

# Insurance Law Update

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### Non-disclosure and misstatement

*North Star Shipping Ltd v Sphere Drake Insurance Plc [2006] 2 All ER (Comm) 65*

The decision of the English Court of Appeal in *North Star Shipping Ltd v Sphere Drake Insurance plc & Ors* [2006] 2 All ER (Comm) 65 is the latest development in a series of cases concerning the obligation of an insured to disclose allegations of dishonesty.

The plaintiffs were the owners of a ship called the North Star, which was insured under a war risks policy with the defendants. The North Star was damaged by an explosion, and the plaintiffs claimed under the policy. The defendants refused to pay, and asserted that (amongst other things) they were entitled to avoid the policy on the grounds of non-disclosure. In particular, they claimed that the plaintiff should have disclosed the fact that at the time of placement: (1) there were pending criminal proceedings in Greece concerning allegations of fraud against the two brothers who owned and managed the plaintiff; (2) there were civil proceedings against the brothers in Panama claiming damages for fraud on a business associate; (3) the valuation of the North Star under the policy of US\$4m exceeded, by a considerable margin, the actual value of approximately US\$1.3m; and (4) the insurance of the entire fleet of vessels operated by the brothers had been cancelled by hull and machinery underwriters for non-payment of the premium.

Waller LJ noted that facts (3) and (4) were "*individually very arguably not material*" and His Honour had "*doubts whether it is legitimate to add them together in order to make them more arguably material*". The appeal therefore principally concerned whether facts (1) and (2) were material. His Lordship observed that the criminal charges in the Greek courts had subsequently been dismissed, and that the position with respect to the civil proceedings was similar. The question raised by the appeal was therefore: "*what is the correct approach to an allegation of dishonesty which at the time of placement the insured would maintain was false, and ultimately after placement of the insurance turns out to be false, or an allegation that the insurers do not seek to establish as true?*"

Waller LJ noted that *“the courts have previously wrestled with this problem”* because *“there is something unjust in the notion that insurers can avoid a policy on the grounds of a suspicion as to the insured’s probity flowing from an allegation which is in fact false”*. His Lordship stated that *“if every false allegation of dishonesty must be disclosed in all types of insurance, that may place some insureds in the position of finding it difficult to obtain cover at all, and will certainly expose them to having the rates of premium increased unfairly”*.

However, Waller LJ accepted that, despite these considerations, whether or not a given fact was material was still a matter of evidence - not a matter of law. In this case, the evidence did establish that facts (1) and (2) were material and therefore should have been disclosed. As a result, the insurer was entitled to avoid the policy.

Longmore LJ delivered a brief concurring judgment, in which he noted that the case *“brings into sharp focus the problems of the present state of the law about non-disclosure”*. His Lordship stated that the Court was compelled to conclude, as a result of the expert evidence, that false allegations of fraud made by third parties were material matters to be disclosed to underwriters at the time of placing. He questioned whether:

*“Is it not time that the law was changed at least to the extent that an insured’s disclosure obligation should be to disclose matters which the insured knows are relevant to the insurer’s decision to accept the risk or which a reasonable assured could be expected to know are relevant to that decision?”*

#### ***Proposed changes to non-disclosure and misstatement laws in New Zealand***

The problems identified by the English Court of Appeal in *North Star* are presently under review in New Zealand. Last month, the Ministry of Economic Development released a discussion paper on insurance as part of its *“Review of Financial Products and Providers”*. Most of the changes proposed in the paper relate to the regulatory regime applying to insurance companies, rather than substantive insurance law. However, the paper also proposes significant changes to an insurer’s remedy of avoiding a policy where the insured has breached his or her duty of disclosure or made a misstatement.

The present position is that an insured has a common law duty to disclose all material facts. A fact is material if a prudent insurer would have taken it into account, either in deciding whether to take the risk at all or in fixing the premium. If an insured fails to disclose a material fact, then the insurer is entitled to avoid the policy. The insurer also has a common law right to avoid a policy for positive misstatement, but section 5 of the Insurance Law Reform Act 1977 provides that a policy can only be avoided on the grounds of a misstatement in a proposal or similar document if the statement was substantially incorrect and material.

