IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2005-404-004322

BETWEEN	AUCKLAND DISTRICT LAW SOCIETY Plaintiff
AND	D A CONSTABLE SYNDICATE 386 Defendant

Hearing: 7, 8, 9 April 2008

Appearances: M G Ring QC and S A Thodey for Plaintiff
A R Galbraith QC and J F Anderson for Defendant

Judgment: 20 August 2008

JUDGMENT OF COOPER J

This judgment was delivered by Justice Cooper on
20 August 2008 at 9.30 a.m., pursuant to
r 540(4) of the High Court Rules

Registrar/Deputy Registrar
Date:

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Introduction

[1] The plaintiff in this proceeding ("ADLS") seeks to recover sums that it paid to settle three separate proceedings in which it was a party, and costs that it incurred in relation to those proceedings prior to the settlement. ADLS's claim is for breach of the relevant professional indemnity policies issued by the defendant under which it says the defendant was obliged to indemnify it.

[2] The defendant was the plaintiff's underwriter at all relevant times. It denies liability to indemnify ADLS essentially on two grounds. First, it denies there was cover under the relevant policies of insurance. Secondly, it claims that, even if there was cover under the policies, ADLS incurred the costs and settled the proceedings without its written consent, contrary to Condition 2 of the policies.

[3] Before dealing in detail with the respective positions of the parties, it will be appropriate to describe the three proceedings and the events which led to their settlement.

The three proceedings

[4] The proceedings arose out of and related to actions taken or contemplated by the plaintiff in the investigations of complaints under Part VII of the Law Practitioners Act 1982. Those complaints were made against Mr P C Carran, who was at the relevant times a partner in Russell McVeagh McKenzie Bartleet and Co. a prominent firm of solicitors, and against the firm itself.

[5] In one of the proceedings ("the first proceeding") the first plaintiffs were present and former partners of Russell McVeagh together with counsel who had been advising them, A A Lusk QC. The second plaintiff was the partnership. There were three defendants, respectively ADLS, its counsel G J Judd QC and solicitor S C Ennor. Issues raised in the first proceeding were the subject of decisions by the High Court (Paterson J, 6 July 2000), the Court of Appeal (16 October 2001) and the Privy Council (19 May 2003). The decision of the Court of Appeal was reported as *Auckland District Law Society v B* [2002] 1 NZLR 721 and that of the Privy Council as *B v Auckland District Law Society* [2004] 1 NZLR 326.

[6] There is a convenient summary of the factual context in the majority judgment delivered by McGrath J in the Court of Appeal, at [30] – [34]. I respectfully adopt it:

> [30] Three special partnerships were formed for the purpose of bloodstock investment, between 1985 and 1987. The solicitor for the promoter of each of the partnerships was Mr Carran who was a partner of Russell McVeagh. Following failure of the partnerships, proceedings were issued in the High Court against the promoters and professional advisers to the promoters. In all proceedings Russell McVeagh was either an original defendant or was subsequently joined. All proceedings were ultimately settled out of Court in 1996.
>
> [31] As a result of the partnership failures the Auckland society received several written complaints against Russell McVeagh or partners the first being a complaint from Mr Hatton, on 3 August 1996 which was expressed to be against the firm. As a result, on 13 October, a former partner of Russell McVeagh, Mr McElrea, who is a District Court Judge, provided the Auckland society with a confidential report under R 6.03 of the *New Zealand Law Society Rules of Professional Conduct for Barristers and Solicitors* (6th ed, 2000). In this report Mr McElrea alleged improper conduct by Mr Carran, who by then had ceased to be a partner at Russell McVeagh. We refer to it as the McElrea complaint. The report suggested that the Auckland society request from Russell McVeagh copies of all relevant documents,

> including privileged documents, relating to the professional indemnity insurance cover of the firm.
>
> [32] A third complaint, known as the Otto complaint, was received by the Auckland society on 13 March 1997. It was made against the firm and unnamed partners. A fourth complaint, the Molloy complaint, was received on 21 May 1998 from Mr Molloy QC. Serious allegaions were contained in the Molloy complaint against a number of partners and former partners of Russell McVeagh which concerned the establishment of the bloodstock partnerships but also traversed wider grounds, including the conduct of the subsequent litigation.
>
> [33] On 25 November 1996 the complaints committee was set up by the Auckland society to investigate the complaints received against Russell McVeagh and various partners. Mr Ennor was appointed as counsel advising the complaints committee.
>
> [34] The Auckland society wrote to the partners of Russell McVeagh on 19 March 1997 concerning the McElrea complaint and requested copies of the documents concerning professional indemnity insurance that Mr McElrea had referred to in the report accompanying his complaint. Russell McVeagh was aware of that report. The letter of 19 March referred only to the McElrea complaint and did not mention the Hatton or Otto complaints. To assist the Auckland society with its investigations, Russell McVeagh expressed willingness to provide it with certain documents subject to certain restrictions on their use. Arrangements for the documents to be provided were subsequently made between counsel acting for Russell McVeagh, Mr Lusk QC, and Mr Ennor. Alleged breaches of this agreement by the Auckland society have led to the current proceedings.

[7] In their first cause of action, the plaintiffs sought declarations and a mandatory injunction preventing Mr Judd from continuing to act for ADLS in relation to the Molloy complaint. In a second cause of action, the plaintiffs sought the return of documents that they claimed were privileged, and had been provided in confidence, by their counsel Mr Lusk QC, to Mr Ennor. These were the documents referred to in [34] of the majority judgment of the Court of Appeal.

[8] ADLS itself commenced a proceeding (“the second proceeding”) in which it sought a declaration that it was entitled to receive and use certain information for the purposes of investigating complaints made against Mr Carran and Russell McVeagh, and if thought appropriate, for charges under s 101 of the Law Practitioners Act. The information in question was contained in the confidential report referred to at [31] of the majority judgment of the Court of Appeal. The first, second and third defendants named were respectively the firm, present and former partners and Mr Carran. The first and second defendants claimed in their statement of defence

that the information was confidential and/or subject to solicitor/client privilege, with the result that ADLS could not use the information as it wished to.

[9] The first and second defendants also filed a counterclaim. They sought a declaration that the information had been communicated to Mr McElrea by senior counsel acting jointly for him and the partners in the firm for the purposes of settlement of litigation brought against them, with the result that it was privileged jointly to all of the defendants in that litigation. In addition, an injunction was sought against Mr McElrea restraining him from further providing or disclosing privileged information. The defendants claimed declarations that ADLS and its counsel were not entitled to have regard to, use, disclose or disseminate the information and that r 6.03 of the *Rules of Professional Conduct for Barristers and Solicitors* (6th ed, 2000) did not entitle or require practitioners to report privileged information.

[10] Apart from those claims the defendants sought "general and/or equitable damages against the counterclaim defendant" (Mr McElrea), and advanced the same claim against ADLS. The issues raised by the second proceeding were similar to those in the first proceeding. The parties in fact apparently took the view, in June 2002, that the second proceeding should effectively be stayed while the privilege and confidentiality issues raised in the first proceeding were pursued to the Privy Council, as will be discussed below.

[11] The final proceeding ("the third proceeding") was commenced by Russell McVeagh suing as a firm, and by its present partners and those who had previously been partners at the relevant times. ADLS was the defendant.

[12] The plaintiffs alleged that ADLS had failed to comply with a statutory obligation to inquire into the complaints as soon as practicable, that it had failed to act fairly and observe the rules of natural justice, including the rule against bias and also that it had failed to comply with its obligations under s 27 of the Bill of Rights Act 1990. It was alleged that the committee constituted by ADLS for the purpose of investigating the complaints had adopted a prosecutorial and partisan attitude and had actively sought to obtain evidence in support of the complaints. Various other

particulars of bias were pleaded. An additional allegation was that ADLS had failed to comply with the terms of a settlement agreement by which it was obliged to co-operate with the first and second plaintiffs to ensure the expeditious disposal of the complaints in terms of the Law Practitioners Act. The settlement agreement had been made on 1 May 2000. Apart from providing for expeditious disposal of the complaints, under its terms ADLS also agreed that it would not continue to instruct Mr Judd in relation to the complaints.

[13] There was an extensive prayer for relief, including various declarations that ADLS had acted contrary to its obligations in the respects alleged, injunctions restraining ADLS from inquiring further into the complaints and damages. There were three heads of damages. First, in the event that an injunction restraining ADLS for inquiring further into the complaints was not granted, the plaintiffs sought "general damages in equity in lieu of such an injunction". Then, damages were sought for "breach of the right to justice set out in s 27 of the New Zealand Bill of Rights Act 1990". Finally, there was a claim for general damages for breach of the contractual obligation under the settlement agreement to dispose of the complaints expeditiously.

