IN THE COURT OF APPEAL OF NEW ZEALAND

CA565/2008
[2010] NZCA 237

BETWEEN	D A CONSTABLE SYNDICATE 386 Appellant
AND	AUCKLAND DISTRICT LAW SOCIETY INC Respondent

Hearing: 25 February 2010

Court: Chambers, O'Regan and Ellen France JJ

Counsel: A R Galbraith QC and J F Anderson for Appellant
M G Ring QC and S A Thodey for Respondent

Judgment: 8 June 2010 at 2.30 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay the respondent costs for a complex appeal on a band A basis and usual disbursements. We certify for second counsel.

REASONS OF THE COURT

(Given by Ellen France J)

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Introduction

[1] In the course of an investigation under the Law Practitioners Act 1982 the respondent, the Auckland District Law Society (ADLS),[1] became involved in litigation with Russell McVeagh McKenzie Bartleet and Co (Russell McVeagh), a legal firm. The litigation related principally to whether or not ADLS was entitled to retain and use documents over which Russell McVeagh claimed legal professional privilege. The proceedings were ultimately settled with ADLS paying the litigation costs incurred by Russell McVeagh (over $650,000) as well as its own costs (over $850,000).

[2] ADLS sought to recover these costs under its professional indemnity insurance policy. The insurance cover was provided by D A Constable Syndicate 386 (D A Constable), a Lloyd's syndicate. The policy relevantly provided cover for "all sums which [ADLS became] legally liable to pay as damages and claimants costs and expenses ... arising out of any negligent act, error or omission" on ADLS's

[1] Now an incorporated society.

part. D A Constable declined cover. ADLS brought proceedings to recover its losses incurred by D A Constable's failure to indemnify.

[3] In the High Court, Cooper J concluded ADLS was covered under the policy for the full amount of its claim.[2] Judgment was entered in favour of ADLS. D A Constable appeals against that decision.

Issues

[4] There are three issues for determination:

1. Does the phrase "damages and claimants costs and expenses" provide cover for claimant costs and expenses where there is no damages claim?

2. Did ADLS's liability for costs and expenses arise out of "any negligent act, error or omission" on its part?

3. If there would otherwise have been cover under the policy, what was the effect, if any, of ADLS not complying with Condition 2 of the policy, which required ADLS to obtain D A Constable's consent before incurring legal and settlement costs?

The factual background

[5] We first need to say something about the proceedings involving ADLS and Russell McVeagh which gave rise to ADLS's claim on its insurance policy. We then discuss the terms of the insurance policy.

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2 *Auckland District Law Society v D A Constable Syndicate 386* [2009] 1 NZLR 677 (HC).

The proceedings involving ADLS and Russell McVeagh

[6] Cooper J gives a helpful summary of the earlier proceedings which we essentially adopt.[3]

[7] In the late 1990s, ADLS was investigating complaints under the Law Practitioners Act against Paul Carran, a partner in Russell McVeagh at the relevant times, and against Russell McVeagh itself. The complaints related to the conduct of failed bloodstock syndicates in the 1980s and ensuing litigation.

[8] The first of the proceedings was brought against ADLS by various present and former partners of Russell McVeagh. In this proceeding, Russell McVeagh sought to restrain ADLS from retaining Gary Judd QC as its counsel and to secure the return of privileged documents provided in confidence to ADLS's counsel. The plaintiffs sought declarations and a mandatory injunction to prevent Mr Judd from acting, as well as the return of the documents. The issue over Mr Judd's involvement was settled but the question of the return of the documents ultimately reached the Privy Council. Paterson J in the High Court found in favour of Russell McVeagh[4] and ADLS appealed successfully to this Court.[5] On Russell McVeagh's appeal to the Privy Council, their Lordships ruled against ADLS and awarded costs to Russell McVeagh.[6]

[9] In the meantime, the second and third proceedings were commenced. In the second proceeding ADLS sought a declaration that it was entitled to receive and use information provided to ADLS by Judge McElrea, a former Russell McVeagh partner. Russell McVeagh defended the claim on the grounds the information was confidential and/or privileged and also filed a counterclaim. The counterclaim sought declarations as to the status of the information and an injunction restraining Judge McElrea from providing further information. Russell McVeagh then filed an amended counterclaim which also sought damages against both Judge McElrea and ADLS.

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3 At [5]–[25].
4 *B v Auckland District Law Society* HC Auckland M1539/SD99, 6 July 2000.
5 *Auckland District Law Society v B* [2002] 1 NZLR 721 (CA).
6 *B v Auckland District Law Society* [2003] UKPC 38, [2004] 1 NZLR 326.

[10] The third proceeding was brought by Russell McVeagh against ADLS and alleged various breaches of statutory duty, of the New Zealand Bill of Rights Act 1990 and of natural justice. Russell McVeagh sought declarations, injunctions and damages.

[11] The second and third proceedings were settled following the Privy Council's decision in the first proceeding. The settlement agreement provided that ADLS became liable for Russell McVeagh's costs.

[12] As Cooper J noted,[7] under the settlement agreement, ADLS would pay Russell McVeagh $191,667 for costs in the High Court and this Court on the first proceeding, and in the High Court on the second and third proceedings. A further $465,464.29 was paid in relation to costs in the Privy Council on the first proceeding. ADLS's own defence costs were $850,679.69. This means the total amount sought by ADLS from D A Constable is $1,507,810.98.

[13] None of the sums paid in settlement included any amount as damages. It is accepted that no question of negligence on the part of ADLS arose in the context of the proceedings.

The relevant insurance policy

[14] ADLS was in fact covered by two D A Constable policies over the period in question. The first policy covered the period 1 November 1998 to 1 November 2000 and the second applied from 1 November 2000 to 1 November 2001. There are no relevant differences between the two policies. In each, the principal obligation is set out as being to:

> ... insure against loss, including but not limited to associated expenses specified herein, if any, to the extent and in the manner provided in this Policy.

[15] D A Constable agreed to indemnify ADLS:

> ... against all sums which [ADLS] shall become legally liable to pay as damages and claimants costs and expenses as a result of any claim or claims

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7 At [24]–[25].

