AIDA CIVIL LIABILITY INSURANCE WORKING PARTY
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Settlement with third parties (where the claim is indemnified) under the general law and the Australian *Insurance Contracts Act*

Introduction

In order to consider the above topic it is necessary to consider in the first instance the right of an insurer to conduct the defence of a claim made against its insured. I have taken the liberty of considering the scenario where the claim is partially indemnified, as well as totally indemnified, because dealing with a partially indemnified claim raises particular problems which are appropriate for this discussion.

The right of an insurer to conduct its insured's defence derives from a contractual entitlement under the terms of the policy with the insured. The extent of that right, and how it is exercised, will in the first instance be determined by the terms of the insurance contract.

I have set out below three examples of such terms. The first two are from a general and products liability insurance wording and a construction insurance wording and the third is from a professional indemnity policy.

General and products liability insurance wording

Defence Costs and Supplementary Payments

With respect to the indemnity provided by this policy, we will:

1. *Defend in your name and on your behalf, any claim or suit against you alleging such Personal Injury, Property Damage or Advertising Injury and seeking damages on account thereof even if any of the allegations of such claim or suit is groundless, false or fraudulent.*

2. *Pay all charges, expenses and legal costs incurred by Us and/or by You with Our written consent.*

   2.1 *in the investigation, defence or settlement of such claim or suit, including loss of salaries or wages because of your attendance at hearings or trials at our request; or*

2.2 *in bringing or defending appeals in connection with such claim or suit.*

Rights Regarding Claims

1. *Following the happening of any Occurrence in respect of which a claim is, or may be, made under this Policy, We shall have full discretion in the conduct of any proceedings in connection with any claim. You shall give such information and assistance that we may reasonably require in the prosecution, defence or settlement of any claim.*

2. *We may at any time pay to You, in respect of all claims against You arising directly or indirectly from one source or original cause:*

   2.1 *the amount of the Limit of Liability or such other amount specified in respect thereof (after the deduction of any sum(s) already paid by Us, which sum(s) would reduce the amount of Our unfulfilled liability in respect thereof); or*

   2.2 *any lesser sum for which the claim(s) can be settled;*

   2.3 *upon making such payment, We shall relinquish conduct and control of, and be under no further liability under this Policy in connection with, such claim(s) except for Defence Costs and Supplementary Payments:*

      (a) *recoverable from you in respect of the period prior to the date of such payment (whether or not pursuant to an order made subsequently); or*

      (b) *incurred by Us, or by You with Our written consent, prior to the date of such payment.*

This wording also contains a dispute resolution process working within the company in the first instance but with the right of the insured to refer the matter to the insurance industry's independent complaints scheme (subject to eligibility).

Construction insurance wording section 2 – third party liability

Claims Procedures

What the insured must do

1. Do not admit liability

   The insured must not admit liability for, or offer to agree to settle any claim without Our prior written consent.

"We are entitled to take over and conduct the defence of any claim made against the insured for damages by a third party. We have full discretion in conducting and negotiations, proceedings and the settlement of any claims.

If the claim is for legal liability, the insured may make a written request to us to agree that the insured is covered in respect of the claim".

What happens after the insured makes a claim

Authorising repairs and settlement

"...We may pay the insured the sum insured or limit of liability under the applicable section or any lesser amount for which a claim or claims under that section may reasonably be settled. After we have paid the insured, we will no longer be liable for the claim(s) (or future conduct of the claim(s)) except for costs and expenses incurred up until the time we agreed to pay.

This wording contains a similar wording in respect of defence costs and dispute resolution as the previous one.

Professional indemnity liability policy wording

We can:

(a) *take over and defend or settlement any claim in the insured's name; or*

(b) *claim in the insured's name any right the insured may have for contribution or indemnity or recovery".*

An insured must not:

(a) *admit liability for or settle any claim; or*

(b) *incur any costs or expenses for a claim without first obtaining our consent in writing. If our prior written consent is not obtained, the insured's right to cover under this policy may be affected.*

If an insured elects not to consent to a settlement that we recommend and elects to contest or continue the legal proceedings, then we only cover the insured (subject to policy limit) for:

(a) *the amount for which we could have settled the matter, less*

(b) *the relevant excess listed in the schedule, plus*

(c) *the defence costs calculated to the date the insured elected not to consent to the settlement.*

Senior Counsel

Unless a senior counsel, that we and the insured both agree to instruct, advises that the claim proceedings should be contested, then neither we nor the insured can require the other to contest any legal proceedings about a claim if the other does not agree to do so.

