

Introduction and welcome

Welcome to the insurance Law update session for the 2005 New Zealand insurance law association conference.

My name is Paul Michalik. My co-presenter for this session is Hamish McIntosh

I am a partner in the insurance Law and litigation team at Morrison Kent here in Wellington. I also teach the insurance law course at Victoria University. Hamish is a partner at Russell McVeigh also here in Wellington. Hamish's team is dedicated to insurance Law and dispute resolution work.

This session is devoted to helping us all keep up to date with new developments in the case law relating to insurance that have occurred during the past year. Hamish has kindly volunteered to talk about the Jaggar and Techfarm cases, the law of nondisclosure dealing with questions of litigation privilege and.

I will talk about QBE Insurance Ltd v the Attorney General and about the case McAllister Todd Phillips Bodkins v AMP General insurance Ltd.

Macallister

The McAllister case is a reported decision of the High Court in Christchurch. The plaintiff was a firm of solicitors holding a professional indemnity policy with AMP. In the course of his professional work, Mr Todd acted as trustee of the Walker family trust.

The affairs of trust involved development work on land in various South Island locations. Mr Basil Walker, the settlor and principal beneficiary of the trust was the principally active party in carrying out the development work in the course of a seven unit development in Queenstown. Mr Walker carried out the financial management of the development on behalf of the trust, while Mr Todd acted as solicitor and trustee. Mr Walker failed to provide for GST although GST was payable on the sale of each unit.

Neither Mr Todd nor the legal executive assisting him with the conveyancing recognized the GST liability. All of the funds from each sale went to reduce indebtedness to the BNZ.

The GST liability was subsequently recognized. However the trusts did not have sufficient funds from its other developments to meet the outstanding debt. The IRD made demand on Mr Todd for \$173,000 of unpaid tax, including this GST, with interest and penalties, together with unpaid income tax, PAYE deductions and ACC levies.

Potential claims on the firm and Mr Todd were notified to the insurers the same day. Cover was declined on the basis that the loss was trading loss of a trust of which Mr Todd was a trustee. AMP relied on the exclusion in the policy of loss "arising from a trading loss or trading liability incurred by a business managed by or carried on by the insured."

Settlements were reached with the IRD, with the approval and involvement of a barrister acting for AMP. As trustee, Mr Todd was personally liable to the IRD. He managed to settle the claim for \$72,000. Mr Lindsay Walker, the other trustee, also claimed on the firm for some \$27,000 that he had paid to settle with the IRD.

Mr Todd (the solicitor trustee) and Mr Lindsay Walker (the independent trustee) each claimed against the firm, alleging negligence in the handling of the GST on the sale of the Queenstown units was the cause of their loss - in the amount each had personally had to pay to settle the trust's tax obligations.

AMP accepted cover for the claim by the independent trustee, Lindsay Walker, and defended the proceedings he issued.

But AMP declined the claim from Mr Todd. The insurer argued that there was no claim by a third party for civil liability, as Mr Todd was not a third party and his claim was for an indemnity to make up the shortfall in the trust's trading rather than to meet a liability to a third party, arising out of the conduct of the professional services of the firm.

The High Court found for the solicitors. Essentially, the court decided that Mr Todd as trustee was entitled to sue himself as the Trust's Solicitor for his own negligence and that he had been negligent in not advising that provision for GST had been overlooked.

According to the Court, the claim was not one for the statutory liability to pay the GST itself, but for the foreseeable consequences of the firm's negligence in failing to advise on a conveyancing point. (Perhaps not surprisingly, Mr Todd accepted that he had been negligent and the expert the firm called to give evidence endorsed this.)

By failing to make provision at the early stage when the funds were available the court found that the trust faced the foreseeable consequence that further funds were not available from the assets of the trust when it was later called upon to pay.

For insurance lawyers this case is a reminder that a trust, although not a separate legal entity from the trustees is separable in certain circumstances. In particular, a trustee can sue himself in a different capacity. So far so good, it is a pretty straightforward example of a case where a trustee has done just that. The AMP response that there is no claim by a third party under the circumstances is one that would test the extent to which the trust does have separate legal existence, but it isn't a surprise to see the Court recognize the separateness of the trust to this extent at least.