> made against [ADLS] during the period of insurance stated in the Schedule arising out of any negligent act, error or omission on the part of
>
> (a) [ADLS]
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> ...
>
> in or about the conduct of [ADLS's] business as specified in the Schedule.

[16] A separate clause covered ADLS for its own costs and expenses incurred in relation to any "claim which falls to be dealt with under this Insurance". It is common ground that if ADLS is covered for Russell McVeagh's costs, then it is also covered for its own costs.

[17] Condition 2 of the policy is also relevant. That condition directed ADLS not to incur any costs or expenses or settle any claims without D A Constable's written consent. It also entitled D A Constable to take over conduct of the proceedings. ADLS was entitled to litigate proceedings D A Constable considered should be settled but this was to be at ADLS's own risk.

[18] At various stages over the course of the litigation with Russell McVeagh, ADLS and the agents for D A Constable discussed whether or not ADLS had cover under the policy. The content of these discussions is relevant to the effect of Condition 2 and we say more about them in considering that issue. We also discuss some further detail of the policy later in this judgment.

[19] The premium for the first, two-year, period of cover was $35,100. The premium for the further year of cover was $19,500. The cover provided was $3 million.

The High Court judgment

[20] On the first issue Cooper J concluded there was cover for sums ADLS became legally liable to pay, whether those sums were damages and/or costs and/or expenses. The Judge said this was the plain meaning of the words of the policy.

[21] As to the second issue, Cooper J took the view that ADLS had made "an error" of the sort to which the policy responded. Before the High Court D A Constable did not argue directly, as it does now, that "negligent" qualified the meaning of "error or omission" in the indemnity clause.

[22] Finally, on the third issue, the Judge considered that D A Constable's actions in denying cover amounted to repudiation. ADLS was therefore excused from complying with Condition 2 of the policy.

Meaning of "damages and claimants costs and expenses"

Principles of interpretation

[23] The parties agree that Cooper J correctly stated that the interpretation of insurance contracts is to be approached in the same way as contracts generally. There is also no dispute that, as Tipping J said in *Vector Gas Ltd v Bay of Plenty Energy Ltd*, the "ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear".[8] There were some differences between the parties as to how the parties' intention was to be objectively ascertained but we do not see those differences as critical in terms of our approach.

Submissions

[24] D A Constable contends that there is cover only for those costs and expenses associated with a claim for damages. If all costs and expenses are covered, irrespective of whether there is a damages claim, D A Constable says that the policy becomes a general underwrite of ADLS's litigation expenses, not a professional indemnity policy.

[25] In developing this submission, Mr Galbraith QC on behalf of D A Constable says that the starting point is the concept of claim. It follows from that concept that there must be something giving rise to the alleged entitlement. By contrast, where

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8 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5 at [19].

the claim is intended to ensure ADLS carries out its duties in a lawful manner that does not fit with the notion of "claim" under the policy.

[26] At the conceptual level, D A Constable also submits that the approach taken in the High Court places the insured's and the insurer's interests in conflict. Mr Galbraith makes the point that an insurer has no interest in the substance of a claim that does not involve a claim for loss arising as the consequence of a fortuity. For example, the substance of a claim for an injunction or a declaration does not expose the insurer to any risk. If a professional indemnity policy is held to cover such claims, he submits that it is in the insurer's interest to consent to the relief sought by the third party claimant in order to avoid a legal liability to pay costs and expenses.

[27] Finally, D A Constable says its approach is consistent with other provisions of the policy which turn on the character of a claim for damages, not on who is the initiating party.

[28] ADLS supports the interpretation adopted by the Judge.

Discussion

[29] We consider that the ordinary meaning of the words "damages and claimants costs and expenses" does not mean that only those costs and expenses associated with a claim for damages are covered. That conclusion follows from the fact that, in its ordinary meaning, "and" may be conjunctive or disjunctive or both, depending on context.

[30] ADLS advanced its case on the basis that "and" meant "and/or". There is support for that view in other parts of the policy where the word "and" is used in both senses. For example, on the front page there is an entitlement to apply to the Lloyd's Policy Signing Office to ascertain the identity "and" proportionate liability of each Underwriter. "And" here must mean "and/or".

[31] D A Constable focuses on whether damages are claimed and argues that attention should be placed on the real nature of the claim. We agree with ADLS that this confuses "claim" with "legal liability". The policy says it covers the legal liability flowing from the claims. As drafted this must, at least, mean liability whether as damages and/or claimants costs and/or expenses. The claim does involve sums ADLS became legally liable to pay and it is common ground that ADLS acted reasonably in settling the proceedings. Accordingly, the fact that some of the claims did not involve a claim for damages is not determinative.

[32] This approach disposes of D A Constable's argument that the policy does not provide a general underwrite of ADLS's legal expenses.

[33] The interpretation favoured by ADLS and adopted by Cooper J is also supported by the fact that damages traditionally have been treated as a separate head of claim, which does not necessarily coincide with a claim for costs and expenses.[9]

[34] We agree with Mr Ring QC's submission on behalf of ADLS that the perceived conflict which results from this interpretation is more apparent than real. Two factors are relevant here. First, an insurer which exercises its right to take over and undertake the insured's defence must act bona fide in the common interests of both and not for its own interests for some ulterior purpose. Sir Wilfred Greene MR in *Groom v Cocker* said of a policy containing a clause equivalent to Condition 2 that the insurers had:[10]

> ... the right to decide upon the proper tactics to pursue ..., provided that they do so in what they bona fide consider to be the common interest of themselves and their assured. But the insurers are ... not entitled to allow their judgment as to the best tactics ... to be influenced by the desire to obtain for themselves some advantage altogether outside the litigation in question with which the assured has no concern.

The authors of *Derrington & Ashton* make the same point.[11]

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9 See Desmond Derrington and Ronald Ashton *The Law of Liability Insurance* (2nd ed, Lexis Nexis, Chatswood, 2005) at [8-502] and *McCarthy v The Insurance Commissioner* [1960] Qd R 554 (QSC).

10 *Groom v Cocker* [1939] 1 KB 194 (CA) at 203.