In formulating his or her advice, senior counsel must be instructed to consider the economics of the matter; and the damages and costs likely to be recovered; and the likely costs of defence and the insured's prospects of successfully defending the claim.

The cost of senior counsel's opinion is to be taken as part of the defence costs.

If senior counsel advises that the matter should be settled and if the terms of the settlement which we recommend are within limits which are reasonable (in senior counsel's opinion), then the insured cannot subject to s.X object to the settlement and the insured must immediately pay the applicable excess".

An insured can also agree, independently of the terms of the policy, to an insurer conducting their defence to a third party claim and the scope of the insurer's right to do so will in those instances depend upon the precise terms of the agreement between the insurer and insured. However, in the absence of the wording such as those set out above, the insured is not contractually compelled to agree with the insurer, taking over conduct of the insured's defence or the terms upon which it will do so, and so it is clearly preferable for the rights of the insurer to be set out in the policy wording, because it is in the insurer's interests to be able to directly control conduct of any litigation when a claim is made and to compel the insured to consent to that course.

However, taking on the conduct of an insured's defence for a third party claim does not give an insurer the right to conduct the defence or settle the claim however it sees fit.

Firstly, an insurer can only act within the scope of the rights given to it by the terms of the policy or the agreement. A good example of the operation of this limit on the insurer's right is the decision in *Groom v Crocker* [1939] 1 KB 194. The case concerned a collision between a car driven by William Groom and a lorry owned by Tea Brothers. Aubrey Groom, who was a passenger in his brother William's car when the collision occurred, sued William and Tea Brothers for the injuries suffered by him as a result of the collision. William was insured for any liability he had to Aubrey under a Fireman's Union Mutual insurance policy.

Fireman's Union Mutual, as it was entitled to do under the policy, instructed Crockers, a firm of lawyers, to defend the action on behalf of William.

Tea Brothers was insured for any liability it had to Aubrey under a Motor Union Insurance Company Limited insurance policy.

Although Fireman's Union Mutual and Crockers agreed with William that Tear Brothers was solely responsible for the collision, Motor Union Insurance and Fireman's Union Mutual agreed to share their liability to Aubrey equally, with Fireman's Union Mutual filing a defence for William admitting he negligently caused the collision. The benefit for Fireman's Union Mutual was a favourable apportionment of liability in an unrelated matter it had with Motor Union Insurance. The deal was done without William's agreement.

William subsequently sued Crockers in contract, tort and for libel. Crockers defended the action on the basis they acted in accordance with the instructions of their client, Fireman's Union Mutual.

Sir William Green MR said at [203] that the policy gave Fireman's Union Mutual:

> *"The right to decide upon the proper tactics to pursue and the conduct of the action, provided they do so in what they bona fide consider to be the common interests of themselves and William. But Fireman's Union Mutual are in my opinion clearly not entitled to allow their judgment as to the best tactics to pursue to be influenced by the desire to obtain for themselves some advantage altogether outside the litigation in question with which William has no concern ….*
>
> *The policy gave Fireman's Union Mutual an absolute right to control William's defence, but the scope of this right was, in my view, subject to certain implied boundaries and limitations. It was not one which they would be entitled to exercise arbitrarily. They were bound to exercise a real discretion upon each question as it arose in the conduct of the defence, making each decision after due consideration of the circumstances of the particular case.*
>
> *Fireman's Union Mutual here in making its profitable bargain with the Motor Union were acting as much outside that discretion as if it had accepted a bribe from a stranger in consideration of its instructing Crockers to put on record in Aubrey's action an admission of William's negligence. The inclusion of the other action in which William had no interest whatsoever, as the circumstance material to the exercise of its discretion, of itself imported a failure to exercise the discretion which*

by the contract they had undertaken to exercise, and was therefore a breach of their contract, and that initial breach and validated the whole of their consequent instructions to Crockers. The policy conferred upon it no right to call upon Crockers to act on its mandate, and the solicitors derived no authority from it to do what they did".

That decision has been endorsed by the New South Wales Court of Appeal in the matter of *Nigel Watts Fashion Agencies Ltd v GIO General Limited* (1994) ANZ Ins Cas 61-235.

