

**Farmers Mutual Association Limited v Watson (2001) 11 ANZ Insurance Cases**

This Court of Appeal judgment just escapes the 12 month period under review but is undoubtedly worthy of mention. The Watsons purchased a house. The house had been constructed on unfirm ground. Inevitably the house started to sink and was damaged. The Watsons sued a number of apparently responsible parties and also sued their insurer. The claim was declined on the basis that the damage resulted from subsidence. The subsidence exclusion was contained in a section of the policy bearing the subheading “War, nuclear and Natural Disasters”. The majority of the Court of Appeal determined that the policy was unhappily drafted and contained various ambiguities. The basis of the decision in favour of the insured, however, was that subsidence reasonably envisaged a natural cause and the subsidence exclusion positioned where it was in the policy was qualified by the heading “Natural Disasters”. This left unexcluded, according to the majority, such risks which were not the product of nature but of human conduct. In this case human conduct definitely played a part in creating the unstable ground and therefore the insurer was ordered to pay up.

The case is notable on two grounds. Firstly, a remarkably pithy dissenting judgment by Justice William Young. Justice Young looked at the subheading and looked at the various items caught by the subheading and seized upon the words “normal settlement, shrinkage or expansion of buildings, foundations, walls, pavements, roads and other structural improvements”. Justice Young determined that the majority decision was based on a view that “subsidence” would only be excluded if it was within the concept of a “Natural Disaster”. He held that the normal settlement, shrinking or expansion exclusion could not possibly be described as a natural disaster and could not easily be regarded as subsets of the concepts of war or nuclear disaster. It was inescapable for him, therefore, to conclude that the claim filed by the Watsons was within the exclusion paragraph.

The second notable point arising from this judgment is the importance accorded by the majority of the Court of Appeal to the insurer's marketing description of the policy. The policy was described by the insurer as inviting the insureds to "enjoy complete protection with total confidence. The promise of complete protection with total confidence appears to have weighed heavily with the majority of the Court of Appeal. That much is revealed by having regard to the judgment as a whole. There is a refrain occurring repeatedly throughout the majority decision relating to this particular promise. At paragraph 36 of the judgment it is held that it would be inconsistent with the commercial nature of the contract to take a microscopic view of the physical mechanism causing loss. "Such a view would be inconsistent with the policy's bold assurance of "complete protection with total confidence"."

At paragraph 40 the majority stated "The question then resolves itself into a consideration of whether there is anything else wherein the policy which displaces an otherwise reasonable appreciation of what the parties intended, which of course included the assurance to the targeted market of complete protection with total confidence."

Reference is also made to paragraph 44 of the decision where it is held "To regard the loss as having been caused, even indirectly, by natural mechanisms would be an over-technical appreciation, quite at odds with the intention of the parties to assure the older demograph of confidence in their insurance cover. The policy having purported to be generous should not too readily be allowed to invoke a parsimonious interpretation."

It is of course not possible to gauge the precise weight given by the majority in the Court of Appeal to the insurer's promise to provide complete protection with total confidence. The many repeated references to that promise, however, seem to indicate at least that the promise played some substantive part in the judicial determination.

What then can we learn from this decision? I am not suggesting that all puffery be excised from policy documents. The market would not stand for that. Some care, however, has to be taken. If the relevant policy contains an apparent absolute promise of protection and confidence then New Zealand courts will seize upon those words as a means of defeating technical arguments raised by the insurer.

The next lesson is for the policy draftsman. If you use subheadings, make sure they are appropriate. Then question whether they are really necessary? If they are intended to provide plain English assistance to insureds then do they really fulfil that purpose or do they merely confuse or worse give grounds for a court to find ambiguity.

**Hugo trading as Hugo Auto Services v AMP General Insurance (NZ) Limited  
(2002) 12 ANZ Insurance Cases 61-529**

Mr Hugo was in business as a mechanic who carried out some work refitting a steering box on a truck. A month after the work was carried out the driver experienced a sudden loss of steering and an accident occurred causing extensive damage to the vehicle. The vehicle was insured by NZI. NZI acted quickly. They retained a consulting engineer and loss adjuster. Mr Hugo was interviewed by both of these gentlemen. He made various statements about the nature of the work carried out and the cause of the accident. NZI sent a hold liable letter to Mr Hugo. Then and only then did he notify his insurer AMP as to a possible claim under the policy. AMP declined Mr Hugo's claim initially on the basis of late notification but by the time the matter went to court the declinature was based not only on that ground but also on breach of condition 3(c) of the policy which provided "You must not make or give any admission, offer, promise, payment or indemnity".

