

LUMLEY

“YOUR EDGE LIABILITY SYMPOSIUM 2009”

PROFESSIONAL INDEMNITY POLICIES

Introduction

- 1 Claims Made Policies for professionals have been entrenched in the New Zealand market for a considerable period of time. They were developed for the Professional Indemnity market, primarily to avoid the long-tail for insurers that could arise from occurrence based policies.
- 2 There is considerable misunderstanding by insureds about how they work. For example a common complaint is that the policy that responds is ‘less favourable’ than the one that existed at the time of the occurrence giving rise to the claim. This paper endeavours to address some of those issues/misunderstandings, so as to assist you in dealing with the same when (or before) they arise with your clients.

How Claims Made Policies Operate

- 3 Broadly, there are two types of Professional Indemnity policies:
 - (a) Errors or omissions policies which provide cover against losses sustained by the insured due to negligent acts or omissions; and
 - (b) Policies which provide protection in respect of loss sustained by the insured as a result of being held legally liable to a third party.
- 4 It is the latter type of policy which is most common in the New Zealand market and with which most of you will be familiar.
- 5 However, both policies have the common feature that a claim must be made upon the insured during the currency of the policy, to trigger cover. Put another way the policy must be in existence at the time the claim is made.

- 6 Most Policies will exclude cover for claims arising out of circumstances that the Insured was aware of at the date of commencement (or renewal) of cover. This can of course lead to a 'gap' in cover.
- 7 To deal with this, most good claims made policies will provide an extension to the primary cover to include circumstances that could give rise to a claim. Providing those circumstances have arisen within the currency of the policy period (and have been properly notified) then the policy will treat/deem any subsequent claim as having been made during the period of cover.

Notification

- 8 Obviously managing the claims process is vital to the broker-client relationship. In practice, two broad areas of concern arise:
- (a) Have all the conditions for notification been complied with.
 - (b) Does what you are being told/advised need to be notified

Condition requiring Notifying

- 9 Most claims made policies require notification within the policy period; of any claim or occurrence/circumstance which may subsequently give rise to a claim.
- 10 In the event that those terms are not complied with then it may be necessary to have resort to section 9 of the Insurance Law Reform Act 1977. Section 9 provides that a condition prescribing a time limit within which the insured must notify the insurer of a claim against it will only bind the insured under a liability insurance policy if "the insurer has been so prejudiced by the failure of the insured to comply with such provision that it will be inequitable if such provision were not to bind the insured".
- 11 In the Court of Appeal's decision in *Sinclair Horder O'Malley v National Insurance Co of New Zealand Ltd [1995] 2 NZLR 257*, it was held that no distinction was to be drawn between a condition requiring a claim to be notified within a particular time period and a condition requiring that

circumstances likely to give rise to a claim to be notified within a particular time period. Both are to be subject to section 9. Of course, section 9 will not be of any assistance unless the circumstances arose during the currency of the policy.

- 12 The principles relating to prejudice to the insurer has received relatively little judicial consideration. In *Sinclair Horder O'Malley v National Insurance Company of New Zealand Ltd* [1992] 2 NZLR 706, the High Court suggested that the insurer bears the burden of proof to establish prejudice. Tipping J went on to say that such prejudice must be specific rather than general. It must be of such a nature that the insurer has "been materially disadvantaged in the particular case by the non or late notification".
- 13 If the insured only misses the notification deadline by a matter of days, it will be difficult for the insurer to show that they have been 'materially disadvantaged'.
- 14 Although the High Court's decision in *Sinclair Horder* was subsequently reversed by the Court of Appeal, on different grounds, the High Court's statements on prejudice have been accepted in other cases. In *Bradley West Clark List v Keeman* (1997) 6 NZBLC 102,292, a 6½ year delay and the lost opportunity to settle the claim more advantageously led the Court to conclude there was prejudice such that the insured should be bound by the terms of the policy requiring notice within the policy period.
- 15 And in *UEB Packaging v QBE Insurance Ltd* [1998] 2 NZLR 64, the insurer was not notified of the claim against the insured until almost 3 years after the insured had been told of the claim. In the meantime, proceedings had been instituted and default judgment against the insured had been entered. The Insurer suffered, to use the court's words, 'clear' and 'obvious' prejudice.

What needs to be notified

- 16 What constitutes "a claim"? Although it would be unusual today, if there is no definition in the policy, 'claim' is simply an assertion by a third party of a right against the insured. Common examples of the same would include a letter of

demand, (from a lawyer or otherwise), a hold liable letter from an assessor, and of course the institution of proceedings.

- 17 However most policies define the word. For example Clause 1.2 of Lumley's standard Professional Indemnity policy defines claim as "legal proceedings instituted and served upon the insured, or any threat or intimation that legal proceedings will be instituted against the insured".
- 18 The definitions in the policy are all important. In *QBE v Ministry of Agriculture (CA 174/04, 3 August 2005)*, the 1999/2000 policy indemnified the Ministry of Agriculture against "claims made against the insured and reported to the Insurers within the period of insurance". Although the Ministry was obliged to notify circumstances that could give rise to a claim, the policy defined "claim" as being a "demand for compensation made by a third party against the insured". Significantly there was also no clause in the 1999/2000 policy deeming notified circumstances, which subsequently give rise to a claim, as a claim within the policy period.
- 19 In its proposal for the 1999/2000 year, the Ministry had notified QBE of a judgment declaring that its actions in respect of barring logging of particular indigenous forest were unlawful. However, the third party who had sought the declaration, Alan Johnston Sawmilling Ltd ("AJS"), had yet to request compensation for the Ministry's illegal actions. Therefore, there was no "claim" within the period of insurance as defined.
- 20 In 2002 proceedings were issued by AJS seeking damages, claiming amongst other things, that the Ministry had been negligent. The claim was excluded in the Ministry's policy for the 2002 year because they were known circumstances and because of the limitations in the cover for the 1999/2000 year there was also no cover in that year.
- 21 Lawyer/clients letters which don't threaten proceedings or hold liable the Insured can be a hazy area. Close attention should be paid to what in substance is actually being asserted. In the Australian case of *Antico v C E Health Casualty & General Insurance Co Ltd (1995) 8 ANZ Ins Case 61-258*, the NSW Supreme Court held that a letter expressing "grave concerns" in

relation to a matter and reserving the client's rights in relation to those matters probably did not amount to a claim.