The discussion paper outlines a number of problems with the current law of non-disclosure and misstatement, which are based on the concern that the duty of disclosure is not properly understood by policyholders and the *“all or nothing”* remedy of contract avoidance is disproportionately harsh. The proposed solution is to limit the insurer’s right to avoid a policy for non-disclosure or misstatement to

four situations: (a) where the misstatement or non-disclosure is fraudulent; (b) where the misstatement or non-disclosure is contained in an answer to a question expressly put by the insurer, and is substantially incorrect and material; (c) where the insurer seeks to avoid the contract within 10 days of risk first attaching; and (d) where the contract is for reinsurance.

Where an insurer is not entitled to avoid a contract, but a reasonable person ought to have known that the undisclosed or misstated fact would have influenced the judgment of a prudent insurer (i.e. the insured was careless), the insurer would be able to decline to accept the risk prospectively or accept the risk only at a higher premium or on different terms. Where the insured's age has been misstated in relation to a life insurance policy, a specific formula would apply.

The above proposal is based on the recommendations made by the Law Commission in a 1998 report. However, there are two significant changes.

The first is that the Law Commission's proposal covered only non-disclosure, whereas the current proposal covers non-disclosure and misstatement. This would appear to be a sensible development, given that non-disclosure and misstatement are closely related and will often overlap.

The other significant change is that the Law Commission proposed that an insurer would be able to avoid a policy if the failure to disclose a fact was careless, meaning that a reasonable person ought to have known that the undisclosed fact would have influenced the judgment of a prudent insurer. In contrast, under the current proposal, an insurer will still not be able to avoid a policy even if the non-disclosure (or misstatement) was careless. The only relevance of carelessness is that it would entitle the insurer to cancel or alter the policy prospectively - but the insurer would still be obliged to provide cover for any insured events which have already occurred.

There is a strong argument that the proposal goes too far in providing that an insurer cannot avoid a policy for nondisclosure, even where the insured was careless. The duty of disclosure is based on the principle that an insurance contract is a speculative transaction and the insurer depends, in the calculation of the contingency, on circumstances that are within the special knowledge of the insured. As between the parties, why should an insurer, with no other means of knowing the relevant facts, bear the risk of the insured's carelessness? As a practical matter, the removal of an objective standard as a ground for avoiding the policy has the potential to cause significant evidentiary difficulties, as an insurer will have to prove that the insured acted fraudulently (or rely on another exception) in order to avoid a policy.

There is no doubt that, if these changes come into force, they will have a significant impact on the law of non-disclosure and misstatement. For example, if *North Star* had been decided under the proposed framework, the result might well have been different. The case would have largely turned on whether the insurer had asked a specific question regarding allegations of dishonesty (just how specific that question would have needed to be is not clear). If such a question had not been asked, then unless the insured fraudulently withheld the allegations from the insurer, the

plaintiffs would have been entitled to indemnity. The insurer's only remedy, if it could show that a reasonable person should have known that the allegations of dishonesty were material, would have been to avoid or modify the policy prospectively.

Submissions on the discussion paper close on 1 December 2006. A full copy of the paper, together with information on how to make submissions, is available from: [http://www.med.govt.nz/templates/ContentTopicSummary\\_22180.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_22180.aspx).

## **Barristerial Immunity**

### ***Chamberlains v Lai* [2006] NZSC 70**

In *Chamberlains v Lai* [2006] NZSC 70, the Supreme Court abolished the longstanding common law rule that barristers are immune from negligence claims for work done in court and work "*intimately connected*" therewith.

