YELDHAM PRICE O'BRIEN LUSK

CGU INSURANCE LIMITED V PORTHOUSE

INSURERS TAKE COMFORT FROM RECENT HIGH COURT DECISION

So just how much of an insured's subjective interpretation of the relevant facts must an insurer take into account when considering the operation of an exclusion clause in the contract of insurance?

On 30 July 2008 insurers around Australia breathed a collective sign of relief as the High Court of Australia confirmed that CGU was not required to take into account the insured's subjective opinion about certain known circumstances when assessing whether his failure to disclosure those circumstances prior to inception of the professional indemnity policy was a breach of the policy.

CGU provided professional indemnity insurance to Mr Porthouse, a barrister. The policy excluded cover for claims arising from a circumstance known prior to the inception of the policy.

Section 11.12 of the policy contained a subjective and an objective limb of a "known circumstance". A "known circumstance" was defined as:

> "any fact, situation or circumstance which:
>
> (a) an Insured knew before the policy began; or
>
> (b) a reasonable person in the Insured's professional position would have thought, before the policy began,
>
> might result in someone making an allegation against an Insured in respect of a liability that might be covered by this policy."

The High Court held that the objective limb of this section was a question of fact to be determined independently from the insured's state of mind.

The facts

In June 2001 Mr Porthouse, a barrister, incorrectly advised a person injured while working under a community service order that the Workers Compensation Act (**WCA**) did not apply to his claim. In November 2001 the WCA was amended to prohibit the award of damages unless the injury suffered resulted in at least a 15% permanent impairment. The worker's proceedings against the State of NSW were not filed until December 2001.

The Crown Solicitor contended that the WCA applied and the worker was not entitled to damages as his injury did not meet the 15% threshold. In mid June 2003 Mr Porthouse researched the issue and concluded that if the Crown Solicitor was correct the worker would lose his case. The worker won at first instance; however proceedings were stayed pending the State's appeal to the Court of Appeal. Mr Porthouse conceded that the State had an arguable point. In April 2004 the worker's senior counsel advised Mr Porthouse that the State's appeal had reasonable prospects of success.

On 20 May 2004 Mr Porthouse completed his professional indemnity proposal form. He did not notify CGU of the circumstances surrounding the worker's claim.

The Court of Appeal found in favour of the State. The worker commenced proceedings against Mr Porthouse (and his solicitor) alleging negligence. CGU denied indemnity to Mr Porthouse. Mr Porthouse joined CGU as a cross defendant. It was accepted that Mr Porthouse did not believe that the worker would make a claim against him. At first instance Balla J found in favour of Mr Porthouse. Her Honour held that Section 11.12(b) was not an entirely objective test as it involved consideration of whether Mr Porthouse's actual state of mind was unreasonable.

The High Court findings

CGU unsuccessfully appealed to the Court of Appeal and was granted leave to appeal to the High Court. The main issues before the High Court were:

1 Whether, in interpreting the objective test in Section 11.12.(b) , the Court was confined to taking into account Mr Porthouse's experience and knowledge as a barrister and and not his actual state of mind as to whether the circumstances might give rise to an allegation against him.

2 Whether evidence of Mr Porthouse's actual state of mind could be taken into account when considering whether the hypothetical reasonable person "would have thought" that the facts and circumstances "might result in" an allegation of negligence against him.

Section 21 of the *Insurance Contracts Act* (**ICA**) contains the statutory test for an insured's duty of disclosure and had been interpreted objectively to mean that only 'extrinsic' factors were taken into account and not 'intrinsic' ones, such as the personal idiosyncrasies of the insured. The High Court considered that clause 11.12(b) was worded similarly to section 21 and should be interpreted in the same wholly objective way.

Therefore the High Court found that CGU was entitled to consider what the hypothetical reasonable barrister in Mr Porthouse's position would have thought, without reference to Mr Porthouse's subjective appreciation of the facts and circumstances.

As CGU bore the evidentiary onus, the Court noted that CGU could have led evidence as to what a reasonable barrister in Mr Porthouse's position would have thought. The Court considered evidence of a standard of conduct set by the Bar Association, or established by common usage, may assist a Court in considering what the hypothetical reasonable person "would have thought". However this should not be taken as an indication that expert evidence is required in all cases. The High Court found that as there could be no doubt that the hypothetical barrister in the position of Mr Porthouse would have thought that there was a real (not fanciful or remote) possibility (but not certainty) of a claim against him, there was no need for CGU to lead such evidence.

The appeal was successful and CGU were entitled to deny indemnity.

Implications

Obviously this decision turns upon the precise wording of section 11.12(b), so when considering its application to other clauses a careful comparison of the policy wordings is required. However, as a general proposition, insurers should gain comfort from the High Court's affirmation that an objective test contained in an exclusions clause may protect them from an insured's, albeit genuine, unreasonable or unrealistic opinion on whether an allegation may be made against them. After all, this is precisely how insurers intend such clauses to operate.

While this case relates to the interpretation the CGU professional indemnity policy, it is likely that a similar approach would be applied to like clauses in D&O policies. The High Court's approach is likely to influence how Courts will interpret deeming provisions (ie, notification of circumstances which may give rise to a claim deems the claim covered) and the application of section 40(3) of the ICA.

On a practical level, in preparing litigation relating to the interpretation of an exclusion clause with an objective limb, insurers and their legal representatives should be mindful of the High Court's indication that evidence of the standard of practice, set by a professional body or common usage, may assist in considering what the hypothetical reasonable person in the insured's position would have thought.

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For further assistance please contact Julie Somerville, Senior Associate (t: 9231 7019, e: jsomerville@ypol.com.au), or Kathryn Rigney, Director (t: 9231 7027, e: krigney@ypol.com.au).

LEVEL 7, 12 CASTLEREAGH STREET
SYDNEY NSW 2000

DX 162 SYDNEY

T: +61 2 9221 7774
F: +61 2 9221 7775
WWW.YPOL.COM.AU

YPOL PTY LTD TRADING AS
YELDHAM PRICE O'BRIEN LUSK
ACN 109 710 698

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