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Insurance law update

June 2015

CASE NOTE

Claims against insurers

Claims against insurers under s601AG of the Corporations Act 2001 (Cth) and application of the Proportionate Liability Regime

In the recent Supreme Court of New South Wales decision of *Smart v AAI Ltd; JRK Realty Pty Ltd*[1] , The Hon Justice Robert Beech-Jones ("His Honour") examined the prerequisite elements of a claim under s601AG of the Corporations Act 2001 (Cth) ("the Act"). In doing so, His Honour also discussed the application of the proportionate liability regime under the *Civil Liability Act* 2002 (Cth) and the *Trade Practices Act 1974* (Cth) ("TPA") to the plaintiffs' claims in the proceedings.

BACKGROUND

Between July 2007 and October 2007 the, the plaintiffs, namely Mr Smart and Ms Kanters the sole director of JRK Realty Pty Ltd ("JRK") were persuaded by Mr Lynch, the General Manager of a company named Q1, to transfer a total of $267,000 into Q1's account. Mr Lynch represented that that the monies would then be used either alone or in conjunction with loans from other financiers, to finance short term private client loans at a high rate of interest return.

As it transpired, Mr Lynch never intended to make those funds available to clients and instead misappropriated the funds. Mr Lynch and Q1's Director, Mr Carthy, were the sole shareholders in the company. Q1 was later wound up and deregistered.

Between May 2007 and May 2008, Q1 had held an insurance policy with AAI Ltd ("the policy"), then known as Vero Insurance Ltd ("Vero"). Mr Smart and JRK sought to invoke s601AG of the Corporations Act ("the Act") which would allow them to make a claim directly on the policy so long as:

A. Immediately before its deregistration, Q1 had a liability to them; and

B. That at this time, the policy "covered" that liability.

There was no real dispute that Q1 had a liability to Mr Smart and JRK prior to deregistration. What was in dispute was the nature of that liability and whether the policy covered that liability.

FINDING

Indemnity

In summary, His Honour found as follows:

1. The plaintiffs had not made a claim against Q1 during the period of insurance and so the policy did not respond.

   Relevantly, the insuring clause provided that the insurer would indemnify the insured "against civil liability for compensation [our emphasis]…*in respect of any Claim or Claims first made against the Insured and notified to the Insurer during the Period of Insurance resulting from the conduct of the Professional Services…"*

[1] [2015] NSWSC 392

"Claim" was defined relevantly as meaning "any demand by a third party upon the insured for compensation, [our emphasis] *however conveyed…"*

Whilst the plaintiffs had, during the policy period, demanded the return of the funds advanced by them either in accordance with the contractual arrangements entered into with Q1, or any alleged debt, the plaintiffs had not alleged any breach of duty or obligation giving rise to compensation. As there was no "Claim" within the meaning of the policy, the claims against Vero failed.

2. Although not necessary given His Honour's finding that the insuring clause was not enlivened, His Honour nevertheless considered that had the insuring clause responded, the liability of Q1 was excluded from cover because:

   a. It arose directly or indirectly from a liability that Q1 assumed 'outside the normal course of the Professional Services'.

      "Professional Services" was defined in the policy schedule as *"Mortgage Broker/Finance Broker/ Mortgage Originator/Mortgage Management/ Debt Reduction."* His Honour considered that notwithstanding the transactions Mr Lynch promoted to the plaintiffs were "variations on a typical broking transaction" the deals at least in their initial stages were consistent with the professional business of broking loans. The claims were therefore sufficiently causally connected to Q1's professional business of broking to satisfy the criteria that the claims *result from* the business described in the policy schedule;

      Vero was entitled however to rely on an assumption of liability exclusion in the policy. The exclusion clause provided in effect that Vero would not be liable to indemnify the insured in relation to any liability arising directly or indirectly from or in respect of liability which is assumed by the Insured outside the normal course of the Professional Services.

      Q1 assumed a contractual liability and liability for false and misleading conduct when Mr Lynch accepted funds from the plaintiff, promised to lend them to clients but failed to do so. His Honour accepted the evidence of banker, Mr Dennis Roams, that in accepting funds from the plaintiff's into its account, Q1 assumed a liability outside the normal course of the Professional Services. It was usual practice for lenders to provide finds directly to borrowers not to mortgage or finance brokers. Q1 was the lending entity.

   b. Further, Q1's liability was not covered because of an exclusion clause excluding liability arising directly or indirectly from relevantly dishonest, fraudulent and criminal conduct. There was a write back to this clause in relation to the conduct of Q1's employees. This was not engaged however as Mr Lynch was not on the evidence an employee but rather a "half owner" of the business.

Application of the Proportionate Liability Regime

3. In the shadow of the High Court's decision in Selig & Anor v Wealthsure Pty Ltd [2015] HCA 18 ("Selig's Case"), upon which we have previously commented, it is worth noting that the nature of Q1's liability in this case was also relevant to whether Vero could rely on the proportionate liability provisions of the TPA or the Civil Liability Act 2002 (Cth) to diminish the quantum of any liability to the plaintiffs.