[14] The issue concerning the on-going involvement of Mr Judd having been resolved by the settlement agreement, the remaining issue arising under the first proceeding concerned the ability of ADLS to use the information that had been provided by Mr Lusk to Mr Ennor. On that issue, the plaintiffs succeeded before Paterson J, failed in the Court of Appeal but succeeded in the Privy Council. Lord Millett delivered the judgment of the unanimous Board. At [72] – [73] he said:

> [72] The majority of the Court of Appeal accepted that it was possible to waive privilege for a limited purpose only, but held that Mr Lusk had not done so. They considered that he had waived the privilege for all the purposes of the complaints committee's investigations. They reasoned that, when reaching his agreement with Mr Ennor, Mr Lusk could not have believed that privilege applied in an investigation by a complaints committee or he would not have disclosed the documents to Mr Ennor at all. He must therefore have intended to preserve privilege for a quite different reason connected with the bloodstock litigation.
>
> [73] Their Lordships cannot accept this reasoning. It is inconsistent with the primary facts found on unchallenged evidence by Paterson J and with the express terms of Mr Lusk's letter, which offered to make the documents

> available "on the express basis that, in doing so, privilege is not waived". The limitations which Mr Lusk imposed were limitations on the use which Mr Ennor might make of the documents, not on the extent of the waiver. Save in respect of the agreed use, privilege was expressly reserved. It is true that a reason for maintaining the claim to privilege was that not all the litigation relating to the bloodstock partnerships had been resolved when the letter was written. But this was not necessarily the only reason, nor would it make any difference if it were. If on the true construction of Mr Lusk's letter, objectively ascertained, privilege was not waived, that is the end of the matter. It does not matter what his reasons were, nor whether they were wholly logical.

[15] It should be noted that the Privy Council held that the appellants should have their costs in the Court of Appeal and before the Board. In the High Court, Paterson J had said that if the parties were unable to agree on costs, then memoranda could be filed. He expressed a provisional view that costs should be calculated in accordance with Category 3 Band B. It is implicit that, as the plaintiffs had succeeded, then any entitlement to costs was theirs. That was effectively underlined by the outcome in the Privy Council.

[16] ADLS incurred legal costs in relation to the first proceeding of $484,554.98 (inclusive of GST). Those costs are part of what ADLS now seeks to recover from the defendant.

[17] ADLS's claim in the second proceeding raised essentially the same issues as had been raised by Russell McVeagh and its partners in the first proceeding. There was the added element that the allegedly confidential information in this case had come into the hands of ADLS through the agency of Mr McElrea as a former partner of the firm. However, the information had been conveyed to Mr McElrea by senior counsel advising not only him, but other partners of the firm and consequently it was privileged. The effect of the Privy Council's decision was that legal professional privilege properly claimed would defeat any right that ADLS had to use the information either at the stage of investigating complaints or subsequently in disciplinary proceedings (*B v Auckland District Law Society* [2004] 1 NZLR 326, at [65]).

[18] The same issues arose on the counterclaim, made against both ADLS and Mr McElrea. Among the costs that ADLS now seeks to recover from the defendant

is the sum of $96,144.56 which were its legal costs incurred in respect of the counterclaim.

[19] As has been seen, the decision of the Privy Council was directly relevant to the issues raised in both the first and the second proceedings. ADLS apparently took the view that it was also, at least indirectly relevant to its position in respect of the third proceeding. According to Mr Bryers, who had been a member of the Council of ADLS at relevant times and, for a period of about seven years, a member of the ADLS committee that was investigating the complaints, as a result of the Privy Council decision ADLS gave consideration as to the best way forward in relation to the investigation of the complaints. That, he said, included "managing the liability to Russell McVeagh for costs in the High Court, Court of Appeal and Privy Council, as well as how to best resolve the other proceedings that were then on foot in relation to the investigation".

[20] He also noted that:

> By October 2003 the advice of counsel was that it may be possible for ADLS to reach some form of agreement with Russell McVeagh concerning the outstanding issues involved in the three sets of proceedings … . As a result of negotiations … an appropriate agreement on the substantive issues was obtained.

[21] By that stage, Colin Carruthers QC was acting on behalf of ADLS in respect of the first two proceedings and he was negotiating with Richard Craddock QC, acting for Russell McVeagh, in relation to possible settlement. John Billington QC had been retained by ADLS in respect of the third proceeding and he also became involved in the settlement negotiations.

[22] Mr Billington gave evidence in the present proceeding that:

> 7. By 14 October 2003 the discussions between Richard Craddock QC, Colin Carruthers QC and myself had reached the point where an agreement had almost been reached in relation to issues concerning the wording of a judgment in the McElrea proceedings.
>
> 8. However, the costs issues in respect of the various proceedings remained outstanding.

> 9. Over the next few days negotiations continued in relation to the issue of costs payable to Russell McVeagh. There was a without prejudice exchange of communications between counsel acting for the various parties.
>
> 10. As a result of that exchange advice was given to ADLS that the matter could be resolved by way of payment to Russell McVeagh for costs and that a payment of approximately NZ$650,000 would be reasonable in all the circumstances.

[23] There was then a judicial settlement conference. Mr Billington noted that ADLS instructed him to use the conference to achieve a final resolution of all outstanding issues between ADLS and Russell McVeagh in relation to all three proceedings. He stated that at the joint settlement conference terms were agreed relating to return of documents with undertakings from ADLS about future reference to them. The agreed terms were recorded in a formal judgment delivered on 16 October 2003.

[24] At the judicial settlement conference agreement was also reached in relation to the payment of costs. The costs agreement was not the subject of a formal order of the Court. Pursuant to the agreement, ADLS would pay Russell McVeagh the sum of $191,667 in respect of costs in the High Court and Court of Appeal on the first proceeding, and in the High Court on the second and third proceeding. An additional sum of $465,464.29 was paid in respect of the costs in the Privy Council on the first proceeding. These sums, totalling $657,131.29, were paid on 21 and 22 October 2003.

[25] When that sum is added to ADLS's own defence costs of $850,679.69, the total for which ADLS now seeks recovery from the defendant is $1,507,810.98.

The principal issues

[26] The are two principal issues between the parties. The first is whether there was cover under the applicable insurance policies for the defence costs and the amount paid to the other parties to settle the three proceedings. The second is whether the defendant repudiated the contract by wrongly declining cover with the consequence that that ADLS did not have to comply with Condition 2 of the policies.

That condition would normally oblige ADLS not to admit liability for or settle any claim, or incur any costs or expenses in connection therewith without the defendant's written consent.

[27] The balance of this judgment will concern the resolution of those issues, dealing first with the issue of whether or not there was cover.

Indemnity

[28] Over the period relevant to the claim, ADLS had cover under two policies successively issued by the defendant. The first applied in the period 1 November 1998 to 1 November 2000. The second applied from 1 November 2000 to 1 November 2001. Their terms were identical. In the discussion that follows I will refer to both of them as "the policy".

[29] The policy was a professional indemnity insurance policy. The main indemnity clause was in the following terms:

> Indemnity Clause
>
> Underwriters agree, subject to the terms, limitations, exclusions and conditions of this Insurance to indemnify the Assured against all sums which the Assured shall become legally liable to pay as damages and claimants costs and expenses as a result of any claim or claims made against the Assured during the period of insurance stated in the Schedule arising out of any negligent act, error or omission on the part of
>
> (a) the Assured,
>
> (b) any employee or former employee of the Assured, or
>
> (c) any other person, persons, partnership or company acting for or on behalf of the Assured, including any Council member or Society member or employee,
>
> in or about the conduct of the Assured's business as specified in the Schedule.

[30] There was a separate clause, which will be discussed below, that covered costs and expenses of investigating and defending claims.

ADLS's argument

[31] Mr Ring QC argued for ADLS that the words provided indemnity against ADLS's legal liability to pay "damages and claimants costs and expenses", resulting from claims arising out of "any negligent act, error or omission" for which ADLS was responsible, and relating to the conduct of ADLS's business specified in the policy schedule. The schedule described the business as a "Professional body established under the Law Practitioners Act …".

[32] Mr Ring submitted that the phrase "damages and claimants costs and expenses" should be read as if "and" was both conjunctive and disjunctive. The result of his approach would be as if the clause had been drafted "damages and/or claimants costs and/or expenses". He contended that it was inconceivable that the parties would have intended for example that ADLS would have no indemnity unless there were a claim for both costs and expenses.

[33] However, he argued that "damages" and "claimants costs and expenses" were clearly different types of liability, and capable of being separately insured. There was in the circumstances nothing in the words of the indemnity clause, or the policy as a whole to indicate that the policy did not operate so as to provide indemnity for ADLS's legal liability for claimants' costs and expenses and that cover would be available only where there was also a legal liability for damages.

[34] Mr Ring further submitted that the purpose of the policy, as a professional indemnity policy, was to protect ADLS in respect of unplanned financial outlay because it had incurred legal liability as a result of wrongful conduct in its professional capacity. Such wrongful conduct was delineated by the words "negligent act, error or omission", and the cover related to "all sums" which ADLS became "legally liable to pay". In others words, an established liability to pay the sum of money was sufficient to trigger cover. Further, it would be wrong to allow the nature of the claim made to determine the extent of indemnity which would be available under the policy. Given some kinds of claim for both damages and costs, costs might be declined even though damages were granted and equally damages might be declined because there was no proven loss, yet an award of costs might still

be made against ADLS. The same position should apply whether the liability arose from a judgment or in relation to a settlement.