In that instance, Nigel Watts (the employee) was an employee of the employer Nigel Watts Fashion Agencies Pty Ltd. He was also an officer of the employer and apparently its principal. In the course of, and for the purposes of his employment, he required daily access to premises leased by the employer in a builder owned and occupied by John Shorter Pty Ltd (the occupier). The employer leased certain premises on the fifth floor of the building. It provided stairs and elevators to permit access to the leased premises. The employee was accessing the premises when he was injured whilst getting into an elevator on the fifth floor of the building when the elevator stopped at a point several centimetres higher than the floor landing. He stumbled as he entered the elevator and fell heavily striking his head on the wall. He was 71 years of age at the time of the accident. As a result of the fall, he fractured his hip.

The employee recovered benefits from the employer under the *Workers' Compensation Act*. However, the employee then sued the occupier in the District Court claiming damages at common law for negligence. The occupier, in turn, issued a third party notice joining the employer as a third party to the worker's proceedings. The occupier alleged an entitlement to a complete indemnity under the terms of the lease, or in the alternative, contribution pursuant to s.5(1)(c) of the *Law Reform (Miscellaneous Provisions) Act (NSW)* 1946 (which gave one tortfeasor the right to claim contribution from any joint tortfeasor).

At first instance, the trial judge found there was negligence on the part of the occupier and the employee was entitled to damages, subject to a deduction for contributory negligence. He also found the employer was not in breach of its duty of care which it owed to the employee as its employee, but found the employer was obliged to indemnify the occupier under the terms of the lease by which the employer was permitted to occupy the leased area of the building.

The occupier sought to recover from the employer the amount of the judgment which it had paid to the employee. The employer claimed indemnity from its insurer in respect of that

judgment. The insurer denied indemnity on the basis that the judgment against the employer was in respect of a contractual liability and not a tortious liability.

It transpired that when the employer was served by the occupier with a third party notice it passed it to its insurer. The insurer appointed solicitors to defend the action on behalf of the employer. Those solicitors filed a defence to the third party notice on behalf of the insurer in the name of the employer. The solicitors did not, and nor did the insured, then draw to the attention of the employer, as the insured, the limit of the insurer's indemnity as relevant to the dual basis upon which the third party notice claimed indemnity or contribution. Nor did the insurer or its solicitors warn the employer of the risk that the employer would be denied indemnity if the basis of recovery against it were ultimately held to be the second claim (framed in terms of a contractual indemnity) and not the first claimed (framed in terms of liability in negligence as a joint tortfeasor).

At first instance, Windeyer J dismissed the employer's claim against the insurer for indemnity. The employer then appealed to the New South Wales Court of Appeal. In its appeal it claimed it was entitled to indemnity on three bases – contract, election and estoppel:

1. the promise of the extended term contained in the workers' compensation policy;

2. the fact the insurer, which had taken over the defence of the employer's interest in the third party proceedings, by its conduct of the employer's defence, had elected to indemnify the employer as its insured; and

3. the fact that the insurer was, in the facts and circumstances proved, estopped from denying to the employer having (as it was alleged) represented that it would provide indemnity. On the basis of that alleged promise it was argued the employer acted to its detriment in allowing the insurer to take over the conduct of the employer's defence.

The Court of Appeal did not accept the employer's claim that the contract of insurance extended to cover the contractual indemnity liability. The employer's indemnity policy was limited to indemnity to the employer for common law liability to an employee qua employee.

However, the court was satisfied that there was an estoppel by representation and that the employer had acted to its detriment. Kirby P, with whom Mahoney and Handley JJA agreed, said as follows:

"The duty of good faith which the insurer owed to the insured obliged it to be candid in its dealings with the employer, as insured. It required that in the circumstances of this case to make clear to the insured:

(a) *the limit of the obligation;*

(b) *the differential liability of the insured;*

(c) *the risk which the insured thereby ran in respect of which it might need to secure its own separate advice.*

...

This was not a case where the insurer was entitled to remain silent. At least it was not entitled to do so if the product of the silence was a relevant detriment to the insured. I consider the representation made was equivocal – it was that indemnity would be provided. It remained so until after the insured had suffered loss.