11 At [9-164].

[35] Secondly, as Mr Ring submits, terms in the policy recognise there may be a conflict between the parties' interests. Under Condition 2, for example, the insured can insist on the appointment of a Queen's Counsel to advise whether the defence is as good as the insurer believes.

[36] Nor do we see any merit in D A Constable's submission that its approach is more consistent with other provisions of the policy. D A Constable relies on the following aspects of the policy:

(a) The Schedule to the policy, under the heading "Legal Action", refers only to an action for damages;

(b) The exclusion of legal action outside the specified territories refers to an "action for damages" (Exclusion (i)); and

(c) Endorsement 3 limits liability for the actions of any solicitor as an outside director to professional advice given on behalf of ADLS. Such liability can only sound in damages.

[37] The provision in the Schedule relied on by D A Constable sets out the territories for which there is liability to indemnify, as follows:

> Legal Action: In respect of any claim made against the Assured which results in an action for damages, Underwriters shall only be liable to indemnify the Assured if the initial action and all subsequent actions are brought in the Courts of the following territories:
>
> Worldwide excluding United States of America and Canada.

[38] Exclusion (i) provides there is no cover:

> where action for damages is brought in a court of law outside the territories specified in the Schedule, or where action is brought in a court of law within those territories to enforce a foreign judgment whether by way of Reciprocal Agreement or otherwise.

[39] The Exclusion accordingly limits the cover where the action for damages is brought outside the territories set out in the Schedule. In terms of the Schedule, if

the claim against ADLS "results in an action for damages" there is worldwide cover, except for Canada and the United States.

[40] We agree with the ADLS submission that these two provisions indicate an intention to treat "damages" and "claimants costs and expenses" as separate indemnity entitlements. Indemnity for the latter is preserved in any overseas jurisdiction while damages claims in North America are excluded. Were the two not treated separately, the "for damages" qualification to "action" would be otiose. Mr Ring submits that the commercial sense, objectively, of that approach is to avoid exposure to what are generally perceived as very high jury awards for damages in North American jurisdictions.

[41] Endorsement 3 records the parties' agreement that the Underwriters are not liable to indemnify ADLS:

> ... against any claim arising out of the activities of any solicitor as an outside director except for professional advice given as a representative of the Law Society.

[42] Cooper J dealt with D A Constable's argument that this terminology was only appropriate to deal with damages claims in actions for negligence as follows:[12]

> While that may be so, again it by no means follows that the indemnity clause should be read down as a consequence. I do not see why or how claims not within the ambit of the Endorsement and which would otherwise fall within the words of the indemnity clause could be excluded from cover on the basis of the words used in the Endorsement.

We agree.

[43] There is another way of interpreting the clause which also supports the conclusion of the Judge. That is, that "and" is used here in the conjunctive sense, ie, it means "and". On this approach, which we also consider has merit, the meaning of the clause is that the insurer provides cover for sums the insured has to pay by way of damages and claimants' costs. The pool for which cover is provided includes damages and costs. If the insured has to pay damages, that is covered. If the insured has to pay damages and costs, that is covered. Similarly, if the insured has to pay

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[12] At [97].

costs, there is cover for that as well. On either approach, whether "and" means "and/or" or "and" means what it says, we agree with Cooper J's conclusion.

Did ADLS's liability arise out of "any negligent act, error or omission"?

D A Constable's contentions

[44] D A Constable says that "negligent" should be read as qualifying "error or omission" in the indemnity clause. Alternatively, D A Constable argues that an error or omission cannot be a consciously chosen course of conduct which results in an undesired outcome.

[45] In developing the submissions on this point, Mr Galbraith says that the interpretation favoured by D A Constable is clearly available on the wording used in the policy. He also submits that this interpretation is consistent with the context of a professional indemnity policy which provides cover where a liability has arisen because of a breach of professional standards.

[46] D A Constable relies on the evidence of Stephen Bryers, a past president of the ADLS who acted as convenor of the relevant ADLS Complaints Committee at various points in time. Mr Bryers accepted in cross-examination that ADLS was trying to conduct "a proper thorough investigation" and essentially wanted to establish whether or not ADLS was acting correctly. Mr Galbraith says this is not the sort of thing covered by the policy because ADLS was not negligent or, alternatively, had made no error. Mr Galbraith also contends that D A Constable's interpretation is consistent with other provisions in the policy.

[47] ADLS argues the phrase should be read as covering non-negligent errors and omissions and relies on a number of authorities. Mr Galbraith, on the other hand, submits that those authorities which favour ADLS's interpretation are distinguishable while there are other cases, particularly from the United States, which support the approach taken by D A Constable.

Discussion

[48] As a matter of linguistics, it makes good sense to treat the word "negligent" as governing all of the words which follow. That also appears to be the drafting technique in Exclusion (c) which excludes liability "arising directly or indirectly from any dishonest, fraudulent, malicious or illegal act or omission". The words "act or omission" in Exclusion (c) appear to be qualified by each of the preceding words.

[49] There is also some force in D A Constable's argument that on Cooper J's approach the reference to "negligent acts" in the indemnity clause becomes surplusage because both negligent and non-negligent acts are caught under either "error" or "omission". Further, on ADLS's approach, the description in the Schedule of ADLS's business which refers to claims "alleging negligent act, error or omission in the course of [ADLS's] business" is a little odd if "negligent" only governs the word "act". The phrase needs to be able to be read as "alleging ... error or omission". But, as Mr Galbraith submits, it would be unusual to describe "allegations" of error or omission without a qualifying word to show the allegation leads to liability, eg, "unlawful".

[50] On the other hand, on D A Constable's interpretation, there would be no need to refer to "errors" at all because if errors must be *negligent* errors, won't they always be either negligent acts or negligent omissions? There is accordingly force in Mr Ring's submission that there is an element of redundancy on either approach.

[51] There are two other contextual matters which strongly suggest that "negligent" does not qualify "error or omission" in the insuring clause.