Barristerial immunity had been established in New Zealand law since the decision of the Court of Appeal in *Rees v Sinclair* [1974] 1 NZLR 180. However, in *Arthur J S Hall v Simons* [2002] 1 AC 615, the House of Lords reversed its earlier position (on which *Rees v Sinclair* was based) and held that barristerial immunity was no longer justified. The New Zealand Court of Appeal followed suit in *Chamberlains v Lai* [2005] 3 NZLR 291 and held, following the more recent English case, that barristerial immunity no longer existed. However, since the Court of Appeal's judgment was delivered, the High Court of Australia released its judgment in *D'Orta-Ekenaike v Victoria Legal Aid* (2005) 214 ALR 92, in which the High Court expressed a different view and held that the immunity still existed. Accordingly, in *Chamberlains v Lai*, the Supreme Court was faced with a choice between the conflicting Australian and English approaches.

Elias CJ delivered the leading judgment, which began by observing that access to the courts for vindication of legal right is part of the rule of law and any restriction on this principle required justification "*in some public policy sufficient to outweigh the public policy in vindication of legal right*". The justifications normally offered in support of the immunity are that it: (a) prevents the fear of subsequent litigation from eroding the barrister's duties to the court; (b) avoids relitigation of previous court decisions, thereby securing public confidence in the judicial system; (c) recognises that, given the "*cab rank rule*", barristers cannot "*pick and choose their clients to minimise risk of future incrimination*", and it is desirable that they continue to represent anyone who requires representation; and (d) is an essential part of a wider scheme of immunity which applies to judges, jurors and witnesses.

Elias CJ considered that these justifications were not sufficiently compelling to warrant the immunity given to barristers, and could be protected in other ways. She therefore held that barristerial immunity should be abolished in New Zealand and the other members of the Court (Gault, Keith, Tipping and Thomas JJ) agreed.

The abolition of barristerial immunity raises a number of issues concerning the insurance arrangements of lawyers conducting court work.

The general rule is that judgments overriding settled law have retrospective effect, and the Supreme Court held that this case was no exception. Accordingly, barristers may now be liable to claims for events which occurred in the past, unless those claims accrued so long ago that they are now time barred (generally, six years).

Justice Tipping observed that, if policies held by barristers respond to all of the claims which can now be brought, the detriment from the abolition of the immunity “*would be to the underwriters in not collecting a premium coincident with the expanded risk*”. However, given the decisions of the House of Lords and the Court of Appeal foreshadowing the demise of the immunity, the premiums collected by insurers in the last few years may already reflect the increased risk. For example, the insurer for the Victorian Bar increased its premiums for the 2004/2005 policy year in expectation that barristerial immunity may be abolished by the High Court of Australia.<sup>1</sup>

In a prospective sense, *Chamberlains v Lai* will increase the exposure of barristers and therefore their insurers to civil claims, but the implications of the judgment need to be considered in context. The reality is that civil proceedings against barristers will still face a number of hurdles. As Elias CJ recognised, lawyers are often faced with finely balanced problems and the fact that he or she adopts one of a range of reasonable views does not necessarily mean that he or she has been negligent, even if that view does turn out to be wrong. Even if there has been negligence, a plaintiff will often face substantial difficulties in proving that such negligence caused his or her loss (whatever that loss may be). Further, the Court indicated that many claims against barristers will amount to an improper attempt to relitigate matters which have already been decided, and are likely to be struck out as an abuse of process. This will be almost inevitable where the claim amounts to a collateral challenge to a subsisting criminal conviction; Tipping J even went so far as to hold that “*there should be a total embargo on collateral challenges to subsisting convictions*”.

The fact that *Chamberlains v Lai* may not have opened the floodgates to claims against barristers (and their insurers) is reinforced by a 2005 review conducted in Australia.<sup>2</sup> This review considered the position in the United Kingdom after *Arthur J S Hall* and concluded that, although there was an increase in insurance notifications during the policy year in which *Arthur JS Hall* was decided, the notifications in subsequent years have returned to approximately the same levels as before the decision.<sup>3</sup> The Bar Council of the United Kingdom and the Bar Mutual Indemnity Fund (the insurer for barristers in private practice) have advised that there has been no significant increase in actions against barristers after the *JS Hall* decision.<sup>4</sup> There has been some increase in insurance premiums, but this has been caused by unrelated factors.<sup>5</sup>

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<sup>1</sup> Standing Committee of Attorneys-General, *Advocates’ Immunity from Civil Suit: Options Paper* (August 2005), paragraph 79.