What is more difficult about the case is the Court's rejection of AMP's point of view as to the real source of the loss.

The trust claimed back GST on all of the expenses of its development. It was then liable to pay GST on the sale of the units. If the development were profitable in itself, this money should have been available to the trust, regardless of when the liability were

recognized. The trust's liability to pay GST arises from the course of its trading not from anything its solicitors did or did not do. The consequence of the solicitor's negligence (if indeed they were negligent) was just a timing difference. The solicitors did not make the trust liable for GST. The trust did that itself by its trading. The liability may not have been recognized until the cash immediately available to pay it had gone to the BNZ. But overall, there was no increase to the trust's liabilities from anything the lawyers did wrong.

(And I'm grateful to Neil Campbell for pointing out that case law establishes that it is a mortgagee's right to collect all the proceeds of a sale, including any money collected for GST. Making it seriously questionable whether the solicitors were in fact negligent at all.)

The better view seems to be that the assets of the trust were just insufficient to meet its liabilities. Because of the way the GST was treated, this was discovered later rather than sooner. But if it had been discovered immediately, it seems probable that, all other things being equal, the trust would simply have been insolvent at an earlier stage.

The law as applied by his honour is an entirely orthodox. The fact that the logical argument that an admittedly negligent solicitor nevertheless did not cause the loss found no favour with the court is also (unfortunately) fairly orthodox. Courts are commonly unwilling to see professionals who have done something wrong point out other factors as the cause of the loss. Ultimately, a logical argument is not always protection.

This judgment is reported and is useful as an example of the exposure a firm of solicitors may have. Ultimately, on the approach taken by the court, the exposure is neither extended nor reduced by the solicitor acting as trustee. Where the solicitor had also acted as solicitor to the trust what was important for the court was the solicitor's actions as solicitor and not his actions or responsibilities as trustee.

QBE Insurance Ltd V. the Attorney General.

QBE insured MAF under a claims-made policy. The cover was for errors and omissions. MAF was given an indemnity for its legal liability for claims made by third parties arising out of any act or error or omission.

Claim was defined as a demand for compensation made by a third party on the insured.

The policies were renewable for 12 month periods from 30 June to 29 June annually. The original form of policy wording covered claims **made against the insured and reported to the insurers within the year** in question. There was a ten-day extension period for reporting where claims came to the attention of the insured within the last ten days of the policy period.

Under this form of policy it is clear that notification is vital. If the claim was not both made and notified in the policy year in question or within the ten-day grace extension it was not covered by the policy in question.

The policy structure was supported by very clear definition of claim. The claim was the demand made by the third party. With such a clear definition of claim it becomes possible for the insured to notify as promptly as required by the policy, and fair to expect that will do so.

MAF was required to give QBE notice in writing “as soon as practicable” of any claim or of receipt of the notice of intention to claim by another party or of its knowledge of circumstances which could give rise to a claim. But it is clear from the policy definition that only the actual claim triggered cover.

The policy structure contains an obvious potential for a gap in cover. If a claim is made in one year but not notified until the next then the insured has a problem.

There is a second potential gap where notice of an intended claim or circumstance is given in one year, but a claim is not made immediately. In this case the insured must give notice to the insurer of the circumstance or notice of the signaled intention to claim. But the insurer is not bound to give cover.

If the renewal date arrives before the claim does, the insurer is free to choose not to renew. Having been given fair warning of the circumstance, the insurer could simply decide that it did not want to stay on risk.

Conversely the insured could seek cover elsewhere, and the notified circumstance would form a material fact that would have to be notified to the new insurer. Commonly new insurers are reluctant to accept cover for pre-existing circumstances. An insured who changes insurers having notified a circumstance less than a claim is likely to find itself without cover under the old policy (as there had been no claim) and unable to get cover under any new one, as the new insurer is very likely to exclude cover for previously known circumstances.

MAF fell into this gap. As from the 1999/2000 insurance year, the policy wording in use changed. MAF stayed with same insurer, but moved to an updated policy wording. Going away from the strict claims made and notified form of policy it had been using.

