

A Miscellany of Traps and Terrors

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Harm Caused by Insured's Defective work or product

This discussion concerns liability insurance cover for the insured's **liability arising from defective work performed by the insured under a contract for a principal**. The same observations apply in principle to the insured's liability cover in respect of a defective product provided to a buyer, but for convenience, I shall refer only to work product.

A few preliminary thoughts to keep things in order –

- Liability insurance indemnifies the insured against loss due to **liability** to a third party who has suffered loss for which the insured is liable. It differs from a **first party policy, particularly a Performance Bond**, under which the insurer indemnifies directly the party who has suffered the primary loss, that is, the principal for which the work is to be performed. A **Performance Bond does not cover the party performing the work in any way**. On the contrary, it is first party cover for the principal and the insurer would have the subrogated rights of the insured principal to pursue recovery for the loss from the party performing the work.
- Insofar as property is concerned, liability cover is usually defined to mean physical harm to property or loss of its use, and its consequences – **not pure economic loss**. Other policies can be bought that cover that. There are some issues relating to physical harm, but these are not relevant here¹.
- The insured's liability in tort for damage to property first arises **when the harm occurs** – not when the wrongful or negligent act occurs. If an insured builder installs faulty foundations, and as a result the building sinks and cracks two years after it has been handed over to the principal, there is a breach of contract and contractual liability when the inadequate product is handed over, but the resulting property damage by which tortious liability is incurred does not take place until the inadequacy causes harm. It is only then that the issue of liability cover for the property damage arises.
- Usually, there is **nothing in the insuring promise of the policy to limit the cover to tortious liability**, and it should not be presumed that it does not extend to contractual liability if the circumstances meet the other criteria that it stipulates.² The cover may be limited in this respect through conditions and exclusions. There is a presumption against cover of pure economic loss arising from breach of contract, but if there is tortious damage to property, the cover is not affected by the fact that there may also be a breach of contract.³
- A common commercial liability policy usually contains '**Business Risk**' exclusions, which, among other things, typically exclude claims for damage to property in the possession of or worked on by the insured; or claims for repair or replacement of defective work; or claims for damage to property worked on by the insured after it has left the possession of the insured⁴. For convenience, this discussion will proceed without regard to such exclusions, that is, the issue is confined to the effect of the general promise of cover in the insuring clause. These exclusions will be discussed briefly later.
- Harm to the work may occur **before** it is handed over in performance of the contract, or **after**. If before, the **harm is suffered by the insured** and not by the principal, since the insured must fix it in order to meet its contractual obligations. If the insured tenders defective work that is not in accordance with the contract, this is **not damage to property of the principal**. It is simply a **breach of the contract**, involving only pure economic loss to the principal. Because the property tendered under the contract does not

¹ Diminution in the value of work because of the defects in parts of its construction by the insured is more controversial, though the obstruction caused by it and the need to find a new design qualitatively different from the original, or the need to remove other property because of the defect may be persuasive in that respect. *Viking Construction Management Inc v Liberty Mutual Insee Co* 2005 Ill App LEXIS 517; *The Travelers Indemnity Co of America v Moore* 2007 Tenn LEXIS 234. The prevailing view is that the incorporation of a potentially dangerous and defective component or product into a larger structure does not alone constitute property damage unless and until the defective part causes physical injury to tangible property in at least some other part of the system: *Pilkington United Kingdom Ltd v CGU Insee plc* (2004) EWCA Civ 23.

² *Am Family Mutual Insee Co v Am Girl Inc* 673 NW 2d 65, 83 (Wis 2004); *United States Fire Insee Co v JSUB Inc* 2007 FLA LEXIS 2394. "Occurrence" is not defined by reference to the legal category, as distinct from the cause of action, of the claim.

³ The cover depends on the actions of the insured and not on the cause of action pleaded: *Kreuger International Inc v Royal Indemnity Co* 2007 US App LEXIS 8169, where these matters are discussed.

⁴ This is the 'Products or Completed Operations hazard'.

meet the required standards, the principal suffers only **economic loss**, for **what is received is something less valuable than what was paid for**.⁵

- No-one seriously claims that the insurance cover applies to the **mere remedy of defects or the insured's liability in contract for failing to comply with the contract by reason only of their presence**. This is the province of a Performance Bond, if one is taken out. Poor workmanship, with its product, is not an 'occurrence' in itself, but if it later causes harm to other property, the infliction of such harm is an 'occurrence'.⁶ This is usually made abundantly clear by the 'business risk' exclusions since it is the predicate of their operation. Consequently, this discussion does not apply to such circumstances, though this point will be mentioned later as part of the total picture.
- The relevant harm, may be caused **before or after the handover**.
- It may be caused to **the work or to property other than the work**. This may be the property of the **insured**, the property of the **principal**⁷, or the property of a **stranger**. The expression, "**Property Damage**", in the **insuring clause of an ordinary public liability policy covers the harm done by the insured's defective work to such property of the principal or others**. Except in relation to the work itself after it has been accepted by the principal, this is uncontroversial and is not within the issues under discussion. It is however relevant to the later discussion by analogy that if before or after the handover of the work it causes damage to other property of the principal, that is "property damage" that is covered by the policy.
- The insured **cannot be liable to itself** for damage to its own property or to property in which it has an interest, such as **the work while it is still under construction and has not been tendered by way of performance of the contract**.
- **Nor is damage to the work that is caused by the insured's fresh conduct after tender and acceptance of it**, that is, by conduct that has nothing to do with the work done in the performance of the contract. In such circumstances, the ordinary principles as to cover will apply, and the involvement of the earlier works is an irrelevant consideration.
- **The only issue here is harm to the work product itself**, that is, harm beyond the mere existence of defects, **after its tender and acceptance**, resulting from a defect through the insured's earlier fault. Using the above example, this would take place when the defective strength of the foundations causes them to give way, allowing the building to sink and crack. The following discussion will be confined to this.
- At this time, **in a literal sense, such damage is 'property damage'**⁸ since it is property and it is damaged. Further, at that time it is the **property of another** since the finished work has been tendered to and accepted by the principal in performance of the contract. When it is later damaged by the defects, it is the property of the principal, who suffers the harm since it is no longer a matter of requiring the insured to perform the contract or to remedy defects⁹. In addition to liability for breach of the contract, with consequential damage, the insured may also become **liable in tort**. These, together, **answer all the elements of the general insuring clause of the policy**.¹⁰ However, there is some controversy as to whether later damage to sound parts of the work caused by such defects would amount to the occurrence of property damage.¹¹

⁵ Though the work may, in a sense, become the property of the principal, if it is constructed on the principal's land and become part of it, the principal's rights to it are controlled by the contract.

⁶ *Greystone Constr Inc v National Fire & Marine Insce Co* 2009 US Dist LEXIS 73055.

⁷ Damage to other property may include damage to furniture, drapery & wallpaper through water leaks or the collapse of a ceiling (*Wm C Vick Construction Co v Pennsylvania National Mutual Casualty Insce Co* 52 F Supp 2d 569, 591 (EDNC 1999); *Kalchthaler v Keller Construction Co* 224 Wis 2d 387; 591 NW 2d 169 (Wis App 1999)); and damage to cement by its mixture by another party with that party's cement, and the subsequent production of defective structures with the faulty mixture are both occasions of property damage: *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687; but not to cracks in floor or loose paint directly connected with the faulty work (*Indiana Insce Co v Hydra Corpn* 245 Ill App 3d 926; 61 NE 2d 70 (Ill App 1995)). Other cases where property damage was not found are *Privest Properties Ltd v Foundation Co of Canada Ltd* (1991) 57 BCLR (2d) 88; *Bird Construction Co v Allstate Insce Co of Canada* (1996) 36 CCLI (2d) 29; *Carleton Iron Works Ltd v Ellis Don Construction Ltd* (1996) ILR 1-3373. Cases where it was found are *Ontario (Attorney-General) v Fatehi* (1984) 2 SCR 536; 15 DLR (4th) 132; *Gulf Plastics Ltd v Cornhill Insce Co* (1990) ILR 1-2644; aff (1991) 3 CCLI (2d) 203; *Carwold (Carwald) Concrete & Gravel Co v General Security Insce Co of Canada* (1985) 17 CCLI 241; 24 DLR (4th) 58. Causing major structural defects to a structure is physical harm to property that is more than a mere threat: *Alie v Bertrand & Frere Construction Co Ltd* (supra). Whether the harm is to the insured's own product or to the property of another is a question of fact: *ibid*, where the supply of defective fly ash that was added to cement causing failure of the concrete part of a structure was held to be property damage. See also the topic, *Accident*, in this chapter.

⁸ *Travelers Indemnity Co of Am v Moore & Assoc Inc* 216 SW 3d 302 (Tenn 2007); *Am Family Mutual Insce Co v Am Girl Inc* 673 NW 2d 65, 83 (Wis 2004); *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394; *Lamar Homes Inc v Mid-Continental Casualty Co* 242 SW 3d 1, 13 (Tex 2007); *Trinity Universal Insce Co v Employers Mutual Casualty Co* 2008 US Dist LEXIS 39581.

⁹ It will be remembered that we are not speaking of defects to be remedied in accordance with the contract, but of additional and separate harm.

