albury will always have his/her claim assessed in accordance with New South Wales law, but what Albury resident would choose to issue proceedings in Sydney that might be heard by a parsimonious judge, when they can potentially issue in Melbourne and take a chance on a generous jury hearing the case?

To that end, there are obvious sympathy factors that steer plaintiffs towards jury trials. However, in an era of heavily policed case management by the courts with strict enforcement of litigation timetables and mandatory mediation, and given the excessive cost of litigating any dispute at all (much less a dispute that proceeds to verdict), one has to ask whether the jury has a valuable or viable role to play going forward.

In relation to legal costs, it is inevitable that a jury trial will take substantially longer than a trial by judge alone, thereby increasing litigation costs. At the outset, time is lost in empanelling a jury. There are generally more delays during a jury trial to allow the jury to have breaks. Evidence can be slower with a jury, and legal concepts and even courtroom protocol may need to be explained to them. Any objections taken during the running of the trial generally require the removal of the jury, with subsequent rulings given in the jury’s absence. Often, a judge who is required to rule on a point of law mid-trial may send a jury home for the day while the judge considers his or her ruling, thereby resulting in the loss of valuable court time in which further evidence can be heard. At the conclusion of a trial, a judge’s “charge” (or summary of the evidence) to a jury can take several days.

After all of this, the litigants do not even receive written reasons explaining the verdict. Instead, they have to go away and work out why the jury may have found as they did, and then (if still dissatisfied) consider whether the verdict was reasonable on the evidence and worth appealing.

In both simple and complex matters, this can be particularly frustrating for the unsuccessful litigant. The prospects of successfully appealing a jury verdict are far lower (to the point of almost impossible) and there are countless appellate decisions confirming that fact. With courts seeking to attract the best lawyers to sit as judges, why are we still insisting that the years of legal training and expertise that these judges hold are wasted by having them merely steer or assist a jury to decide the dispute? Proponents of juries would no doubt argue that juries (and not judges) are more attuned to society’s thinking and will reflect the community’s views when delivering verdicts. Even so, why let slip the opportunity of having expert judges publish legally informed reasons for their decision?

Recent verdicts like the King verdict only seek to provide further scope for questioning the role of the jury in modern civil litigation. Perhaps it is time for all states and territories to give serious thought to placing the responsibility for the dispensing of justice into the hands of their highly qualified and highly experienced judges and judicial officers.

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CLASS ACTIONS:
SURVEYING THE LANDSCAPE

Class actions have been long established in the litigation landscape of Australia. We are experiencing a steady rise in the number of class actions brought, the complexity of the claims, the amount of media attention given to them and the value in dollar terms. While there has been a notable rise in class actions concerning securities and financial services, there remains a strong focus on medical misadventure (transplants and drugs). We are also seeing claims being brought by those who suffered losses in natural catastrophes such as the Victorian bushfires and the Queensland floods.

The increase has also put the litigation funding industry under the spotlight, though it has emerged relatively unscathed and mostly unregulated.

In this article we examine some of the cases that have recently resolved, class actions currently afoot and those that are in the pipeline.

RECENT SETTLEMENTS AND JUDGMENTS

Class actions are no different to other types of litigation in the sense that far more settle rather than proceed to judgment. However, last year, two landmark decisions were delivered in class actions in relation to complex investment vehicles.

On 21 September 2012, judgment was delivered in favour of Wingecarribee Shire Council and other New South Wales councils that invested in complex investment products that ultimately led to large losses. The councils alleged that the investments should never have been recommended to them by the financial adviser, and the court agreed.

Another group of councils similarly complained that complex investment products should not have been recommended to them. However, they also joined the ratings agency, Standard & Poor’s (S&P), in relation to S&P’s AAA rating of the investment product. Judgment was delivered in favour of Bathurst Regional Council in November 2012. The decision against S&P was a world-first.

Both of these decisions are dealt with in detail on pages 56 and 58.

In July 2012, the distributors of thalidomide in Australia settled with the lead plaintiff, paving the way for further settlements. Thalidomide, used in the late 1950s and early 1960s to inhibit morning sickness, caused congenital defects, which were often profound.

A class action was commenced in the Supreme Court of Victoria in 2011 against the German manufacturer and the British distributor. The lead plaintiff, Ms Lynette Rowe, who was born without arms and legs caused by thalidomide, settled with the distributor, which also agreed to negotiate with the other members of the representative action. No settlement has been reached with the manufacturer. Ms Rowe therefore remains the lead plaintiff in the litigation, which has been adjourned to allow group members to negotiate with the distributor.

A class action was launched in the Federal Court in 2010 against DePuy and Johnson & Johnson in relation to the alleged failure of knee implants. The class action settled on 29 August 2012.

The deadly 2009 Victorian bushfires have so far been the subject of three class actions. The fires were widespread and the cause of the destruction varied from place to place. The Beechworth and Mudgegonga fire class action involved a claim against SPI Electricity and others, alleging that fire started when a tree fell across a powerline. That class action settled in May 2012 for AU$32.5 million.