The solicitors acting for the insurer had consented to costs orders for solicitor/client costs and although Kirby P thought that that was relevant, he thought what was much more relevant to the conduct of the proceedings was:

The loss of the real chance that the worker would have been persuaded by the employer (whose principal he was) – being alert to the risk presented by the claim for indemnity in the lease, of the wisdom of abandoning the common law right and pursuing his rights under the Workers' Compensation Act or settling both together.

Even more clear is the fact that in the way the proceedings were conducted, the employer lost the opportunity of negotiating a settlement which would have secured a real contribution by the insurer to the total payment to the worker which avoided the Pyrrhic victory which, in the circumstances, eventuated".

Mahoney JA stated as follows:

"The relationship between insured and insurer is an unusual one. Under the general law each owes the other a duty to act with the utmost good faith. In some classes of insurance this duty is now to be found in Part II of the Insurance Contracts Act 1984 (Cth) operating of its own force or as adopted by State law.

It is well known that the insured is under this duty when proposing for insurance and the duty continues after contract for other purposes. The insurer owes the same duty

to the insured and this also continues after contract. ….. The insurer thus owes an obligation of good faith in the management of litigation conducted pursuant to rights given by the policy."

His Honour then referred to the statements by Green MR in Groom v Crocker, above.

The decision of the Court of Appeal in the case of Nigel Watts has been applied by the South Australian Supreme Court in the case of *ACN 007 838 584 Pty Ltd v Zurich Australia Insurance Limited* (1997) 69 SASR 374. The case involved a product liability insurance cover. The insurer intended to deny indemnity under both the primary indemnity provision and some exclusion clauses, but nonetheless appointed solicitors who conducted the defence of the claim against the insured, in circumstances where the court considered that they were doing so to further the interest of the insurer and not the insured. Although the decision turned on an interpretation of the insuring and exclusion clauses, there is a very interesting discussion concerning the conduct of the insurer and its appointed lawyer that caused the court to come to the conclusion that it would have found that an election had occurred by the insurer to provide indemnity under the policy, despite the fact that the insurer did not intend to do so.

There is also reference to the decision of the Full Court of the Supreme Court of South Australia in *Sheldon v Sun Alliance Australia Limited* (1989) 53 SASR 97 at 152 where Bollen JA stated:

"*The obligation of utmost good faith means exactly what it says – it does not mean a mere measure of good faith. The concept of "good faith" in relation to exclusion clauses entails more than mere honesty, although it is resistant to precise definition.*"

As Ron Ashton said when presenting the Geoff Masel Lecture in 2010:

"Certainly, the duty requires honesty, but that is not sufficient of itself. It may require each party to the insurance contract to act with due regard to the legitimate interests of the other".

See *CGU Insurance Limited v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1.

Whilst it is not the purpose of this paper to review the law in relation to the duty of utmost good faith, because it is so pivotal to the exercise of the insurer's right to conduct the insured's defence, participants of the working party are referred to the excellent papers on the topic, including Ron Ashton's paper referred to above, which can be found in the library on the website of the Australian Insurance Law Association.

This question has also been considered by Stephen J in *Distillers Co (Bio-Chemicals) (Aust) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 29, 31 where his Honour said:

> *"Where conflicts of interest arise between an insured and an insurer, the insurer must exercise its powers under the policy with due regard for the interests of the insured … an insurer must act in good faith towards the insured and must have regard to his interests both in the defence of actions against the insured and in their settlement".*

Examples of when the duty requires an insurer to consider the insured's interests are as follows:

1. Settling a third party claim. The factor to be weighed up against settling with a third party is if a settlement in the terms contemplated by the insurer will leave the insured with an uninsured liability; for example, the amount of an excess or the extent to which the settlement amount would exceed the policy limit of liability; or

2. Take a third party claim to trial. A factor to be weighed up against taking a third party claim to trial is if an adverse judgment might leave the insured with an uninsured liability; for example, it might exceed the policy limit of liability.

If the insurer has the right under the policy to conduct the insured's defence then it can settle a third party claim or take it to trial without the insured's consent (subject to a senior counsel clause if one exists), but it must in any event have regard for the insured's interests when making a decision about how to resolve the claim.

The *Insurance Contracts Act* 1984 (Cth) and its impact

The duty of utmost good faith owed between an insurer and insured is set out in Part II of the *Insurance Contracts Act* 1984 (Cth) ("**ICA**"). Whenever considering the provisions of the ICA regard must be had to its scope and particularly the exceptions set out in s.9 and 9A of Part I of the Act. Relevantly in respect of liability insurance the exceptions will include reinsurance claims, claims in relation to which the *Marine Insurance Act* 1999 (Cth) applies, liability claims in respect of workers' compensation and motor vehicle injury.