¹⁰ In summary:

- Defects in the product or works prior to handover are not in themselves 'damage to property' nor are they damage to the property for which the insured would be liable since no other party suffers loss

This **last item is the point of this discussion**. It needs more elaboration. As it has been shown, it is plainly distinguishable from any underlying claim for breach of contract that is based purely on harm consisting of defective work, without damage to other property or other parts of the works and which the insured is contractually obliged to repair or replace. That is simply the fitting subject of a Performance Bond. This is **harm beyond the mere presence of the defects**. The essential issue is whether this distinction makes any difference.¹²

In these circumstances, although there is **certainly property damage, and the insured is liable for it**, logically, it may not be enough to refer to such factors alone. There may be **other considerations**. The rules of construction require that the terms of the contract be read together and in the light of its **purpose as a liability policy** rather than as a Performance Bond. Conversely, it is necessary to acknowledge that the relevant harm, for which the insured is liable, is **additional to simple non-performance of the contracted work**. **There is different property damage that is superimposed upon the defects that constituted mere breach of the insured's contractual obligations**. In this respect it may be **compared to the insured's liability for damage to other property**.

Further, *ex hypothesi*, the damage takes place **after the work has been handed over** to and accepted by the principal, but this factor is not necessarily decisive since it is not relevant to the issue of cover in respect of repair and replacement of parts with developing defects.¹³

In the **United States, there is a common, though not universal, view** that, despite that the harm is "property damage" for which the insured is liable in accordance with the literal meaning of the insuring clause, such liability is not within the cover because the liability insurance policy is **not a Performance Bond**.

necessary to liability.

- Damage to the product or works from the defect at that time is also 'damage to property', but the insured is not liable to another for it since again it is the insured who suffers the loss.
- Damage at any time to other property of another, whether the principal or some other party, is 'damage to the property' for which the insured would be liable, and comes within the cover.
- Damage to the property in the form of the post-handover presence or progression of defects that require repair or replacement does not produce liability for 'property damage' within the meaning of the policy: The resulting liability is for economic loss for failure to perform the contract by providing property that did not answer the contractual requirements: *Bituminous Casualty Corp v Gust K Newberg Construction Co* 218 Ill App 3d 956; 578 NE 2d 1003 (1991); *Indiana Insce Co v Hydra Corp* 245 Ill App 3d 926; 615 NE 2d 70 (1993); *Whitman Corp v Commercial Union Insce Co* 2002 Ill App LEXIS 1105; *Green v State Farm Fire & Casualty Co* 2005 Utah App LEXIS 582. A distinction is to be made between the defective work, on the one hand, and damage that defective work causes to other property or other non-defective parts of the works. In the situation under discussion in this point, the property supplied was not damaged: it was merely inadequate, and the claim is for purely economic loss because the principal did not receive the product bargained for. (The same reasoning applies to a breach of implied warranty in a sale of damaged property. It does not render the insured liable for property damage: the liability is in contract: *Aluise v Nationwide Mutual Fire Insce Co* 625 SE 2d 260 (W Va 2005); *Nationwide Property & Casualty v Comer* 2008 US Dist LEXIS 24724.) The same principle and reasoning apply to the case where insured is in breach of a warranty, such as in the sale of property: *Nationwide Property & Casualty v Comer* 2008 US Dist LEXIS 24724. This is the real basis of the proposition that a liability policy is not a performance bond, a proposition primarily derived from the nature of the policy, but supported by the 'business risks' exclusions. This liability is almost invariably the subject of a specific 'business risk' exclusion that is widely supported: *Shelby Mutual Insce Co v LaMarche* 371 So 2d 198, 200 (Fla 2nd DCA 1979); 390 So 2d at 326; *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394.
- Damage to non-defective parts of the product or works after it has been handed over is probably 'damage to the property' within the meaning of that expression in the policy, and the next issue is whether any of the business risks exclusions is engaged.

¹¹ For example, in *Greystone Constr Inc v National Fire & Marine Insce Co* 2009 US Dist LEXIS 73055, it was held that it does not.

¹² It will be remembered that the mere presence of such defects is not regarded as 'property damage'; and that the presence of defects and the harm to the works caused by them prior to handover are not distinguished from each other.

¹³ Logically, this observation has its limitations since the reasons for the exclusion of that area of liability from the cover does not touch any temporal factors, but it is useful to note that the temporal factor may not necessarily be a consideration.

As it has been indicated above, this reasoning is certainly correct as to any liability for merely fixing defective work. But insofar as there is other damage to the property of another, which corresponds to the language of the insuring clause, there must be **some doubt as to this justification** for denying the insured's claim for cover on this ground.

The validity of this doubt is recognised in some parts of the United States, but some courts have then rejected the cover on an even more tenuous basis. It is said that the cover does not apply because the insuring clause always contains an element of **'accident'**.¹⁴ Because the insured contractor must know or expect that it will be liable for any loss caused by any defect, it is argued, **the loss, that is, the liability of the insured, is not an accident.**¹⁵ Extrapolating this to the present issue, it is argued that liability for any faulty workmanship is not an 'accident' because it is not a fortuitous event, that is, it is the natural and ordinary result of a failure to perform under the contract cannot be characterised as unexpected.¹⁶

This might be valid as to any defect in the property that is the plain result of the insured's deliberate conduct. Deliberately defective workmanship produces the expected harm of a defective product and any consequences that are actually expected to flow from it. It may also apply to any later harm that was so plainly likely that the insured can be said to have courted the risk.

But it is **not valid to go further. It cannot logically apply to any unintended and unforeseen loss (liability)** caused by defective work. Even the existence of the defect is usually unintended and unforeseen.¹⁷ A fortiori, as to any later harm caused by such an unintended defect.

Negligence, which is the classic risk for which insurance protection is usually obtained, predicates an absence of intention to execute the work in a faulty fashion or, at least, to cause the **harmful consequences** beyond the presence of the defects themselves, which may **not be expected or even foreseeable.**¹⁸ 'Accident' will be found and cover applies when the damage is done to other property in such circumstances. There is **no valid distinction in this respect** if the damage is done to the work itself when it is the property of the principal.

Further, insofar as this theory seems to rely on the insured's expectation of liability for breach of the contract rather than on expectation of damage to the property, it fails to recognise that **the element of accident mentioned in the policy relates to the causing of 'property damage'** and not to the breach of performance that cause it. The breach of performance, an abstraction involving the terms of the contract, is the cause of action, but the cause of the property damage was the physical conduct causing that result. It is the conduct and its result that are the relevant factors for determining accident.¹⁹

'Moral hazard' as the basis of a **public policy** disallowance of the cover is sometimes raised. It is said that to permit insurance cover would encourage the insured's negligence by producing a windfall. This might be valid in respect of the repair and replacement of any defective work; but **this does not extend to harm to other property**, and so it is difficult to see why it should extend to harm to the works beyond any defect. After all, negligence causing harm may be covered without any offence to public policy. Further, the reasoning could not apply to the insured's liability for the harm caused by a sub-contractor for which the insured is liable. Understandably, this theory is seldom adopted.

¹⁴ This limitation is introduced either directly or through a definition, usually of "occurrence". See that topic in this chapter. See also the review of the authorities in *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394.

¹⁵ E.g., *State Bancorp Inc v US Fidelity & Guarantee Insce Co* 483 SE 2d 228 (W Va 1997); *Nationwide Property & Casualty v Comer* 2008 US Dist LEXIS 24724. More particularly, it has been held that defective construction tghat damages the work product itself can never constitute an accident, e.g., *Auto-Owners Insce Co v Home Pride Cos* 684 NW 2d 571, 577 (Neb 2004); *Oak Crest Constr Co v AustinMutual Insce Co* 998 P 2d 1254, 1257 (Ore 2000); *Kvaener Metals v Commercial Union Insce Co* 621 SE 2d 33, 35 (SC 2005)

¹⁶ Put another way, this argument says that damage resulting from a breach of contract must be presumed to be expected . It is said that this is so because the consequential damage is foreseeable, but that is not an appropriate factor in the construction of an insurance policy: *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394. But the same criticism may be levelled at it. It is based on the proposition that no breach of contract can amount to an accident, presumably because it is the party's duty to perform it, so that any failure to do so has an expected consequence, which precludes accident.

¹⁷ *Lamar Homes Inc v Mid-Continent Casualty Co* 242 SW 3d 1, 13 (Tex 2007); *Trinity Universal Insce Co v Employers Mutual Casualty Co* 2008 US Dist LEXIS 39581.

¹⁸ *Am Family Mutual Insce Co v Am Girl Inc* 673 NW 2d 65, 83 (Wis 2004); *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394

¹⁹ If, when so conducting itself, the insured did not intend or expect the harm, or the legal liability that flowed from it, it would usually be regarded as an accident.

In other parts of the United States, recognition of the application of the literal meaning of the terms of the insuring clause to later unforeseen and unintended harm to the principal's property by defective work has led to a different line of reasoning. The cover is denied in these cases **only when a 'Business Risk' exclusion is engaged**. This appears to be the correct line of reasoning.

The persuasive *arguments in favour of cover* (aside from the effect of any exclusions) are that, while **any further harm to the works** in the hands of the principal caused by the defects predicates non-performance of the contract, it **is of the kind to which liability insurance usually applies**. And the **tender/acceptance** of the property before the harm occurs changes the relevant rights and obligations of the parties, which **distinguishes** the earlier position where the harm falls directly upon the insured and cannot be the subject of a liability policy.²⁰ While both this harm and purely defective work both arise out of non-performance of the contract, **this additional harm is a supervening feature**, albeit a consequential effect of it, amounting to the causing of fresh and distinct harm. This argument invokes the **similarity in principle with the cover afforded to the insured's liability if the harm had been done to other property of the principal or to that of another**, which is, beyond dispute, covered.

The **emphasis** of this proposition is on the factor of **property damage** which is consequential on breach of the contract, rather than on the **source of the insured's liability**, which is the breach. The damage is of a different kind from damage that consists only of defects. This focus on the mere fact that there is physical damage to property for which the insured is liable has to be distinguished from the principle that leads to the conclusion that the further deterioration of a defective part is also literally property damage for which the insured is liable, but it does not attract the cover. In the description of the insured's cover, the element of the insured's liability is as important as the factor of physical damage to the property, but usually it refers to the insured's liability for damage to property without any distinction whether it arises from breach of contract, which, incidentally, is in the form of damage to property, or from tort.