Agrieved shareholders in agricultural company Nufarm Limited commenced a class action in relation to, amongst other things, alleged misleading and deceptive profit forecast. The class action settlement was approved by the Federal Court on 28 November 2012 for AU$46.6 million.

The near collapse of the Centro group following the Global Financial Crisis has been the subject of a lot of legal activity. In 2011, the Australian Securities and Investments Commission successfully prosecuted the Centro directors for their role in approving the company’s 2007 financial accounts. Given the bona fides of that board, the prosecution has been widely questioned. When Centro share prices plummeted, shareholders commenced a class action in 2008. That action settled for AU$200 million on 19 June 2012.

Another shareholder action, against Sigma Pharmaceuticals, was settled on 19 December 2012 for AU$57.5 million. Shareholders in Sigma alleged misleading and deceptive conduct relating to a profit guidance issued to investors prior to a 2009 capital raising.

The global experience of class actions against Merck Sharp & Dohme (Merck) in connection with the arthritis drug Vioxx has varied widely. The company withdrew the big-selling drug
from the market in 2004 after a study showed it increased the risk of heart attacks and strokes. What followed was a mountain of litigation.

In the US, 16 cases have gone to trial, with Merck winning 11 of those cases. In response to the unpredictable court decisions and the risk of huge jury awards, Merck set up a US$950 million settlement fund. It also pleaded guilty to a criminal misdemeanor charge to resolve US Government allegations that the company illegally promoted its former painkiller Vioxx and deceived the Government about the drug’s safety.

In Australia, the class action against Merck was ultimately unsuccessful, leaving legal firm Slater & Gordon with a large loss on its books, thanks to approximately AU$10 million in unpaid fees. Last year its full-year profit fell by 11% because of its loss in the Vioxx class action.

In that action, the lead applicant, Mr Peterson was successful at first instance. He suffered a heart attack while taking Vioxx and brought proceedings against Merck, alleging that his consumption of Vioxx contributed to his heart attack. On appeal the Full Court found that it was not proven that but for the taking of Vioxx, Mr Peterson would have suffered a heart attack. The Full Court concluded that Vioxx was amongst a mix of factors that may have caused the heart attack, but it had not been shown that Vioxx was a necessary condition for the heart attack occurring.

Interestingly, the court found that Vioxx did have a defect within the meaning of s 75AC Trade Practices Act 1975 (Cth) – a defect that affected some people, not all. It was found that Vioxx increased the risk of myocardial infarction and that the product information contained no advice or warning about this effect. Nevertheless, the state of scientific or technical knowledge at the time when the goods were supplied by Merck was not such as to enable that defect to be discovered.

As such, even if Mr Peterson could have established causation, Merck would not have been found liable, thereby sealing the fate of the rest of the class.

**CLASS ACTIONS CURRENTLY BEFORE THE COURTS**

A pharmaceutical class action has been commenced in the Federal Court of Australia against Aspen Pharmacare Australia Pty Ltd and Eli Lilly Australia Pty Limited. The proceeding arises out of the alleged side effects of changed and abnormal behaviour, being compulsive gambling, compulsive spending, compulsive eating and hyper-sexuality following the consumption of the drug Permax. The drug is used in the treatment of Parkinson’s Disease, restless legs syndrome and pituitary tumours.

With similar cases successful in the UK and Canada, 200 former Australian users are now suing the manufacturers of Permax and a similar drug, Casabar, alleging that the uncontrollable and compulsive behaviour causes significant financial and emotional damage.

Although these drugs have helped thousands of patients who have suffered none of these strange side effects, studies indicate up to a quarter of users may have been affected by odd compulsions.

Since 2008, the drugs’ product information leaflets have contained mandatory warnings about possible side effects.

Prior to December 2009, Bonsoy soy milk was sold widely in most supermarkets as well as health food shops and cafes. However in that month, Bonsoy’s distributor, Spiral Foods voluntarily withdrew the product from the Australian market when it was discovered that it contained extremely high levels of iodine, which could lead to serious health problems such as hyperthyroidism and hypothyroidism.
A class action of affected persons has been commenced in the Victorian Supreme Court against Spiral Foods and two Japanese companies that manufactured and exported Bonsoy.

In late 2012, a class action was commenced by a group of women against Johnson & Johnson in relation to a product called a transvaginal mesh. The mesh is said to have been widely implanted in women who have suffered organ prolapse, however it is alleged to cause extreme pain, discomfort and injury in some women.

Poor lending decisions are at the heart of the class action against some of the directors and officers of City Pacific Ltd (in liq) (City Pacific). Approximately 10,000 “mum and dad” unitholders in City Pacific lost their investments as a result of loans to property developers and are claiming losses of around AU$60 million. Trilogy Funds Management Limited, now the responsible entity for City Pacific, is bringing the claim on behalf of the unitholders.

**Victorian bushfires**

In the Murrindindi-Marysville bushfire class action, the lead plaintiff alleges that SP AusNet, a power utility company, was negligent in (amongst other things) failing to detect that a power line (which broke and caused the fire) was too close to an earthed stay wire. Claims are also brought against the Victorian Government, the Country Fire Authority and the Department of Sustainability and Environment in relation to the failure to issue timely and appropriate warning about the approaching bushfire.