Under the new wording, MAF was still required to give notice of any circumstance as soon as reasonably practicable. However, any claim now arising from a notified circumstance would be treated as a claim in the policy year in which the circumstance had been notified.

But now, in practical terms, as notice of a circumstance is going to stand in for a claim by a third party in certain circumstances, it is necessary to exclude from later year policies claims that arise from previously notified circumstances.

If this is not done then the claim could be a claim in two different policy years, the first in which the circumstance is notified and the second in which the claim is received. Quite sensibly therefore, the new wording excluded from cover “any claim arising from a circumstance that had been notified in a previous year”.

MAF had been in dispute with Allan Johnston Sawmilling. MAF had prevented AJS from logging certain blocks of native timber under the Customs Export Prohibition Order 1996. AJS had argued that under the South Island Landless Natives Act 1906 the timber in question was fair game for export as the statutory right could not be taken away by later regulation. Justice Wild agreed in a decision delivered on 29 June 1999. By 29 July 1999 MAF had notified QBE of Justice Wild’s decision. MAF included notice of the AJS situation as a potential claim in a questionnaire it completed for the purposes of its 1999/2000 renewal.

MAF noted a contingent liability provision of \$500,000 which explained it had “notified previously” to its broker as a potential claim.

The claim subsequently came from AJS in June 2002. MAF kept QBE informed but QBE declined cover. MAF settled with AJS and claimed \$1,215,028 from QBE. QBE maintained its declinature on the basis that the claim arose from a circumstance notified under a previous policy and was therefore excluded from the current policy. But when it was notified, the then current policy wording did not extend cover to circumstances. So it was not within the earlier year policy either.

The claim simply fell into a gap in cover.

MAF sued QBE to enforce its claim. QBE sought defendant’s summary judgment. In the High Court at Wellington the Associate Judge found that there was an arguable case for indemnity. QBE appealed. The Court of Appeal recognized the gap in cover created by the policy structure and endorsed QBE’s argument that this situation simply fell into this gap.

The case is a striking example of the courts actually acting to apply the strict and plain meaning of the policy before it. In contrast to so many of these update reports given to our conferences, where we have previously seen the courts appear to bend the plain words of policy to give cover to a hapless insured (I recall especially the Ferrari driver in *Rogers v HIH*), here we see the Court of Appeal both articulating the principle that words and phrases used in an insurance contract to be given their ordinary meaning, and applying it.

The court pointed out that the risks of a policy structure that went beyond “claims made” to “claims made and reported” (which the court referred to as a “hybrid policy”

borrowing a Canadian judicial expression) were well-known. Such policy structure's create the potential for gaps in cover. The Court drew the logical conclusion that they are probably cheaper because of this.

The court was unwilling to find that the words used by the parties were insensible in the context and therefore susceptible of reinterperatation otherwise than in accordance with their plain meaning.

The court was also reluctant to reinterpret exclusion 6 (which excluded claims arising from previously notified circumstances) so that it applied only to those previously notified circumstances for which another policy would give cover. The court was unwilling to imply any such term or limitation purely on the basis that the parties must have intended to create a seamless cover continuing from year to year. The policies the parties had chosen simply did not create such a structure. Where the market did offer such polices at the relevant time, the Court was not willing to rewrite the policy before it, and make it a better type by implication.

This is the first significant reexamination of "claims-made" policy structures since the *Sinclair Horder* case. In that case the Court applied section 9 of the Insurance Law Reform Act 1977 to relate late notification of a claim back into the year the claim arose. In this case, however, the notification was too early. So section 9 could not help. Ironically, by behaving as a good insured, and notifying early, MAF denied itself cover.

The case is interesting as an endorsement of the possibility of creating the claims made and reported structure. And as recognition that this will create the potential for gaps in coverage.

The court will not fix a problem that the market has created when the gap in cover comes up to bite an insured. The message is brokers beware! All involved in designing and negotiating the terms of policies must take special care. If policy wordings are to change this can have significant implications. The fact that the parties might expect seamless cover to run on from year to year is not going to be enough to persuade the court to fix things when a broker sets an insured up with a policy structure that has gaps in cover.