[35] Mr Ring endeavoured to derive support for his argument from exclusion (i). Under the heading "Legal Action", that exclusion provided that underwriters should not be liable to indemnify ADLS against any claim "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".

[36] In the "Schedule" the relevant wording was 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.

[37] Mr Ring's argument was that this wording showed an intention to treat "damages" and "claimants costs and expenses" as separate indemnity entitlements. The wording would leave cover in place where a claim was brought in the North American Courts other than a claim for damages; but if damages were claimed, then the exclusion would apply because of the widespread perception that damages awards by those Courts were exorbitant.

[38] Underlying these submissions were arguments that the clauses should be read widely, so as to provide ADLS with the maximum cover for the premium paid, and, in the case of any ambiguity, including two equally possible meanings, the ambiguity must be resolved against the underwriters as the drafters of the policy (*Molyneux Holdings Ltd v IAG New Zealand Ltd* (2007) 14 ANZ Insurance Cases 61-733, at [22]). The result of these various arguments was the submission that the word "and" used in the indemnity clause should not be given a "strictly conjunctive" meaning, and that an established liability on ADLS for claimant's costs would be sufficient no matter what the claimant had alleged, and regardless of whether ADLS had become liable for any damages.

[39] In the case of the first proceeding, in terms of the Privy Council judgment, as has been seen, ADLS became legally liable to Russell McVeagh for costs in the Privy Council and the Court of Appeal and by implication, the High Court as well.

[40] The costs sought in relation to the second proceeding were in relation to the counterclaim where costs had been sought all along. By the amended counterclaim, filed approximately ten months after the original counterclaim, a damages claim was added.

[41] In the case of the third proceeding, there was a claim for costs falling within the phrase "claimants costs and expenses" in the indemnity clause, as well as claims for damages.

[42] On the question of whether the claims made against ADLS arose out of any "negligent act, error or omission" Mr Ring accepted that there were no relevant allegations of negligence against ADLS. However, the word "negligent" stood on its own, and was not to be seen as qualifying "error" or "omission". The claims in fact arose through errors and/or omissions, and were covered by the indemnity clause.

[43] Mr Ring argued that because "negligent error" could only arise through a negligent act, negligent omission or a combination of both, there would be a "necessary linguistic redundancy" if "negligent" were treated as qualifying each of act, error or omission. He argued that while all negligent acts must be errors, not all errors are negligent, and it is quite conceivable that a person may act with all due care and still make a mistake. Consequently, the only interpretation which gives utility to "error" in this context is if the "error" does not have to be a "negligent error". He referred to a number of authorities which supported this approach, including *B.C. Rail Ltd. v American Home Assurance* (1991) 79 D.L.R. (4th) 729, at 748-749, per Cumming and MacDonald JJ and *Lumberman's Mutual Casualty Co. v Bovis Lend Lease* [2005] 1 Lloyd's Rep. 494. In the latter, where the words to be construed were "neglect error or omission or breach of warranty of authority", Colman J held at [69]-[70] that:

> "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" .
>
> In the result I have no doubt that "error or omission" are intended to refer to non-negligent conduct giving rise to liability, for example the liability under *Rylands v Fletcher* (1868) L.R. 3 H.L. 330 or in conversion.

[44] Mr Ring submitted that this was consistent with the generally accepted purpose of a professional indemnity policy. In *Haseldine v Hosken* [1933] 1 KB 822 the relevant clause indemnified a solicitor against liability in respect of "any neglect, omission or error". Greer LJ said, at 837:

> What it was intended to do was to cover the case of the 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.

[45] Mr Ring also pointed to relevant exclusion clauses for dishonesty, in relation to defamation, and liability assumed by contract. The first of those clauses excluded liability in respect of claims "arising directly or indirectly from any dishonest, fraudulent, malicious or illegal act or omission of the Assured".

[46] The defamation exclusion excluded claims "alleging libel or slander" and the contractual liability exclusion related to claims "arising directly or indirectly from any liability assumed by the Assured under a specific contract which would not have been assumed under the Assured's standard contract or trading conditions".

[47] Mr Ring's point was that those exclusions would have been unnecessary had the indemnity clause been limited to cover for negligent acts.

[48] Mr Ring argued that, in the first proceeding, the plaintiffs had effectively alleged incorrect use of statutory powers, unlawful acts and breach of an obligation of confidence with respect to the information given by Mr Lusk to Mr Ennor. The Privy Council had held that ADLS had been wrong in its reliance of s 101(3)(d) of the Law Practitioners Act 1982 (which contained a power to require practitioners complained against to produce documents for inspection) as overriding legal professional privilege and it also held that ADLS had been mistaken in its view that

privilege in the documents had been waived by the disclosure to Mr Ennor. Mr Ring noted that in his evidence, Mr Bryers had confirmed that, with respect to the decision-making process about the use of the confidential information, ADLS had at all times received and considered professional advice which had consistently been to the effect that its stance was reasonable. Effectively the Privy Council had held that ADLS had made an error of law. This in turn had resulted in its liability for costs.

[49] As to the second proceeding, Mr Ring characterised the claims made in the defendant's counterclaims as being that ADLS had received and used or was proposing to use confidential information made available to Mr McElrea when it was not entitled to do so. This was, similarly, effectively a claim that ADLS had made a mistake about the law. It was not a claim of negligence; negligence could not be alleged because ADLS had received and relied on professional advice throughout.

[50] As to the third proceeding, the allegations which I have earlier summarised were characterised by Mr Ring as being collectively that ADLS had made errors and omissions. Once again, there was no suggestion of negligence. ADLS had taken and followed appropriate advice, but had nevertheless allegedly failed to comply with its statutory duties and breached obligations that it had to the plaintiffs.

[51] In the result, all of the claims made against ADLS were properly to be regarded as having arisen from its errors or omissions. Insofar as ADLS's own costs and expenses incurred in relation to the proceedings were concerned, Mr Ring relied on the clause in the policy mentioned earlier. It immediately followed the indemnity clause and was in the following terms:

> Costs and Expenses
>
> In addition Underwriters also agree to pay all costs and expenses incurred in the investigation, defence or settlement of any claim which falls to be dealt with under this Insurance, provided that if a payment in excess of the amount of indemnity available under this Policy has to be made to dispose of a claim, the Underwriters' liability for such costs and expenses shall be such proportion thereof as the amount of indemnity available under this Policy in respect of that claim bears to the amount paid to dispose of this claim.

[52] Mr Ring submitted that as a result of this provision, if there was indemnity under the policy in respect of liability for claims against ADLS, there was also

indemnity in respect of the defence costs incurred in defending or settling those claims. It would be sufficient to trigger this cover that, if the liability were established, it would be indemnified; there did not have to be an actual liability established against ADLS. He pointed out that the presumed intention of the parties must in fact have been to prevent findings of liability against ADLS, with the costs of achieving that outcome payable by the underwriter under the "costs and expenses" clause.

[53] Because there was in fact indemnity in respect of the claims made in each of the three proceedings, ADLS had a parallel right to indemnity under the costs and expenses clause for its costs incurred in defending and/or settling the proceedings.

Defendant's argument

[54] For the defendant, Mr Galbraith QC argued that the policy which was fundamentally to provide insurance against "loss", did not cover ADLS in respect of the three proceedings because the substance of those three proceedings did not require to be litigated to avoid loss; the loss was not caused by a claim arising from a negligent act, error or omission, but rather, from the deliberate act of ADLS; and ADLS chose to litigate in circumstances where it either accepted or was estopped from denying acceptance of its liability for the costs of the litigation.

[55] Pointing out that the policy in question was a professional indemnity policy, generally in standard Lloyds terms, he emphasised the nature of a professional indemnity policy, being to insure against the consequences of professional negligence and breach of professional duty in the conduct of the business of the insured as a professional person. He argued that because it was an indemnity policy, it required proof of loss.

[56] Mr Galbraith pointed to the opening words of the policy in which the underwriters agreed, in consideration of the payment to them of the premium by the Assured:

> 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.

[57] As to the indemnity clause, Mr Galbraith linked its use of the word "damages" to the "loss" for which the policy provided. "Claimants costs and expenses" were costs and expenses associated with the damages claims. He bolstered these arguments by reference to the terms of the Schedule set out at [36] above, which he claimed demonstrated that the only cover was in respect of damages claims. Reliance was also placed on Endorsement 3 to the policy, which provided that the underwriters would not be liable to indemnify ADLS against claims arising out of the activities of any solicitor as an outside director except for professional advice given as a representative of the Law Society. Mr Galbraith contended that the Endorsement supported his argument that there was indemnity only for damages claims.

[58] In advancing these arguments, Mr Galbraith pointed out that the obligation to pay under the policy was the sole contractual obligation of the underwriter. It had no contractual obligation to advance the interests of the insured in any other manner. He pointed to the respective rights of the parties under Condition 2 to the policy, as being an important indication of the purpose of the policy and the scope of the interest for which it provided. Condition 2 provides as follows:

> Claims Handling
>
> 2. The Assured 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 the Assured the defence or settlement of any claim.
>
> The Assured shall not be required to contest any legal proceedings unless a Queen's Counsel (to be mutually agreed upon by the Assured and Underwriters) shall advise that such proceedings should be contested.
>
> The Assured 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 a result of the Assured's refusal to compromise or settle such claim or legal proceedings.