Likewise, those affected by the Kilmore East-Kinglake fire have commenced proceedings against a power company, SPI Electricity and also government authorities responsible for land clearing and fire warnings.

**WHAT’S IN THE PIPELINE**

**Equine influenza**

A class action is being prepared against the Commonwealth in relation to the equine influenza outbreak in 2007. It will be alleged that the Commonwealth failed to prevent the escape of the equine influenza virus and also failed to control dangerous activities at its Eastern Creek Quarantine Station. The evidence and findings of the Commonwealth’s own Equine Influenza Inquiry will encourage the action.

**Poly Implant Prothese (PIP)**

The French brand of silicone breast implant PIP received massive worldwide publicity when it was found to be highly prone to rupture. The silicon used in the implants was of an inferior grade. An estimated 400,000 women worldwide have had the implants, with many reporting problems. The French Government ordered all women with PIP implants to have them removed (and replaced). However, as we go to print it appears that the contemplated class actions will not proceed.

**South East Queensland floods**

Seqwater, the operator of the Wivenhoe and Somerset Dams in South East Queensland, is the likely target of the proposed class action to be brought on behalf those who suffered loss and damage as a result of the floods. Again, the evidence and findings of the Queensland Floods Commission of Inquiry, which found that the Wivenhoe Dam was mismanaged, will encourage the action.

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THE “UN SOPHIST I C AT ED IN V EST OR”: EXPLOITING IGNORANCE

In September 2012, the Australian Federal Court handed down a landmark decision in a class action involving three representative local councils (the councils) in Wingecarribee Shire Council v Lehman Brothers Australia (in liq) [2012] FCA 1028. This is the first decision anywhere in the world that examines the conduct of an investment adviser regarding the manufacture and marketing of synthesised collateralised debt obligations (SCDOs). It sets an important precedent on the treatment of unsophisticated investors and the duties around disclosure of risks in complicated financial products such as SCDOs. It is also the first time that the courts have classified local councils as “unsophisticated” investors. This may pave the way for similar types of investors to argue that they fall within the same classification.

The court’s observations about the “legislative porridge” created by the current legislative framework contained in the Australian Securities and Investments Commission Act 2001 (Cth), the Corporations Act 2001 (Cth) and the Competition and Consumer Act 2010 (Cth) in relation to “misleading and deceptive conduct” may be addressed by Parliament. We welcome returning to a simple statutory prohibition against “misleading and deceptive conduct”.

BACKGROUND

Prior to 2007, Lehman Brothers Australia (now in liquidation) (Lehman Australia) sold SCDOs to various local councils, charities, church groups and not-for-profits. At the time the SCDOs were sold, they had a high credit rating (at least equivalent to the credit rating of the four major Australian banks) and offered higher interest rates. These SCDOs went sour during the Global Financial Crisis. As a consequence, these investors incurred substantial losses.

A single judge of the Australian Federal Court, Rares J held that Lehman Australia is liable to compensate the investors for losses incurred as a result of investing in SCDOs. The fundamental question at the heart of the proceedings was this: “How was it that relatively unsophisticated council officers came to invest many millions of ratepayers’ funds in these specialised financial instruments?” The court found that the only way the councils could have come to invest in SCDOs was because Lehman Australia had either recommended and advised them, or used its Investment Managed Portfolio (IMP) agreement mandate to purchase them. In doing so, the court said Lehman Australia “preyed on [the council officers’] lack of expertise and the trust the councils placed in its expert advice…”.

The facts and findings set out below are a summary of the views of the judge and are not our views.

The relationship between Lehman Australia and the councils

The councils were typically conservative and risk-averse investors. They had usually invested in products such as bank bills, term deposits and bank-issued Floating Rate Notes (FRNs). Council officers had little financial or investment experience outside those products. The councils were unsophisticated investors. They were concerned to ensure that none of their investments had a substantive risk of loss of the capital invested but earned the best returns available consistent with their conservative investment policies.

Lehman Australia was engaged to act as the councils’ financial adviser. It was entirely conscious of their lack of financial sophistication. Lehman Australia represented to the councils that it understood their investment requirements.

The councils relied on Lehman Australia to make appropriate recommendations for investments that suited them. Council officers were not in a position to make independent investment decisions. Lehman Australia’s persuasion informed or changed the councils’ perception of the material risks associated with the unfamiliar new SCDOs. Lehman Australia encouraged the councils to infer that SCDOs with similar credit ratings had similar risks as other basic financial products.

DECISION: COMPREHENSIVE LOSS

Breach of fiduciary duties

First, Lehman Australia, as the councils’ investment adviser, owed them fiduciary duties, independent of any contractual obligation owed to the councils. Lehman Australia had an obligation (a) not to obtain any unauthorised benefits from its relationships with the councils and (b) not to put itself in a position where its interests or duties conflicted, or where there was a substantial possibility of a conflict arising.
Lehman Australia breached those fiduciary obligations. It made substantial profits in relation to the underwriting, structuring and selling of SCDOs. On average, Lehman Australia was making between AU$1 million to AU$2 million in profits per SCDO. It failed to (a) adequately disclose its own financial incentive to the councils and (b) obtain informed consent on recommended investments. Whilst it disclosed to the councils that it had an “interest” in the transactions, it did not disclose the extent of that interest. Consequently, the councils could not have made a fully informed decision.