The *argument against cover* relies on the presumed fact that the **further damage was the result of the original defect that constituted non-performance and was merely an extension of the breach of contract – non-performance**. The claim for any additional harm, it would be argued, is merely a claim essentially for economic loss in contract for consequential damages in addition to damages for the defects that caused the additional harm.²¹ In this respect, insured's liability consequential on breach of the contract is the same as liability for the defects. This **emphasis is on the nature and source of the insured's liability rather than the factor of 'property damage'**. Despite its force, this does not adequately address the point that in a sense the insured is liable "for" the property damage, albeit that such liability arises from the breach of the contract.

Each of these propositions has attractive features, and in the United States, the many judgments on the matter are seriously divided, depending on where the emphasis is placed. Some authorities on both sides attract rejection because, in justifying their chosen line, they do not sufficiently address the valid aspects of the contrary arguments. Both lines would seem to be correct so far as they go, and consequently the validity of the answer lies elsewhere, as some cases have indicated. The best of these are as follows.

First, the reasonableness of both arguments ipso facto predicates, at least, **ambiguity**, which must be **resolved in favour of cover**, a device that is sometimes overused but which is classically suitable in this case. Nevertheless, it would be desirable to have some other and stronger grounds.

Secondly, many policies **contain the 'business risks' exclusions**, which often directly deal with this issue, as well as, cognate issues of cover. This **implies** that the insuring clause is to be **construed in favour of cover in respect of the circumstances to which the exclusions apply**, subject to limitation to the extent that they tailor it. Again, this process of implication by reading the contract as a whole is a classical process of construction.²²

Thirdly, it is common for the **'business risks' exclusions to contain an exception** when the harm to the completed works is caused by the negligence of a sub-contractor. If the general promise did not cover such harm, the exception would be otiose and have no operation. Such a

²⁰ It is true that the principal's cause of action is still breach of contract and consequential damages, but in this position, the principal can no longer refuse to accept the tendered work product as performance of the contract.

²¹ This is sometimes expressed in the proposition that there can never be 'property damage' within the meaning of the policy in cases of faulty construction because the defective work rendered the entire project damaged from its inception. This seems to be another way of saying that, although the later development amounts to physical harm, it is merely a feature of the non-performance for which the insured is liable.

²² Some policies foolishly do not contain the 'business risks' exclusions²² so that such an implication is not available, but the problem and the availability of such a clear solution to it support an implication that the insurer intended that the insuring clause should provide cover in such circumstances. A construction in favour of cover should be given to the promise in the insuring clause.

result will be avoided when an alternative reasonable construction is available.²³

Fourthly, even in respect of those policies that do not contain any ‘business risk’ exclusions, **insurers now know** of this issue and have the **opportunity** to, and do, **limit the cover in this respect through those exclusions, if it is intended to do so**. There is no logical reason why the cover should not extend to cover the loss in such circumstances if the parties wish it. In the light of the engagement of the terms of the insuring clause to such circumstances, **any failure to use the exclusions implies that the ordinary meaning of the insuring clause should be adopted without any modification in this respect** and that such claims are not intended to be excluded from cover. Further, the canons of construction applicable to policies require that the **insuring clause is to be read broadly**, and that where there is **ambiguity** of this kind, the policy is usually to be read against the construction favoured by the insurer who had proffered it in that form.

In Australia, it will be **safer for insurers to expect this view to prevail and to attend with precision to the drafting of the ‘Business Risks’ exclusions**, tailored to meet the limits on the cover that are intended. If the issue arises in respect of a claim, practitioners should expect that the words of the insuring clause in its common form may well encompass such a claim, and look to the ‘business risks’ exclusions for the more refined issues.

A Cognate Issue - The Contractual Provision of Joint Insurance and its Consequence

A complication arises when, pursuant to the contract between the principal and the contractor, one of them is to arrange that the parties are to be **jointly insured for harm to the works during the period of the contract so that the insurance moneys are to be applied to any necessary repair or restoration**.²⁴ In respect of this issue, it is usually irrelevant whether the duty to insure falls upon the principal or the contractor. **This discussion is concerned with the insurance relevant to a claim against the contractor by the principal or, more particularly, by the insurer in a subrogated claim made in the name of the principal.**

This is usually, but not necessarily, the insurer of the named insured against the party to whom the contract says the cover is to be extended; and **the issue is whether an insurer of one insured can bring a subrogated claim in the name of that insured against the other insured to whom the policy also refers.**

Two questions have arisen –

- **whether** in the circumstances of such joint insurance, **the wrongdoing insured remains liable to the other insured for causing loss that comes within the cover of the policy**²⁵; and, if so,
- **whether** there is **any reason in law why the joint insureds’ insurer should be unable, by such a subrogated action, to recover from the insured wrongdoer** the amount of the indemnity that it has provided to the other insured.

As it has been indicated, **if the insured defendant wrongdoer is not liable to the other insured, there is no foundation for such a claim. In the absence of any liability of the defendant insured, no liability cover in relation to that party is relevant.** This situation may come about if, for example, there has been a **waiver of, or other legal reason against, such liability**. Waiver is straightforward and is not relevant here; and the ‘other legal reason’, if any, is to be found in **the contractual arrangement between the parties for joint insurance**.

Consequently, this whole discussion depends on **the hypothesis that the defendant insured would have been liable to the nominal plaintiff/ insured but for the effect of the contract between them; that it was intended under the agreement between the insureds that the relevant insurance should cover the defendant for a claim such as that brought by the other insured.**

Under the first of the available alternative theories, the defendant relies on the contractual arrangement for the joint insurance **to escape such liability on the basis of an implied term that there should be no liability between them in respect of losses covered by the insurance**. Under the implied arrangement, the **insurance is to be a substitute** for any relationship that would admit liability as a remedy for a wrong done by one to the other within that range. When liability is excluded in this way, it is because a **term to that effect is implied from the agreement** in the absence of an express term to the contrary.²⁶

²³ *Lee Builders Inc v Farm Bureau Mutual Insce Co* 137 P 3d 486, 491 (Kan 2006); *Lamar Homes Inc v Mid-Continent Casualty Co* 50 Tex Sup Ct J 1162, 116ex 2007); *8Lennar Corp v Great Am Insce Co* 200 SW 3d 651, 673 (Tex App 2006); *United States Fire Insce Co v JSUB Inc* 2007 FLA LEXIS 2394.

²⁴ This is usually associated with a similar agreement as to liability cover. For ease of discussion, this will be discussed separately below.

²⁵ If not, there can be no subrogated claim, for the subrogated party can do no more than enforce the rights of the subrogor, and if that party has no cause of action, there is nothing to enforce.

²⁶ *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls_Royce Motor Cars Ltd* [2008]EWCA Civ 286; [2008] All ER (D) 16.

It is **necessary** within this theory to have a **release from liability implied** from the arrangement. There is **no principle of insurance law** to the effect that **one joint insured cannot be liable to another joint insured in respect of the subject matter of the cover.**²⁷

That is the **first answer**. **The result is a matter of construction of the contract, but with a serious possibility that there will be found to be an implied term by which each party exculpates the other from liability to itself in respect of the insured risk.**

The **alternative theory** works on the assumption that such liability has not been affected in that way – that the wrongdoer still remains liable to the other party, who may share the insurance cover. If they do so, there is a line of authorities to the effect that **such a subrogated action will not be permitted because it would involve circuity of action**. If successful, the insurer would obtain judgment against an insured whom it would then have to indemnify to the full extent of the judgment. This principle has received respectable judicial support.

By an obiter comment in the **House of Lords**²⁸, taken up and supported in the Court of Appeal²⁹, a preference has been expressed for the **'implied term' solution over circuity of action.**³⁰ This preference is, of course, subject to any express term to the contrary in the contract.³¹

The **resolution** of this problem may be found **in the terms of the policy**; but it may sometimes be **necessary to look to the terms of the contract**, particularly when the nominal plaintiff was required to obtain the relevant insurance covering the defendant.³² If the policy does not provide cover in respect of the loss, and if it was never agreed that it should do so, no issue arises.³³

When, however, the intended cover does apply, it is always a matter of construction of the contract -

- whether either party is to be liable to the other at all for the harm, irrespective of the authorship of any negligence; or
- whether liability remains, but only to the extent that it is not covered by the joint insurance; or
- whether any release of liability is limited to the works or extends to other property; or
- whether the issue of liability is not affected by the joint insurance arrangements because they may be explained without touching the insured's liability.³⁴

The answer to these questions will depend on the terms of the contractual arrangements in the factual matrix of the particular case. Nothing more can be said except that there is a tendency for the matter to be resolved in favour of the defendant on the reasoning that the parties have impliedly agreed to replace any mutual liability *inter se* with the agreed insurance.

²⁷ Ibid

²⁸ *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* (supra); [2002] 1 WLR 1419.

²⁹ *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls_Royce Motor Cars Ltd* [2008]EWCA Civ 286; [2008] All ER (D) 16.

³⁰ The expression of preference did not say that the alternative was wrong.

³¹ *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls_Royce Motor Cars Ltd* [2008]EWCA Civ 286; [2008] All ER (D) 16.

³² A typical circumstance when this is so arises when the nominal plaintiff has failed to obtain the insurance as required. Another is when the insurer's policy covering the plaintiff automatically extends to any party to whom the nominal plaintiff is contractually obligated to obtain insurance cover, and then only to the extent to which the obligation requires it.

