

July 2008

High Court finds for Insurer on “known circumstances” exclusion

CGU Insurance Limited v Porthouse

The High Court today handed down a unanimous decision (Gummow, Kirby, Heydon, Crennan and Kiefel JJ) which confirms that a known circumstance exclusion in a Barrister Professional Indemnity policy sets an objective standard, with the modification that the insured’s professional experience and the insured’s knowledge of facts and circumstances are imputed to “a reasonable person in the Insured’s professional position”. Kennedys acted for the successful insurer, CGU.

Background Facts

Mr Porthouse, a barrister, was briefed to advise a client in relation to workplace injuries sustained in 1999. Mr Porthouse failed to advise his client that if he wanted to avoid imminent changes to workers compensation laws in New South Wales, he needed to file a statement of claim prior to 27 November 2001. These changes were retrospective and required claimants to show that their injuries met a degree of permanent impairment of 15%. Mr Porthouse’s client did not meet this threshold.

Mr Porthouse’s client filed a statement of claim against the State of New South Wales on 11 December 2001. While his client succeeded at arbitration, the Crown applied for a re-hearing before the District Court. The District Court found for Mr Porthouse’s client. The Crown appealed this decision.

More than three months after filing submissions on the appeal, on 20 May 2004, Mr Porthouse completed a proposal form for professional indemnity insurance from CGU. The form required Mr Porthouse to state whether he was aware of any circumstances which could result in any claim being made against him. Mr

Porthouse answered in the negative. CGU then issued the policy, which commenced on 30 June 2004.

The policy did not cover “*known claims*” or claims arising from “*known circumstances*”. The policy defined “*known circumstances*” as:

11.12 “*Any fact, situation or circumstance which:*

- (a) *an Insured knew before this Policy began; or*
- (b) *a reasonable person in the Insured’s professional position would have thought before this 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 client’s appeal was heard on 19 July 2004. Judgment for the Crown was delivered about five weeks later, setting aside the client’s damages award (see *NSW v Bahmad* 2004 NSW CA 287). During the course of the appeal the client raised the issue of negligence by his solicitors with Mr Porthouse.

The client then issued District Court proceedings against his solicitors and Mr Porthouse for negligence. Mr Porthouse in turn claimed on his policy with CGU. When CGU declined indemnity on the basis of the “known circumstances” exclusion, Mr Porthouse joined CGU to the client’s proceedings.

The proceedings before the District Court

The presiding judge, Balla J, held that Mr Porthouse had breached his duty of care in failing to advise his client of the need to commence proceedings before 27 November

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2001. However, her Honour found for Mr Porthouse on his claim against CGU. At issue was whether the “*known circumstances*” clause provided an entirely objective test or whether it also required a consideration of whether Mr Porthouse’s state of mind at the time he made his application for the policy was unreasonable.

Judge Balla found that the clause required the latter consideration also, and upon considering Mr Porthouse’s state of mind at the relevant time, found for Mr Porthouse.

CGU appealed.

The Court of Appeal proceedings

On 11 April 2007 the Court of Appeal (Hodgson JA and Young CJ in Equity, Hunt AJA dissenting) dismissed CGU’s appeal. The majority held that the second limb of the exclusion clause was ambiguous, that it was correctly construed at first instance and that an element of subjectivity was permissible. Justice Hunt, however, would have allowed the appeal. His Honour held the applicable test was wholly objective and that a person in Mr Porthouse’s position would have been aware of the consequences of his oversight.

CGU appealed to the High Court.

The case before the High Court

There were three main issues of construction before the High Court.

Whether, upon a proper interpretation of the phrase “*a reasonable person in the Insured’s professional position*”, one was confined to taking into account the insured’s experience and knowledge and was not permitted to take into account the insured’s state of mind, as to whether “[*a*]ny fact, situation or circumstance” known to the insured might give rise to an allegation against the insured.

The second main issue of construction concerned the correct interpretation of whether the hypothetical reasonable person “*would have thought [any fact, situation or circumstance known to the insured] might result in*” someone making an allegation against the insured.

The third issue in the appeal concerned the correct application of clause 11.12(b) and whether evidence of what the insured actually thought could be taken into account when determining what the hypothetical reasonable person “*would have thought*”.

Conclusion

The High Court unanimously found that:

“(Clause) 11.12(b) sets an objective standard, with the modification that the insured’s professional experience and the insured’s knowledge of facts and circumstances are imputed to ‘a reasonable person in the Insured’s professional position’. An enquiry about what a reasonable person ‘would have thought’ enquires about real (not remote or fanciful) possibilities; it does not enquire about certainties. When applying (clause) 11.12 it is not wrong to take into account what an insured thought, as a piece of possibly relevant evidence, but the standard described in (clause) 11.12(b) is an objective standard, and a question of fact to be determined independently of the insured’s state of mind.”

This decision confirms the disclosure obligations of professionals under claims made policies and the consequences that follow if known circumstances are not notified.

**Penny Taylor, Senior Associate and
Kathryn Wilson, Solicitor**

**Kennedys
30 July 2008**

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