Lehman Australia also borrowed from its clients on the security of the SCDOs, on terms far less favourable than what could be achieved by borrowing from commercial financiers. Some of the clients lent money to Lehman Australia on the basis that the SCDOs offered as security had a value of 100% of their face value, ie the SCDOs were as good as cash. The clients were not aware that the SCDOs could depreciate. Lehman Australia had not explained fully the risks of depreciation in the value of SCDOs. Lehman Australia capitalised on the councils’ ignorance of this risk and breached its fiduciary duties.

**Contractual breach**

Second, Lehman Australia breached its agreements with the councils by selling products that did not meet promised contractual specifications. The products sold (a) did not have a high level of security to protect the invested capital; (b) could not be easily traded on a secondary market; (c) were illiquid; and (d) were inappropriate investments for risk-averse clients.

**Misleading and deceptive conduct**

Third, Lehman Australia engaged in misleading and deceptive conduct. Lehman Australia used the SCDOs’ high ratings as a key selling point. False representations were made that the SCDOs (a) had high credit ratings, which made them equivalent to the debts of major Australian banks; (b) were suitable for conservative investment strategies; (c) complied with the statutory and council policy requirements; (d) had the risk profiles equivalent to traditional FRNs; (e) were prudent and capital-protected investments; (f) were readily redeemable for cash; and (g) were tradable on a secondary market.

**Negligence**

Fourth, Lehman Australia was negligent in recommending and advising investments in SCDOs. Lehman Australia owed the councils a duty of care as the councils’ financial adviser. This required it to provide a full and accurate explanation of the products it was marketing, recommending and purchasing. Alternatively, it had an obligation to act with reasonable skill and care in performing its functions under the IMP agreement. Lehman Australia breached its obligations by causing the councils to invest in the SCDOs, which were illiquid and were not able to be sold on a secondary market. This conclusion was based on the councils’ complete reliance on Lehman Australia to provide appropriate investment recommendations.

**No defence**

The court rejected all Lehman Australia’s arguments on absolving it from liability based on disclaimers, proportionate liability, concurrent wrongdoers and concurrent liability.

- None of the disclaimers in the presentations and documents provided to the councils and in the agreements were adequate.
- The court did not attribute any responsibility for the loss to ratings agencies as Lehman Australia’s misuse of those ratings in its sales pitch caused the councils to invest in SCDOs. The ratings agencies had no control over or responsibility for how Lehman Australia used ratings or what Lehman Australia told the councils.
- The attempt to exclude liability by reference to acting in accordance with peer professional opinion was rejected. The court said this had no application to all the conduct complained of. Lehman Australia had also not proved the existence of any professional practice to make the recommendations it made to the councils. Evidence of similar offers by other banks to the councils was insufficient. The existence of such a practice did not displace the specific contractual requirements on how the councils’ money should be invested.

**WHAT NEXT?**

All the members of the class action must be compensated. The calculation of damages may have to be postponed if an appeal is lodged by Lehman Australia. Lehman Australia has yet to announce if it will appeal.
OBSERVATIONS

The key question – is this decision a game changer for investors and advisers, or is it a case confined to its facts?

We think the court’s decision will have an impact, both internationally and locally, given SCDOs have been sold all over the world. The court’s findings will put many investment bankers and other professional advisers on the alert. The judgment sets a high bar for investment advisers.

Where a professional recommends a complex financial product, ordinarily clients are not equipped to properly analyse the basis on which the recommendation is given. It is not essential for a client to critique each recommendation in any detail once a professional has gained the client’s confidence and the client continues to have that confidence in future dealings. Professional advisers should understand this when preparing their sales pitches, recommendations, presentations and documents.

Characterising the councils as “unsophisticated investors” as they lacked sufficient knowledge about the SCDOs’ operation on which to make an informed judgment of risks has wider implications for institutions selling financial services to councils, charities, church groups and not-for-profits. This makes this category of investors more like retail, or “mum and dad”-type investors. It hails potential changes to the level of disclosure and suitability of products for them. Clients need to be specifically informed if the products sold are not suitable for or are well beyond their stated risk appetite. They need to be told if there is a prospect that some part of their capital may not be recovered and that there may potentially be no redress for this loss.

Each circumstance will determine what exactly constitutes adequate disclosure by a fiduciary of its own financial interest. Professional advisers will have to tread with caution when faced with a situation where they have a potential conflict of interest. If they wish to contract out of a common law duty of care, they will have to state that in very clear words and ensure that their clients understand the effect of that disclaimer.

In addition, caution will have to be exercised in promotional material or in material that seeks to summarise complex financial products and associated documentation. The court disregarded the fact that the documents presented to the councils referred them to underlying documents. It said that the recommendations made to the councils were meant to and did induce the councils into relying on them. It was “inappropriate and unhelpful” for Lehman Australia to refer the councils to voluminous documentation. In fact, the councils had no obligation to look any further than what was presented to them. In practical terms, this may mean that professional advisers cannot absolve themselves by providing a synopsis of documentation and then referring their clients to the actual documents for the details. They have the onus of explaining properly those documents and highlighting anything material.