³³ If, as within the reasonable bounds of theoretical possibility, the nominal plaintiff has obtained cover for the defendant that exceeds the contractual obligation to do so, and if it covers the claim, then, rectification aside, the defendant will be entitled to the benefit of the cover and circuity of action will be involved, though the contract between the parties could not be construed as waiving liability, nor could there be any implied term precluding liability, arising from the agreement for joint insurance since it did not extend so far. This may be productive of difficulty if circuity of action is discarded as an operative principle in favour of construction of the contract and/or implied term: see *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* [2002] UKHL 17; [2002] 1 WLR 1419 and *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls_Royce Motor Cars Ltd* [2008]EWCA Civ 286; [2008] All ER (D) 16, which are discussed below.

³⁴ *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* (supra); [2002] 1 WLR 1419; *Surrey Heath Borough Council v Lovell Constr Ltd* [1990] 48 BLR 108; *Scottish & Newcastle plc v GD Constr (St Albans) Ltd* [2003] EWCA Civ 16; [2003] LI Rep IR.

The same reasoning in principle arises in cases where **one party agrees to provide insurance cover for the other, usually as an added insured under its own policies, in respect of liability to third parties, and the insurer, having paid the claim on behalf of the named insured, seeks to recover contribution from the beneficiary as a joint co-tortfeasor in subrogated proceedings.** In principle, the claim is on all fours with the position discussed above. The insurer, having indemnified the named insured for the loss, seeks through subrogated proceedings to recover from the other party to the contract for that party's liability, if any, to the named insured.

If the named insured has kept its promise so that the **defendant is an added insured** under the subrogated insurer's policy, there will be an issue as to whether the parties' agreement has **impliedly waived any such liability**; and **the rule against an insurer's recovery from its own insured** in respect of a covered risk will also defeat the action.

If the named insured has **failed to have the defendant added** as an insured under the policy, the action will fail because the **defendant will be insulated** against liability because its **cross-claim for breach of the promise** will equal any sum to which the nominal plaintiff would be entitled.³⁵ Further, the defendant may not be liable to the nominal plaintiff if **such liability had been impliedly waived** in advance in accordance with the above discussion. And the insurer's subrogated rights are no better than those of the party who subrogates them.

If the contractual arrangement between the principal and the contractor does not require that both parties be covered by the same insurer, the same result will obtain if it can be implied that the parties have agreed that the insurance arrangements replace their respective liability to each other. The principle remains the same.

Addendum: A further related question has arisen in relation in respect of a claim for contribution between an insurer and a party who has contractually agreed to indemnify the insured as part of the transaction between them. Subject always to the terms of the contractual indemnity, the respective obligations of the obligors are not co-ordinate and the contractual indemnity is primary. If the insurer pays, it may recover up to the limit of the contractual indemnity, while in the reverse situation that obligor cannot obtain contribution from the insurer.³⁶

"Established by Final Judgment" or "In Fact"

A policy provision sometimes uses an expression such as "**established by judgment or final adjudication**"³⁷ or "**in fact**".³⁸ For all purposes here, the expressions are synonymous. There has been controversy as to whether the matter to which the expression refers may be **proved in an application between the insurer and the insured, or whether it must be proved in separate underlying proceedings** before the provision in which it is contained can operate. It may refer to such things as the insured's fraud. Any such provision is **not engaged until the specified fact is so established**, either in the third party claim or prosecution against the insured, or in proceedings between the insured and the insurer. **The insurer can rely on it when its terms are fulfilled, but not while the relevant matter remains unproven.**³⁹

This discussion does **not touch** the general principle that, absent anything in the policy to the contrary, the **insurer's obligation to indemnify the insured under the liability policy is not enforceable against the insurer until the insured's liability to the third party has been established** by judgment, award or settlement. Of course, **other obligations may be imposed by the contract to operate before that time.**

³⁵ *The Home Insee Co (in liq) v The Travelers Indemnity Co* 2008 US Dist LEXIS 7851.

³⁶ *Speno Rail Maintenance Aust Pty Ltd v Hammersley Iron Pty Ltd* [2000] WASCA 408; followed in *Caledonia North Sea Ltd v British Telecommunications plc* [2002] UKHL 4; *HIH Claims Support Ltd v Insee Aust Ltd* [2009] VSC 434.

³⁷ The reference to proof "by judgment or final adjudication" is simply to make it clear that findings such as those of a Royal Commission or official investigation would not be sufficient for this purpose: *Silbermann v CGU Insee Ltd* (2003) NSWCA 203 (rev on other grounds).

³⁸ For convenience, this discussion will refer only to an exclusion. The nature of the provision is irrelevant. Any conflict between a provision of this kind and the wide terms of the insuring promise does not create any ambiguity: *Ball v NCRIC Inc* 2005 US App LEXIS 1379.

³⁹ *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; (2005) 13 ANZIC 61.641 *Rich v CGU Insee Ltd*; *Silbermann v CGU Ltd* [2005] HCA 16; (2005) 13 ANZIC 61.642. For example, the insured's claim for defence costs generally may be put in issue on this ground when ultimately the claim for them is made. A difference should be noted between the operation of an exclusion and the insurer's exercise of its right to refuse to indemnify the insured on the basis of its anticipated operation. For example, an exclusion may be expressed to depend on the formal establishment of facts, such as fraud, and so the exclusion will not operate until such formal establishment takes place; but in the meantime, in anticipation of that result which it can establish, the insurer may not be in breach of utmost good faith should it refuse to meet its obligations that would exist but for the exclusion: *Silbermann v CGU Insee Ltd* (2003) NSWCA 203; 12 ANZ Ins Cas 61-571; *Wilkie v Gordian Runoff Ltd* [2003] NSWSC 1059; (2004) 13 ANZ Ins Cas 61-619 (rev on other grounds).

The issue usually arises in two ways. First, if the **third-party claimant has succeeded against the insured without proving the relevant matter**, the insurer may wish to prove it as a defence in the insured's later claim for indemnity. Secondly, the issue may, but for the exclusion, arise in respect of **an obligation of the insurer that would exist prior to the trial of the underlying action**. For example, an issue may arise as to whether the insurer must advance defence costs, or has an obligation to undertake the defence of the insured.

The expression **does not necessarily require adjudication by the underlying fact-finder in the third-party's claim**. For example, it may be established in **prior proceedings between the insurer and the insured** to test the parties' rights and obligations when the insurer has invoked the exclusion in order to decline to provide indemnity.⁴⁰ But it **requires a curial process**.⁴¹ And it **requires evidence** upon which the fact may be determined in the relevant proceedings.⁴²

It is usually **sufficient to prove that the relevant fact, and no other, is the basis of the insured's liability** in the underlying third party's action. If that has already been proved in the underlying action, the insurer need not prove the fact again.⁴³ But this does not necessarily imply the need for proof prior to the underlying litigation of the insured's claim against the insurer.⁴⁴

There is an **important caveat**. It is **necessary to be precise as to the subject matter** of the rights to which an expression of this kind applies. For example, some policies **expressly, but generally**, provide that **the promised indemnity will not be provided if it is established that the insured is guilty of fraud**. But the promise to advance defence costs will be contained in a **specific provision**. If the insurer declines to advance defence costs on the basis that the insured is guilty of fraud, as alleged in the claim, there will be an **issue as to whether the general exclusion applies to the specific promise**.

The **literal language of the exclusion applies to defence costs** as well as damages. But in the absence of clear language to the contrary, it will **not apply for very practical reasons**. The **importance to the insured of an advance of costs at that stage of litigation** favours the view that, where it is reasonably possible, the court should **avoid a construction that deprives the insured of it**. If there is a clear expression to the contrary, the insurer's duty of **utmost good faith** would not affect its entitlement to refuse to advance costs on valid grounds.⁴⁵

This term of the policy, or a promise of the insurer's provision of the defence, usually reserves **to the insurer the right to recover the sums it pays out if later it is proved that the cover did not apply**.⁴⁶ Of course, the efficacy of this rider will depend on the **financial capacity of the insured to repay**. *Ex hypothesi*, that party will have lost in the underlying litigation and will not be indemnified under the policy, which would further reduce that financial capacity. This frequently **leads the insurer to try to escape** from liability to the insured before it provides a defence or advances defence costs.

⁴⁰ *Westport Insce Corp v Hanft & Knight PC* 2007 US Dist LEXIS 90599.

⁴¹ *Wilkie v Gordian Runoff Ltd* (2005) 79 ALJR 872; [2005] HCA 17; *Mead v Allianz Aust Ltd* [2006] NSWSC 366.

⁴² *PMI Mortgage Insce Co v Am International Specialty Lines Insce Co* 2006 US Dist LEXIS 24853, WL 825266 (ND Cal); *Federal Insce Co v Cintas Corp v Cintas Corp* 2006 US Dist LEXIS 33369, WL 1476206 (SD Ohio); *Am Chem Socy v Leadscope* 2005 Ohio LEXIS, WL 1220746; *St Paul Mercury Insce v Foster* 268 F Supp 2d 1035, 1045 (CD Ill 2003); *Brown & LaCounte LLP v Westport Insce Corp* 307 F 3d 660 (7th Cir 2002); *Westport Insce Corp v Hanft & Knight PC* 2007 US Dist LEXIS 90599.

