

## FEATURE



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## legal update

# PUBLIC LIABILITY INSURANCE

## – time for a new operative clause?

AN UNNOTICED ASPECT OF A 1996 DECISION OF THE NEW SOUTH WALES COURT OF APPEAL COULD LEAD TO A RESULT QUITE CONTRARY TO THE POLICY'S INTENTION – YET THE OFFENDING CLAUSE COULD BE CORRECTED WITH A SIMPLE RE-WRITE, SAYS TOM MCDONALD OF DEAKIN UNIVERSITY'S FACULTY OF BUSINESS & LAW.

In 1996 the NSW Court of Appeals case of *GIO v Newcastle City Council* attracted considerable attention as it related to an interpretation of s40 of the Insurance Contracts Act. What escaped attention was an aspect of the decision made in that case that related to the application of the operative clause which has a significant effect on an operative clause that is widely used in public liability policies today.

The effect of the decision on one of these points, that was not critical to the s40 decision, could lead to losses being denied in situations where the policy was intended to provide cover.

### Review of the cases

At first instance, the case had been heard in the Supreme Court in NSW before Bainton J.<sup>ii</sup> The GIO appealed to the Court of Appeal court. Briefly the relevant facts were:

*An earthquake occurred on 28 December 1989. The Newcastle Workers Coop building was badly damaged. The Council had inspected the building in July 1988 and an engineer had found a critical chord member had been omitted from a roof truss during construction. Despite this, the council issued a certificate of structural soundness. The omitted chord member apparently caused the west wall to be unstable and the roof to collapse during the earthquake.*<sup>i</sup>

The policy contained the following operative clause:

*GIO will pay to or on behalf of the insured all sums for which the insured shall become legally liable to pay by way of compensation (excluding punitive and exemplary damages) in respect of*

- (a) Public liability
- (i) Personal injury
- (ii) Damage to property

*(Other than personal injury and damage to property arising out of products liability)*

- (b) *Products liability (as defined herein) happening during the Period of Insurance **caused by an occurrence in connection with the business of the insured** (emphasis added).*

- (c) *Professional Liability ...*

In addition section (a) of the policy had the following exclusion:

### Exclusion 16

*The rendering or failure to render professional advice or service by the insured or any error or omission connected therewith except as provided in liability coverage (c).*

"Occurrence" was defined as:

*An event, including continuous or repeated exposure to substantially the same general conditions, which results in personal injury or damage to property neither expected nor intended from the standpoint of the insured.*

The most widely used operative clause in the market today reads:

*This policy insures all amounts which you become legally liable to pay as compensation for personal injury and/or property damage **as a result of an occurrence in connection with your business.** (Emphasis added.)*

Although the operative clause in this case differs from the clause above, the aspects discussed by the court in *GIO v Newcastle City Council* are the same.

The appeal related to the property damage only and the task of the Appeal court was to decide:

- ❑ does the loss fall within section (a) (ii)?
- ❑ does exclusion 16 apply?
- ❑ does the loss fall within section (c)?

The focus of this paper relates only to the interpretation of the Operative Clause. Other areas of the case have been well documented and will not be examined here.

### Did the loss fall within section (a)(ii)?

In considering this point, at first instance Bainton J held that the "occurrence" was *the earthquake and the contemporaneous collapse of the building*. It also held that the council activities were statutory and not professional. The conclusion was that both sections a(ii) and (c) applied.

The NSW Appeals court comprised three judges. In the decision of the President, Kirby P, with whom Powell JA agreed, the following comments were made on the Supreme Court's finding:

*The difficulty with this finding is that "the collapse of the building" was, in fact, the relevant "damage to property". Hence if Bainton J is correct, the property damage was, in part, caused by itself. With respect, this construction would not make sense. Therefore, the relevant "occurrence" must be limited to the earthquake itself. This characteristic conforms with commonsense. The most direct and obvious cause of the damage was the Newcastle earthquake. Moreover, as the appellant pointed out, this characterisation conforms with the information provided by both parties in the agreed statement of facts" supplied to Bainton J and the letter sent to the appellant on 23 December 1991. Paragraph 5 of this "Agreed Statement of Facts states:*

*5. On 28 December 1989 an earthquake OCCURRED in Newcastle causing death and personal injury to property." (Emphasis added.)*

Kirby P went on to point out that the operative clause requires that the occurrence must be *in connection with the business of the insured*. And



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that an earthquake alone cannot be in connection with the business of local government. For this reason Kirby P. concluded that the Club's claim against GIO does not fall within Operative Clause of the policy.

Kirby P also found that Exclusion 16 applied. This meant that regardless of the interpretation of the word "occurrence", the policy could not apply! The court's attention then shifted to the professional indemnity cover.

The remaining judge, Sheller JA, dissented with this aspect of the decision. In discussing the phrase "caused by an occurrence", Sheller JA said

*... it speaks in the context of the insured's legal liability for injury or damage which is "casually relevant", a phrase I have taken from Fleming on the law of tort, 8th ed, at 194. In that context the occurrence is not the earthquake but the insured's act which rendered it legally liable to pay. Thus if the structure is unsound because the insured designed it negligently, the fact that its collapse was caused by an earthquake does not mean that it was not caused by an occurrence or event of negligence.*

Sheller JA disagreed with the assertion that liability is excluded merely because the damage was caused by an earthquake and went on to state that what is causally relevant is the act of the insured which rendered it legally liable to pay compensation and concluded that this was an occurrence in connection with the insured's business.