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RATINGS AGENCIES ARE NO LONGER BULLETPROOF

In November 2012, the Australian Federal Court delivered a landmark first instance judgment that holds a credit rating agency liable for the first time (among other things) for the negligent AAA rating of a structured financial product. And in February 2013, the US Government commenced a fraud claim against Standard and Poor’s (S&P) seeking US$5 billion. The US Attorney General says that S&P falsely claimed that its ratings were objective and that this went "to the very heart of the recent financial crisis".

In Bathurst Regional Council v Local Government Financial Services & Ors (No 5) [2012] FCA 1200, the court held that 13 local councils were entitled to be compensated for their estimated AU$30 million losses arising out of their investment in Rembrandt notes, comprising constant proportion debt obligations (CPDOs) arranged by ABN Amro Bank N.V., rated AAA by S&P and marketed and sold to them by the financial advisory business, Local Government Financial Services (LGFS). These defendants were held liable in equal measure on various grounds for misrepresenting, mis-rating and mis-selling the CPDOs.

The decision comes almost six years after the onset of the credit crisis, which coincides with the expiry of the limitation period that typically applies to claims in negligence. As a consequence, it is likely the decision will in the near future result in a spate of copycat claims in Australia and very possibly elsewhere. S&P warned the court in its ultimately unsuccessful trial submissions that holding S&P liable for what it characterised as its opinion rather than advice would result in “a flood of claims by disappointed investors”. Unsurprisingly, S&P said it would appeal, however there has been no sign of an appeal as yet.

Please note that ABN Amro Bank N.V., the defendant in this litigation, is now part of The Royal Bank of Scotland N.V. and is a separate entity to ABN Amro Bank. Neither ABN Amro Bank nor any of its related entities (including its Australian arm, ABN Amro Clearing Sydney SD Pty Limited) was a defendant in this litigation.

BACKGROUND AND DECISION

Insofar as it is relevant for the purpose of this article (which focuses on the rating agency aspects of the decision), S&P was retained by ABN Amro Bank N.V. to rate the CPDOs, which S&P proceeded to do using a financial model provided to S&P by ABN Amro Bank N.V. S&P was found to have used unjustified and unreasonably optimistic assumptions for some of its inputs for the modelling of the CPDOs’ performance, which produced a AAA rating. Had they been eliminated or properly stress-tested, the modelled performance of the CPDOs would have changed from AAA to sub-investment grade (ie below BBB). In those circumstances, the councils would have been prevented by law from investing. There was ample evidence that S&P knew ABN Amro Bank N.V. had engaged it to provide a credit rating for the very purpose of communicating it to potential investors and that S&P’s expert opinion of the creditworthiness of the CPDOs was intended to be relied upon by those investors, particularly those who were restricted to investing in products rated at or above a certain level, such as the claimant councils.

Further, the councils were found, following the earlier decision of the Federal Court in Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq) [2012] FCA 1028, to have been unsophisticated investors who were unable to “protect themselves from the consequences of [S&P’s] reasonable care” because they did not have the “resources or expertise to assess creditworthiness or to second-guess the rating of a structured financial product” (read our report on page 56). It is noteworthy that Jagot J thought the CPDOs were “grotesquely complex”.

As a consequence, Jagot J held (among other things) that S&P:

- Owed a duty of care to potential investors who were vulnerable in the sense that they were unable to assess the creditworthiness of the CPDOs or to second-guess S&P’s AAA rating of the same, which included the councils
- Breached that duty because S&P’s analysis was “fundamentally flawed, unreasonable and irrational in numerous respects” and comprised “failures of such a character that no reasonable ratings agency exercising reasonable care and skill could have committed in the rating of the CPDOs”
- Was liable (together with ABN Amro Bank N.V. and LGFS, for other reasons) to compensate the councils for the loss they had suffered by investing in the CPDOs, which had performed badly and well below the standard expected of a AAA investment, rejecting out of hand that the Global Financial Crisis was the “real, essential or effective cause of the loss”.

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SIgnificance

Jagot J’s judgment, which fills several hundred pages, is significant because of Her Honour’s findings about the obligations of a rating agency to investors with whom they have no contract (they are usually hired and paid by the arranger), and to whom their advice or opinions are not addressed (they typically provide their ratings advice or opinions to the relevant issuer of the financial product concerned). The device used to overcome these difficulties was to impose a duty of care for the reasons referred to above and to characterise the rating as the making of a representation. While this creates a precedent under Australian law, which will no doubt be called in aid by similarly situated claimants in future cases, it swims against the tide of decisions and legal principle in other common law jurisdictions.

In the various European cases that have been brought, and under English law, the disclaimers of liability that usually accompany credit ratings are typically applied and upheld, in the absence of contrary legislation, so as to deprive an investor of the ability to pursue a negligence claim. The underlying logic for this is that an investor cannot claim to have relied upon a credit rating (and thus to be owed a duty of care) where a valid exclusion of liability provision states that they may not do so and recommends they take independent financial advice before investing.