⁴³ *Steadfast Insce Co v Stroock & Stroock & Lavan LLP* 2004 US App LEXIS 16144; *PMI Mortgage Insce Co v Am International Specialty Lines Insce Co* 2006 US Dist LEXIS 24853, WL 825266 (ND Cal); *Federal Insce Co v Cintas Corp v Cintas Corp* 2006 US Dist LEXIS 33369, WL 1476206 (SD Ohio); *Am Chem Socy v Leadscope* 2005 Ohio LEXIS, WL 1220746; *St Paul Mercury Insce v Foster* 268 F Supp 2d 1035, 1045 (CD Ill 2003); *Brown & LaCounte LLP v Westport Insce Corp* 307 F 3d 660 (7th Cir 2002);. It is not necessary that there be an adjudication by the underlying fact-finder: *Westport Insce Corp v Hanft & Knight PC* 2007 US Dist LEXIS 90599.

⁴⁴ *Brown & Laconte LLP v Westport Insce Corp* 2002 US App LEXIS 21241

⁴⁵ The insured is not entitled to an advance of defence costs if it does not show a clear entitlement in the face of a policy exclusion: *Anglo-Am Insce Co v Molin* 691 A 2d 929 (Pa 1997); nor when the policy provides for indemnity for costs only when the claim is established through a judgment or settlement: *Stonewall Insce Co v Asbestos Claims Management* 73 F 3d 1178 (2d Cir 1995); nor when the policy provided for a priority system for the payment out of limited insurance proceeds that necessarily precludes contemporaneous payment of legal fees: *In re Ambassador Group* 738 F Supp 57; nor when the policy provides merely for reimbursement of costs without any provision for an advance of them: *In re Kenai 136 BR* 59 (SDNY 1992), all discussed in *In re Worldcom Inc* 2005 US Dist 1466.

⁴⁶ This may help the court to construe the policy as meaning, by implication, that the limitation or exclusion was not intended to apply to the promise to advance defence costs: *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; (2005) 13 ANZIC 61.641 *Rich v CGU Insce Ltd*; *Silbermann v CGU Insce Ltd* [2005] HCA 16; (2005) 13 ANZIC 61.642.

This **same issue** in a different form has arisen in respect of some legislation **investing an insolvent insured's rights against the insurer in the third party claimant**. A reference to rights **"in respect of the liability (of the insured to the third party)"** has been narrowly construed.⁴⁷ Because the insured's right to indemnity does not arise until that party's liability has been established by judgment award or settlement, it was once thought that the third party's rights cannot commence until that time.⁴⁸ This view could lead to the liquidator's or insurer's refusal to provide to the claimant information concerning the policy, as provided for by the legislation if the insured were liable to the third party. This would have meant that an application for such information made before final judgment would have been made prematurely in this sense.⁴⁹ This view has now been reversed. **The transfer of the insured's rights under the policy under the Act takes place on insolvency without the need to wait for the establishment of the insured's liability and the amount.** The rights so transferred may be inchoate in the sense that they do not give rise to liability on the insurer's part until those things have been established, but that does not affect the transfer of the rights.⁵⁰

Again, this **same issue** sometimes arises in a different way in connection with other expressions, such as by the use of the **past participle of a critical verb** in a context where other verbs are qualified by an expression that imports a distinction between actual and alleged conduct or circumstances.⁵¹ This, it may be argued, implies that the former must be proved, rather than merely alleged, before the provision that carries it may operate.⁵² In that case, it is a **matter of construction** of the particular policy.

Personal Profit

Claims for the **recovery of property or moneys to which the insured is not entitled** do not come within the cover. In the first place, in substance the judgment is for **restoration of property and not for damages or compensation**. Damages are intended to provide the victim with monetary compensation for an injury to the person, property or reputation, while **restitution is intended to return to the victim the specific money or property taken⁵³ or, it is suggested, wrongfully withheld contrary to the insured's contractual or similar obligations⁵⁴**. **The distinction between restitution and damages can, however, seem elusive⁵⁵**.

Conversely, as the insurance is a **contract of indemnity**, since such a judgment is for the **disgorgement of what the insured is not entitled to**, the insured suffers **no loss that calls for indemnity**.⁵⁶ This reasoning applies to the restitution⁵⁷ of property improperly obtained; or to

⁴⁷ *Murray v Legal & General Assce Socy Ltd* [1970] 2 QB 495; [1969] 2 Ll Rep 405; [1970] 3 All ER 794.

⁴⁸ *Bradley v Eagle Star Insce Co Ltd* [1989] AC 957; [1989] 2 WLR 568; [1989] ICR 301; [1989] 1 All ER 961; [1989] 1 Ll Rep 465.

⁴⁹ *Woolwich Building Socy v Taylor* (1994) **Times, 17 May. [is this correct?]**

⁵⁰ *In the matter of OT Computers Ltd (in admin); First National Tricity Finance Ltd v OT Computers Ltd (in admin)* [2004] EWCA Civ 653.

⁵¹ This argument is supported to a degree by the same reasoning that supports the interpretation of "in fact" as requiring a determination.

⁵² For example, a reference to fraud "committed", when other provisions refer to "real or alleged" claims: see *Moscarillo v Professional Risk Management Services Inc* 2007 Md LEXIS 185.

⁵³ *Bowen v Massachusetts* (1988) 487 US 879, 893; *Aerojet-General* (supra).

⁵⁴ In *Cortez* (supra), wrongfully withheld wages were held to be the property of the employee, but this demonstrates the artificiality of the reasoning of this kind when attention is directed to the form of the insured's liability in a technical sense rather than whether the insurer would suffer loss by making the payment.

⁵⁵ *Inline Inc v Apace Moving Systems Inc* (2005) 125 Cal App 4th 895, 903; *SWH Corpn v Select Insce Co* 2006 Cal App Unpub LEXIS 8694. **In *Kreuger International Inc v Royal Indemnity Co* 2007 US App LEXIS 8169, the court held that this principle did not apply to the case where the insured was sued for damages for the misrepresentation of its employee which enabled the insured to purchase its own shares at a price lower than should have been the case. This is discussed only briefly in the judgment and must be on the borderline. The court found for the insurer on other grounds.**

⁵⁶ *School Committee v Dept of Education* 471 US 359; 105 S Ct 1996 (1985); *Walker v Duist of Columbia* 969 F Supp 794 (1997), distinguished in *The General Star Indemnity Co v Lake Bluff School Dist No 65* 2004 Ill App LEXIS 1404, where the issue related to whether reimbursement of parents for the expenses that a school committee should have met in the first instance could amount to damages. In fidelity insurance, also, the restitution of property to which the insured was not entitled does not amount to the financial

payment of an amount due for a benefit obtained by the insured, for in each case, there would be no loss suffered by the insured in restoring the property to which there is no entitlement⁵⁸; or in paying for a benefit in accordance with the insured's obligation in receiving that benefit.⁵⁹ The important factor is **not the specificity of the policy language, but the restitutionary character of the payment.**⁶⁰ It does **not depend upon malfeasance** of the insured, for a party has no greater right to something acquired by mistake or accident than it does to something acquired by fraud⁶¹. There is an element of **public policy** as well. This reasoning does not apply to response costs by way of restitution to an environmental agency⁶², nor to any restitution of property that the insured did not receive⁶³.

It has been said that the result should **not depend on any technical form of the claim or the settlement**, both of which may be manipulated, but upon the **substantive issue as to whether the insured is suffering a loss** through the liability, since the disgorgement of property that the insured is not entitled to withhold or the payment of an obligation for a benefit that the insured has received involves the insured in no loss, and indemnity predicates loss⁶⁴.

detriment constituting a loss: *Cargill Inc v National Union Fire Insce Co* 2004 Minn App LEXIS 33. See also *Bank of the West v Superior Court* (1992) 2 Cal 4th 1254, 1267; 833 P 2d 545; *Harry W Low v Golden Eagle Insce Co* 2003 Cal App Unpub LEXIS 8881; *Kentucky Assn of Counties v McClendon* 2005 Ky LEXIS 93, where the claim for recovery of increased salary that the insureds had illegally given themselves was shown not to be a claim in tort or for breach of a fiduciary duty. Although it was not discussed in such terms, the substance of the claim, although labelled as damages for conversion or trover, was in reality nothing more than a claim for restitution. This is consistent with the understanding that the insureds would have suffered no loss by returning what they had not been entitled to; and if there is no loss, there is nothing to indemnify.

⁵⁷ In some jurisdictions, there is public policy against cover for the "disgorgement" and the view that it is not insurable, but this is more simply justified on the basis that it does not amount to a loss: *Reliance Group Holdings Inc v National Union Fire Insce Co* 188 AD 2d 47 (NY App 1993); *Westfield Group v Campisi* 2006 US Dist LEXIS 24731; 2006 WL 328415 (WD Pa); *Western World Insce Co v Empire Fire & Marine Insce Co* 2006 US Dist LEXIS 83800; *Genesis Insce Co v Crowley* 2007 US Dist LEXIS 45878.

⁵⁸ *AIU Insce Co v Superior Court* (1990) 51 Cal 3d 807, 822; *State Farm Fire & Casualty Co v Superior Court* (1987) 191 Cal App 3d 74; *Jaffe v Cranford Insce Co* (1985) 168 Cal App 3d 930, 935; *Reliance Group Holdings Inc v National Union Fire Insce Co* 594 NYS 2d 20 (NY App 1993); *Level 3 Communications v Federal Insce Co* 272 F 3d 908 (7th Cir 2001) (insured obtained the claimant's company under false pretences); *Conseco Inc v National Union Fire Insce Co* 2002 WL 31961447 *12 (Ind App 2000); *Vigilant Insce Co v Credit Suisse First Boston Corpn* 782 NYS 2d 19, 20 (App Div 2004); *Vigilant Insce Co v Bear Stearns Cos Inc* 2006 WL 118368 *4 (NY Supp 2006) (disgorgement of commissions and other moneys improperly obtained not a "loss" simply because the complaint had not identified any particular funds as having been improperly obtained); *CNL Hotels & Resorts Inc v Houston Casualty Co* 2007 US Dist LEXIS 17904 (return of moneys gained by company through misrepresentation as to value of its shares). In *Limelite Productions Inc v Limelite Studios Inc* 60 F 3d 767 (11th Cir 1995), the insurer infringed a trademark and was ordered to pay its "ill-gotten profits". This was held to be covered by the policy since the damages awarded to the claimant were not based on restoring to the claimant something that had necessarily come from its pocket – the award is restitutionary in form but not in substance. In addition, the policy referred to "damages" but not to "loss"; but it is submitted that this should make no difference, since the basic nature of the policy is one of indemnity, which necessarily requires a loss. This case is of doubtful validity in that it allows the insured a windfall for its wrongdoing, except that the profits that it was required to restore came at the expense to it of earning the profits, and this may be the explanation for the court's conclusion. In *International Insce Co v Johns* 874 F 2d 1447 (11th Cir 1989), directors settled a claim by a shareholder for waste of the company's assets by returning part of 'golden parachute' payments they had received that had been the subject of the claim. The settlement was held to be a loss under their policy because they were entitled to the payments.