   Vero pleaded that there should be a reduction of any judgement against it on the basis:

   a. Of contributory negligence on the part of Mr Smart and Ms Kanters;

   b. That the plaintiffs' claims were apportionable claims within the meaning of s34 of the *Civil Liability Act 2002* (Cth) and s87CB of the TPA and that Mr Smart and Mr Lynch on the one hand and Ms Kanters and Mr Lynch on the other hand, were concurrent wrongdoers.

His Honour determined that Vero may raise claims in contributory negligence and proportionate liability assuming they are otherwise available to defeat or mitigate the causes of action against Q1. Where s601AG is invoked, the insurer effectively stands in the shoes of the deregistered company and is able to raise against a plaintiff whatever defences would have been open to the company.

Contributory Negligence

The claim for contributory negligence failed as the claims in contract did not amount to a breach of a contractual duty of care that would allow a reduction for contributory negligence.

Section s34 of the Civil Liability Act 2002 (Cth)

Under s34 of the *Civil Liability Act 2002* (Cth) a claim is apportionable, relevantly, if it is *"a claim for economic loss or damage to property in an action for damages (whether in contract, tort or otherwise) arising from a failure to take reasonable care…"*

His Honour determined that the plaintiffs did not have an apportionable claim under s34 of the *Civil Liability Act 2002* (Cth) as the absence of reasonable care was not an element of their contract claim against Q1. The section did not apply to the claim for misleading and deceptive conduct under s52 of the TPA.

Section 87CB of the TPA

Under section 87CB of the TPA a claim will be apportionable:

"(1)… if the claim is a claim for damages under s82 for:

(a) economic loss; or

(b) damage to property;

caused by conduct done in contravention of section 52."

(2) For the purpose of this Part there is a single apportionable claim in proceedings in respect of the same loss and damage even if the claim for loss and damage is based on one or more cause of action (whether or not of the same or a different kind)…"

In this case the claim in contract did not fall within s87CB (1), but the claim for damages for misleading and deceptive conduct under s52 did. The question was whether both claims could be characterised as a single apportionable claim for the purpose of s87CB (2) making both claims apportionable.

His Honour referred to the determination in Selig's Case, which dealt with the equivalent provision in the Corporations Act 2001 (Cth). In that case the High Court held that only claims caused by conduct in contravention of the equivalent provision to s52, namely section 1041H, could be deemed to be a single apportionable claim. Claims under other provisions of the Corporations Act could not be so deemed. Applying this rationale, His Honour determined that the proportionate liability provisions of the TPA did not apply to the plaintiff's claims in contract.

'TAKE HOME' MESSAGES

There a number of 'take home' messages from this case in relation to what insurers and their lawyers should turn their attention to when considering indemnity.

1. Where the enlivening of the insurance clause is dependent upon a demand for or alleged liability to pay compensation, careful regard should be had to the nature of the claim being made. A liability to pay 'compensation' presupposes a breach of a duty or obligation. If the demand or claim is simply a demand or claim for return of monies pursuant to the exercise of an existing right vested in the 'claimant' under contract, this is not in the true sense a demand for compensation which would enliven such an insuring clause.

2. As is common, the insuring clause in this case was worded to cover "Claims…***resulting from*** the conduct of Professional Services". This allowed the Court to interpret the insuring clause broadly to encapsulate claims arising from conduct done ostensibly in the pursuit of the insured Professional Services, notwithstanding that conduct was a 'variation' on typical broking practices and in fact fraudulent.

   This did not however, prevent the insurer from then relying on an assumption of liability exclusion to exclude the indemnity. This was because the liability assumed by Q1 when it accepted the claimants monies to its own account on the basis of Mr Lynch's representations, was outside the normal course broking services.

   That is, while the insuring clause of a policy may be interpreted broadly to include conduct carried out ostensibly in the pursuit of the insured profession or business, any such conduct which caused the insured to assume a liability beyond that normally assumed in the course of the insured profession or business, may be excluded. Careful attention should therefore be paid to the operation of any assumption of liability exclusion.

3. The Court adopted the reasoning in *Selig's Case* to confine the application of the proportionate liability provisions of the TPA. It follows that the same finding is likely to apply in respect of the equivalent provisions contained in the Australian Consumer Law.

NATONAL INSURANCE CONTACTS

Shona Wilde, Sydney
Graeme Armstead, Melbourne
Hubert Wajszel, Melbourne
Peter Harvey, Newcastle
Peter Jones, Adelaide
Peter Forbes-Smith, Hobart
Darren Miller, Perth
Chris Osborne, Darwin

Authors:
Sarah McPherson, Senior Associate
Hubert Wajszel, Partner