Jagot J considered the disclaimers relied upon by S&P were not effective because she was not satisfied adequate steps had been taken to bring them to the attention of investors. It remains to be seen whether European or English courts would be prepared to adopt a similar position, particularly given the clear and unambiguous terms of most disclaimers and any applicable regulatory requirements for those marketing or selling financial products to bring all material information to the attention of would-be investors, particularly unsophisticated investors such as the claimant councils.

There is also a threshold question that is yet to be answered under English law, but has been addressed in the US, as to whether a credit rating constitutes advice or an opinion. Whereas the former is actionable where the advice is negligent, the argument goes that the latter is not. In a number of US cases, credit rating agencies have successfully established that their ratings are in the nature of an opinion as to the creditworthiness of a transaction, in respect of which they enjoy the right of free speech and First Amendment protection under the US Constitution.

Jagot J rejected this characterisation (ie the dichotomy between advice and opinion) and held that the assignment of a AAA credit rating carried with it a “representation that S&P has a genuine and reasonable basis, formed following the application of its expertise, for reaching the conclusions that it reached…” The US position aside, where constitutional arguments apply, it is questionable whether English law would impose liability for an opinion that can be construed as the making of a representation, without also considering the effectiveness of accompanying disclaimers of liability.

Conclusion

The decision was pored over by the credit rating agencies, their lawyers, myriad regulators and countless aggrieved investors, all of whom are pondering the question whether the decision of the Federal Court will be followed in future claims against rating agencies. Media reports suggest that many such cases are planned in Europe, the UK and the US.

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Courts Nail Down Some Vexing Issues

Insurers face procedural difficulties when, having denied indemnity to an insolvent insured, it is joined to proceedings by a third party. Who defends the insured? In particular, who raises crucial defences such as proportionate liability? Can the insurer be subrogated to the insured’s rights when it has denied indemnity?

In The Owners-Strata Plan 62658 v Mestrez Pty Limited & Ors [2012] NSWSC 1259 (Mestrez), the plaintiff sued numerous defendants in connection with the failure of fire control and drainage systems in an apartment complex. Two of the defendants (insureds) had previously had indemnity denied by their insurer, AXIS. They were also insolvent and did not participate in the proceedings. The plaintiff therefore joined AXIS direct.

This left AXIS in a difficult position. If it lost the indemnity argument, it would have to pick up the liability of the insureds which had not defended themselves, and in particular, not pleaded the other defendants as concurrent wrongdoers. Having denied indemnity, technically AXIS could not be subrogated to the insureds’ rights, the right to subrogate being dependant on the grant of indemnity. AXIS therefore sought leave to amend its own defence to plead proportionate liability. However, as AXIS itself could not be considered a concurrent wrongdoer, it would be a nonsensical pleading.

A different solution needed to be found to protect the insurer – in short, his Honour Justice Lindsay concluded that AXIS was permitted to file defences on behalf of the insureds to protect its prospective right to subrogate.

His Honour arrived at that solution after a careful analysis of some of the key principles relating to joinder of insurers to proceedings in the context of an insurer maintaining its denial of indemnity to its co-defendant insureds. Those key principles included the Anjin line of cases, election and subrogation.

In this article, we primarily focus on the court’s analysis and findings in terms of subrogation.

His Honour accepted that the equitable right of subrogation is prospective and contingent upon the insurer granting indemnity and making a payment to, or on behalf of, the insured. Therefore, AXIS could not subrogate. The answer to AXIS’ dilemma was found in the contractual rights and obligations of the insurer and insured. The insurer’s right to take over conduct of proceedings is not dependent on indemnity being granted. Further, AXIS had an equitable right to protect its prospective entitlement to subrogation. His Honour quoted Barwick CJ’s judgment in State Government Insurance Office (Queensland) v Brisbane Stevedoring Pty Limited (1969) 123 CLR 228:

“... the right of subrogation is no more than a right to enforce and have the benefit of the insured’s rights in relation to the subject matter of the loss which the insurer has paid: it includes, of course, a right to have such rights maintained pending the occurrence of a loss within the policy.”

In other words, when insurers retain lawyers to defend proceedings against their insureds, not only are they exercising rights under the policy to conduct the defence, they are also maintaining, or protecting, their right to subrogate.

In Mestrez, the only realistic way to maintain or protect AXIS’ rights was to permit AXIS to file defences on behalf of the insureds. His Honour held that the insurer should be no worse off, procedurally, by its joinder in the principal proceedings than it would have been if, having denied liability to indemnify the insureds, it had been sued by them on a cross-claim in the ordinary course. The inactive status of the insureds, particularly in their defence of the proceeding, was a deciding factor.

Mestrez confirms that although an equitable right of subrogation exists from the moment that a contract of insurance is entered into, that right cannot be exercised until indemnity has been granted. However, an insurer has the right to protect that right.

In terms of election, contrary to the plaintiffs’ submissions, filing defences in the names of the insureds did not amount to an election by AXIS to abandon its entitlement it might otherwise have to deny indemnity.

Does a builder or developer owe a duty of care to an owners corporation? And is a dwelling which offers a resort lifestyle and holiday accommodation subject to the Home Building Act 1989 (NSW)?