Part II of the ICA provides as follows:

1. Section 13 - The duty of utmost good faith.

   > *A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.*

2. Section 14 - Parties not to rely on provisions except in the utmost good faith.

   (a) If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely upon the provision.

   (b) Sub-section (1) does not limit the operation of s.13.

   (c) In deciding whether reliance by an insurer on a provision of the contract of insurance would be to fail to act with the utmost good faith, the court shall have regard to any notification of the provision that was given to the insured, whether a notification of the kind mentioned in s.37 (unusual terms) or otherwise.

3. The duty of an insurer to act towards its insured with utmost good faith exists at common law in any event and the provisions of the ICA do not appear to extend the common law position any further.

Duties owed by the insurer's lawyer to both the insurer and insured when considering settlement of a claim

A lawyer appointed by an insurer to defend the insured's claim is often in a difficult position. That lawyer owes duties both to the insurer and to the insured. The scope of the duty owed to the insured can be affected by the terms of the policy and by the terms of any agreement with the insured. However the new provisions of the ICA do provide for penalties for breach of the duty of good faith, and this creates a further incentive for insurers to ensure they always act with utmost good faith to their insureds.

However, whatever the terms of the lawyer's retainer, the lawyer continues to owe duties to both the insurer and insured, and this can result in a very difficult situation particularly where the indemnity under the policy does not completely cover the insured's potential liability under the claim. That may be because the claim is in respect of both of loss indemnified under the policy and loss not indemnified under the policy, as was the case in the *Nigel Watts* decision referred to above, or may be a case where the insured has suffered loss beyond the limits of the policy, such that part of the loss will be indemnified and part will be an uninsured loss.

What is clear from the decisions discussed above is the lawyer can very quickly find themselves in a situation of conflict of interest.

If a lawyer is to consider continuing to act in circumstances where the claim is not fully indemnified because some part of the claim is excluded under the terms of the policy, then the insured should be advised to obtain separate legal advice in relation to the insurer's

decision in that regard. The insurer's lawyer can only continue to act if the insured, having been separately advised, accepted that part of the claim was not indemnified and the lawyer acting for the insurer was satisfied that the interests of the insurer and insured were the same in respect of litigating or settling the matter. In those circumstances if there is any dispute between the insurer and insured in relation to whether the claim should be litigated or settled, the lawyer appointed by the insurer should not continue to act for the insured and the insured should be separately represented.

Similarly, if the claim is not fully indemnified because it exceeds the limit under the policy, then the lawyer appointed by the insurer could only continue to act if they were satisfied that the interests of the insurer and insured (in respect of the non-insured portion of the claim) were the same. If the insured disputed the insurer's decision to litigate or settle the matter and/or the terms of settlement, then the lawyer appointed by the insurer should immediately withdraw from acting altogether and the insured should be separately represented and advised in relation to the uninsured portion of the claim.

The right of an insurer or an insured to refuse a proposed settlement will in the first instance be determined by the terms of the insurance contract. Provided the insurer acts in good faith towards the insured and gives full consideration to the interests of the insured, the insurer will have the right to determine whether to settle a matter that is indemnified under the terms of the policy.

In circumstances where the claim is not fully indemnified under the terms of the policy, then the insurer would only have the right to settle that portion of the claim which is indemnified and this will create a very difficult situation.

Although the senior counsel clause requires senior counsel to consider the economics of the matter, the damages and costs likely to be recovered, the likely costs of defence and the insured's prospects of successfully defending the claim, there remains an overriding obligation for the insurer to act in good faith towards the insured and to take into account the full interests of the insured which necessarily includes matters such as the insured's excess and any uninsured liability that the insured might be left with.

Can the insured endorse or transfer the policy of a way of settlement with the third party

As indicated above, if the policy wording is in the form of any of the three policies above, then the insurer can effectively transfer risk to the insured by advising the insured that it will pay:

1. the amount for which it considers the claim can be settled;

2. less any excess payable by the insured;

3. together with any defence costs incurred up until that point.

In exercising that right under the policy the insurer would of course have to act with the utmost good faith towards the insured. That would include a bona fide view as to the amount for which the matter can be settled. Generally that would involve a situation where an offer had been made which was capable of settlement.

