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BLUE MOUNTAINS FIRE CLASS ACTION

The 2013 Blue Mountains Fire Class Action: Do Insurers have the right to opt out of class actions on an insured's behalf?

Introduction

On 19 August 2015 Garling J of the Supreme Court of New South Wales delivered a judgment in *Johnston v Endeavour Energy* [2015] NSWSC 1117. He found that opt out notices filed by the insurers on behalf of over 550 of their insureds were invalid. In reaching this decision, the Court considered two key issues: the principles of subrogation and the relevant wordings in the insurance policies. This article will summarise the key findings on these two issues, and consider the implications the case will have on insurance policy drafting.

Facts

In 2014, a class action was commenced for damages caused in the 2013 Blue Mountains bushfire by Mr Johnston against Endeavour Energy at the Supreme Court of New South Wales (**Johnston Class Action**). In New South Wales a class action is an 'opt out' process. In other words, a representative plaintiff (in this case, Mr Johnston) can begin a proceeding on behalf of a class of people who suffered loss in the same event, and the class members remain as part of the proceeding until and unless they 'opt out' by filing opt out notices.

In the Johnston Class Action, class members were broadly defined as all who have suffered personal injury, property damage and economic loss as a result of the 2013 Blue Mountains bushfire. Many class members had properties insured by Insurance Australia Group Ltd or its subsidiaries (**IAG**). Most of these properties were under-insured.

On 10 October 2014, IAG filed notices purporting to opt out on behalf of 565 of its insureds from the Johnston Class Action. No instructions were obtained from any of the insureds prior to the filing of the notices. IAG claimed that it was entitled to file the notices because the insureds' rights had been subrogated to it, and/or it was contractually entitled to conduct recovery actions on behalf of the insureds.

After filing the opt out notices, IAG commenced a second class action against Endeavour Energy, purporting to include all class members who had opted out from the Johnston Class Action (IAG Class Action).

It appears that the underlying reason for the action of IAG was to ensure that it had priority over its insureds in respect of any recovered sum. It has been suggested that, if the 565 class members remained in the Johnston Class Action, they would be the dominus litis (ie. the persons to whom a suit belongs), and they would have the first priority to any recovered damages, including any uninsured losses. Only the amounts recovered above that (if any) would then be repaid to IAG. Removing the 565 class members from the Johnston Class Action to the IAG Class Action would reverse such priority, so that IAG would be paid first, and only the sum recovered in excess of the insured loss would be paid to the insureds.[1]

On 15 January 2015, the solicitors for Mr Johnston filed a Notice of Motion in the Johnston Class Action, seeking inter alia an order to set aside the opt out notices filed by IAG on the basis that they were invalid.

[1] See paragraphs [143] to [145] of *Johnston v Endeavour Energy* [2015] NSWSC 1117

The principles of subrogation

IAG claimed that it was entitled to file the opt out notices on the insureds' behalf as their rights had been subrogated to it. Generally speaking, the law of subrogation means that an insurer, having paid out the insured loss, is entitled to assume the rights of an insured, including the right to sue in the insured's name in order to recover the insured loss from a defendant.

The Court noted that subrogation is only applicable where an insurer has fully indemnified an insured for all the losses suffered arising from an event. In the event where an insured is under-insured (as in the present scenario), the insured retains his/her right to recover the entire loss as the *dominus litis*.[2] In other words, the insured retains the right to commence and control a recovery proceeding for both the insured and uninsured losses without the interference of the insurer. The insurer's right is limited to an equitable interest by way of a lien over the judgment sum recovered by the insured.

The Court noted that the insured interests of the 565 class members were not indemnified for their full value. In the circumstance, IAG had no entitlement to assume the conduct of the proceeding on behalf of the insureds, and accordingly, did not have the right to file the opt out notices on their behalf under the principles of subrogation.