In another case involving an owners corporation, in Owners Corporation Strata Plan 72535 v Brookfield [2012] NSWSC 712 the New South Wales Supreme Court held that a builder or developer of a luxury low-rise apartment complex does not owe a duty of care to the owners corporation. A decisive
factor in the decision was the fact that the owners corporation, as an immediate successor in title, had the benefit of the statutory warranties set out in sections 18B and 18C the *Home Building Act* 1989 (NSW) (HBA). This latter finding was largely related to the court’s assessment of the nature of the dwelling and its use.

The plaintiff in this case was the owners corporation of a strata title development, known as “Star of the Sea”, at Terrigal. The Star of the Sea development was designed and constructed by Brookfield, pursuant to a design and construct contract made with the developer, Hiltan. The owners corporation identified a number of defects in the common property. It issued proceedings against Brookfield and Hiltan, claiming that both Brookfield and Hiltan owed it (and breached) warranties implied by sections 18B and 18C of the HBA, and a common law duty of care.

This case, which arose out of Brookfield and Hiltan filing notices of motion seeking prior determination of questions of law, required the court to answer the following:

- Is the owners corporation entitled to the benefit of the statutory warranties implied under the HBA as against either Brookfield or Hiltan?
- Did either of Hiltan or Brookfield owe the owners corporation a common law duty of care?

The first question involved an analysis of the legislative scheme, and as a matter of fact, whether the Star of the Sea was residential building work within the meaning of the HBA (section 6(f) of the HBA specifically excluded a house or unit designed, constructed or adapted for commercial use as a tourist, holiday or overnight accommodation from the definition of “dwelling”). Justice McDougall considered the nature of the development, which comprised 52 residential lots, many of which are advertised and let for holiday accommodation. One issue was the intended use of the development at the time of the design and construct contract (2003), as opposed to the use it ultimately came to have.

His Honour ultimately held that the language of the statutory warranties suggests that application of the section is to be determined when the contract is made, and whether it is a contract to do residential work. On the basis of the contract, plans and specifications in this case, what was to be constructed was 52 residential apartments, although exhibiting luxurious features more often found in upmarket holiday resorts. The contract between the builder and the developer was one to do residential building work. Therefore, the owners corporation was entitled to benefit from the statutory warranties implied under the HBA.

As to a duty of care, His Honour referred to the leading authorities on duty of care owed by subsequent owners. In *Bryan v Maloney* (1995) 182 CLR 609 (Bryan), the High Court upheld the existence of a duty of care owed by a builder of a dwelling to a subsequent purchaser, on the basis that sufficient proximity existed between the builder and the owner. By contrast, in *Woolcock Street Investments Pty Limited v CDG Pty Limited* (2004) 216 CLR 515 (Woolcock), the High Court held that no such duty was owed to subsequent owners, in circumstances where the premises was a commercial dwelling.

In conclusion, His Honour provided three reasons for finding that a duty was unlikely to exist in this case:

- The owners corporation had the benefit of the statutory warranties. His Honour did not think it was open to a trial judge to hold that some additional common law duty of care should be imposed.
- The concept of proximity expounded in *Bryan* has been discarded as the basis of the imposition of a duty of care (relying on Gleeson CJ, Gummow, Hayne and Heydon JJ in *Woolcock*).
- In *Bryan*, the duty of care depended on the anterior conclusion that Bryan had owed a duty of care to the initial owner. In this case, there was no ground for concluding that Brookfield owed any common law duty of care to Hiltan. They had negotiated, on equal footing, a detailed contract in which each bargained for what it would give as the price for what it would receive. That said, His Honour refrained from making a finding in relation to the owners corporation’s alleged vulnerability (although he thought it was questionable).

Builders and developers, and their insurers, should note that while no duty of care was held to exist in this case, His Honour’s finding was persuaded by the fact the owners corporation had the benefit of the relevant statutory warranties.

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On 29 November 2013, the Western Australia Supreme Court found that the proportionate liability regime does not apply to commercial arbitrations.

Justice Beech determined the question (at least in part) in the case of Curtin University of Technology v Woods Bagot Pty Ltd [2012] WASC 449.

This decision is significant for:

- Contracting parties in determining what method of dispute resolution should be included in contracts, particularly where that party assumes a liability greater than it would ordinarily assume such as a lead design consultant
- Professionals and professional indemnity insurers in that a professional, having agreed to arbitrate a dispute, will be placed in a significantly different position to that which exists where the dispute is before a court or tribunal
- Legislators, as the decision has the potential to undermine the intent of the legislation to limit a defendant’s liability to an amount proportionate to its degree of fault rather than its financial capability to fund an award or judgment.

The decision will also be of interest to the proponents of domestic arbitrations as this will be yet another reason why some contracting parties will seek to avoid arbitration in order to protect their rights under the proportionate liability regimes. Read our more detailed article here.

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HOW WE CAN HELP

The depth of our insurance sector knowledge combined with our strength in the corporate and commercial areas means that we are uniquely positioned to provide the full range of legal services. In Australia, we provide solutions in a broad range of areas.