⁵⁹ *SWH Corpn v Select Insce Co* 2006 Cal App Unpub LEXIS 8694 (wages owing to an employee). In this case, the exclusion of restitution from the cover, and its possible application to wages, is recognised, but there is a suggestion that it may be limited to those occasions when public policy against a person's retaining a benefit from fraud and the like would be influential; but there is no discussion of the limitation arising from the factor of indemnity. In *Cortez v Purolator Air Filtration Co* 23 Cal 4th at 177-8, the recovery of unlawfully withheld wages was restitutionary. See also *Bank of the West v Superior Court* (1992) 2 Cal 4th 1254, 1272.

⁶⁰ It does not affect this that part of the amount restored to the claimant goes to its lawyers as payment of its legal expenses: *CNL Hotels & Resorts Inc v Houston Casualty Co* 2007 US Dist LEXIS 17904.

⁶¹ *Conseco* (supra); *CNL Hotels & Resorts Inc* (supra).

⁶² *Aerojet-General Corpn v Superior Court* (1989) 211 Cal App 3d 216, 231

⁶³ *Level 3* (supra); *CNL Hotels & Resorts* (supra). It is submitted that this exception does not extend to the case where the insured has not directly received the property but has directed the benefit to another. In *Level 3*, it was said that where an officer of a company had stolen property for the company's benefit without its knowledge and the company had innocently defended the action seeking the property's return, the company would suffer an indemnifiable loss in the costs to it of conducting the defence.

⁶⁴ An ordinary reasonable insured would understand that, in this context, "loss" and its derivatives would not comprise the insured's return of property to which there was no entitlement. In *Securities & Exchange Comm v Rind* 991 F 2d 1486, 1493, it was held that a Commission order on the insured for disgorgement was not an award of damages but rather an order in equity to prevent unjust enrichment. This is the obverse of the more persuasive point that disgorgement predicates the absence of any loss to the party who

The removal of this feature of liability from the cover **does not eviscerate the policy**, and it would be unreasonable for an insured to expect otherwise.⁶⁵

Claims as to any personal profit or advantage gained to which the insured was not legally entitled are **often specifically excluded**.⁶⁶ This could lead to the inference that the exclusion is the limit of basis on which the insurer is entitled to decline cover.

Personal profit from a **fraud that the insured did not intend to pay back** cannot be treated as a loan, and comes within this exclusion.⁶⁷

Insurer's Obligation to defend

We are all familiar with the jurisprudence relating to the common condition in a policy that provides that the insurer has a **discretion** to take over the defence of the third party claimant's action in respect of a covered risk.⁶⁸ In the United States and Canada, a majority of cases in insurance litigation relate to the issue whether in respect of the underlying claim the insurer is **obliged** to provide the insured with a defence, engaged and paid for by the insurer. This is usually contained in the same condition.⁶⁹ It is somewhat the equivalent of an "advance of defence costs"

The reason for introducing the topic here is that such provisions are **now sporadically appearing in some policies in Australia** without much publicity, and some lawyers may not even bother to check or be aware of the provision or its implications.

The problem is when the **insurer declines to provide a defence because it says that the claim is not covered**. The problem is particularly acute because the **obligation to defend is much wider than the obligation to indemnify**. And **if the insurer wrongly refuses to provide a defence, its right to decline to indemnify may be adversely affected**.

The law on the topic is quite **complex – too much so to be discussed here**. Here are **a few brief statements of major principles** –

- The insurer's duty to defend is **very broad**. It is distinct from and **much broader than the duty to indemnify**.⁷⁰
- If **any or part of the claims**, or if only a single one or part of one, arguably arises from covered events, the insurer is required to defend the entire action; and it is immaterial if other claims fall within exclusions.⁷¹
- It **depends on the allegations in the claim**: the duty to indemnify depends on the findings at trial.⁷²

disgorges what was not properly his or hers. This case was followed in *Doeren Mayhew & Co PC v CPA Mutual Insce Co of America Risk Retention Group* 2007 US Dist LEXIS 1890, where the principle was applied to reach the strained construction that "money", as referred to in the insuring clause had an appropriately limited meaning. See also *Local 705 Int'l Bhd of Teamsters Health & Welfare Fund v Five Star Managers* 735 NE 2d 679, 682 (Ill 1st Dist 2000); *Federal Insce Co v Arthur Andersen LLP* 2005 US Dist LEXIS 15706.

⁶⁵ *Conseco* (supra); *CNL Hotels & Resorts Inc* (supra).

⁶⁶ See, for example, *Westport Insce Corp v Black Davis & Shue Agency Inc* 2007 US Dist LEXIS 39039. Personal profit from a fraud that the insured did not intend to pay back cannot be treated as a loan, and comes within this exclusion: *Westport Insce Corp v Hanft & Knight PC* 2007 US Dist LEXIS 90599

⁶⁷ *Westport Insce Corp v Hanft & Knight PC* 2007 US Dist LEXIS 90599.

⁶⁸ In liability insurance, the risk is the **insured's liability**, in respect of specified matters, to a third party.

⁶⁹ This aspect of the cover is so ubiquitous and is regarded as so important to the insured that in some jurisdictions it has been implied from those factors alone, unless there is an express provision to the contrary. The absence of the first factor in Australia would deprive such an inference of validity here – at present.

⁷⁰ *Open Software Foundation Inc v United States Fidelity & Guaranty Co* 2002 US App LEXIS 20873. LEXIS 6100.

⁷¹ *Montrose Chemical Corp v Superior Court* (1993) 6 Cal4th 287, 300; *Employees Insce Representatives Inc v Employers Reinsurance Co* 653 So 2d 27, 29 (La App 1st Cir 1995); 658 So 2d 1268; *Motorola Inc v Associated Indemnity Corp* 2002 0716 (La App 1 Cir 06/25/04) 2004 La App LEXIS 1641; *General Motors Corp v Royal & Sun Alliance Insce Group plc* 2007 Mich App LEXIS 1113; *Frog, Switch & Mfg Co v Travelers Insce Co* 193 F 3d 742, 746 (3rd Cir 1999); *Westport Insce Corp v Black, Davis & Shue Agency Inc* 2007 US Dist LEXIS 39039; *Insce Commr of the State of California v Golden Eagle Insce Co* 2007 Cal App LEXIS Unpub 2485; *Horace Mann Insce Co v Leeber* 376 SE 2d 581, 584; *Westfield Insce Co v Merrifield* 2008 US Dist LEXIS 8554; *Home Depot USA Inc v National Fire Insce Co of Hartford* 2007 US Dist LEXIS 20032.

⁷² *The Travelers Indemnity Co of America v Moore* 2007 Tenn LEXIS 234.

- To determine whether the duty exists, the courts first look to the allegations within the four corners⁷³ of the underlying complaint, as enlarged by the insurer's actual or constructive knowledge. Evidence of such knowledge is admissible unless the claim unambiguously excludes cover, that is, without consideration of extraneous evidence or the potential inapplicability of the policy.⁷⁴ (There is a qualification to this when the insured can show an intention to plead self-defence, which goes to the issue of "accidental or unexpected" harm, and which must usually be raised in the defence⁷⁵. The test depends on the scope of the allegations made against the insured.⁷⁶) When the underlying action is indisputably outside the cover, the insurer is not required to defend though the claim alleges facts that are within it.⁷⁷ The injury referred to in the claim, as enlarged by the insurer's actual or constructive knowledge, must have the necessary causal nexus to covered conduct.⁷⁸
- The focus is on the factual allegations in the claim and not on the causes of action pleaded.⁷⁹ The insurer may rely on the gravamen of the allegations rather than the form in which they are couched. If the substance of the claim is outside the scope of the cover or excluded from it, the duty does not arise.⁸⁰ For example, a claim of sexual assault must fall within an exclusion relating to intentional acts even if it is pleaded as negligence⁸¹, or as derivative negligence such as in failing to supervise a party who commits a sexual assault.⁸² The test objectively analyses the relevant conduct in order to assess whether the act, to any reasonable mind, betrays an unequivocal intent to inflict an unmistakable injury. If so, the conduct alleged could not be interpreted as coming within the plea in negligence⁸³. But this applies only when the result is conclusive and not if there is an alternative possible finding that is within the cover.⁸⁴ Ambiguity in the pleadings will favour the insured if the ambiguity leaves

⁷³ The "four corners rule", sometimes said to be the "eight corners rule" by matching the four corners of the claim with the four corners of the policy.