<sup>2</sup> Standing Committee of Attorneys-General, *Advocates’ Immunity from Civil Suit: Options Paper* (August 2005).

<sup>3</sup> *Supra*, paragraph 74.

<sup>4</sup> *Supra*, paragraphs 74-75.

<sup>5</sup> *Supra*, paragraph 77.

## Effect of insurance arrangements on liability of insured

### *Shirley v Wairarapa District Health Board [2006] 3 NZLR 523*

*Shirley v Wairarapa District Health Board [2006] 3 NZLR 523* is another recent decision of the Supreme Court which indicates that the courts will sometimes consider insurance arrangements in determining the liability of a party.

Mr S, a surgeon employed by the WDHB, had carried out a vasectomy on Mr Bensemann. Two years later, Mrs Bensemann gave birth to Zachary Bensemann, who the High Court found to be a “*healthy and much-loved*” but “*unexpected*” member of their family. The couple brought proceedings against WDHB to recover their loss.

WDHB was insured by QBE but that insurance excluded cover for doctors employed by it. They carried separate cover, which WDHB paid for (as is common in the industry). WDHB (at the instigation of QBE) therefore joined the doctor who had allegedly been negligent. The High Court held that this was done for tactical reasons, to try and force Mr S (through his insurer, the Medical Protection Society) to contribute to a settlement.

The Bs settled with WDHB for \$20,000 before the case went to trial. Mr S refused to settle, partly because he wanted to protect his professional reputation. The case then proceeded to trial and Mr S was found not to have been negligent. The Bs were legally aided and so Mr S was unable to recover his costs from them. Mr S therefore applied for costs against WDHB, on the basis that WDHB had caused Mr S to incur legal costs by joining him as a defendant.

The High Court took into account the unusual circumstances of the case and awarded Mr S 30% of scale costs. A majority of the Court of Appeal allowed an appeal but the Supreme Court then granted leave to Mr S to appeal.

The Supreme Court held for a number of reasons that Mr S should not have been awarded costs against WDHB, and dismissed the appeal. Significantly, one of these reasons was that the Court considered that the High Court (and a majority of the judges in the Court of Appeal) had failed to take into account the relevance of the insurance arrangements.

The Court accepted that the fact of insurance cover is normally irrelevant to the issues of liability or damages in a proceeding. However, the arrangements in this case were held to represent an agreement between the Board and Mr Shirley that Mr Shirley would meet the risk of any claim against him personally, including a claim for costs, by means of insurance cover paid for by the Board. Anderson J stated that: “*He cannot now ignore this arrangement on the maturing of the insured risk and ask to be paid again when the Board has already covered him for his costs*”.

The Supreme Court’s reasoning suggests that, where a person agrees to pay for insurance on behalf of another, this will often be regarded as an agreement that the insured (typically, through his or her insurer) will not be able to hold the person who has paid for the insurance liable for an insured risk. This reasoning is consistent with

an earlier decision of the Court of Appeal, *Marlborough Properties Ltd v Marlborough Fibreglass Ltd* [1981] 1 NZLR 464 (a case cited by the Supreme Court). In that case, a lease agreement provided that the lessee would pay for an insurance policy for the leased premises. A fire occurred in the premises and the lessor recovered under the policy, but then (at the instigation of the insurer) brought an action against the lessee for the full amount of the damage, alleging that the fire was caused by the lessee's negligence. A majority of the Court of Appeal held that the parties had impliedly agreed that, to the extent of the insurance cover, the risk of the loss by fire had passed to the lessor. The lessee had supplied a fund which the parties could draw on if the risk materialised, and having done so, could not later be deprived of that benefit and required to pay again when the risk did materialise.