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We have significant experience in this area and provide the following services to our aviation clients: air transport regulation, industrial relations, and airport and aviation insurance and litigation.

CONTRACT WORKS
We have considerable experience in handling claims involving contract works insurance policies and have advised both insurer and insured clients, head contractors and subcontractors. Such building-related contracts require careful consideration of indemnities and insurance clauses and a proper analysis of the entities indemnified by a contract works policy.

CORPORATE/REGULATORY
Our full range of services includes applications for approval to operate insurance businesses, ongoing licensing and implementation issues including product disclosure statements, transferring portfolios, industry regulation by the Australian Prudential Regulatory Authority and the Australian Securities and Investments Commission, reinsurance issues and distribution of products through intermediaries.

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Our services in this area range from pre-publication review and advice through to acting for plaintiffs and defendants in litigated matters. We provide pre-publication review and advice to most major book publishers in Australia, which includes contempt as well as defamation issues.

DIRECTORS AND OFFICERS (D&O) INSURANCE
Our lawyers have been acting and advising on D&O insurance issues across Australasia since D&O insurance first appeared in Australia in the 1970s. We have drafted a number of D&O policies and advised on the impact to insurers of legislative implications and recent corporate governance legislation.

EMPLOYMENT LAW
We have a strong understanding of the responsibilities and obligations of employment law, including unfair dismissals and discrimination claims. We provide comprehensive legal representation to employers, insurers and self-insurers and are the preferred solicitors for a large number of employers in the government, hospital and private sectors.

GENERAL POLICY WORK
We have extensive experience in advising clients on risk management and risk allocation. This includes the structuring and implementation of appropriate insurance. We often advise and draft policy wordings and other policy documents and consider the most appropriate insurance to meet the client’s risks.

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Our lawyers are experienced in all classes of property-related claims, including industrial special risks. The claims have involved coverage disputes, double insurance, claims quantification issues and recovery actions.

INTERNATIONAL TRADE
We are experienced in all areas of international trade law and are backed by a global network of trade lawyers. We have expertise in areas of customs and quarantine, the sale of goods and trading terms, transport and logistics, security and payment, regulation and international conventions.

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We are recognised internationally for our expertise in all areas of law affecting the marine sector. Our marine industry clients include marine cargo, hull and liability insurers and brokers, vessel operators and owners, carriers and forwarders, terminal and port operators, government agencies involved in the regulation or the purchase of maritime transport services, importers and exporters.
MOTOR
We are regularly retained to advise on interpretation of motor vehicle policies by a range of general insurers in the context of the Insurance Contracts Act 1984 (Cth), which limits the liability of an insurer to rely on exclusion clauses. Such exclusions must be considered very carefully.

PRODUCT LIABILITY
We have extensive experience in the handling of claims under product recall policies and product liability policies. Many of these claims involve difficult issues of loss and damage as well as complex technical matters. We also have particular expertise in the area of the attachment of the loss (“the happening of the occurrence”) and the operation of the various interlocking exclusions to cover customarily found in these policies.

PROFESSIONAL INDEMNITY
We have a team of leading professional indemnity practitioners across a wide range of professions. Our expertise includes claims defence, coverage advice and disputes, and risk management.

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We have a long history of providing advice to our insurance clients in relation to property coverage. This includes advice on physical or material damage and the consequential loss covers that flow from it, such as business or income interruption. We also have established relationships with the specialist firms of adjustors in this area.

REINSURANCE
Our Reinsurance team includes lawyers with strong international reputations in this area. We are experienced in claims defence, coverage advice and disputes, and corporate and regulatory advice. Our team has been involved in a large proportion of Australia’s leading reinsurance disputes and claims for local and international clients. The corporate advisory members of our team provide specialist corporate and regulatory advice to the industry.

NOTE: Please note that legislation in some Australian jurisdictions effectively prohibits practitioners from promoting legal services for personal injury claims.

RISK MANAGEMENT
Our team is recognised internationally for its risk management expertise. One of our distinct strengths in this area lies in our ability to identify potential risks before they manifest into issues, problems or claims. Consistent with our view that avoidance and early detection of potential legal problems is the most effective way of managing legal risk, we develop training and preventative programs for many of our key clients.

OUR INTERNATIONAL INSURANCE TEAM
Our Insurance and Reinsurance team advises a broad range of international insurers and reinsurers on all aspects of transactional, regulatory and litigation matters. Our expertise in regulation and knowledge of the industry gives us a unique perspective on all aspects of risk, which enables us to anticipate problems and assist clients with restructuring, acquisitions and dispute resolution.

Our unrivalled geographical reach enables us to offer a truly international and cross-jurisdictional service to the insurance and reinsurance industry. Our lawyers are located in each of the firm’s major offices in the Americas, Asia Pacific, Europe and the Middle East. We also have strong links with law firms in Africa.

As well as being truly international in our reach, we believe in delivering local expertise in each jurisdiction in which we practice through lawyers with deep experience of the local legal and business environment.
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DLA Piper is a global law firm with 4,200 lawyers located in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East, positioning it to help companies with their legal needs anywhere in the world. In Australia, DLA Piper has more than 450 lawyers located in five offices across the country.

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