[59] Mr Galbraith saw significance in the fact that under Condition 2 primacy is given to the right of the underwriters to mitigate their liabilities. Further, the insured must not incur any liability, once a claim has arisen, without the insurer's written consent. The insurer is entitled to take over the conduct of the claim, and to settle it.

[60] Referring to the "Queen's Counsel" clause within Condition 2, Mr Galbraith submitted that it provided the insured with a limited protection for matters such as reputation risk where the insurer wished to contest proceedings. However, as noted in the following paragraph, where the underwriters wish to compromise or settle a claim, the assured is entitled to contest the claim at its own risk, and in that case the underwriter is not liable for damages, costs or expenses incurred as a result of the assured's refusal to compromise or settle the claim.

[61] Against the background of these provisions, Mr Galbraith argued that the purpose of the policy was to indemnify where the negligent act, error or omission giving rise to the claim (and consequent liability) has occurred at the time of a claim, even though there may have to be a subsequent judicial determination or agreement to settle, or to ascertain the loss.

[62] Referring to the first proceeding, Mr Galbraith pointed out that the proceeding had never involved a claim for damages. The issues concerning the ongoing involvement of Mr Judd, and retention and proposed use of the privileged documents could equally well have been the subject of a proceeding commenced by ADLS itself, as indeed had at one stage been contemplated. In the circumstances, ADLS was simply seeking its legal costs, and the costs that it had become obliged to pay to Russell McVeagh as a result of its choice to pursue litigation because it perceived that to be in its interests in carrying out its investigative and adjudicative functions under the Law Practitioners Act. No "loss" had been incurred at the time the Russell McVeagh proceeding had been filed, and the subsequent incurring of legal costs was not necessary for the purpose of avoiding or mitigating any loss under the policy.

[63] As to the second proceeding, it had been commenced by ADLS itself. Similar issues were raised as in the first proceeding, although this time in the context

of the information provided by Mr McElrea. Mr Galbraith pointed out that there had in fact been no claim by ADLS for its costs in respect of the initiation of the second proceedings and that all that had been sought was legal costs from December 2000 when a statement of defence and counterclaim was filed. It was not until October 2001 that the counterclaim had been amended to include a damages claim. Prior to then, Mr Galbraith argued that it was artificial to describe the counterclaim as a "claim" under the policy when the issues raised in the counterclaim could equally have been raised by way of defence and/or affirmative defence.

[64] Once the counterclaim was amended to include damages claims, then the defendant accepted that such a claim could come within the indemnity clause. However, the claim could have been struck out under s 137 of the Law Practitioners Act, which protected ADLS from civil liability in respect of anything done, or in respect of words spoken or written in connection with any investigation of a practitioner's conduct. In any event, Mr Galbraith pointed to evidence that the damages claim had been seen by advisers to ADLS as having been raised for strategic purposes, and that it was of little or no concern. I agree that that is a fair summary of what Mr Billington said in cross-examination. Mr Galbraith also pointed out that the damages claim had been withdrawn in June 2002, although I observe that the circumstances at the time were such that the claim might have been subsequently resurrected had matters gone to trial.

[65] As to the third proceeding, Mr Galbraith accepted that the damages claims might have engaged the indemnity clause, but he contended that they had never really become an issue in respect of which any identifiable legal costs were incurred. Once again, the damages claims could have been struck out under s 137 of the Law Practitioners Act.

[66] Mr Galbraith argued that in respect of all three proceedings ADLS had adopted the stance that it did in the litigation because it perceived it was necessary in performance of its statutory obligations, and that it was in the public interest. While it was entitled to act on those views, Mr Galbraith maintained that they had nothing to do with mitigating or avoiding "loss" arising out of some negligent act, error or omission that had occurred at the time the claims were made.

[67] Mr Galbraith argued that "costs and expenses" which had not arisen in conjunction with an action for damages were not covered by the policy. In that respect, he relied on the wording of the indemnity clause, the essential character of an indemnity being to pay money in respect of a loss, and the implications of Condition 2 that a relevant claim was one where the facts potentially giving rise to liability for loss have arisen at the time of the claim. He argued that in effect ADLS was relying on the policy as providing a general underwrite of its legal costs incurred in proceedings irrespective of whether the substance of the claim was an exposure to damages. That was outside of what was in fact contemplated by the policy.

[68] As for the words "negligent act, error or omission", Mr Galbraith submitted that there had been no "negligent act" by ADLS, since it had acted throughout with the benefit of legal advice from senior counsel in adopting and pursuing the stance it took in the proceedings. It had acted intentionally, believing that the steps it took were appropriate in performance of its statutory functions. He argued that the words "error or omission" should not be used to undermine the clear intent of the policy wording which was to exclude cover for non-negligent acts. While accepting that errors and omissions were not qualified by the word "negligent", nevertheless the juxtaposition of the reference to "negligent acts" indicated that in order for an "error or omission" to be covered, it would have to be shown that there had been conduct which failed to meet a legal standard, for which there would be liability. That is to say, a breach of statutory duty and not simply conduct that the insured chose to pursue that may have had an undesired outcome. The fact that, in the first proceeding, the Privy Council had ultimately held that ADLS had adopted the wrong stance was not indicative that ADLS had made a relevant error or omission.

[69] In this part of the defendant's argument Mr Galbraith had to concede that the third proceeding was in a different category because it contained allegations of breach of statutory duty and of the principles of natural justice for which damages were sought as an alternative to remedies of injunction or declaration. Here, however, he repeated the argument that s 137 of the Law Practitioners Act provided a complete shield to the damages claimed, unless bad faith was established, in which case the protection afforded by s 137 would be lost, and exclusion (c) to the Policy would also preclude cover. There had, however, been no suggestion of bad faith.

Thus ADLS could and should have applied to strike out the action for damages under s 137. For its own reasons, it appeared that the society chose not to do so despite plainly being aware of s 137. In that respect, Mr Galbraith was able to refer to an e-mail communication between counsel acting for ADLS, dated 27 February 2003 in which it was said:

> …we made a conscious decision early on, not to invoke s 137 in the Society's defence, but (responsibly) to submit to the Court's jurisdiction, and obtain a ruling on the matters at issue.

[70] Mr Galbraith accepted that the defendant's argument based on s 137 of the Law Practitioners Act would only apply were the Court to hold that a claim for damages was necessary for the policy to be engaged. The defendant accepted otherwise that a breach of statutory duty would constitute an "error or omission" within the policy and that relief against such a claim would not be available under s 137.

Discussion

[71] Both counsel referred to the general approach to the interpretation of contracts set out in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at 114-115, so that the intention of the parties is ascertained by reference to the words used in the context of the clause in question, in turn considered in the context of the policy as a whole and the surrounding factual matrix. In these respects, contracts of insurance are to be interpreted in the same way as contracts generally.

[72] Mr Galbraith's purpose in emphasising that approach was to further his argument based upon the general nature of professional indemnity policies, which he described as to provide an indemnity against loss. Mr Galbraith further relied on a statement of Vautier J in *Tru-Line Plumbers Ltd v CML Fire and General Insurance company Ltd* (HC AK M191/81, 26 February 1982) to the effect that in construing the policy it is essential to have regard to the type and nature of the policy and its commercial purpose.

[73] Notwithstanding Mr Galbraith's reliance on the word "loss" in the first clause of the policy, I consider Mr Ring was correct when he submitted that in order to ascertain the nature of the loss insured against, it is necessary to construe the words of the indemnity clause. If an event falls within the wording of the indemnity clause, then it seems plain that that will be a loss insured against. And in construing the indemnity clause, primary regard must be had to the words used. The interpretative guidance derived from cases as *Investors Compensation Scheme Ltd v West Bromwich Building Society* has to be applied in relation to the words actually used in the contract. As Panckhurst J observed in *Clasper v Duns & Others* (HC CH CIV 2004-009-002116, 4 October 2007) at [94]:

> A contract of insurance is an agreement governed by the same rules of interpretation as apply to contracts generally. The intention of the parties is to be ascertained by objective reference to the words used in the contract. Hence, the starting-point is the words themselves.

[74] The indemnity clause then is to be approached on the basis that its words should be given their ordinary meanings unless there is some indication in the contract or the factual setting which indicates that a different approach is required. The approach taken can also allow that if a literal interpretation of a contract such as this would result in a conclusion that "flouts business common sense", then the literal meaning must be made to yield to business common sense (*Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1985] AC 191, at 201 per Lord Diplock).

[75] Approaching the clause on that basis, the following points appear clear. First, insofar as ADLS's claim seeks to recover amounts paid to the other parties in the three proceedings, it involves sums which ADLS became legally liable to pay. The fact that a liability arose as a result of an agreed settlement does not affect that conclusion.