[52] The first of these matters is that, on D A Constable's interpretation, there would be no need for some of the exclusions in the policy. In particular, if the indemnity clause limited the cover to negligence, why have express exclusions for dishonest or malicious acts or omissions[13] and for contractual liability?[14] Mr Galbraith suggests such exclusion clauses are commonplace and are included for emphasis. But neither reason adequately explains the need for these clauses.

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13 Exclusion (c).
14 Exclusion (e).

[53] The approach to defamation is also instructive. Exclusion (d), removes cover for libel or slander. The business of ADLS is, however, defined to include the LINX information database published by ADLS, the operation of which potentially could give rise to issues of defamation. However, by Endorsement No 1, Exclusion (d) is cancelled. Cover is then available for libel or slander in ADLS's publications or by reason of words written or spoken by, amongst others, ADLS or a person engaged by the society of the Waitangi Committee (organised by and for members of ADLS) to perform as a lecturer or speaker and so on. This suggests some tailoring of the policy to fit the business of ADLS, a point to which we return shortly.

[54] Secondly, on D A Constable's approach there would be no cover under the basic insuring clause for breach of fiduciary duty, or a breach of statutory duty unless the acts, errors and/or omissions giving rise to it were also negligent. Other potential liability under, for example, the Fair Trading Act 1986 or the Consumer Guarantees Act 1993, would also be excluded. The business of the insured, which the insurer knew about, is relevant here. That business is stated in the Schedule to be that of "a Professional body established under the Law Practitioners Act". Given the business of ADLS, it would be odd for the basic insuring clause to exclude liability for these sorts of matters.

[55] We turn then to consider whether the authorities relied on by the parties assist.

[56] A helpful starting point for this discussion is the decision of Webster J in *Wimpey Construction UK Ltd v Poole (DV).*[15] The primary insuring clause of the professional indemnity policy in that case provided cover in relation to "omission, error or negligent act" as did cl 12, which was described as the extending clause. Another clause, dealing with "claims notified", referred to "negligent act, error or omission", as did the "slip".

[57] Webster J noted that *MacGillivray and Parkington on Insurance Law* had been cited as support for the proposition that on a policy indemnifying the insured against "negligent act error or omission" it was an "open question whether the word

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[15] *Wimpey Construction UK Ltd v Poole (DV)* [1984] 2 Lloyd's Rep 499 (QB).

'negligent' qualifies only the word 'act'".[16] *MacGillivray* went on to note that the ambiguity had been "resolved by decisions which have laid down that such policies are intended to cover negligence ... [not fraud or dishonesty]".[17] Webster J expressed doubt that the cases cited in *MacGillivray* supported the proposition that only negligence was covered. For example, the Judge said that in *Davies v Hosken*[18] the Court was concerned not with the exact meaning of the phrase (there, "neglect, omission or error") but, rather, with whether the phrase included the fraud of a clerk. Porter J in *Davies v Hosken* concluded the words did not encompass that situation.

[58] Webster J also referred to *Haseldine v Hosken.*[19] In that case the insurance policy covered "any neglect, omission or error" on the part of a solicitor. Webster J noted the following passage from that judgment:[20]

> What it was intended to do was to cover the case of a solicitor who, in conducting the business of his client, either in conveyancing or when representing him in litigation, made a mistake about the facts or a mistake about the law, or did something while acting on behalf of his client which rendered him, the solicitor, liable to a third party.

[59] In *Wimpey*, Webster J concluded that a professional indemnity policy "does not necessarily cover only negligence".[21] The Judge went on to say that:[22]

> In my view I must give effect to the literal meaning of the primary insuring words and construe them so as to include any omission or error without negligence.

[60] As Mr Galbraith submits, a considerable part of the judgment in *Wimpey* was directed to whether the wall which had caused the damage giving rise to the claim was designed negligently or not. Further, the case is dealing with different wording from that in issue in the present case. That said, *Kelly & Ball* cites *Wimpey* as authority for the proposition that policies which provide cover for liabilities arising from a "negligent act, error or omission" cover not only negligence but also errors or

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16 *MacGillivray and Parkington on Insurance Law* (7th ed) at [2024], cited in *Wimpey* at 513.
17 Ibid.
18 *Davies v Hosken* [1937] 3 All ER 192 (KB).
19 *Haseldine v Hosken* [1933] 1 KB 822 (CA).
20 *Haseldine* at 837,cited in *Wimpey* at 514.
21 At 514.
22 At 514.

omission which fall short of negligence.[23] *Derrington & Ashton* also cites *Wimpey* for the proposition that the words "omission or error" are not "controlled by" negligence,[24] but, later discussion[25] is less clear cut. *Halsbury's Laws of Australia* similarly cites *Wimpey* for the proposition that the word "negligent" does not qualify "error" or "omission".[26]

[61] The current edition of *MacGillivray*[27] says only that "confusion has arisen" as to whether non-negligent breaches of contract are covered. *MacGillivray* refers to *Wimpey* noting that Webster J held that "in the context of the particular policy" non-negligent acts were covered. The focus in *Halsbury's Laws of England* is on whether criminal acts are outside the phrase.[28] *Enright & Jess*[29] tends to the view that only negligence is covered. The authors describe the wording as providing cover which is, at its heart, "cover against professional negligence".[30]

[62] Of the later cases cited to us, we note that in *Lumberman's Mutual Casualty Co v Bovis Land Lease Ltd,*[31] the words used were "any neglect error or omission or breach of warranty of authority". Colman J said:

> [69] Obviously, a breach of warranty of authority can be negligent or non-negligent on the part of the person giving it. So, as a matter of commonsense, there can be no question of the clause singling out negligent breaches of warranty of authority. It is obviously designed to protect against liability for all such breaches save those deliberately and knowingly caused. If this peril does not necessarily require negligence, it is hard to see why "error or omission" should incorporate such a qualification. "Neglect" clearly involves negligent conduct, specifically a negligent omission. If so, there is no need to re-iterate negligent omission by using "omission". Similarly with error.

[63] The treatment of breach of warranty in that clause appears to have been the key factor. Similarly, other cases referred to us such as *BC Rail Ltd v Amer Home*

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23 David Kelly and Michael Ball *Principles of Insurance Law in Australia and New Zealand* (online looseleaf ed, LexisNexis) at [14.0040.1].

