



CGU Insurance Limited v Porthouse [2008] HCA 30

The High Court of Australia handed down its decision of *CGU Insurance Limited v Porthouse [2008] HCA 30* on 30 July 2008. CGU Insurance Limited was successful in its appeal from the decision of the Court of Appeal of the Supreme Court of New South Wales.

Facts

1. Porthouse was retained in May 2001 to advise on a client's entitlement to compensation for injuries sustained while performing work pursuant to a Community Services Order. In advising his client, Porthouse failed to recognise that legislative amendments to the *Workers' Compensation Act*, which commenced on 27 November 2001, had the potential to deny his client's claim. The proceedings were commenced after this deadline, and although the District Court judge found that the amendments did not defeat the claim, this decision was later overturned by the Court of Appeal. The client subsequently made a claim against Porthouse and his instructing solicitors for professional negligence. Porthouse sought indemnity from CGU who denied
2. coverage on the basis of a "Known Claims and Known Circumstances" exclusion. Porthouse cross-claimed against CGU for indemnity under his professional insurance policy. Although Porthouse had completed the policy proposal form after he became cognisant of the potential effect of the amendments on his client's case, he answered "No" to a question asking whether he was aware of any circumstances which could result in any claim being made against him.
3. The "Known Claims and Known Circumstance" Exclusion read as follows: "**We do not cover any liability for the following Claims (or losses):**
Known Claims and Known Circumstances
(a) **Known Claims (or losses)** as at the inception date of this **Policy**, or
(b) **Claims (or losses)** arising from a **Known Circumstance**, or
(c) **Claims (or losses)** directly or indirectly based upon, attributable to, or in consequence of any such **Known Circumstance**

- or **Known Claim** (or losses), or
- (d) **Claims** (or losses) disclosed in the **Proposal** form or arising from facts or circumstances disclosed in the Proposal form."
4. The Policy included the following definition:
"11.12 Known Circumstance
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."
5. The primary judge held that Porthouse had been negligent with respect to the client. She also held that there was no circumstance which Porthouse knew or a reasonable person in his professional position would have thought might result in someone making an allegation against him. She ordered CGU to indemnify Porthouse. CGU appealed to the Court of Appeal of the Supreme Court of New South Wales.
6. Justices Hodgson JA and Young CJ in Eq dismissed CGU's appeal essentially finding that:
- On the construction of the insurance agreement, the phrase "thought...might result" can cover a spectrum of likelihoods. The primary judge applied the correct standard of "believed as a realistic possibility", having construed the agreement *contra proferentem* against the insurer, because of the ambiguity in the phrase.
 - The question whether a reasonable person in the respondent's position "would have thought" something can be approached by considering the person's actual state of mind and then considering whether this was reasonable, so long as this does not distract attention from the ultimate question, whether a reasonable person in the respondent's position "would have thought" it.

7. Hunt AJA dissented essentially finding that:
- The test to be applied was a solely objective one, albeit from the perspective of a reasonable person in Porthouse's position, and not the test applied by the primary judge. Applying the objective test, a reasonable person in Porthouse's position would have been far more perceptive of the consequences of his oversight than he was.

High Court decision

8. The issues which the High Court was called upon to determine were:
- (a) 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 "*any fact, situation or circumstance*" known to the insured might give rise to an allegation against the insured.
 - (b) The correct interpretation to be

given to the conditional expressions italicised below, when determining 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.

- (c) The correct application of Section 11.12(b) of the definition of "*Known Circumstances*" and whether evidence of what the insured actually thought could be taken into account when determining what the hypothetical reasonable person "*would have thought*".

9. In relation to 8(a) the High Court found that:
- The phrase "*a reasonable person in the Insured's professional position*" in Section 11.12(b) posits an objective standard, with a modification relating to professional, not personal, matters. The phrase describes a hypothetical reasonable person with the experience and knowledge of the insured coupled with the capacity of such a reasonable person to draw a conclusion

(whether it is plain and obvious or not) as to the possibility of someone making an allegation against the insured.

- There is nothing in the context or language of the policy to suggest that there is to be imputed to the hypothetical person the insured's personal idiosyncrasies or the insured's state of mind.
 - There is also nothing in the language to support reading down a reasonable person's capacity to draw conclusions as limited to conclusions which are plain and obvious.
 - All of these facts and circumstances known to Porthouse were to be imputed to "a reasonable person in the Insured's professional position".
- 10.** In relation to 8(b) the High Court noted three preliminary points:
- First, the reference in Section 11.12(b) to "allegations", not claims, emphasises that the expression "Known Circumstance" is not confined to claims likely to be successful.
 - Secondly, the phrase "*before this Policy began*" in Section 11.12(b) is a temporal expression meaning earlier in time, no matter how much earlier in time.
- Thirdly, the reference to "*any fact, matter or circumstance*" in Section 11.12 is plainly a reference to objective matters and is not a reference to a state of mind or belief.
- 11.** The High Court went on to find that:
- In the context of the policy, the conditional expression "*would have thought*" was a reference to a supposed conclusion reached by the hypothetical "*reasonable person*".
 - Once that person satisfies the condition of being "*in the Insured's professional position*" and once knowledge of "*any fact, situation or circumstance*" known to the insured is imputed to that person, the phrase "*would have thought*" coupled with the expression "*might result in*" requires a conclusion by the hypothetical person that there was a real (not a fanciful or remote) possibility (not a certainty) of an allegation being made.
- 12.** In relation to 8(c) the High Court found that:

- Section 11.2(b) provides an objective standard, and whilst it is not wrong to take into account what an insured thought, as a piece of possibly relevant evidence, it requires a determination of a question of fact to be determined independently of the insured's state of mind.
- Section 11.2(b) provides an important practical protection for insurers, by protecting the insurer from a genuine but unreasonable or unrealistic estimate or understanding of the insured.

Implications for Insurers

- 13.** The decision provides insurers with a greater level of certainty in relation to the objective test in the definition of "Known Circumstances".
- 14.** The High Court found that whilst evidence of an insured's state of mind can be taken into account as evidence of what a reasonable person would have thought, the test remains an objective question of fact to be determined independently of the Insured's state of mind.
- 15.** The High Court confirmed that the purpose of "Known Circumstances" exclusions is to provide important practical protection to insurers. They protect insurers from providing cover where an insured holds a genuine but unreasonable or unrealistic belief in relation to the potential of a claim being made.
- 16.** The High Court's judgment has effectively confirmed the efficacy of "Known Circumstances" exclusions.
- 17.** Please note that this decision was in relation to a particular clause in a particular policy. Care would need to be exercised before determining whether the decision in Porthouse applies to other "Known Circumstances" exclusions.

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