- 22 However, in practice it will generally be easy to distinguish a claim from circumstances which could rise to a claim. However difficulty can arise in ascertaining whether the circumstances as advised to you by the insured are in fact circumstances which should be notified and/or trigger cover under the policy.
- 23 The starting point in deciding whether to notify is the wording of the policy: However there a number of different 'circumstances' wordings around. The words, 'likely, may, or could' have all been used to qualify the phrase 'circumstances giving rise to a claim':
- 24 In *Sinclair Horder* at 715 the court thought that "likely" should be construed as meaning a real risk of a claim. In *FAI General Insurance v McSweeney (1999) 10 ANZ Ins Cases 61-443* the Court said the word 'may' meant to a reasonable person that there was definite risk, or a real possibility of a claim. The Court even used the words 'on the cards/springing to mind' as appropriately expressing what was meant.
- 25 In this uncertain state the best that can be said is that circumstances making a claim more probable than not are unlikely to be required. If in doubt, the insured should notify.

Scope of Cover

Civil Liability v Negligence Wording

- 26 We have already touched on the two types of common policies, namely that which provides covers for negligent acts or omissions and the policy which provides cover for civil liability.
- 27 The former is more limited in scope because it only provides cover for negligence, whereas a professional's liability may arise from other sources, for example a breach of fiduciary duty, or pursuant to the Fair Trading Act or the Consumer Guarantees Act.

Insured's Business

- 28 It's important to recognise that an important limitation in the policy will be that there is only cover for liability arising in the conduct of the insured's business. How the insured's business is defined is all important because there will be wide variations of risk between one business and another.
- 29 Obviously if an insured conducts more than one type of profession (multi disciplinary practices are very common in the construction area for example) then the liability arising out of all professions must be covered. Having a full and complete picture of the insured's business will be all important.
- 30 Sometimes it will be difficult to determine whether the activities of the Insured are those of a professional. Cover will only be available for the conduct of a profession, although the meaning of this term can vary with the context.
- 31 Although the Courts have shown a willingness to regard as 'professional' a greater range of services, not traditionally within that concept, essentially to give commercial sense to the policy, problems still arise at the margins. For example, incorrect information about the location of a water main trench provided by a local Authority was, without more, not the provision of professional advice/services. *FAI General Insurance v Gold Coast City Council* (1999) 7 ANZ Ins Cases 61-1533.
- 32 Probably the best way to determine whether the activities of your insured are likely to be covered is to ask whether they are involved in the provision of advice/services of a skilful character according to some established discipline. (They don't have to be a member of a recognised profession, or hold qualifications to be engaged in the provision of professional services.) If the answer to the question is yes then they probably need PI cover. If not, then a general liability policy may be more appropriate or perhaps, depending on what they are doing, they need both types of cover.
- 33 The importance of having both PI and general liability cover is made clear by the case of *Boulderstone Hornibrook Engineering Pty Ltd v Gordian Runoff Ltd* [2008] NSWCA 243. In that case, the insured was engaged as the head

contractor on the project for the construction of a third runway at Sydney Airport. The insured's professional indemnity policy indemnified the insured against claims for breach of professional duty in the profession stated in the schedule (engineers). The insurance also extended to liability for the professional conduct of specialist designers and consultants acting on the insured's behalf.

- 34 The Airport successfully claimed against the insured for losses arising out of defective earth walls making up the perimeter of the runway. The Court of Appeal found that the defect in the walls was not due to a design or specification error, but arose out of the adoption of negligent construction techniques. Because the defective techniques had not been mandated by the design documentation, the loss was caused by the way the construction work was in fact performed, and thus was not covered by professional indemnity insurance.

What is not covered

- 35 This list is obviously not exhaustive but not included are:
- (a) Assuming an obligation by contract, for example, warranting the commercial outcome of a project will not be covered. Unless the obligation assumed is akin to the type of liability that will be imposed by the common law, then generally, there will be no cover..
 - (b) Loss resulting from wilful or deliberate acts or omissions of the insured will not be covered because the essential nature of the Insurance contract is to cover against fortuities.
 - (c) Business losses, risks or fees associated with the business of the Insured

Helping the Insured to Help Themselves

- 36 Clearly the major driver for insureds is the cost of insurance and the extent of any excess payable under Professional Indemnity policies.

- 37 In order to assist insureds to limit liability and thus the cost to insurers and themselves all professionals should be encouraged to:
- (a) Ensure the professional's client signs a standard form of agreement, describing clearly what the professional is being asked to do/advise on and which include relevant (and lawful) provisions limiting the time for suing, and the amount of any liability;(and then proportionately if others are liable).
 - (b) Incorporate in the written terms of conditions clear identification of who they are contracting with, limiting their liability to that person and no others (disclaimers).
 - (c) Ensure that they engage in active risk management programmes including, up-to-date awareness of the regulatory environment which affects their profession and current practice standards.
 - (d) Ensuring someone within the business has overall responsibility to ensure that risk management strategies are complied with by all professionals within the business.