According to AMP Mr Hugo committed three sins. Apparently he stated to a representative from NZI that he was not aware that there was a special tool for fitting the steering drop arm and that he used a heavy hammer instead. His second damning admission was that when he had a look at the truck after the accident he observed that the drop arm was separated from the steering box shaft, that the grub screws were protruding and that they could be turned by hand. Finally, Mr Hugo commented after the accident to the consulting engineer that the accident was a serious thing to have to happen about which he was worried at the time.

At first instance the District Court upheld the declinature. The Judge found Mr Hugo made statements which were admissions. The Judge considered the provisions of section 11 of the Insurance Law Reform Act and said that Mr Hugo had failed to discharge the onus imposed by section 11, in other words that he had failed to prove on the balance of probabilities that the breach of the condition did not cause or contribute to the loss.

On appeal the decision was reversed by Justice Panckhurst. Justice Panckhurst analysed the various statements or admissions made by Mr Hugo which included for the reasons set out in the judgment, that none of the admissions or statements had caused or contributed to the loss. In the body of the decision he dealt at length with section 11 of the Insurance Law Reform Act and its relevance to the facts of the case.

When I first began to read the decision it was with great expectation. It had been over a decade since the decision in *NZI v Harris* (1990) 1 NZLR 10 (CA). I have always held strong personal views about the applicability or otherwise of section 11 of the Act. Those views have been held by me in an academic sense only since judges at the highest level have thought differently. Nevertheless after over a decade's silence I hope to find a refreshing reassessment of the applicability of section 11. The decision was comprehensive, well

reasoned and possibly correct but I was disappointed to read that Justice Panckhurst thought that section 11 was relevant to his determination.

Section 11 of the Insurance Law Reform Act does not appear on its face to present any real interpretation problem. You all know the section, probably by heart. Subsection (a) refers to exclusions or provisions within a contract of insurance being so defined as to exclude or limit the liability to indemnifiers. There is nothing magical about this. Such provisions are called exceptions, exclusions and/or conditions. Subsection (b) requires a little more analysis. To be applicable the liability of the insurer must have been so defined because the happening of such events or the existence of such circumstances was in the view of the insurer likely to increase the risk of such loss occurring. What is the loss we are discussing? It has to be the loss for which the insured seeks to be indemnified. This can be loss sustained by way of damage to the insured's own property or as in the Hugo case, loss resulting from negligent work carried out with the damage being suffered by a third party. A hypothetical, indeed a classic example, demonstrate how section 11 operates. An insurer in a motor vehicle policy will also always require the driver not to be under the influence of alcohol. Subsection (a) is satisfied. Subsection (b) is similarly satisfied. A drunk driver is more likely to cause loss, either his own or a third party's. Ordinarily the insurer will prevail. In exceptional circumstances, however, the insured can take advantage of section 11 by proving on the balance of probability that although he was drunk his drunkenness did not cause or contribute to the loss since at the time of the collision with the third party vehicle he was in fact stationary and in a lawful position on the road. This is, as I have said, a classic demonstration on how section 11 can and should work. Contrast this, however, to the facts of the Hugo case. The loss referred to in section 11 is the loss for which Mr Hugo sought to be indemnified, i.e. any damages for which he would be found liable at the suit of the truck owner. Refer also to exclusion 3(c) which provided that "You must not make or give any admission, offer, promise, payment or indemnity". Subsection (a) of section 11 is satisfied,

of that there can be no doubt. But what of subsection (b). Remember that the loss is as a result of the alleged negligent work on the truck. How could it possibly be argued that such loss could have been caused or contributed by Mr Hugo making some alleged admission of responsibility after the accident had occurred? This is not like the drunken driver. His very drunkenness causes the collision and thus the loss. By the time Mr Hugo spoke to the loss adjuster and consulting engineer, the damage had already occurred. Undoubtedly an admission by an insured can prejudice an insurer but does such an admission actually cause or contribute to the loss for which the insured seeks to be indemnified by the insurer? I say no. Justice Panckhurst said yes. His reasoning seemed to be based for the most part on the belief that the loss in question was in fact the establishment of liability for that loss. I do not see that it is necessary to read such words into the terminology of section 11.