24 At [8-315].

25 At [11-340].

26 *Halsbury's Laws of Australia* (online ed) at [235-1825].

27 Nicholas Legh-Jones (ed) *MacGillivray on Insurance Law* (10th ed, Sweet and Maxwell, London, 2003) at [28-63].

28 *Halsbury's Laws of England* (4th ed, reissue, 2003) vol 25 at [693].

29 WIB Enright and Digby Jess *Professional Indemnity Insurance Law* (2nd ed, Sweet and Maxwell, London, 2007).

30 At [10.007].

31 *Lumberman's Mutual Casualty Co v Bovis Land Lease Ltd* [2004] EWHC 2197 (Comm), [2005] 1 Lloyd's Rep 494.

Assur Co[32] ("errors in design") and *Simon Warrender Pty Ltd v Swain*[33] ("errors or omissions") are based on different wording.

[64] Accordingly, while the United Kingdom authorities, particularly *Wimpey*, at first blush provide support for ADLS's view, in the end, we do not consider that they are conclusive.

[65] Finally, there are, as Mr Galbraith submits, a number of American cases which support D A Constable's approach.[34] Perhaps the clearest of these is *Group Voyagers, Inc v Employers Insurance of Wausau*[35] in which the obligation was to pay loss sustained in relation to the insured's employees for whom the insured became liable to pay as a result of "any negligent act, error or omission" in the administration of the insured's employee benefits programme. The Court rejected the argument the wording was ambiguous and read the phrase as meaning "negligent act, negligent error, or negligent omission".[36] The Court said the alternative argument, ADLS's argument in this case, was "inconsistent with the ordinary rules of grammatical construction".[37] However, Mr Galbraith accepted that the expectation was that it would be to the New Zealand or United Kingdom authorities that the parties would look. Accordingly we do not attach much weight to the American cases.

[66] Where does this leave us? Two points can be made.

[67] First, in an article on *Wimpey*, one commentator posited that the decision "may well" lead underwriters to reconsider the terms of their policy.[38] Certainly the authorities point to an ambiguity which it may have been expected insurers would want to avoid by re-drafting. As Mr Ring notes, some insurers did react to *Wimpey*

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32 *BC Rail Ltd v Amer Home Assur Co* (1991) 79 DLR (4th) 729 (BCCA).

33 *Simon Warrender Pty Ltd v Swain* [1960] 2 Lloyds Rep 111 (NSWSC).

34 *Baylor Heating and Air Conditioning, Inc v Federated Mut Ins Co* 987 F 2d 415 (7th Cir 1993); *Cincinnati Ins Co v Metropolitan Properties, Inc* 806 F 2d 1541 (11th Cir 1986)*; Golf Course Superintendents Assn of America v Underwriters at Lloyd's, London* 761 F Supp 1485 (D Kan 1991)*; Richards v Fireman's Fund Ins Co 417 NW 2d 663 (Minn App 1988); New Hampshire Insurance Company v Westlake Hardware, Inc* No 98-3023, 10th Circuit November 26 1999 *cf USM Corp v First State Ins Co* 37 Mass App Ct 471, 641 NE 2d 115 (Mass App Ct 1994).

35 *Group Voyagers, Inc v Employers Ins of Wausau* (unreported) (ND Cal 2002).

36 At 4.

37 At 3.

38 John Birds "Construing a Standard Professional Indemnity Policy" [1985] JBL 166.

by changing policies to make it clear the indemnity clause dealt only with negligence. He cites *Lloyd's TSB General Insurance Holdings Ltd v Lloyd's Bank Group Insurance Co Ltd*[39] where the relevant policy referred to "negligent act, negligent error or negligent omission".

[68] Secondly, the other problem for D A Constable is one we have alluded to earlier, namely, that in various respects (the Exclusions, the write-back for defamation, and the description of ADLS's business) the policy has been tailored to meet the business of ADLS. But it stops short of making the correlative change to the basic insuring clause. The end result of the language used when considered in context is, at best, ambiguous.

[69] The commentators are agreed that the contra proferentem rule for resolving ambiguity has a place in the interpretation of insurance contracts, as it does in the construction of other contracts.[40] There is some debate about the exact application of the principle. For example, some commentators suggest the rule has application only once other means of resolving the ambiguity have been exhausted,[41] whilst others refer to a trend in insurance law to adopt a liberal interpretation in favour of the insured and to resort more readily to the contra proferentem rule.[42] What is clear is that in the case of genuine ambiguity, a court will resolve the ambiguity against the party who proffered the phrase, here, D A Constable.[43] *Enright & Jess* express the principle in this way:[44]

> If a word or phrase in an insurance contract after application of [the ordinary meaning and context] principles remains, on an objective view, genuinely ambiguous, a court will resolve the ambiguity against the party which offered the word or phrase ... .

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39 *Lloyd's TSB General Insurance Holdings Limited v Lloyd's Bank Group Insurance Company Limited* [2003] UKHL 48, [2003] 4 All ER 43 at [33].

40 *Enright & Jess* at [5-021]; Robert Merkin (ed) *Colinvaux's Law of Insurance* (8th ed, Sweet & Maxwell, London, 2006) at [3-10]; *Kelly & Ball* at [5.0290.15]; *Derrington & Ashton* at [3-5]; and *MacGillivray* at [11-33].

41 *Enright & Jess* at [5-021]; *Colinvaux* at [3-10]; and *McGillivray* at [11-35].

42 *Kelly & Ball* at [5.0330]; *Derrington & Ashton* at [3-1] and [3-81].

43 *Enright & Jess* at [5-021]; *Colinvaux* at [3-10]; *Kelly & Ball* at [5.0290.15]; *Derrington & Ashton* at [3-5]; and *MacGillivray* at [11-33].

44 At [5-021].

McGillivray states that it is only where the court is "unable to decide by ordinary principles of interpretation which of the two meanings is the right one" that the rule applies.[45]

[70] We do not need to consider whether it is appropriate to adopt a liberal interpretation in favour of the insured as we consider this is a case of genuine ambiguity. We therefore resolve that ambiguity in favour of ADLS. We conclude that the policy should not be read as confined to "negligent error".