In Australia the position is that an insured can transfer the benefit of a policy to a third party as a means of settling with a third party. The issue has been considered by the High Court of Australia in the case of *CGU Insurance Limited v One.Tel Limited (In Liq.) & Ors* (2010) 268 ALR 439.

Mr Grieves, the third respondent, served as a director of the first respondent, One.Tel Limited. Mr Grieves was insured under a directors and officers liability policy of insurance ("**the policy**") with the appellant, CGU Insurance Limited ("**CGU**") being the insurer under the policy. Pursuant to the policy, CGU covenanted to indemnify Mr Grieves for the *"loss"* he suffered which was relevantly defined as meaning *"the amount payable in respect of a claim made against the directors and officers for a wrongful act and shall include damages, judgments, settlement, interest, costs and defence costs"*.

The fourth respondent, the Australian Securities & Investments Commission ("**ASIC**") sued Mr Grieves ("**the ASIC proceedings**") the Supreme Court of New South Wales made orders and declarations by consent that Mr Grieves pay compensation to One.Tel in the sum of $20m ("**the compensation order**") and that he pay $350,000 to ASIC. After the institution of the ASIC proceedings, but before the consent orders and declarations were made by the court, CGU purported to avoid the policy.

Mr Grieves subsequently entered into a deed of arrangement ("**the deed**") pursuant to Part X of the *Bankruptcy Act* 1966 (Cth) ("**the Act**"), and the second respondent was the trustee of the deed ("**the trustee**"). By cl.2 of the deed, Mr Grieves relevantly covenanted to assign his rights under the policy to the trustee. Clause 4 provided that the trustee shall get in and realise Mr Grieves' assets, which included his rights under the policy. Clause 5 provided that the trustee should apply any amount received by him under the policy and payment of any liability that Mr Grieves might have to ASIC and One.Tel. Clause 7 provided

that the trustee execute a certificate upon Mr Grieves complying with his obligations under the deed.

The trustee executed a certificate pursuant to cl.7. Clause 8 relevantly provided that Mr Grieves was released from all debts and claims against him upon execution of the cl 7 certificate, except for any liability under the compensation order. Clause 9 provided that the trustee execute a certificate upon either pursuing to judgment or settling a claim under the policy, or deciding not to pursue a claim under the policy, and cl 10 relevantly provided that Mr Grieves was absolutely released and discharged from all liability in respect of the compensation order upon execution of the cl 9 certificate. Clause 11 relevantly provided that, prior to the execution of the certificate referred to in cl 9, neither the trustee nor any creditor would take any steps to enforce the compensation order against Mr Grieves other than to seek recovery pursuant to the arrangements constituted by the deed.

The trustee instituted proceedings ("**the trustee proceedings**") in the Supreme Court of New South Wales pursuing Mr Grieves' cause of action on the policy in respect of the compensation order, but not the $350,000 ordered to be paid to ASIC. CGU defended the action and claimed that its purported avoidance of the policy was valid.

The deed was thereafter terminated by reason of cl 17(c) of the deed and s.235(d) of the Act because three years had passed since it was executed. In consequence the name of the plaintiff in the trustee proceedings was changed such that the action was brought in a personal capacity. The issues in the trustee proceedings were propounded in questions reserved for separate determination prior to the resolution of other issues.

The primary judge in the trustee proceedings held that the trustee had no power to continue the trustee proceedings once the deed terminated, and that Mr Grieves had suffered no *"loss"* because cl 11 survived the termination of the deed so as to prevent the trustee and creditors from enforcing against Mr Grieves the orders made in the ASIC proceedings.

The New South Wales Court of Appeal allowed an appeal against the primary judge's decision and remitted the matter back to the Supreme Court for further hearing.

CGU then appealed the decision of the Court of Appeal to the High Court. It contended that:

(a) there was no valid assignment at law or an equity of the policy to the trustee;

(b) the trustee had no power to continue the trustee proceedings once the deed was terminated,

(c) neither the Act nor the deed gave that power; and

(d) Mr Grieves had suffered no *"loss"* to which the policy responded.

At issue before the High Court was:

(a) whether there was an assignment of the benefit of the policy;

(b) whether the Act or the deed disentitled the trustee from continuing the trustee proceedings after the deed came to an end;

(c) whether Mr Grieves suffered a *"loss"* to which the policy responded; and

(d) how the questions reserved for separate determination should be answered in consequence.