[76] In *Lumberman's Mutual Casualty Co. v Bovis Lend Lease Ltd* [2005] 1 Lloyd's Rep 494, Colman J observed at [44] that where a settlement is relied on the insured must prove by extrinsic evidence that there was a liability insured by the policy and secondly that what was paid by way of settlement was reasonable having regard to the amount of damages that the insured would have had to pay if the matter

had gone to trial. Leaving on one side the question of whether the costs that ADLS agreed to pay related to a liability insured by the policy, I am satisfied on the basis of Mr Billington's evidence that the amount paid by way of costs was reasonable, and I did not understand there to be any challenge from the defendant on that issue. There was no evidence that questioned that of Mr Billington on this point.

[77] It was also Mr Billington's evidence, however, that none of the sums paid in settlement included any amount as damages. The settlement was in relation to costs and expenses alone. The more difficult question then arises as to whether the sums which ADLS became legally liable to pay fall within the expression "damages and claimants costs and expenses". There can be no doubt that the liability of ADLS was in fact for claimant's costs and expenses. The question is whether there is cover for such costs and expenses in the absence of a claim for damages, or whether, as the defendant maintains, "claimants costs and expenses" are only payable when they arise in a relation to a damages claim.

[78] I do not consider that the restrictive view of the phrase "claimants costs and expenses" urged by the defendant is justified by the words themselves, or their position in the indemnity clause. *Prima facie* on the words used there is cover for sums which the assured became legally liable to pay whether as damages, or costs, or expenses. Words could have been used which plainly had the effect for which the defendant now contends. For example, the reference could have been to all sums which the assured became legally liable to pay as "damages and associated costs and expenses". However, wording such as that has not been employed, and the result of the words that have been used seems to me to leave the position for which ADLS contends plainly open.

[79] In support of its position, Mr Ring was able to refer to a statement in Derrington & Ashton, *The Law of Liability Insurance* (2nd ed., 2005) ("Derrington & Ashton") at para 8-502 noting that where an indemnity clause is limited to "damages", it has been held that claimant's costs are not included. One case referred to by Mr Ring was a decision of the Full Court of the Supreme Court of Queensland in *McCarthy v The Insurance Commissioner* [1960] Qd.R. 554. In that case, there was cover in respect of all sums for which the insured was "legally liable by way of

damages…”. It was held that cover did not extend to the costs of the action in which the insured’s liability had been established. Derrington & Ashton also refer, at para 11-537, to legal costs insurance, which covers the insured “only for the costs of litigation usually including liability for costs in the event of the opponent’s success.” So there is authority for Mr Ring’s proposition that damages on the one hand, and claimant’s costs and expenses on the other are different heads of claim that do not necessarily need to coincide.

[80] I also consider that there is force in Mr Ring’s reference to cases where there may be no claim for damages, such as where an injunction or declaration may be the only remedy sought, yet the judgment might also include an award of costs. Providing the restrained actions were part of the insured’s normal activities, it is difficult to see why the policy should not respond. Putting that another way, it is not easy to see why the third party’s choice of remedy should be decisive of whether or not the accused would have cover. In the present case, for example, damages were sought by the plaintiffs in the third proceeding, as well as declarations and injunctions. The factual and legal issues arising did not differ to any significant degree in accordance with the different forms of relief sought, and the different forms of relief arose out of the same causes of action. It would seem artificial if the claim were to be divided up into parts that were insured and parts that were not, especially in circumstances where it would not be possible to separate in any cogent way the costs attributable to the different kinds of relief sought. But if the same set of facts would found a claim for a declaration and/or injunction as well as a claim for damages it would seem equally artificial to hold that cover would apply only where a damages claim was advanced, with or without the other kinds of relief.

[81] Nevertheless, the defendant argued that that outcome (which I do not consider justified by the plain meaning of the words used in the indemnity clause) was appropriate, partly on the basis of the words in the indemnity clause referring to “claims … arising out of any negligent act, error or omission,” and partly on the basis of other aspects of the policy. As to the former, as earlier mentioned it was the defendant’s argument that ADLS had not acted negligently, and that while the word “negligent” did not qualify the words “error or omission,” nevertheless those words should not be construed so as to undermine the clear intent of the indemnity clause to

exclude cover for non-negligent acts. Putting the position in that way in fact comes close to requiring negligence to be the hallmark of any act or omission that qualifies for cover.

[82] It seems plain from the authorities to which I was referred by Mr Ring (see e.g. *B.C. Rail Ltd. v American Home Assurance* (1991) 79 D.L.R. (4th) 729, at 748-749, per Cumming and MacDonald JJ; *Lumberman's Mutual Casualty Co. v Bovis Lend Lease* [2005] 1 Lloyd's Rep. 494) that "negligent" does not qualify "error or omission" and Mr Galbraith did not directly submit to the contrary. However, he referred to conduct that failed to meet a legal standard, mentioning breach of a statutory duty as conduct that, while not negligent, would attract cover as an error or omission. He contrasted that with conduct that the accused had chosen to pursue that had simply had an undesired outcome. The latter would not be covered.

[83] In the present case ADLS points to its desire to retain and use the confidential information given to Mr Ennor by Mr Lusk. 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 by Mr Lusk 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] I consider that ADLS can properly claim that the test postulated by Mr Galbraith, of the insured having failed to meet a legal standard, was met in relation to the privileged documents. 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.

However, it was the Privy Council's decision that led ADLS to reconsider its position, settle all of the outstanding proceedings and abandon the investigations on which it had embarked. In the circumstances, errors and omissions (whether actual or alleged) were causative of the costs that had to be paid as the price of settlement, and they also led to the incurring of ADLS's own defence costs.

[85] Consequently, I do not consider that the words "negligent act, error or omission" should have the effect of causing the words "damages and claimants costs and expenses" to be construed in the manner for which the defendant contends. A relevant error or omission might be such as to subject the insured to claims for costs without any concomitant liability for damages, and that is what in fact occurred.

[86] As to the defendant's reliance on other aspects of the policy, Mr Galbraith derived support for the defendant's position on the meaning of the indemnity clause from the fact that the underwriters had agreed only to insure against "loss"; from the reference in the Schedule of the policy to "an action for damages"; from Condition 2, which I have set out at [58] above; from Endorsement 3 and from the general nature of professional indemnity policies.

[87] As to the first of these points, I have effectively already dealt with the implications of the policy's use of the word "loss" above. The policy does not define "loss". Rather, it provides cover for claims falling within the indemnity clause; if they do fall within that clause they will relate to a loss insured against. There is no proper basis for postulating a definition of "loss" which reduces (or expands, for that matter) the ambit of the indemnity clause. All this follows, in my view, from the words used in the opening clause by which the underwriters bind themselves 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*. (Emphasis added.) This wording simply directs one to the indemnity clause, the clause that provides for investigation and defence costs and any relevant exclusions and endorsements.

[88] The Schedule to the policy consisted of a series of headings dealing with such matters as the name of the assured and its address, a description of the assured's

business, the period of insurance, the limit of indemnity, the excess and the premium. Opposite the words "Legal Action" was the text that I have previously set out at [36] above.

[89] I have earlier referred to the rival arguments of the parties about this clause. What appears to be the first sentence may in fact have been intended to be part of the second, with a comma having been omitted between "damages" and "Underwriters." I say that because, as written, the first sentence is not a complete thought. However, leaving that possibility on one side, I do not accept the defendant's argument that the provision indicates a limitation on the indemnity clause to damages claims, for a number of reasons.

[90] First, I do not consider that the intent of this part of the Schedule was to provide for the extent of cover in a manner co-extensive with the indemnity clause. If that had been intended, then a better way of achieving that outcome would have simply been to cross-refer to the indemnity clause. Plainly, that was not the intent, as a comparison between the two clauses shows. Secondly, the wording "in respect of any claim made … which results in an action for damages" suggests that a distinction is being drawn between those claims that result in an action for damages and other claims that do not. Mr Ring pointed to a plausible explanation for that kind of approach which fits with the apparent purpose of this part of the schedule-to exclude cover for damages claims brought in the North American Courts, out of apprehension about the possible magnitude of damages awards in those jurisdictions. I would not accord this clause any effect other than that limited exclusion, for North American damages claims.

[91] Turning next to Condition 2, I accept that it provides for the underwriters to mitigate their liabilities, and that they are entitled in broad terms to take over a claim and settle it. I agree too that the Queen's Counsel clause provides limited protection for an insured who does not wish to contest legal proceedings for reasons that might include damage to reputation, a desire to justify actions taken or, as in the present case, what Mr Galbraith described as "a collateral statutory purpose." Conversely, the Condition enables an accused who wishes to contest a claim that the underwriters wish to settle to do so at the insured's own cost. All of this, however, fails to

persuade me that it should influence the interpretation of the indemnity clause. It is one thing to concede a right in the underwriters to settle a claim and to manage claims in a way that minimises their liabilities; it is another thing altogether to reason on the basis of those rights that the indemnity clause must be narrowly construed.

[92] As I understood the position he advanced, Mr Galbraith sought to distinguish cases where there had been a negligent act, error or omission for which cover is sought and a case such as the present where the circumstances giving rise to the claim might simply be described as the voluntary adoption by the insured of a certain stance in relation to litigation with a claimed consequential obligation on the part of the underwriter to fund the costs, whether successful or unsuccessful. He argued that the policy should not be construed so as to extend cover to "costs incurred by the insured for which the insurer could have no other liability." He emphasised in this context comments that had been made by the convenor of the committee established by ADLS to investigate the complaints made against Russell McVeagh that the litigation in which ADLS became involved would enable it to ascertain "the correct answer to the factual and legal issues which the circumstances throw up". While ADLS might choose to litigate the issues for that reason, the insurer should not be required to fund it.

