

# Insurance Case Note

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## Utmost good faith – dual insurer’s right of subrogation s45 (1) ICA Requirements

### *Speno Rail Maintenance Australia P/L –v– Metals & Minerals Insurance P/L [2009] WASCA 31*

by Andrew Campbell

#### Background

Speno, a rail grinding contractor, entered into a contract with Hamersley, a miner, manufacturer and transporter of iron ore, to carry out certain work (the “Hamersley-Speno contract”).

The Hamersley-Speno contract provided, inter alia:-

1. That Speno arrange its public liability insurance to include Hamersley’s interest as a principal; and
2. That Speno be solely liable for, and indemnify Hamersley against, common law liability arising from personal injury to Speno’s employees engaged in the contract works.

Speno arranged insurance from Zurich (“the Speno policy”) for cover in the nature of that required by the Hamersley-Speno contract.

Hamersley held a contract of insurance with MMI (“the Hamersley policy”) which, inter alia, indemnified Hamersley against liability to pay damages for personal injury occurring in connection with Hamersley’s business.

Each of the Speno policy and the Hamersley policy were in force on 24 May 1995, when two Speno employees (“Nolan” and “Oatway”) were injured while performing work under the Hamersley-Speno contract. The injuries were caused by the negligence of Hamersley.

Nolan and Oatway instituted separate proceedings in the District Court against

Hamersley, alleging negligence and seeking damages for their injuries. Hamersley admitted negligence and sought indemnity from Speno under the Hamersley-Speno contract. Speno claimed against Zurich under the Speno policy.

#### A. The Nolan and Oatway actions

After trial and an appeal in the Nolan action, it was ordered that:

1. Hamersley pay Nolan the sum of \$1,110,186.35; and
2. Speno and Zurich indemnify Hamersley in respect of that sum.

Zurich also paid \$25,000.00 in damages to Oatway in settlement of his claim.

The total paid by Zurich including interest and legal costs was \$1,259,969.07 (“the indemnified amount”).

#### B. The Supreme Court proceedings

After paying the indemnified amounts, Zurich commenced an action claiming contribution from MMI under the Hamersley policy (“the Zurich contribution action”), pursuant to the general equitable right of contribution between co-insurers of the same risk (*Albion Insurance Ltd –v– Government Insurance Office of NSW [1969]*).

In turn, MMI commenced a recovery action against Speno, on the grounds that MMI was entitled to exercise rights against Speno by subrogation of the rights held by its insured (Hamersley)

against Speno (“the MMI subrogation action”).

MMI also caused a writ of *feri facias*\* in the name of Hamersley to be issued against Speno. Speno applied to strike out that writ (“the Speno strike-out application”).

The three actions were heard together before a trial judge in the Supreme Court of Western Australia:-

1. Zurich was successful in the Zurich contribution action, and MMI was found liable to contribute to the indemnified amounts paid by Zurich.
2. MMI was successful in the MMI subrogation action, and was held to be able to exercise Hamersley’s rights against Speno by subrogation.
3. MMI was successful in the Speno strike-out application and the Writ of *feri facias*\* stood against Speno.

#### C. The appeal

The above three actions are the subject matter of this appeal. Speno appeals against the trial judge’s decision in each instance. MMI cross-appeals against the judgment in the Zurich contribution action.

*\*A judicial writ directing the sheriff to satisfy a judgment from the debtor’s property. Also archaic slang for a sheriff, a play on the “fiery face” of habitual drunkenness. [Grose, F. 1931, A Classical Dictionary of the Vulgar Tongue]*

## Issues of Insurance Law raised

### A. 'Other Insurance' provisions

In the Zurich contribution action, Zurich claimed against MMI for contribution on the basis that Hamersley was double insured:-

1. By Zurich under the Speno policy as required by the Hamersley-Speno contract; and
2. By MMI under the Hamersley policy.

In its defence, MMI relied on the 'Underlying Insurance' clause in their policy to Hamersley, which purported to transform the Hamersley policy to an excess policy in the case of double insurance. This in turn purported to preclude the equitable right of Zurich to claim contribution.