Mr Hugo's position with regard to his pre-accident work would always remain the same. He did not use the required tool. Instead he used a heavy hammer. If his work was defective since he failed to use the proper tool and if as a result the steering mechanism became detached, then these actions caused the loss. Mr Hugo telling NZI what he had done did not cause the loss. It may have made NZI's job easier to establish liability for that loss but it was not causative of the loss.

In my personal view, not shared by higher authority, conditions such as condition 3(c) here should not be caught by section 11 at all.

It seems that counsel for Mr Hugo at the trial was of a similar view since one of the five points on appeal raised by him was that the "so-called admissions" were "outside the parameter of section 11" because they concern factual matters which, in the circumstances, were shown to have no causative or contributory potential. That submission was not dealt with at face value by Justice Panckhurst. He preferred the view that the so-called admissions did not cause or contribute to the loss because there was ample evidence available to the

truck owner to establish liability against Mr Hugo without regard to the admissions. That may be so but the submission raised by counsel for Mr Hugo appears not to have been dealt with. In my view section 11 was not relevant in the Hugo decision and there are many other standard exceptions and conditions in current insurance policies which in my view are not caught either. How then in my view should the matter have proceeded? If section 11 did not apply then AMP's reliance on breach of condition 3(c) presents as a stand alone argument. If condition 3(c) is a true condition and if there was in the policy a statement to the effect that compliance with the terms and conditions of the policy is a condition precedent to indemnity and if breach was proven then the insurer should have won. That is a matter of contract law. Prejudice can be proven in the normal fashion. Mr Hugo should have contacted his insurer as soon as he was contacted himself by NZI. He should have made no statement whatsoever to NZI before contacting AMP. Prejudice or loss of bargaining position can be demonstrated. I cannot speak for AMP and its claim team but if Mr Hugo had come clean to AMP before he came clean to NZI then in all likelihood AMP would have instructed their solicitor to deny liability and to settle for less than the full amount.

### **A v Michael Bernard Bottrill**

This is not an insurance case but I imagine almost every person involved in the insurance industry has eagerly awaited the pronouncements in the very recent decision of the Privy Council. Our Court of Appeal held that exemplary damages could only be awarded by the Court where the defendant's conduct amounted to deliberate or reckless risk-taking. The test of conscious risk-taking would be satisfied where on an objective assessment, the defendant had an actual appreciation of the risk or was recklessly indifferent to the consequences and must be taken to have been content for the consequences to happen as

they did. Such words must have brought a smile to the faces of both underwriters and claims managers. What the Court of Appeal was saying in the insurance context was that there was no exposure for underwriters. If the insured's behaviour was deliberate or reckless then the claim could be declined.

Unfortunately the Privy Council did not agree. The majority decision was delivered by Lord Nicholls of Birkenhead. Lord Birkenhead, while disagreeing with the majority decision in the Court of Appeal, has fortunately however not opened the floodgates. At paragraph 24 of the majority decision it is stated as follows:

“Overwhelmingly, in the exceptional cases where questions of exemplary damages fall to be considered at all, the defendant's misconduct will be of a subjectively advertent nature as just described. Overwhelmingly, in cases of negligence, whose essential ingredients are objective in character (“ought to have known”), an award of exemplary damages will be appropriate only where the defendant's wrong-doing was intention or consciously reckless.”

Lord Birkenhead then at paragraph 7 sounds a warning:

“Never say never is a sound judicial admonition. There may be the rare case where the defendant departed so far and so flagrantly from the dictates of ordinary or professional precepts of prudence, or standards of care, that his conduct satisfies this test even though he was not consciously reckless.”

In terms of practical assistance for trial judges, Lord Birkenhead offered the following comment in paragraph 37 of his decision:

“If, having heard all the evidence, a judge firmly believes the case is so truly exceptional and outrageous that an award of exemplary damages is called for, his power to make an award is not dependant upon his being able to conscientiously to

find that the defendant was subjectively reckless. The absence of intentional wrong-doing and conscious recklessness will always point strongly away from the case being apt for an award of exemplary damages. That is a very important factor to be taken into account by the judge. But if the judge decides that although the case is not one of intentional wrong-doing or conscious recklessness, the defendant's conduct satisfies the outrageous test and condemnation is called for, in principle the judge has the same power to award exemplary damages as in any other case satisfying this test."