[93] It can be observed that this argument is not focused on any particular words in the indemnity clause, and logically does not detract from the conclusion earlier expressed that the three proceedings involved relevant alleged errors and omissions by ADLS in the conduct of its statutory duty to investigate complaints under the Law Practitioners Act. The committee convenor's comments must be seen in the context of the dispute that had arisen in relation to the manner in which ADSL was performing those duties. It is only in the narrowest of senses that ADLS could be said to be a voluntary participant in the proceedings. It did have a statutory duty to investigate, and the interests involved were very important for all concerned. Whatever might normally be the position it is perhaps not surprising that there were proceedings in this case, having regard to the seriousness of the issues raised, and the fact that ADLS, as was ultimately shown by the Privy Council's decision, had in fact erred. One can contemplate cover for ADLS in these circumstances without

acceding to any suggestion that the insurer might be called on generally to fund the costs of the Society's functions as regulator of the profession.

[94] Quite apart from provisions such as the "Queen's Counsel clause" in Condition 2 it is well recognised that the underwriter's rights to manage and settle claims must take into account the legitimate interest of the insured in relation to its own affairs, whether in respect of reputation or other matters. In Derrington & Ashton, at para 9-168, it is observed that in taking over an action and deciding on the tactics to be employed the underwriter must act "in what it *bona fide* considers to be the common interest" and at para 9-170 the learned authors say that the insurer "is also bound to act in good faith in respect of any possible settlement, putting the interest of the insured before or at least on the same level as its own." Where the insured is a body such as ADLS, with regulatory duties to be exercised not only in the interests of the legal profession as a whole but also on behalf on the public in respect of its dealings with the profession, it may well be that a straight calculation of where the economic interests lie will not be sufficient to determine the appropriate response to proceedings or allegations questioning the propriety or lawfulness of the insured's actions.

[95] Mr Galbraith referred to the difficulties of such an approach where the claim made is not one for damages, engaging equally the mutual interest of underwriter and insured. He pointed to the unsatisfactory position of the underwriter potentially being required to fund costs related more to the insured's activities in a general sense than to any actual "loss". These points are well made, but the difficulty arises, in my view, from the wording of what was a normal professional indemnity policy applied, apparently without adaptation, to a professional regulatory body.

[96] If underwriters are concerned about the possible breadth of their liability in such circumstances (notwithstanding the need for "negligent act, error or omission") then the answer would lie in a policy that was more specifically tailored to the affairs of such bodies, whether through more extensive exclusion or exception clauses or some other approach. The question here, however, is whether the kinds of consideration raised by Mr Galbraith should have the effect of narrowing the

meaning that would otherwise be given the words used in the indemnity clause. I do not consider that they should.

[97] I turn next to Endorsement 3. It provided that the underwriters would not be liable to indemnify the insured against claims arising out of the activities of any solicitor as an outside director except for professional advice given as a representative of the Law Society. As previously mentioned, Mr Galbraith argued that this language was only apt to refer to damages claims in actions for negligence. 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.

[98] That leaves for consideration Mr Galbraith's references to the general nature of a professional indemnity policy. He maintained that the purpose of such policies is to insure against the consequences of professional negligence and breach of professional duty in the conduct of the business of the insured as a professional person. As has been seen, his submissions on this issue emphasised that the obligation to pay out in respect of a valid claim is the only obligation that the underwriter assumes. He also maintained that the insured's primary concern is to mitigate loss and limit its exposure under the policy. While that may be so (subject to potential limitations arising from the obligation to consider the insured's interests as well as its own, discussed above) once again these considerations do not directly lead to any particular limitation on the ambit of the words used in the indemnity clause.

[99] Mr Ring submitted that the purpose of the policy in this case was to protect ADLS in respect of unplanned financial outlay arising from legal liability incurred in respect of wrongful conduct in its professional capacity. That statement of purpose in fact has a better fit with the policy in issue here than a professional indemnity policy that had been taken out by, say, a firm of solicitors. Mr Galbraith's description of the purpose would be more apt in such a case. In construing the present policy I consider that regard should be had to the fact that at the relevant

times the insured was a district law society with particular powers and duties arising under the Law Practitioners Act. The defendant, of course, knew that when it issued the policy. It was ADLS's needs that the policy was designed to meet.

[100] In any event, I do not consider that any of the issues identified by Mr Galbraith about the general nature of professional indemnity policies should have the effect for which he contends, limiting the breadth of the indemnity clause.

[101] I have not found it necessary to discuss the implications of s 137 of the Law Practitioners Act which, as mentioned earlier, protected ADLS from civil liability in respect of anything done, said or written in connection with any investigation of a practitioner's conduct. I do not consider that the section has any implications for the interpretation of the policy. Further, I understood Mr Galbraith to concede (para 10.4 of his written submissions) that because the section is only relevant to damages claims it would not affect the question of whether cover is available in the event that the Court held that a damages claim was not necessary to trigger indemnity under the policy.

Conclusion

[102] In summary, based on the wording of the indemnity clause, and after considering those other parts of the policy to which counsel referred, as well as the "general nature" of the policy, I consider that ADLS was covered under the indemnity clause for the liability it incurred to the other parties to the proceedings. There were relevant errors and omissions by ADLS (both established and alleged) and the sum paid on settlement resulted from them. The same reasoning would apply to entitle ADLS to recover its own costs in relation to the proceedings under the "Costs and Expenses" clause in the policy. The costs were incurred in respect of claims falling "to be dealt with under this insurance".

[103] In the result, ADLS was covered for the full amount of its claim, unless disentitled under Condition 2, or one of the exclusions to the policy applied. Although some of the exclusions in the policy were invoked on the defendant's

pleadings, in the result none of them were pursued in argument. Consequently, the only remaining issues that need to be addressed arise in the context of Condition 2.

Condition 2

[104] Condition 2 has been set out at [58] above. ADLS argued that it was not required to comply with the condition because underwriters had wrongly declined to indemnify ADLS at all or only to a very limited extent. The defendant contended that ADLS had breached Condition 2 by not obtaining its consent prior to the settlement with Russell McVeagh and prior to incurring the defence costs for which it seeks indemnity. In order to understand the respective positions of the parties it is necessary to say a little more about the facts.

[105] The position of ADLS was based on a letter that it received from J & H Marsh and McLennan ("Marsh") dated 13 August 1999. At that stage Marsh was apparently acting as agent for both ADLS and the underwriters. In its letter of 13 August 1999 Marsh referred to an attached letter from Mr Gilbert of Chapman Tripp Sheffield Young dated 5 August. Marsh advised that the "underwriter's initial response is to agree with Mr Gilbert's recommendations". The letter continued:

> 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 involve 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.

[106] Chapman Tripp Sheffield Young's letter of 5 August (which Marsh referred to as the report) quoted from the indemnity clause to the policy. It noted that "[n]either of the situations notified by ADLS involve any claim for damages. As such, they do not appear to be claims to which the policy responds. Furthermore, neither presently involves any allegation of negligence against ADLS".

[107] The letter then referred in general terms to complaints that had been made against Russell McVeagh arising from the bloodstock partnerships and referred to the two main issues which at that stage were the subject of proceedings threatened by Bell Gully acting for Russell McVeagh. Those issues, raised in Bell Gully's letter of 30 April 1999 and addressed in a draft statement of claim that accompanied the letter, were the ongoing involvement as an advisor to ADLS of Mr Judd, and retention and use of the documents handed by Mr Lusk to Mr Ennor on a confidential basis. Chapman Tripp observed:

> As can be seen from the above summary, the proceedings threatened to be brought by Russell McVeagh against ADLS seek declaratory relief only. There is no claim for damages nor any allegation of negligence. It appears, therefore, that the professional indemnity policy does not respond to this situation.

[108] The conclusion was expressed that it was unnecessary for the underwriters to involve themselves in the claim although ADLS should keep underwriters informed of developments "in the event that circumstances change and a claim for damages arises".

[109] As noted earlier Paterson J's judgment in the first proceeding was delivered on 6 July 2000. The Court of Appeal's decision followed on 16 October 2001 and that of the Privy Council on 19 May 2003. The result was that ADLS had a costs liability in respect of the first proceeding in all three Courts. Between the decision of the Court of Appeal and that of the Privy Council there was a meeting, on 20 November 2001, between representatives of ADLS and Mr Gilbert of Chapman Tripp on behalf of the underwriters.

[110] Before discussing what took place at that meeting it will be useful to describe contact between ADLS and representatives of the underwriters in the preceding period. ADLS had received a further letter from Bell Gully, acting for Russell McVeagh, dated 30 August 2001. That letter alleged breach by ADLS of its statutory duty under s 101 of the Law Practitioners Act to inquire into the complaints that had been received, apparent bias, breach of duty to act fairly, breach of the New Zealand Bill of Rights Act and breach of the settlement agreement (entered into at the time when it was agreed that ADLS would no longer instruct Mr Judd) by failing

to co-operate to ensure the expeditious disposal of the complaints. These were the allegations that were to become incorporated in the statement of claim filed in the third proceeding, which was commenced on 4 October 2001. It was on the same day that Russell McVeagh had amended its statement of defence and counterclaim in respect of ADLS's own proceeding ("the second proceeding"). The effect of the amendment was to add damages claims against ADLS.