⁷⁴ For example, a complaint of sexual assault upon a child: cf *Yount v Maisano* 627 So 2d 148 (La 1993); *Vaughn v Franklin* 785 So 2d 79, 84 (La App 1st Cir 2001); v *State Farm Insce Co* 632 So 2d 736, 743 (La 1994); *Ledbetter v Concord General Corp* 665 So 2d 1166, 1169 ((La 1996); *Motorola Inc v Associated Indemnity Corp* 2002 0716 (La App 1 Cir 06/25/04) 2004 La App LEXIS 1641; *American Home Assce Co v United Space Alliance LLC* 2004 US App LEXIS 15606; *The Burlington Insce Co v Texas Krishnas Inc* 2004 Tex App LEXIS 5795; *Curb v Texas Farmers Insce Co* 2005 Tex App 4480; *Warnke v Brick Oven Pizza & Pasta Café Inc* 2007 US Dist LEXIS 17186; *Scopel v Donegal Mutual Insce Co* 698 A 2d 304 (Pa 1994); *Westport Insce Corp v Black, Davis & Shue Agency Inc* 2007 US Dist LEXIS 39039.

⁷⁵ *Royal & Sun Alliance Insce Co of Canada v Thorne* (2003) 230 DLR (4th) 587.

⁷⁶ *Westfield Insce Co v Milwaukee Insce Co* 2005 Ohio App LEXIS 4255.

⁷⁷ *Preferred Risk Insce Co v Gill* 507 NE 2d 1118 ((Ohio 1987).

⁷⁸ *Open Software Foundation Inc v United States Fidelity & Guaranty Co* 2002 US App LEXIS 20873.

⁷⁹ *National Union Fire Insce Co v Merchs Fast Motor Lines Inc* 939 SW 2d 139, 141 (Tex 1997); *Trinity Universal Insce Co v Employers Mutual Casualty Co* 2008 US Dist LEXIS 39581.

⁸⁰ *Thomas v Appalachian Insce Co* 335 So 2d 789, 792 (La App 1st Cir 1976); *Minnesota Mining & Mfg Co v Travelers Indemnit Co* 457 NW 2d 175, 179 (Minn 1990); *Motorola Inc v Associated Indemnity Corp* 2002 0716 (La App 1 Cir 06/25/04) 2004 La App LEXIS 1641; *United National Insce Co v Parish* 48 Mass App Ct 67 (1999); *Peters v United National Insce Co* 53 Mass App Ct 775 (2002) (assault and battery); *Erie Insce Exch v Muff* 851 A 2d 743, 745 (Pa 1999); *Westport Insce Corp v Black, Davis & Shue Agency Inc* 2007 US Dist LEXIS 39039.

⁸¹ See also *Montgomery County Board of Education v Horace Mann Insce Co* 2003 Md App LEXIS 192; *Mutual Benefit Insce Co v Haver* 725 A 2d 743 (1999); *Donegal Mutual Insce Co v Baumhammers* 2004 Pa Super 397; 2004 Pa Super LEXIS 3832; *Acceptance Insce Co v Seybert* 757 A 2d 380 (Pa Super Ct 2000); *Erie Insce Exchange v Fidler* 808 A 2d 587 (Pa Super Ct 2002); *Allstate Insce Co v Mugavero* 79 NY 2d 153.

⁸² *Fire Insce Exchange v Cornell* 2004 Nev LEXIS 40; 120 Nev Adv Op Rep 35; *Maryland Casualty Co v Lab Discount Drug Inc* 2006 US Dist LEXIS 83682. In particular, a sexual assault on a child is inherently harmful, and so the deliberate conduct is deemed to be deliberate as to the consequences; *Doe v Liberty Mutual Insce Co* 423 Mass 366, 369 (1996).

⁸³ *Timpson v Transamerica Insce Co* 41 Mass App Ct 344 (1996).

⁸⁴ *Essex Inse Co v Starlight Management Co* 2006 US App LEXIS 24362; *Royal Insce Co of America v The Boston Beer Co Inc* 2007 US Dist LEXIS 25513.

such a finding possible. Even if the allegation asserts nothing but intentional acts, if one of the claims can be proved without an element of intention, there is a duty to defend.⁸⁵

- The insurer must provide a defence whenever the **allegations of the claim suggest, or the insurer has actual knowledge establishing, a reasonable possibility of cover, that is, one that is “fairly debatable”**.⁸⁶ The cause of action stated need give rise to only a **possibility**, not necessarily a probability, of recovery.⁸⁷ The test is whether the allegations in the claim are reasonably susceptible of an interpretation that the claim **may be covered**, that is, whether the claim could, without amendment, impose liability for covered risks.⁸⁸ The favoured expression is “**potential**” because the cover extends to claims where a covered risk is not pleaded but where there is a **potential that a covered risk may be found as an alternative**.⁸⁹ Although a primary allegation may clearly fall within an exclusion, such as in the case of a claim for fraudulent breach of a fiduciary duty, or a breach of contract, if it is possible that a finding outside the exclusion and within the cover may be made, such as a finding of simple actionable negligence, the duty applies.⁹⁰ Any doubt should be resolved in favour of the insured.⁹¹ It is not necessary for the claim to delineate, specifically and unequivocally, a claim within the cover.⁹² The insured may lead evidence to establish the potential for the claim to lead to cover.⁹³
- Once the obligation to provide the defence arises if even part of the allegations comes within the cover, the duty **remains throughout, even if the claim is amended to remove the only ground on which the duty arose**.⁹⁴
- The duty operates **irrespective of the quality of the claim**. If it is within the cover, whether it is **frivolous or plainly wrong** is immaterial.
- To avoid the duty on the basis of a policy **exclusion**, the insurer must show that the **claims in the complaint fall solely and entirely within the exclusion** and that the allegations *in toto* are subject to no other reasonable interpretation and that no legal or factual basis exists that would potentially oblige the insurer to indemnify the insured.⁹⁵ It is a heavy burden to show that the allegations cast the pleadings wholly within the exclusion and that there is no possible factual or legal basis for finding liability covered by the policy.⁹⁶
- If there is a **possible conflict of interest** because one of the claims is plainly excluded and the alternative claim is within the cover, the insurer may avoid estoppel if it agrees to defend the insured on the latter while refusing to defend on the former.⁹⁷

⁸⁵ *Napoli Kaiser & Bern LLP v Westport Insce Corp* 2003 US Dist LEXIS 22497, which gathers the New York authorities on this topic.

⁸⁶ *Liebovich v Minnesota Insce Co* 2007 Wisc App LEXIS 34; *Willoughby Hills v Cincinnati Insce Co* (1984) 9 Ohio St 3d 177,180; 459 NE 2d 555; that is one that is arguably or partially within the cover: *Cincinnati Insce Co v HPE Inc* 2005 Ohio App LEXIS 3994.

⁸⁷ *Simplex Techs Inc v Liberty Mutual Insce Co* 429 Mass 196 (1999); *Royal Insce Co of America v The Boston Beer Co Inc* 2007 US Dist LEXIS 25513.

⁸⁸ *Horace Mann Inse Co v Leeber* 376 SE 2d 581, 584; *Westfield Insce Co v Merrifield* 2008 US Dist LEXIS 8554.

⁸⁹ *Brohawn v Transam Insce Co* 347 A 2d 842 (1975); *Moscarillo v Professional Risk Management Services Inc* 2007 Md LEXIS 185.

⁹⁰ For example, if a claim alleges deliberate harm, which is outside the cover, but has the potential that the insured will be found liable in negligence, the duty to defend operates. This defeats the insurer frequently.

⁹¹ *Penn-Am Insce Co v Disabled Am Veterans Inc* 490 SE 2d 374 (Ga App 1997); *BBL-McCarthy LLC v Baldwin Paving Co* 2007 Ga App LEXIS 419

⁹² *Horace Mann Insce Co v Leeber* 376 SE 2d 581, 584; *Westfield Insce Co v Merrifield* 2008 US Dist LEXIS 8554.

⁹³ Such as self defence as a defence to allegations of assault, but not for the purpose of a frivolous defence to attract cover: *Aetna Casualty & Surety Co v Cochran* 651 A 2d 859, 863 (Md 1995). But it must relate to a cause of action actually alleged in the pleading, and it cannot be used to create a new unasserted claim that would create a duty to defend: *Walk v Hartford Casualty Insce Co* 852 A 2d 98 (Md 2004); ; *Moscarillo v Professional Risk Management Services Inc* 2007 Md LEXIS 185.

⁹⁴ *Home Depot USA Inc v National Fire Insce Co of Hartford* 2007 US Dist LEXIS 20032.

⁹⁵ *Frontier Insulation Contractors Inc v Merchants Mutual Insce Co* 690 NE 2d 866 (NY 1997) *The Trustees of Princeton University v National Union Fire Insce Co of Pittsburgh Pa* 2007 NY Misc LEXIS 2350.

⁹⁶ See, for example, *Kelleher Construction Corp v Transportation Insce Co* 2008 US Dist LEXIS 57009.

⁹⁷ *Burd v Sussex Mutual Insce Co* 267 A 2d 7 (NJ 1970); *New Jersey Mfrs Insce Co v Vizcano* 2007 NJ App LEXIS 124.