## Scope of directors and officers liability policies

### *Intergraph Best (Vic) Pty Ltd v QBE Insurance Ltd (2005) 13 ANZIC 78,064*

*Intergraph Best (Vic) Pty Ltd v QBE Insurance Ltd (2005) 13 ANZIC 78,064* is a recent decision of the Supreme Court of Victoria, Court of Appeal reinforcing the need for care in considering the cover provided by a directors and officers liability policy.

Intergraph was responsible for the operation of a telephone call system for an ambulance service. A Royal Commission was established to inquire into that service and a number of Intergraph's directors and officers were compelled to give evidence before the Commission. Intergraph incurred and paid legal costs for the representation of its directors and officers at such attendances. It subsequently sought to recover the costs under a directors and officers liability policy which it had obtained from QBE.

The Court held that the policy, which was "*of a type which became prevalent during the 1980s*", provides "*two standard components of cover*". First, it provides direct cover to directors for claims against them arising out of the performance of their duties to the company. Second, it provides cover to the company, to the extent that it is permitted or required to indemnify the directors with respect to such claims. The indemnity sought by Intergraph was under a specific extension providing cover for "*defence costs arising out of any legally compellable attendance by an Insured Person at any official investigation, examination or inquiry*" but this extension was subject to the insuring clauses and therefore operated within the general framework provided by those clauses.

It was accepted that Intergraph, not its directors, had procured and paid for the legal costs. The Court therefore held that the policy did not provide indemnity in respect of those costs. The costs had not been incurred by the directors, nor had they been incurred by the company in indemnifying the directors for such costs (since it was the company, not the directors, which was liable to pay the costs in the first place).

## Duties owed by a broker after placement

*HIH Casualty & General Insurance Ltd v JLT Risk Solutions Ltd [2006] EWHC 485*  
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considered the duties owed by an insurance broker after placement of a policy.

The insured, L, was involved in the production of low-budget films for television. It engaged JLT, the defendant broker, to obtain insurance against the risk that the films would not produce sufficient revenues to recoup production expenses. JLT obtained a number of insurance policies from HIH and was, in turn, engaged by HIH to obtain reinsurance policies from a number of other insurers.

Many of the films were not successful and the returns fell short of those predicted by very substantial amounts. Claims totalling approximately US\$55 million were made on the insurance policies and paid by HIH. HIH sought an indemnity from the reinsurers. Some of the reinsurers with small lines paid, but others with larger lines did not. HIH brought proceedings against the non-payers, who claimed that they were not liable under the reinsurance contracts because a warranty as to the number of films which had to be produced had been breached. Ultimately, the English Court of Appeal agreed, and HIH abandoned its claims against the reinsurers.

HIH then sought to recover its losses from JLT (which had earlier been joined as a defendant in the proceeding). HIH did not allege that JLT had been negligent in respect of the placing of the reinsurance. Instead, it alleged that JLT had been negligent, after placement of the reinsurance policies, by: (a) failing to act of its own accord and obtain the reinsurers' consent to a reduction in the number of films; and (b) failing to ensure that HIH was properly informed of the reduction in the number of films.

Langley J held that whether a broker owed a duty of care after placement, and what the content of that duty was, must depend on the circumstances. In this case, JLT had continued to disseminate information about the films and their production status and earnings to HIH after placement, and had presented claims when they arose. Langley therefore rejected the contention that JLT was "*obliged only to act as a mere postbox*" and held that it should have studied the information which it received and "*alerted*" HIH to any matters of at least potential concern on coverage issues. It was not sufficient to simply forward the information on to HIH and rely on it to detect the issue.

For these reasons, Langley J held that JLT had breached its duty of care to HIH. However, HIH had failed to establish that it would have obtained the reinsurers' consent to a reduction in the number of films, if its attention had been drawn to the issue. Accordingly, His Honour held that JLT's negligence had not caused HIH's loss.

HIH has appealed the judgment of Langley J to the Court of Appeal. The appeal is due to be heard in March 2007 but a judgment may not be available until some time after that.