IAG's contractual right under insurance policies

The Court then turned to look at the question of whether IAG had any contractual right to conduct recovery actions on behalf of the insureds under the relevant insurance policies.

There were 24 separate policies of insurance. It was conceded in relation to 7 of these policies (covering 12 insureds) that IAG was authorised to file the opt out notices, and nothing further was said about them. The rest of the policies could be grouped as follows:

Group	Comments	Example wordings
1	Group 1 comprised of 8 policies covering 553 insureds. None of these policies contained a clause by which the insureds explicitly assigned to IAG the rights to take proceedings against a third party. Two of the policies included clauses dealing generally with recovery from a third party, but these clauses had preconditions affixed to them, including the requirement that the insured request the insurer to recover uninsured loss from a third party on its behalf.	*"If we pay your claim and take steps to recover from a third party some or all of the amount we pay you, we may, if we choose to, also attempt to recover on your behalf, loss or damage which is not covered by your policy, but that you suffer in connection with the incident.* *This means we may decide to recover your uninsured loss, as well as our claim payment, from a third party.* *You must:* ▪ *have told us about your uninsured loss and asked us to seek recovery of it,* ▪ *provide us with any documents you have that prove your uninsured loss, and* ▪ *have entered into an agreement about the terms on which we, or our recovery agents or lawyers, will recover your insured loss on your behalf. You may need to contribute your share of any legal or recovery agent's costs.* *If we take steps to recover our claim payments, you agree that we can retain any amount we recover."*
2	Group 2 comprised of 9 policies covering 19 insureds. Most policies in this group (with the exception of one) contained a	*"In addition, you also give us your rights to claim from anyone else:* ▪ *if you have a right to claim from anyone else for an incident covered by us, you*

[2] See *Arthur Barnett Ltd v National Insurance Co of New Zealand Ltd* [1965] NZLR 874

Group	Comments	Example wordings
	clause by which the insureds gave IAG the rights to claim from third parties.	*give us your rights to make that claim, to conduct, defend or settle any legal action and to act in your name – you must not do anything which prevents us from doing this and you must give us all the information and co-operation that we require."*

In relation to the group 1 policies (covering 553 insureds), Garling J noted that:

- there was no assignment of rights to IAG to recover uninsured loss in any of the policies; and
- there was no evidence that any of the insureds had asked IAG to recover their uninsured loss from any third parties. In this respect, the preconditions affixed to the third party recovery clauses (in 2 of the 8 policies) had not been met.

Accordingly, Garling held that IAG had no contractual right to claim against a third party on the insureds' behalf, and therefore the opt out notices which it filed on their behalf were invalid.

In contrast, all but one of the group 2 policies (covering 19 insureds) included clauses which gave IAG the 'rights to claim from anyone else' in relation to an event covered under the policies. Garling J interpreted these clauses broadly as an assignment of rights to IAG to claim both the insured and uninsured losses on behalf of the insureds. Accordingly, the insurers were entitled to file opt out notices on behalf of these insureds.

Implications

This decision provides greater clarity on the circumstances under which an insurer may file an opt out notice on behalf of an insured in a class action. No doubt, the Courts will be using this decision as a guideline in the class action proceedings which are currently on foot across the States and Territories.

It is recommended that insurers amend policy wordings (especially in domestic retail policies) to give them greater control over the recovery of uninsured loss from third parties. In doing so, however, insurers ought to be mindful of their duty to act towards the insureds with utmost good faith, as noted by Garling J at paragraph [258] of his judgment, where he said that clauses which assign rights to the insurers to claim both the insured and uninsured losses on behalf of the insureds:

> '...will undoubtedly have the effect of placing onto the insurer some significant obligations owed to the insured with respect to litigation in which claims are made for losses over and above that which the insurer has paid. Such obligations would include but not be limited to obtaining the agreement of the insured to any settlement proposal. That is the insurer's burden which arises by reason of its own choice, it having included the clause in the terms in which it was in the policy which the insurer offered.'

October 2015

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