- **The duty persists until the issue is adjudicated.**⁹⁸ It endures until it is determined with certainty that the policy does not provide cover⁹⁹; but **not when all the claims are clearly and indisputably outside the cover.**¹⁰⁰ There is no duty to defend if at the time the claims were advanced, **the insurer could reasonably have concluded that no aspect of the claim fell within the scope of the cover.**¹⁰¹ The cover does not extend so far: the insurer is not obliged to provide a defence.¹⁰²
- There are **exceptions to the rule that the matter is to be considered within the four corners of the complaint:** if cover is not clear on the face of the complaint, but may exist, the insurer must investigate it and give the insured the benefit of the doubt; if the allegations are in conflict with facts known to or readily ascertainable by the insurer; or if the complaint's allegation as are ambiguous or inadequate.¹⁰³ The insurer's obligation is based, not only on the facts alleged in the complaint, but also on the facts that are known or readily known to it.¹⁰⁴ The relevant material may also include other facts that the insurer could have discovered on reasonable enquiry, but the mere fact of the insurer's failure to make reasonable enquiry does not predicate that such facts exist, so their existence must be proved.¹⁰⁵ They also include facts adumbrated by the pleadings.¹⁰⁶ Extrinsic evidence of facts may be led¹⁰⁷, not to provide a factual predicate for the duty to defend nor to challenge anything contained in the pleadings, but to aid in explaining the claim and its potential scope.¹⁰⁸ The insured cannot establish an entitlement simply by telling the insurer facts. The insurer must give consideration to facts outside the complaint when it considers the allegations in the complaint to determine if cover exists.¹⁰⁹ The court will not stretch the allegations beyond reason.¹¹⁰ In some jurisdictions, it is said that the insurer's duty is determined by the allegations in the claim and the policy, without regard to consideration of extraneous evidence of potential inapplicability of the policy, so that, unless the alleged facts support an exclusion, it is immaterial whether the insurer can show that a particular exclusion is applicable.¹¹¹
- **The insurer must show that each and every claim is unambiguously not covered or unambiguously excluded from cover.** The rule favouring the insured in respect of ambiguities is even stronger in respect of an exclusion and in the context of the issue of a duty to defend. The factual allegations are to be liberally interpreted, and the test is not whether the allegations unambiguously assert cover, but rather whether they do not unambiguously exclude it.¹¹²

⁹⁸ *In re Worldcom Inc* 2005 US Dist LEXIS 1466.

⁹⁹ *Willoughby Hills v Cincinnati Insce Co* 459 NE 2d 555 (Ohio 1984).

¹⁰⁰ *Preferred Risk Insce Co v Gill* 507 NE 2d 1118 (Ohio 1987); *Cincinnati Insce Co v Anders* 789 NE 2d 1094 (Ohio 2003).

¹⁰¹ *Polaroid Corpn v Travelers Indemnity Co* 610 NE 2d 912, 916 (Mass 1993); *General Motors Corpn v Royal & Sun Alliance Insce Group plc* 2007 Mich App LEXIS 1113.

¹⁰² *General Motors Corpn v Royal & Sun Alliance Insce Group plc* 2007 Mich App LEXIS 1113.

¹⁰³ *E_Z Loader Boat Trailers Inc v Traveles Indemnity Co* 726 P 2d 439 (1986); *Truck Insce Exchange v Vanport Homes Inc* 58 P 3d 276 (2002); *Holly Mountain Resources Ltd v Westport Insce Corpn* 2005 Wash App LEXIS 59.

¹⁰⁴ *Desrosiers v Royal Insce Co of Am* 468 NE 2d 625, 627; *Federal Inse Co v Raytheon Co* 2005 US App LEXIS 22742.

¹⁰⁵ *Peterson v The Ohio Casualty Group* 2006 Neb LEXIS 172; *Naddeo v Allstate Insce Co* 533 SE 2d 501, 506 (NC 2000).

¹⁰⁶ *Open Software Foundation Inc v United States Fidelity & Guaranty Co* 2002 US App LEXIS 20873. LEXIS 6100.

¹⁰⁷ For example, letters from the claimant.

¹⁰⁸ *Open Software Foundation Inc v United States Fidelity & Guaranty Co* 2002 US App LEXIS 20873. LEXIS 6100. In some jurisdictions, the limitation on extrinsic evidence is much stricter than this: *Trinity Universal Insce Co v Employers Mutual Casualty Co* 2008 US Dist LEXIS 39581, where it is said that the only exceptions to the exclusion of the evidence are the clarification of ambiguity in the underlying allegations, and when the proffered evidence is relevant only to the issue of cover and neither overlaps with the merits of the underlying suit nor contradicts the allegations in the pleading of the claim.

¹⁰⁹ *Ibid.*

¹¹⁰ *Cardiothoracic & Vascular Surgical Specialists Inc v Travelers Indemnity Co* 2006 Ohio App LEXIS 6857.

¹¹¹ *Yount v Maisano* 627 So 2d 148 (La 1993); *Warnke v Brick Oven Pizza & Pasta Caf  Inc* 2007 US Dist LEXIS 17186.

¹¹² *Vaughn v Franklin* 785 So 2d 79, 84 (La App 1st Cir 2001); *v State Farm Insce Co* 632 So 2d 736, 743 (La 1994); *Motorola Inc v Associated Indemnity Corpn* 2002 0716 (La App 1 Cir 06/25/04) 2004 La App LEXIS 1641. Any doubts are resolved in favour of the insured: *West Bend Mutual Insce Co v Sundance Homes Inc* 238 Ill App 3d 335; 606 NE 2d 326 (Ill 1992); *Association of Trial Lawyers Assce v Tsai* 2004 Miss LEXIS 1012.

- **If the insurer wishes to contest** its obligation to defend a claim tendered to it by the insured, **it must either defend it under a reservation of rights and afterwards contest its liability** to provide indemnity for any adverse judgment; **or it may reserve its rights and at once seek a declaratory judgment** that it is not obliged to conduct the defence.¹¹³ **Wrongful failure to do so¹¹⁴ may lead to an estoppel** from denying that the claim is covered; but such estoppel will not arise when the insurer has not breached its duty to defend, which does not arise when there is clearly no cover.¹¹⁵
- If the **insurer defends and enters into a settlement under a reservation of rights** in respect of a denial of cover, and the **insured** is aware of the conflict of interest but **does not seek separate representation**, the **insurer is not later estopped** from seeking to recover its payment to the third party and expenses incurred in the defence if the claim is found to have been outside the cover.¹¹⁶
- In **some jurisdictions, a unilateral defence under a reservation of rights may amount to a refusal** to provide a defence. This would enable the insured to reject the defence and retain its own lawyers without jeopardising its rights to indemnity.¹¹⁷
- In order to enforce this indemnity, **the insured must elect** to have it by tendering the defence to the insurer, but lateness in doing so does not matter if the insurer is not prejudiced.¹¹⁸
- The **insurer's reservation of rights does not amount to a repudiation** that relieves the insured from compliance with the terms of the policy.¹¹⁹
- A **determination that the insurer is not obliged to defend the insured** will also mean that the insurer is not bound to provide indemnity on the claim.¹²⁰
- **Defence costs will be shared between all insurers whose policies cover the causes of action** included in the action¹²¹; but this does not apply when the claim is plainly and totally derivative from an excluded circumstance, even though the cause of action pleaded does not itself answer the exclusion.

There is **much more** in the fine print that you would need to become acquainted with, but this is enough to demonstrate the complexity of the matter and some of the dangers to be aware of, and, being aware, to avoid.

A Danger in Proportionate Liability Clauses

If a policy contains a **provision to the effect that**, if there is another operative cover for the claim, the **insurer will be liable for only a proportionate share of the indemnity**, and if the provision applies in the circumstances because there is another insurer with a policy with a similar limitation, a difficulty arises if the **insurer voluntarily pays out the whole of the claim** and then tries to recover from the other insurer its proportionate share of the liability.¹²²

In such a case, the **insurer's liability under the cover is limited to the specified proportion** of the loss and the **other insurer's liability is limited to the other proportion** of the loss. It is not as though they are both liable for the whole of the loss and entitled to contribution between themselves. Because its liability is so limited, that is, it does not cover the balance, if it **voluntarily pays more than it is obliged to pay, it cannot claim contribution from the other insurer**. This is because their policies do not cover the same loss. They cover different proportions or parts of the loss.

¹¹³ *Association of Trial Lawyers Assce v Tsai* 2004 Miss LEXIS 1012.

¹¹⁴ That is, although in the end the claim is not within the cover, the insurer may have been in the wrong for failing to defend because at that time, the claim may have been potentially within it.

¹¹⁵ *Employers Insce of Wausau v EHLCO Liquidating Trust* 708 NE @d 1122, 1135 (Ill 1999); *St Paul Fire & Marine Insce Co v Village of Franklin Park* 2008 US Dist LEXIS 8718.

¹¹⁶ *American Guarantee & Liability Insce Co v CNA Reinsce Co* 2005 NY App Div LEXIS 2258.

¹¹⁷ *Aguero v First American Insce Co* 2005 Fla App LEXIS 14055, where the conflicting authorities are discussed.

¹¹⁸ *BBL-McCarthy LLC v Baldwin Paving Co* 2007 Ga App LEXIS 419.

¹¹⁹ *Motiva Enterprises LLC v St Paul Fire & Marine Insce Co* 2006 US App LEXIS 7649.

¹²⁰ *NCMIC Insce Co v Johnson* 2006 US Dist LEXIS 20108.

¹²¹ *Hartford Insce Co v Everest Indemity Insce Co* 2006 Ill App LEXIS 1227; *Liebovich v Minnesota Insce Co* 2007 Wisc App LEXIS 34.

¹²² *Trinity Universal Insce Co v Employers Mutual Casualty Co* 2008 US Dist LEXIS 39581.

Further, because the **insured will have been fully indemnified**, it will have **no remaining loss for which it may claim indemnity**, and so there is **no right** against the 'other insurer' to which the 'paying insurer' might be **subrogated**.

Warning: If you are the paying insurer, do not pay more than your share. If you are the other insurer, send the paying insurer a "thank you" note.

Puzzle:

If a potentially faulty pacemaker is implanted and is removed by operation as a precaution:

Is there an "occurrence"?

Is there bodily injury?

When did it occur?

Is the operation to remove it "deliberate" bodily harm?