To the extent that it is relevant, the underlying insurance clause provided:

*"In the event of the insured being indemnified under such other insurance effected by or on behalf of the insured (not being an insurance specifically effected as insurance excess of this policy) in respect of a claim for which indemnity is available under this policy, such other insurance hereinafter referred to as underlying insurance, the insurance afforded by this policy shall be excess insurance over the applicable limit of indemnity of the underlying insurance but subject always to the terms and conditions of this policy."*

The trial judge held that the underlying insurance clause had the effect of limiting the cover provided by MMI to Hamersley, where Hamersley was also entitled to indemnity under either:-

1. Another contract of insurance entered into by Hamersley; or
2. Another contract of insurance not entered into by Hamersley, but in respect of which Hamersley was entitled to the benefit of indemnity.

Zurich pleaded, and the trial judge held, that the underlying insurance clause was void by the operation of section 45(1) of the *Insurance Contracts Act 1984 (Cth)*.



Section 45(1) provides as follows:-

*"Where a provision included in a contract of general insurance has the effect of limiting or excluding the liability of the insurer under the contract by reason that the insured has entered into some other contract of insurance, not being a contract required to be effected by or under a law, including a law of a State or Territory, the provision is void."*

To shed light on the intended construction of section 45(1), Beech AJA had reference to ALRC Report No 20 of 1982, wherein recommendations were made that led to the *Insurance Contracts Act 1984*. Section 15AB of the *Interpretation Act 1901 (Cth)* provides for the use of extrinsic material in the interpretation of legislation.

The recommendation of the Commission was, inter alia:-

*"There is no substantial justification for any of the various types of 'other insurance' clause. As they may cause the insured's reasonable expectations to be defeated, all forms of 'other insurance' provisions should be rendered ineffective. If more than one insurance is in effect in respect of the same risk, the insured should be entitled to recover the whole of his loss from any one of the insurers, which should then be entitled to obtain contribution from the others."* [289]

Beech AJA found that the thinking underlying section 45 was that 'other insurance' provisions create significant uncertainty for insureds and may defeat their reasonable expectations of indemnity, without being justified by corresponding benefits to insurers.

Accordingly, an insurer should be permitted to limit liability on grounds of double insurance only where a policy is a genuine excess policy.

To be a genuine excess policy, a policy must:-

1. State that it covers the insured's liability over and above that covered by another policy specifically identified in the excess policy; and
2. Have an appropriately reduced premium.

Furthermore, it was held by Beech AJA that a provision of a policy should be defined by its 'potential effect' on its proper construction. Therefore such a clause is void by the operation of section 45(1) from its inception, and not with reference to its 'actual effect', when the clause is evoked:-

*"If, and only if, the effect of that provision is to limit or exclude the insurer's liability on the grounds that the insured has entered into some other contract of insurance, the provision will be void."* [86]

## B. Severability of 'Other Insurance' provisions

As noted above, the trial judge found, and it is not challenged, that the underlying insurance clause operated in each of two circumstances:-

1. Where Hamersley itself had effected another insurance policy over the same risk; and
2. Where Hamersley was entitled to indemnity for the same risk, under a policy effected by a third party.

At trial, section 45(1) was held to be triggered by the first of these circumstances, but not the second. That finding is not challenged.

Speno and MMI appeal on the grounds that the trial judge erred in declining to sever the underlying insurance provision, so it could continue to operate in the second circumstance. Namely, to limit MMI's liability under the Hamersley policy, to the extent Hamersley was also indemnified under the Speno policy pursuant to the Hamersley-Speno contract.

Beech AJA held, in upholding this grounds of appeal, that the 'other insurance' clause was capable of being severed.

The first grounds for this conclusion was that section 45(1) only operates where the other insurance is a policy 'entered

into' by the insured. This is not read to extend to circumstances where the other insurance is a policy entered into by a third party, to which the insured happens to be a beneficiary. No intention for section 45(1) to exclude the severance of these two circumstances is revealed.