The High Court constituted by French CJ, Heydon, Crennan, Kiefel and Bell JJ dismissed the appeal and held:

1. There was a valid equitable assignment of the benefit of the policy such that Mr Grieves as assignor became a trustee of a chose in action (that is, his rights under the policy) for the trustee, and the trustee held equitable title to Mr Grieves' rights under the policy in trust for the beneficiaries identified in the deed.

2. A person who is a trustee as a result of an equitable assignment of the benefit of a contractual right on trust can maintain the same actions on the right as the person could maintain if the contractual right were held by that person free of trust, such that the trustee was not disentitled from continuing the trustee proceedings after the deed came to an end.

3. Mr Grieves suffered a *"loss"* to which the policy responded insofar as the judgment debts payable in the ASIC proceedings were within the meaning of *"loss"* in the policy, and cl 11 of the deed did not discharge or release Mr Grieves from the judgment debts because it did not have the function of giving permanent protection to Mr Grieves, but was rather a short-term regime to hold the position while the trustee attempted to bring in assets for the benefit of creditors.

During the appeal, CGU's first central argument was that there was no absolute assignment at law pursuant to s.12 of the *Conveyancing Act* 1919 (NSW) which created a legal assignment. At first instance, the primary judge had expressed a *"tentative view"* that the deed was a legal assignment to the trustee of Mr Grieves' rights under the policy pursuant to

s.12 of the *Conveyancing Act*, but said that even if that were not so, cl 2 was a valid equitable assignment of those rights because of the consideration flowing from cll 8 10 and 11 and from the trustee's other promises. The Court of Appeal found there was a legal assignment.

The High Court found it was not necessary to determine if there was a legal assignment because there was a valid equitable assignment for the reasons given by the primary judge.

Further, the High Court stated that there was no argument available to CGU that the trustee proceedings were not properly constituted by reason of the non-joinder of Mr Grieves, as assignor.

The decision demonstrates that the benefit of a policy can be assigned both as a legal assignment under relevant property or conveyancing laws or as an equitable assignment based upon consideration.

What is also apparent is that once the benefit of the policy is assigned, then the assignor will take the benefit of the policy subject to any defences that might have been available to the insurer at the time that the assignment occurred. In this instance, CGU argued that there was no loss suffered by Mr Grieves and therefore no benefit payable under the policy. The High Court disagreed, but if it had accepted that argument, then the trustee would not have received a benefit under the policy.

Any third party taking an assignment of the benefit of the policy would be well advised to make enquiries with the insurer as to whether there were any limitations or defences that the insurer alleged were available. For instance, there may have been late notification resulting in prejudice to the insurer, which would give the insurer the right to limit any entitlements under the policy.

Similarly, there may even have been non-disclosure entitling the insurer to avoid the policy, or limit its liability under the policy.

The decision in *CGU Insurance Limited v One.Tel Limited* demonstrates that there can be circumstances where it will be in the insured's interests to assign the benefit to a third party, and it will be in the third party's interests to take the assignment. As the High Court said in that case, if CGU's arguments concerning assignment of the policy had been sound, this would have given CGU an advantageous windfall benefit. Subject to the merits of its defences in the trustee proceedings, it would have been better off to the extent of $20m as a

result of execution of the deed, to which it was not a party, than it would have been if the deed had not been executed.

Accordingly, it can be seen that there are a number of issues that an insurer, and a prudent insured, should take into account when considering defending or settling a claim that includes an uninsured component.

If the interests of the insurer and insured diverge at the point of the uninsured component, then the insurer's lawyer should stop acting for the insured and the insured should seek its own independent legal advice.

This is due to the fact the insurer's obligation to always act in the insured's best interests is rigorously enforced both at common law and under the *Insurance Contracts Act* 1984 (Cth).

That obligation also creates a minefield for insurers when considering taking over the running of an insured's defence in circumstances where less than a full indemnification is envisaged.

The moral of the story for insurers is always obtain considered advice before taking over a defence or settlement where there are uninsured components: you may end up indemnifying in circumstances where you did not intend to. The moral of the story for insurer's lawyers is to always watch out for conflicts of interest between the insured and the insurer where there are uninsured components, or you may end up as an insured yourself under your own PI policy.