The Court of Appeal argued on policy grounds that there should be a limitation on conduct justifying an award of exemplary damages. One of the policy considerations related to insurance ramifications.

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The Privy Council held that the policy reasons including the insurance ramifications are essentially "floodgates" arguments. At paragraph 59 Lord Birkenhead noted that it was important to distinguish between an increase in the number of unsuccessful claims for exemplary damages and an increase in the number of successful claims. He notes also that unsuccessful claims do not result in awards of exemplary damages but do involve defendants in expense and inconvenience. In this context read insurers instead of defendants. Lord Birkenhead had also noted at paragraph 60 that it is settled practice in New Zealand for judges to exercise this discretionary jurisdiction with great restraint and that awards when made are moderate. Lord Birkenhead is undoubtedly correct but from the insurance industry's perspective there are practical considerations to take into account. Whilst it is true that awards of exemplary damages have been moderate, the costs of and incidental to investigating the claims and litigating the claims including strike-out applications, are immense bearing little relevance to the actual awards of compensation when those claims are

successful. The Court of Appeal decision if upheld would have placed an impediment before the would-be plaintiff. Cases have been advanced on the basis that sooner or later a reasonable threshold in terms of degrees of negligence would be reached where that degree of negligence justifies an award of exemplary damages. The Court of Appeal's decision gave a guideline. That guideline has now been removed. No matter how many times the Privy Council states that the courts should use restraint and that cases of negligence justifying an award of exemplary damages are rare, there will always be the triers. There will always be solicitors acting for plaintiffs who believe that their case is special and that with a good tail wind and a sympathetic judge an award of exemplary damages will be made. For as long as that situation persists the insurance industry is exposed. The exposure may not be in respect of large awards of exemplary damages but there is financial exposure nevertheless. Some solicitors may well delight at this recent pronouncement by the Privy Council. I doubt if that delight will be shared by the insurance industry.

**Partridge v Wain & Naysmith (Blenheim District Court NP224/00, Wellington High Court AP1717/01, Judgment 5 June 2002)**

Finally, on a lighter and more encouraging note I refer you to this case, an unreported decision of Ongley DCJ in the District Court and Justice Ronald Young in the High Court at Wellington. For those of you involved in professional indemnity insurance, you can take heart that sensible solicitors can still give independent legal advice to little old ladies and escape civil liability when the transaction in question turns to custard. You may not have heard of the saying, "Sad cases should not give rise to bad decisions". I certainly had not until I made it up. The plaintiff here was the classic little old lady. She allowed her house to be mortgaged to enable her son to borrow some money for a business venture. As is often the case, the business venture was hopeless and failed. The mortgage debt was called up. In terms of sympathy the plaintiff had everything going for her. She was of advanced years, she

owned her own house but it was a modest dwelling. The mortgage debt with the incidence of penalty interest exceeded the value of the property. She was on a pension. Her family could not help. Everybody felt sorry for her including the defendant firm and their insurers. Last minute attempts to settle were unsuccessful. The asking price was simply too high and the matter proceeded to a defended hearing.

The solicitor in question escaped liability because he had done nothing wrong. He had behaved in an exemplary fashion. Whilst he might have appreciated the risks of acting in the circumstances, to have not acted would have resulted in the plaintiff finding an alternative solicitor. She was determined that the business loan should proceed and sooner or later she would have found a solicitor willing to help her.

The case is mentioned for two reasons. First of all for those involved in professional indemnity insurance, the decision provides an excellent summary of the relevant principles relating to conflict of interest and the general duties imposed upon a practitioner when giving independent legal advice. The case is also worth mentioning to those who hold the theory that insurance litigants, whether disclosed by name or disguised by subrogation rights, receive short, sharp shrift in New Zealand courts. Here there was a deserving plaintiff. She was facing the loss of her home. On the other side of the litigation was a firm of solicitors clearly indemnified by a rich insurer. Despite this, the law was applied appropriately and correctly and the correct decision was reached. How refreshing!