The second grounds in favour of severability of the other insurance clause, is that severance would change the extent only, and not the meaning of the contract. This is the test for severability of a contractual term in *McFarlane –v– Daniell (1938)* and others.

By deleting the words 'by or' in the portion of the underlying insurance clause reproduced above, it can be seen that the clause can easily be severed without affecting the meaning of what remains after severance.

## C. Duty to act in the utmost good faith

It was contested by Speno at trial that Zurich's action for contribution from MMI – if successful – would expose Speno to a claim for indemnity from MMI by subrogation of the rights afforded to their insured (Hamersley) under the Hamersley-Speno contract.

Therefore, it was asserted by Speno that Zurich's claim for contribution from MMI, by indirectly exposing Speno to a claim, was in breach of Section 13 of the *Insurance Contracts Act 1984 (Cth)*.

Namely, the implied provision requiring parties to an insurance contract to act towards one another with the utmost good faith.

The Speno policy provided, inter alia, that Zurich would waive any right of subrogation and therefore not pursue any right Hamersley might possess against Speno. Speno asserts that this constituted a promise by Zurich not to make Speno directly or indirectly accountable for any amount claimed against Hamersley.

Beech AJA rejected that assertion in dismissing this grounds of appeal, as the waiver of subrogation clause did not, in this case, disclose an 'underlying intention' to protect the insured from exposure in all circumstances.

Furthermore, it was upheld generally that the duty of good faith in Section 13 of the *Insurance Contracts Act 1984* does not extend to an obligation on the insurer to sacrifice its own interests in the interest of the insured.

## D. The right of subrogation between co-insureds

In the MMI subrogation action, MMI sought to assert rights against Speno by subrogation of the rights held by Hamersley against Speno. MMI's right to do so was upheld by the trial judge.

Speno appealed on the grounds that the trial judge should have found that subrogation was not available to MMI. In upholding that appeal, Beech AJA considered whether, in the case of double insurance, the contributing co-insurer is entitled to assert the rights of the insured against a third party by subrogation.

A considerable weight of authority is noted to the effect that an insurer may only exercise its right of subrogation to the rights of the insured, when the insurer has paid out the full extent of the liability under its own policy. Beech AJA upheld this principle.

Hereby the right to subrogation is held to be attendant to payment in satisfaction of indemnity, as distinct from payment by way of contribution.



Beech AJA also referred to Lord Hoffman in *Caledonia North Sea Limited –v– Norton (No. 2) Limited [2002]* where two solutions to double insurance are put forward at [92]. Either:-

1. The indemnifying insurer is entitled to be subrogated to the rights of the insured to claim from the other insurer; or
2. The payment by the indemnifying insurer discharges the liabilities of both insurers, creating a right to contribution.

Beech AJA finds these remedies to be in the alternative. Therefore, it was held that no right of subrogation to the rights of an insured is available to a contributing co-insurer in a case of double insurance.

## Comments

### Construction of Section 45(1) *Insurance Contracts Act 1984 (Cth)*

- For an insurer to assert that their policy is a true excess policy, and therefore not caught by Section 45(1), the insurer must be able to:-
  - (a) Demonstrate a **reduction in the premium** relative to the reduction in cover; and
  - (b) Point to the part of the policy which describes the **specific other policy** which provides the underlying cover.
- The words 'entered into' in Section 45(1) are to be read as meaning the insured is the **named insured** under some other policy, and not a mere beneficiary under some other policy.

### Duty of utmost good faith

- The scope of the duty in Section 13 *Insurance Contracts Act 1984 (Cth)* **does not** extend to prevent an insurer, in the course of asserting their own rights, from exposing their insured to recovery proceedings by a third party.

### Co-insurer's right of subrogation

- An insurer **cannot** recover from a third party, by subrogation to the rights of their insured, an amount it has paid in equitable contribution to the indemnifying insurer in a case of double insurance.

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