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Insurance Law E-alert

The exclusion for Known Circumstances – what is “Known”

CGU Insurance Limited v. Porthouse [2008] HCA 30 (30 July 2008)

This latest High Court authority provides protection for insurers from the subjective opinions of their insureds.

Facts

Counsel was sued. He was negligent in a failure to advise a plaintiff in relation to personal injury proceedings.

Counsel made a claim against his insurer CGU under his professional indemnity policy.

At the time counsel (“the insured”) filled out his proposal to CGU, he said he had no knowledge of any circumstances that would lead to a claim against him.

The facts however were that soon thereafter a Claim was made against him, the foundation for which occurred before he filled out the proposal. This “foundation” included that a stay of judgment in the personal injury proceedings had been granted pending appeal. If the appeal in the personal injury proceedings was successful, this would mean that the insured had been negligent in his advice to the plaintiff.

The High Court’s decision turned upon the words in the following exclusion:-

“What is not covered

We do not cover any of the following Claims (or losses):

6.1 Known Claims and Known Circumstances

- (a) ...
- (b) Claims (or losses) arising from a Known Circumstance, or
- (c) Claims (or losses) directly or indirectly based upon, attributable to, or in consequence of any such Known Circumstance or known Claims (or losses)...

“Known Circumstance” was defined as:-

“11.12...

Any fact, situation or circumstance which:

- (a) an insured knew before this Policy began; or
- (b) *a reasonable person [1] in the Insured’s professional position [2] would have thought [3], before this Policy began, might result in someone making an allegation [4] against an Insured in respect of a liability, that might be covered by this Policy.* [our emphasis and enumeration [*] added].

District Court

In the District Court before her Honour, Judge Balla, the insured was successful against CGU on the basis that her Honour considered his subjective view that he would not have a sustainable claim against him, as sufficient. Her Honour failed to properly consider section 11.12(b) of the policy.

Court of Appeal

The Court by majority, also dismissed the appeal of CGU.

The issue was whether the primary judge erred by considering the subjective state of mind of the insured when construing and applying 11.12(b). Their Honours held:-

Hodgson JA: The question of what a reasonable person in the insured's professional position would have thought before the policy began could be approached by considering what the actual insured did think and asking if this was unreasonable.

Young CJ: it did not matter because it would not have been found that a reasonable person in the insured's professional position would have had the thought in 11.12(b).

Hunt AJA in dissent: The test in 11.12(b) was solely an objective one.

Judgment of the High Court

It was common ground that the insured and CGU were both well aware of the commercial nature and object of the policy of insurance (McCann v. Switzerland Insurance Australia Ltd applied).

It was CGU's submission in construing the exclusion in 11.12(b), that the words in [2] meant the objective 'reasonable person' having the same experience as the insured and with the same knowledge of any facts and circumstances as the insured had, and the same opportunity to react to such facts or circumstances. In other words, an objective test was to be applied.

The insured however, submitted that the words in [3] imported a *subjective* element to the words in [2] and [1]. This subjective element would allow the insured to draw conclusions which were 'plain and obvious' to him personally when considering whether to notify insurers of known circumstances. It was submitted by the insured that if this was not so, section 40(3) of the *Insurance Contracts Act 1984 (Cth)* could create a gap in cover (this is the section concerning notification of claims despite circumstances being known and not reported as long as the insured is continuously covered).

The High Court observed that section 11.12 in the policy was akin to section 21 of the *Insurance Contracts Act*. That section operated firstly by reference to the actual knowledge of the insured and then secondly, by reference to a reasonable person test. Whilst the section in the CGU policy did not replace section 21, it employed the same technique which was a familiar one for identifying a "known circumstance".

The test of disclosure whether in section 21 or, in the CGU wording at 11.12 both operated by reference to an actual knowledge and then the knowledge of a reasonable person in the same circumstances and were designed to protect the insurer against "claims where the insured's disclosure is inadequate because the insured is unreasonable, idiosyncratic or obtuse and the insured is protected from exclusion from cover, provided he or she does not fall below the standard of a reasonable person in the same position".

"The intention of the second limb [11.12(b)] was to prevent insureds from avoiding the exclusion ...by saying that they did not disclose facts and circumstances because they did not [actually] know that they might give rise to an allegation against the insured."

The use of the word "allegations" in [4] meant whether there were, against the insured, allegations in respect of claims whether they could be successful or not. In other words, it was not for the insured to make any conclusions as to his negligence in deciding whether to notify insurers.

As a matter of proof, when insurers in future need to prove whether an insured has not met the objective test, it is not inconceivable that an insurer will have to bring evidence of what the hypothetical reasonable person 'would have thought'.

The objective component in 11.12(b) was an important practical protection for insurers. The High Court held it:-

"protected the insurer from a genuine but unreasonable or unrealistic estimate or understanding of the insured. It introduced a necessary element of objectivity into the final conclusion to be reached."

Whilst it was not wrong in interpreting section 11.12 to include what an insured thought as a piece of possible relevant evidence, the standard of CGU in this wording at 11.12(b) was objective, a question of fact and was to be determined independently of the insured's state of mind.

Conclusions

The High Court has taken an important step in protecting the balance between the rights of the insured and insurer.

In this matter, the wording and definition in the exclusion required that the Court consider the entirety of the section, not just one part of it.

The second limb or 11.12 (b) of the definition of 'Known Circumstances', required instead of a subjective test of what was 'Known' personally to the insured being all that stood in the way of indemnity, that the more balanced and equitable test of the 'reasonable person in the insured's professional position', was to be applied.

In ascertaining whether the insured had complied with the requirements of the policy, proof from other persons in the same profession, of its common practices and attitudes would be acceptable.

In so holding, the High Court has protected insurers from the vagaries of individual insureds and their self belief in their own infallibility. If it were otherwise, (which it very nearly was) it could be very costly.

This decision however, hinged upon the precise wording of the definition. We would suggest all insurers now look to their definitions of "Known Circumstances" in the context of their own exclusion. It may be that some prudent re-wording could provide increased protection.

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