[111] On 25 September 2001 ADLS's executive director, Margaret Wong, wrote to Marsh attaching a copy of Bell Gully's letter of 30 August. Amongst other things she said:

> I would be grateful if you would advise urgently if you require further information or a meeting to discuss these developments or instructions concerning conduct of these matters.

[112] On 26 September she sent an e-mail to Marsh referring to a hearing scheduled to take place before Paterson J commencing on 15 October 2001 dealing with liability issues in the second proceeding. Amongst other things she said in the e-mail:

> There is a hearing of preliminary matters set down for Wednesday 3 Oct to finalise any outstanding matters required before the substantive hearing on 15 Oct. One outstanding matter is an application by ADLS for further discovery. At present John Billington QC and Grant Illingworth are instructed for the Society. Please advise if you require any further information.

[113] Next, on 9 October 2001 ADLS's professional standards director, Mr Chapman had a discussion with Mr Gilbert. It was Mr Chapman's evidence that in that discussion he explained the present position in respect of all three proceedings and that Mr Gilbert had intimated during the discussion that the policy might respond to the damages component of the counterclaim in the second proceedings and to the damages claims in the third proceeding. According to Mr Chapman Mr Gilbert had gone on to refer to practical difficulties that might arise if underwriters took over the conduct of those parts of the claim having regard to the fact that three of the then partners of Chapman Tripp Sheffield Young had previously been partners at Russell McVeagh.

[114] Mr Chapman also wrote to Mr Gilbert on the same day what he described as "a short note covering the relevant three proceedings involving Russell McVeagh and their partners and former partners". Mr Chapman noted that ADLS effectively faced two claims from Russell McVeagh, one being the counterclaim in the second proceedings and the other being a new set of proceedings ("the third proceedings") served on ADLS on 5 October. He referred to the anticipation of ADLS that Russell McVeagh would seek an interim injunction restraining the complaints committee from continuing with the investigations and noted that preparations were in hand to oppose any such application, observing that Mr Billington QC and Mr Illingworth had been instructed in that respect.

[115] Mr Chapman explained in evidence that he was particularly keen to explore the possibility of Chapman Tripp becoming involved in the proceedings having regard to the apparent need for litigation support. He said that he anticipated that the involvement of Chapman Tripp would be at the underwriter's expense.

[116] The Court of Appeal's judgment in the first proceeding was delivered on 16 October 2001. On the following day, Mr Chapman e-mailed a copy of the decision to Mr Gilbert, asking him for his views on its implications for the second and third proceedings. On 29 October 2001 ADLS's council resolved that it would have no objection to Mr Gilbert acting for ADLS's underwriters notwithstanding that three former Russell McVeagh partners had joined Chapman Tripp. On 31 October Mr Chapman wrote again to Mr Gilbert. His letter referred to on-going work on the second and third proceedings and an application for leave to appeal the Court of Appeal's decision made by Russell McVeagh. His letter ended as follows:

> There are also a number of issues which the Society needs to urgently clarify with its PI insurers. They are as follows:
>
> Have our PI insurers accepted the claim? Will they pick up our Court costs as per the PI cover?
>
> How should we deal with this? The Society has already incurred considerable costs in relation to the RMMB counterclaim in the Judge McElrea documents proceedings case and is now incurring costs in the judicial review proceedings filed by Russell McVeagh on 4 October 2001.
>
> How far does the cover extend? In all likelihood, although we have not done the sums, it will exceed the $10,000 excess.

> Therefore, it is imperative that we know who is to act for the PI insurers and for there to be, in short order, a meeting to discuss the situation.

[117] It was against the background of these events that the meeting of 20 November 2001 took place. Present at the meeting were Ms Wong, Mr Chapman and Mr Gilbert. It was Mr Gilbert's evidence that he had referred to the fact that claims for damages in an unspecified amount had been introduced for the first time in the amended statement of defence and counterclaim dated 4 October 2001, filed and served by Russell McVeagh in the second proceedings, and in the third proceeding that had been commenced by Russell McVeagh on the same day. He said that in the absence of bad faith, which Russell McVeagh had not alleged, the damages claims were vulnerable to a strike out application having regard to the statutory immunity for ADLS in s 137 of the Law Practitioners Act 1992. According to him, Mr Chapman and Ms Wong agreed that ADLS had no real exposure to the damages claims and they doubted that Russell McVeagh was serious about pursuing that aspect of the claim.

[118] Mr Gilbert's evidence, on which he was not cross-examined, continued 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.
>
> 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 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.

[119] Ms Malcolm (as Ms Wong now is) did not have a clear recollection of being present at the meeting. Mr Chapman, however, was able to recall what happened and his account largely agreed with that given by Mr Gilbert although he gave a different emphasis to some matters. For example, Mr Chapman said that Mr Gilbert had referred to the possibility of underwriters being prepared to cover the costs associated with an application to strike out the damages components of the second and third proceedings and that if that application was not successful then ADLS would only be covered for the on-going costs relating specifically to the damages components of the proceedings and anything not directly relating to those components would be the responsibility of ADLS.

[120] Further, with respect to Mr Gilbert's evidence that he and Ms Wong had made it clear that ADLS would not want the underwriters to assume conduct of defence of the claims, he explained that they had expressed reservations about the idea of the insurers assuming conduct of the litigation simply for the purpose of mounting a strike out application in respect of the damages components of the two proceedings. While Mr Gilbert was correct to state that ADLS did not have any real concern about its ultimate exposure to damages and thought that Russell McVeagh's claim for damages was "more tactical than anything else", the limited assistance on offer from the underwriters was not regarded as very helpful. However, Mr Chapman's primary purpose in suggesting the meeting was to request the insurers to assume the conduct of the defence and to provide litigation support at their cost by utilising Chapman Tripp as solicitors for ADLS in each proceeding.

[121] It was Mr Chapman's evidence that the prospect of Chapman Tripp assuming conduct of the litigation for the limited purpose that Mr Gilbert had suggested and then stepping out again did not seem practical given that the damages components of the second and third proceedings were inextricably linked with the other aspects of the proceeding as well as with the first proceeding in which Mr Gilbert had reiterated

that there would be no cover. Mr Chapman said that he had expressed those views at the end of the meeting.

[122] Despite that, at Mr Gilbert's request, ADLS representatives had agreed to attempt to assess the costs that had been involved so far in managing the damages components of the second and third proceedings and to give further consideration to whether it would be feasible for the underwriters to take over conduct of parts of the two proceedings, make the strike out applications and then transfer the matter back to the Law Society for on-going management. However, this was never done.

[123] As I have said, the differences between Mr Gilbert and Mr Chapman as to what happened at the meeting seem largely to be as to matters of emphasis and I accept both accounts. I note that what Mr Chapman said in evidence was consistent with the terms of a brief report that he made for the November 2001 meeting of the ADLS council, shortly before he left ADLS's employ. It was Ms Malcom's evidence that, after the November 2001 meeting ADLS did not make any further attempt to pursue the issue of cover. Nor did it consult with the underwriters before entering into the settlement of all three proceedings. It was Mr Billington's evidence that when he negotiated the settlement he knew nothing about the possibility of any insurance cover.

ADLS's argument

[124] Mr Ring submitted that, despite the references to "initial response" or "preliminary view", the invitation to disagree and the offer to "review their position if circumstances changed", the cumulative effect of the Chapman Tripp letter of 5 August 1999 and the Marsh letter by which it was forwarded were in fact unequivocal and resulted in the underwriters declining to "involve themselves" in the proceeding. Although the proceeding was only in draft at that point, the terms of the underwriter's response were such that they applied equally to the proceeding as actually commenced ("the first proceeding"). Having declined cover in respect of the first proceeding, the underwriters never purported to alter their position: it was only in respect of the second and third proceedings which contained the damages

element that the possibility of cover was evidently discussed at the 20 November 2001 meeting.

[125] Insofar as the second and third proceedings were concerned, Mr Ring relied on the fact that Mr Gilbert on behalf of the underwriters maintained the position at the 20 November 2001 meeting that there could be no cover save for the damages aspects of the claims. Defence costs covered would only be those directly related to damages, a minor element which might not even exhaust the policy excess. While underwriters might be willing to apply to strike out the damages claims at their cost if that were unsuccessful the vast majority of on-going defence costs would not be covered.

[126] In the circumstances Mr Ring submitted there had been actual and anticipatory breaches by the underwriters of their indemnity obligations under the policy. The breaches consisted of denying liability for the first proceeding and denying liability in respect of the second and third proceedings except for the minor element of defence costs incurred only in respect of the damages aspects of those claims. The underwriter had had no right to adopt the stance it did because all of the claims were in fact covered by the indemnity clause. The legal effect of these breaches was to relieve ADLS of any obligation to continue to comply with the terms of Condition 2. In particular, ADLS was in the circumstances not obliged to obtain the underwriter's prior consent to incurring on-going defence costs or a settlement liability.