[71] We add that we do not see any inconsistency between this approach and the purpose of a professional indemnity insurance policy. We agree with Cooper J that the test postulated by Mr Galbraith of the insured having failed to meet a legal standard was met in respect of the privileged documents. The Judge put it in this way:

> [83] In the present case ADLS points to its desire to retain and use the confidential information ... . The decision of the Privy Council plainly determined that it could not do so, and that it was bound to observe the qualifications on its use that had been stipulated ... at the outset. In the circumstances it is not difficult to conclude both that the course on which ADLS embarked was in error and that failure to return the documents when requested was an omission. Both the error and the omission, while made with the benefit of the advice of senior counsel, were subsequently shown to have been based on a misapprehension as to the relevant law. Apart from the issue concerning the privileged documents, the other matters raised by the three proceedings also involved, whether directly or indirectly, arguments about whether ADLS had misused its investigatory powers, or failed to meet duties that it had in relation to the impartial and expeditious investigation of the complaints.
>
> [84] ... The other allegations made against ADLS were also that it had made errors or omissions in performing its statutory duties, albeit that the issue about ongoing use of the services of Mr Judd was settled at a comparatively early stage, and the other allegations were never tested in the Court. ...

[72] That reasoning also answers D A Constable's alternative argument that ADLS made no error.

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[45] At [11-35].

Effect of non-compliance with Condition 2

[73] Our conclusion on the interpretation of the insuring clause means we have to consider the effect of Condition 2 of the policy. That is because D A Constable says that even if the claims fall within the scope of the policy, ADLS is not entitled to cover because ADLS breached the requirement in Condition 2 not to settle or incur defence costs without the underwriters' prior consent.

[74] Condition 2 provides that ADLS:

> ... shall not admit liability for or settle any claim or incur any costs or expenses in connection therewith without the written consent of Underwriters who shall be entitled to take over and conduct in the name of [ADLS] the defence or settlement of any claim.
>
> ... shall not be required to contest any legal proceedings unless a Queen's Counsel ... shall advise that such proceedings should be contested.
>
> ... shall be entitled at their own risk to contest any claim or legal proceedings which in the opinion of Underwriters should be compromised or settled provided that Underwriters shall not be liable for any damages, costs or expenses incurred directly or indirectly as result of [ADLS's] refusal to compromise or settle such claim or legal proceedings.

The issues

[75] As the matter was argued before us, there are two issues. The first is whether, as a matter of fact, the underwriters' response to ADLS in relation to coverage for the three proceedings amounted to repudiation of liability, thus excusing ADLS from compliance with Condition 2. D A Constable argues there was no repudiation because there was no explicit rejection of liability.

[76] The second issue is whether, if there was repudiation of liability, ADLS is nevertheless unable to recover its costs. D A Constable says if the claim had been accepted, it would not have consented to ADLS incurring the costs of the litigation and so on the counterfactual ADLS would not have been entitled to its costs.

Was there repudiation of liability?

[77] There was no dispute between the parties that if the factual question is answered in favour of ADLS then the insurer did not have the right to rely on non-compliance with Condition 2 to avoid paying out on the policy.

[78] We can accordingly deal with this aspect by following the approach taken by this Court in *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*.[46] The appellant in that case accepted the proposition from Sutton's *Insurance Law in Australia* that:[47]

> ... the repudiation of liability by the insurer amounted to an anticipatory breach of contract and that, provided the assured had acted reasonably in settling the claim, the measure of damages for such breach was the amount paid in settlement together with the costs incurred for which the insurer would have been liable had his consent been obtained.

[79] The Court in *Royal Insurance* rejected the suggestion that where the insurer had breached the contract by denying liability the insured could not settle but had to have liability and quantum determined before claiming against the insurer. Gault J for the Court said:[48]

> We consider that the correct approach must prevent the insurer who has repudiated liability from contending that the insured was not legally liable to the extent of the amount of the settlement so long as the insured acted reasonably in settling. ...
>
> ... Having repudiated liability in breach of contract the insured cannot later challenge a settlement arrived at by the insured acting reasonably by seeking to show that had the liability not been repudiated the insurer by litigating would have succeeded in restricting the liability to a lesser amount. That would be to allow the insurer (in effect) to retract its own breach of contract.

[80] ADLS refers in this context to *Drayton v Martin* where Sackville J said: [49]

> Where an insurer wrongfully repudiates liability under a policy, it cannot rely on a condition requiring it to consent to any compromise of a claim against the insured ... .

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46 *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd (*1993) 7 ANZ Insurance Cases 61,172 (CA).

47 2nd ed, cited in *Royal Insurance* at 77,975.

48 At 77,976.

49 *Drayton v Martin* (1996) 9 ANZ Insurance Cases 61,322 (FCA) at 76,600.

> ... it would be curious if the position were otherwise. An insurer could repudiate its contractual obligations and place the insured in a difficult, if not impossible, position. The insured would be forced to defend the proceedings ... and forego all opportunities of a reasonable compromise for fear of losing the indemnity under the policy. I have already found that the compromise was reasonable in the circumstances of the present case ... .

[81] *Derrington & Ashton* put it this way:[50]

> Upon the insurer's repudiation only of the insured's claim for indemnity in respect of a particular loss, the insured, if not wishing to sue for the enforcement of the contract, is no longer bound to observe the obligations imposed by the terms of the policy, and the insurer is no longer entitled to rely on any rights under it, for example, the right to withhold consent to an act of the insured that is given by the policy; or the right to participate in any settlement of the claim. Consequently, in such circumstances the insured may, without reference to the insurer, settle the claim reasonably in order to save costs and is not required to permit it to go to judgment in order to preserve his or her rights.

[82] There is no issue here about the reasonableness of ADLS's conduct in settling the proceedings so the analysis in these cases and texts is applicable.