Sheller agreed with Kirby P that Exclusion 16 applied.

### The effect of the decision

This decision produces an unintended effect in the operation of the clause. The decision restricts the circumstances in which cover is provided. By excluding cover for those circumstances where the actual event that causes the injury or damage is itself not related to the business places quite a limitation and leaves the insured with an unsatisfactory cover. This means that a situation where there has been negligence on the part of an insured (faulty inspection) but the event that triggers the fault from which the injury or damage results (in this case the earthquake) is not a function of the

business then no cover is provided. The insured however is liable for the injury or damaged caused because of the prior negligent act.

The view put by Sheller JA has the occurrence as the initial act of negligence which while it would provide cover is a minority decision and does not solve the problem.

The intention of the policy is to cover such situations. The policy is seeking to provide cover for the insureds legal liability for bodily injury or property damage and not to exclude situations where the occurrence is not related to the business. There is no underwriting reason for excluding situations where the "occurrence" (as defined by this decision) does not arise from the business. The principal problem that has arisen is that the wording relates the "occurrence" to the "business". The intention of the wording can be seen by looking at the wording that this clause was modelled on.

The "occurrence" wording has been in use in the Australian market for over thirty years and was the result of an adaptation of the 1973 US CGL<sup>1</sup> policy by the American International Group (then AIU) in the early 1970s. It represented a broader cover than the standard 'tariff' wording that was widely used in the market at that time. The market very quickly copied the new wording and it forms the basis of most wordings used in the market today. The significance of this is that while changes have been made to the wording since its introduction, the operative clause from the original wording is still very widely used.

In looking back to the 1973 US CGL policy the answer to the problem is apparent. The operative clause in that policy reads.

*The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of:*

- A. bodily injury or
- B. property damage

**to which this insurance applies (emphasis added), caused by an occurrence.**

In the US CGL wording it is the legal liability for bodily injury or property damage that must arise out of the

business. Under the Australian adaptation it is the occurrence that must arise out of the business which leads to losses that should be met by the policy being excluded. In the Australian wording the term *arising out of the business* was used in place of *to which this insurance applies*. As the term *arising out of the business* was in use in local policies at the time this term was retained. The problem is the placement of the words.

This situation can be corrected simply by rearranging the words in the current operative clause as follows:

***This policy insures all amounts which you become legally liable to pay as compensation for personal injury and/or property damage in connection with your business as a result of an occurrence.***

This point has gone unnoticed for many years and as it was not a critical point in the *GIO v Newcastle City Council* case, attention has not been given to it. Underwriters and brokers need to consider changing their wordings to ensure insureds are given the full coverage the policy intends before a problem arises. **II**

### Endnotes

- i This policy form is produced by the Insurance Services office Inc (ISO) who is the leader in the US in developing policy forms that are used by insurers in providing coverage. Their forms are well known and are registered with the state regulators and are widely used by the insurance industry.
- ii *GIO General Ltd v Newcastle City Council* (1996) 38 NSWLR 558 at 572; 9 ANZIC 61-301 at 76,367; (on app (1997) 191 CLR 85).
- iii *Newcastle City Council v GIO General Ltd* (1995) 8 ANZ Cases 61-249 at 75,789.

## Notice of intention to make an application under Part III, Division 3A of the Insurance Act 1973 (Cth) by MMIA Pty Limited and QBE Insurance (Australia) Limited

MMIA Pty Limited (MMIA) (formerly Mercantile Mutual Insurance (Australia) Limited) and QBE Insurance (Australia) Limited (QIA) will make an application to the Federal Court of Australia in Sydney on 6 March, 2008 at 10:15am, or on such later date or time as the Court appoints, for confirmation of a scheme for the insurance business of MMIA to be transferred to and amalgamated with the insurance business of QIA.

A copy of the scheme, the transfer agreement and the actuarial report of Mr Benoit Laganier, FIAA, upon which the scheme will be based, will be open for public inspection, and may be obtained free of charge by any policyholder of MMIA or QIA, between the hours of 9.00am and 5.00pm every day (except weekends and public holidays) for a period of at least 15 business days from 19 December, 2007 at the offices of QIA at the following addresses:

New South Wales	Victoria	Queensland
Ground Floor 85 Harrington Street Sydney NSW	Level 8 628 Bourke Street Melbourne VIC	Level 16 100 Edward Street Brisbane QLD
Western Australia	South Australia	Tasmania
Level 18 200 St George's Terrace Perth WA	Level 13 45 Pirie Street Adelaide SA	Level 7 85 Macquarie Street Hobart TAS
Australian Capital Territory	Northern Territory	
Level 7 220 Northbourne Avenue Canberra ACT	Level 2 43 Mitchell Street Darwin NT	

The scheme may also be viewed on QBE's website at [www.qbe.com.au](http://www.qbe.com.au).

Further enquiries can be made by calling the QIA's Customer Service Centre on 1800 335 302 toll free anywhere in Australia, during the hours of 9.00am and 5.00pm (Sydney time).

Policyholders affected by the scheme may attend the Court hearing and request to be heard by the Court on the application for confirmation of the scheme. Any person who wishes to appear before the Court is requested to advise Mr Peter Smiles of QBE Group Legal, Level 2, 82 Pitt Street, Sydney NSW 2000 (Ph: (02) 9375 4322) at least seven (7) days prior to the hearing date specified above.