[83] There is some debate about the concept of repudiation and in particular about how the approach taken in relation to insurance contracts in cases like the present sits with repudiation in contract law generally. For example, Neil Campbell in an article on the High Court decision in this case expresses agreement with the outcome but questions the reasoning of the Judge on the effect of Condition 2:[51]

> Certainly the insurer appears to have repudiated (assuming, of course, that Cooper J's decision on cover is correct), but there is no suggestion that the ADLS ever accepted that repudiation by electing to cancel the policy. Without cancellation of the contract, both parties remained obliged to perform their obligations under the policy; see Burrows, Finn & Todd, *Law of Contract in New Zealand* (3rd ed, 2007) para 18.3.1.

[84] However, in cases like *Royal Insurance* "repudiation" means indicating a refusal to provide cover for a claim where cover ought to be provided and that triggers the finding that the insured does not have to comply with restrictions that would be relevant only if cover had been provided. In other words, it is a repudiation of liability in breach of the policy terms rather than a repudiation of the whole policy. On this analysis, cancellation of the policy would not be an available

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50 At [13-296].

51 Neil Campbell "Insurance Law Review" [2009] NZ L Rev 725 at 740.

option for the insured: that would arise only if the insurer repudiated the policy itself. The insured is absolved from complying with the terms of the policy in relation to the claim for which liability has been declined, but not generally: both parties remain bound by the terms of the policy in relation to any other claims or potential claims.

[85] It may be that there are other ways of conceptualising what has occurred here and, indeed, ADLS has an alternative argument based on waiver by D A Constable of the need to comply with Condition 2. However, in this case as we have said, the issue was confined to the factual question. Because of the common ground between the parties on these points, we consider we can dispose of the matter by resolving the dispute over whether the underwriters showed an intention not to provide indemnity to ADLS for the particular claim. In particular, was the underwriters' position "unmistakeably clear"?

[86] The pertinent narrative begins in July 1999 when ADLS notified their insurance broker, J & H Marsh & McLennan (Marsh), of a letter of claim and draft statement of claim in what we have termed the first proceeding. At this point, Marsh was acting as agent for both ADLS and for the underwriters.

[87] The underwriters appointed Murray Gilbert, then of Chapman Tripp, to act for them. Marsh wrote on 13 August 1999 to ADLS attaching a letter from Mr Gilbert. Marsh said the underwriters' "initial" response was to agree with Mr Gilbert's recommendations. The letter also said:

> Point 3 of the report attached points out that neither of the situations notified by ADLS involve any claim for damages, and as such they do not appear to be claims to which the policy responds. Furthermore, neither presently involves any allegation of negligence against ADLS.
>
> We appreciate that you may have an alternative interpretation of the circumstances and invite your comments. Additionally the underwriters have indicated they are happy to review their position should circumstances change. Accordingly we would be grateful if could [sic] ensure that we are kept advised of developments in this matter.

[88] Mr Gilbert's letter also noted that neither of the situations referred to by ADLS involved a claim for damages. It continued: "As such, they do not appear to

be claims to which the policy responds". The absence of any allegation of negligence was also noted.

[89] The next developments were the judgments in the High Court (6 July 2000) and Court of Appeal (16 October 2001). Before the Privy Council decision (19 May 2003), the representatives of ADLS and Mr Gilbert met. The meeting took place on 20 November 2001.

[90] The Judge heard evidence about the meeting from Mr Gilbert and from the two ADLS representatives present, Mr Chapman and Ms Wong. Ms Wong (now Ms Malcolm) had no clear recollection of being at the meeting.

[91] The Judge said the differences between Mr Gilbert and Mr Chapman as to what transpired at the meeting were "largely ... matters of emphasis".[52] The Judge accepted both accounts.

[92] Mr Gilbert said he noted there was a damages claim in the amended statement of defence and counter-claim to the second proceeding and in the third proceeding. He said he told ADLS that in the absence of any pleading of bad faith, the damages claims were vulnerable to strike-out on the basis of s 137 of the Law Practitioners Act. That section gave ADLS immunity except where there was bad faith. Mr Gilbert's evidence was that Mr Chapman and Ms Wong agreed there was no real exposure arising from the damages claims.

[93] Like the Judge, we then set out a passage from Mr Gilbert's evidence which summarises the position. This evidence was unchallenged and was as follows:

> 10. I explained that the underwriters would not be prepared to meet any of ADLS's costs relating to their investigation of the complaints, including the costs of seeking the Court's direction as to its rights to use privileged information for the purpose of its investigation. Ms Wong and Mr Chapman seemed to accept this.
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> 11. I indicated that ADLS's professional indemnity policy was likely to respond to the damages claims but that the underwriters had the right to assume conduct of the defence of any proceedings covered by the policy and would probably wish to exercise that right. I pointed out

[52] At [123].

> that the underwriters' exposure under the policy was in respect of any liability by ADLS to pay damages and claimants' costs. I explained that the underwriters would be unlikely to incur, or consent to the incurring of, costs involved in resisting orders requiring ADLS to carry out its statutory duty to investigate the complaints expeditiously and in accordance with the principles of natural justice.
>
> 12. Mr Chapman and Ms Wong made it clear to me that ADLS would not want the underwriters to assume conduct of the defence of the claims.
>
> 13. Matters were left at the conclusion of the meeting on the basis that ADLS would come back to me with a proposal if it considered that it was entitled to claim, under its professional indemnity policy, any of its costs in dealing with the proceedings.
>
> 14. At no stage did I receive any such proposal or submission from ADLS.

[94] As to the matters of emphasis referred to by Cooper J, Mr Chapman explained that ADLS had expressed reservations about the concept of the insurers assuming conduct of the litigation solely for the purpose of seeking to strike out the damages component of the two proceedings. The Judge recorded Mr Chapman's view that "While Mr Gilbert was correct to state that ADLS did not have any real concern about its ultimate exposure to damages ... the limited assistance on offer from the underwriters was not regarded as very helpful".[53] Further, Mr Chapman's main reason for suggesting the meeting was to ask the insurers to assume the conduct of the defence and to provide litigation assistance at their cost by utilising Chapman Tripp as solicitors for ADLS in the proceedings.

[95] Mr Chapman's evidence was that the notion that Chapman Tripp might assume conduct of the litigation for the limited purpose suggested by Mr Gilbert and then step out again did not seem practicable because the damages components of the second and third proceedings were so tied in with the other aspects of the proceedings. The damages aspect was also linked in to the first proceeding in relation to which Mr Gilbert again said there would be no cover. Mr Chapman said he had expressed those views at the end of the meeting.

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[53] At [120].

[96] Nonetheless, at Mr Gilbert's request, Mr Chapman and Ms Wong had agreed to try to assess the costs involved so far in relation to the damages components of the second and third proceedings and to consider further whether it might be practical for the underwriters to take over conduct of parts of the two proceedings, make the strike out applications and then give the matter back to ADLS for ongoing management. This was never done.

[97] Against this background, did the insurer clearly deny liability?

[98] We can deal with this question fairly briefly because we agree with the approach taken by Cooper J.

[99] The Judge concluded that letters sent by the underwriters' agent amounted to a "plain indication on the underwriter's behalf that there was no cover under the policy".[54] The Judge said that if there was any doubt about that, "the underwriter's stance was effectively confirmed at the meeting that took place on 20 November 2001".[55] Cooper J observed that:[56]

> The consequence of the discussion at the meeting of 20 November was that there would only be cover in respect of such elements of the second and third proceedings that could be exclusively attributed to the damages claims raised in the second and third proceedings. ... In context, although apparently conceding cover for the damages claims in the second and third proceedings, the extent of the cover was likely to be so small, on the underwriter's view, that it effectively amounted to a further act of repudiation. By this stage ADLS had clearly sought from underwriter's advice as to whether it was covered under the policy.

[100] Looking at all of these matters in the round, Cooper J concluded that it was "reasonably plain" that the underwriters were declining cover.[57] The Judge considered that, in this respect, D A Constable had plainly departed from its obligations under the policy in a very substantial way:[58]

> ... in other words, putting the letters, the oral advice at the meeting of 20 November 2001 and the effective refusal by the underwriter to comply

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54 At [142].
55 At [143].
56 At [144].
57 At [145].
58 At [155].

> with its contractual obligations together, I consider that there was repudiation.

[101] We agree. Accordingly, applying the approach taken in cases like *Royal Insurance*, it was not possible for D A Constable to rely on Condition 2. As Cooper J put it:[59]

> It does not seem right that [D A Constable] can now effectively adopt the stance that it was up to ADLS to pursue it for cover ... . That ... would be an unreal requirement having regard to what the underwriter had said ... .

[102] It is correct that Marsh's letter of 13 August 1999 referred to the underwriters' "initial" response. There was, however, never any other response and indeed the underwriters still maintain that the policy does not respond to the claim. It is also important that the meeting on 20 November 2001 was preceded by a request from Mr Chapman on behalf of ADLS in a letter of 31 August 2001 for urgent clarification as to whether the underwriters had accepted the claim, whether they would pick up court costs and about how far the cover would extend. The letter also referred to costs already incurred and to ongoing costs in relation to the three proceedings. It is against that background that the underwriters' response has to be construed.

[103] D A Constable relies on authorities that accept that a bona fide assertion, without more, by one party as to the interpretation of a contract is not a repudiation. Mr Galbraith says the discussion at the 20 November meeting amounted to no more than a bona fide assertion as to interpretation.

[104] We agree with Cooper J[60] that this case involved more than a mere assertion of an interpretation. D A Constable was faced with a valid claim but rejected it and has maintained that stance. By contrast, in *The Edge Buying Group (Queenstown 2000) Ltd v Coca Cola Amatil (NZ) Ltd*[61] relied on by D A Constable, this Court noted that Coca Cola, which had advanced a view of the contract, at no point had stopped performing the contract and nor had it threatened to do so.[62]

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59 At [145].
60 At [149].
61 *The Edge Buying Group (Queenstown 2000) Ltd v Coca Cola Amatil (NZ) Ltd* CA145/02, 25 November 2002 at [40].
62 At [41]; see also *Derrington & Ashton* at [13-311].

Further, as Mr Ring submits, *The Edge* and *Denerau Investments Ltd v Ludlow*[63] deal with an inquiry into the merits or otherwise of cancellation by an "innocent party" of the whole contract rather than, as here, a claim for damages for breach of a term in a contract which is otherwise in force. Certainly, we were referred to other cases involving insurance contracts where the courts accepted that declining indemnity because of a mistaken interpretation was a repudiation of liability.[64]

[105] There is also some force in Cooper J's suggestion that there may be cases where it is not sufficient for an underwriter to indicate an initial position and then just stand back in the knowledge the insured is proceeding down a path likely to incur costs for which there will be cover.[65] The Australian Law Reform Commission[66] discussed the problem of insurers neither confirming nor denying liability, pending the outcome of the third party claim. That is not, however, this case and we do not need to decide the point raised by Cooper J.

Damages

[106] D A Constable notes that ADLS's claim is a damages claim (not a debt claim). It is therefore necessary, Mr Galbraith says, to look at the counterfactual and ask what would have happened. We disagree. Once D A Constable was in breach in refusing cover, it cannot then assert reliance on Condition 2 where, as here, it is accepted that ADLS acted reasonably in the circumstances in which it found itself.

Conclusion

[107] For these reasons, we consider that ADLS was entitled to cover under the policy. The appeal is dismissed.

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63 *Denerau Investments Ltd v Ludlow* (2008) 9 NZCPR 525 (CA).

64 *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd* (1993) 7 ANZ Insurance Cases 77,972 (CA) and *Forney v Dominion Insurance Co Ltd* [1996] 1 WLR 928 (QB).

65 At [154] with reference to *Royal Insurance*.

66 *Insurance Contracts* (ALRC R20, 1982) at [244].

Costs

[108] There is no reason why costs should not follow the event. The only issue is the basis on which costs should be calculated. On that aspect, ADLS submitted that the appeal should be categorised as complex either on the basis of its complexity and/or significance. We consider the matter is of sufficient importance to warrant that categorisation. ADLS is therefore entitled to costs for a complex appeal on a band A basis. We certify for second counsel.

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