[127] Mr Ring further submitted that the underwriter's stance that ADLS was only entitled to defence costs in respect of the damages aspects was wrong in any event even if cover was in fact limited to the damages claimed. That submission was based on the fact that the "Costs and Expenses" clause bound the underwriters to "pay all costs and expenses incurred in the investigation, defence or settlement of any claim which falls to be dealt with under this Insurance…", and the fact that the damages claims were based on the same allegations that gave rise to the claims for other forms of relief. In the circumstances all of the costs incurred on the second and third proceeding could be said to be defence costs reasonably related to the damages claims. Here, Mr Ring sought to apply by analogy the Privy Council's decision in

New Zealand Forest Products Ltd v New Zealand Insurance Co. Ltd [1997] 3 NZLR 1. In that case defence costs were held to be payable even if they did not relate exclusively to the costs of the insured and even though they related to the defence of a party who was uninsured. The Privy Council said at p 9:

> So far as any defence costs are concerned which reasonably relate to the defence of the claim against Mr Taylor but do not exclusively do so, they are covered by the policy even although they also relate to the defence of some other party who is not insured. That this may be of use and benefit to a party who is not insured does not exclude the costs from cover because they are still costs which are reasonably related to the defence of the covered claim.

[128] The underwriter's stance in this case, of course, involves a possible allocation of costs between insured and uninsured claims rather than insured and uninsured parties. However, Mr Ring submitted that there should be no distinction between the two kinds of case, noting the quotation by the Privy Council, at p 7, from what was said in *Continental Casualty Co v Board of Education of Charles County* 489 A 2d 536 (Md 1985):

> So long as an item of service or expense is reasonably related to defence of a covered claim, it may be apportioned wholly to the covered claim.

[129] He referred in addition to *Thornton Springer v NEM Insurance Co. Ltd* [2000] 2 All ER 489 where Colman J followed the decision of the Privy Council in *New Zealand Forest Products Ltd*, and observed at [122]:

> …if it is impossible to identify any work which related exclusively to the claims which on the face of it were palpably sustainable only against Mr Kaye in his personal capacity, the practice is entitled to an indemnity in respect of all such dual purpose work.

[130] Here because the factual allegations giving rise to the damages claims in the second and third proceedings were the same as those said to entitle Russell McVeagh to injunctive and declaratory relief there was no sensible distinction to be drawn from a costs point of view between the damages and the other claims. Mr Gilbert's stance on behalf of the underwriters at the 21 November 2001 meeting had in the circumstances amounted to a wrongful declining of cover under the policy even if there was only cover in respect of the damages claims.

[131] Mr Ring submitted that where underwriters wrongly decline cover under a policy they cannot later purport to rely on the insured's non-compliance with a condition requiring their consent to any compromise of the claim against the insured. He relied on *Drayton v Martin* (1996) 9 ANZ Insurance Cases 61-322 at p 76-600 where Sackville J sitting in the Federal Court of Australia referred to various authorities to the effect that an insured may make a reasonable settlement where the insurer breaches the contract by denying liability and refusing to defend or settle. He further observed that if the position were otherwise:

> 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 …
>
> 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 brought by the claimant to a conclusion and to forego all opportunities of a reasonable compromise for fear of losing the indemnity under the policy.

[132] The effect of *Drayton v Martin* and other authorities to similar effect is summarised in Derrington & Ashton at para 13-296 as follows:

> 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.

[133] Mr Ring submitted that in the circumstances of this case the defendant's defence based on breach of ADLS of Condition 2 must fail.

Defendant's argument

[134] For the defendant, Mr Galbraith submitted that an explicit and unequivocal statement rejecting cover is required before an insured may be relieved from complying with a term of the contract. That submission was based on what is said in Derrington & Ashton at para 13-297 where it is said that there needs to be "an

explicit and unambiguous statement" that clearly conveys "the rejection of the claim and nothing else." Measured against this test Mr Galbraith argued that Marsh's indication (in the letter of 13 August 1999) that "the underwriter's initial response" was to "agree with [Mr Gilbert's] recommendations" was insufficient, and the last paragraph of their letter had invited further communication.

[135] As to the 20 November 2001 meeting Mr Galbraith pointed out that Mr Gilbert had advised that the policy was likely to respond to the damages claim but that the underwriters would probably wish to exercise their right to assume conduct of the defence, that they would be unlikely to consent to costs being incurred resisting orders that the Society carry out its statutory duties and that it had been agreed at the meeting that the Society would put a submission to Mr Gilbert dealing with what it believed it could claim in respect of the damages aspects of the claim. Mr Galbraith submitted that the matter had been left on the basis that the Society would go back to Mr Gilbert with a submission. Instead, there had been total silence.

[136] Mr Galbraith submitted that what Mr Gilbert had said at the meeting was not a communication of such an unequivocal nature as to relieve ADLS from its obligations under Condition 2. As to the suggestion that ADLS did not make any further approaches because there would have been no point in doing so, cover having already been rejected, Mr Galbraith referred to evidence that suggested that no further contact had been made because ADLS had received legal advice of its own which was negative on the question of cover and because the Society did not want the underwriters to take control of the proceedings if their interest would be to minimise costs and not to litigate the issues that ADLS wished to pursue.

[137] He argued that it was because ADLS thought it was necessary to pursue the investigation in accordance with its statutory duties, the only real option it had would have been to take over the proceedings at its own risk and cost under the third paragraph of Condition 2. By default this was effectively what ADLS had decided to do.

[138] The result was that the defendant had been left believing that ADLS did not want it to assume the conduct of the defence and that ADLS had no other proposal in relation to the damages claim. The failure to communicate denied the defendant the opportunity to "more formally consider and protect its position". Moreover, the defendant had been disadvantaged because if it had taken over the claims it would have swiftly brought them to an end and much of the costs would have been saved.

[139] On the issue of defence costs, Mr Galbraith contended that ADLS's submissions had gone too far. The question of whether costs incurred in respect of a claim which is not covered should be recoverable because the costs were also incurred in relation to a claim that was covered, is a question of fact and degree. In this case, where s 137 of the Law Practitioners Act operated as a bar to civil liability in respect of the damages claims, it was wrong to suggest that costs related to the other claims for relief, were covered. However, that submission could only be advanced if the Court found that there was cover only for claims for damages and in the earlier part of this judgment I have held that cover was not so restricted. Given that, the issue's present significance is as to whether Mr Gilbert's stance on this issue at the 20 November 2001 meeting was a further factor enabling ADLS to proceed without complying with Condition 2.

[140] Responding to a submission made by Mr Ring that the passage in Derrington & Ashton upon which Mr Galbraith relied at para 13-297 over-stated the position and imposed too high a test for conduct amounting to repudiation by the underwriter. Mr Galbraith maintained that the statement was correct, reflected the general law of repudiation of contracts and was in accordance with authorities such as *Woodar Investment Development Ltd v Wimpey Construction (UK) Ltd* [1980] 1 WLR 277.

Discussion

[141] Mr Gilbert's letter of 5 August 1999 was to the effect that it appeared that the professional indemnity policy would not respond to the circumstances of the claim that had been advised by ADLS. Marsh's letter of 13 August to ADLS, which attached Mr Gilbert's letter stated that:

> The underwriter's initial response is to agree with Mr Gilbert's recommendations.

[142] The letter then repeated the bases upon which Mr Gilbert had concluded that the policy would not provide cover. Although Marsh's letter concluded by referring to the possibility that ADLS might wish to comment on an alternative interpretation, the only indication given that underwriters might change their stance was a reference to the possibility of them reviewing their position "should circumstances change". It would be wrong I think to interpret this reference to changed circumstances as extending to a change of mind on the part of the underwriter about whether or not there was cover. In my view, read together, the letters amounted to a plain indication on the underwriter's behalf that there was no cover under the policy. That indication was wrong, for the reasons that I have addressed earlier in this judgment.

[143] If there is any doubt about that, I consider that the underwriter's stance was effectively confirmed at the meeting that took place on 20 November 2001. It is to be noted that in his letter of 31 October 2001 Mr Chapman had asked specifically for urgent clarification as to whether the underwriters had accepted the claim, whether they would pick up Court costs and as to how far the cover would extend. There was reference to the costs already incurred and on-going costs in relation to all three proceedings.

[144] 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. This again was an incorrect stance adopted by the defendant for reasons that I have given. 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 underwriters advice as to whether it was covered under the policy.

[145] Standing back and looking at what was said in the letters of 5 and 13 August 1999 and at the meeting on 20 November 2001, I think it is reasonably plain that the underwriters were declining cover under the policy. The question of whether there

has been repudiation of a contract is to be answered by having regard to both the words and conduct of the party said to have repudiated (c.f. Contractual Remedies Act 1979, s 7(2)). In this case it was not just the letters and verbal advice given at the meeting of 20 November 2001, but also the conduct of the defendant, which never waivered with respect to potential liability on the first proceeding and adopted a stance in relation to the second and third proceedings which meant that cover would largely be denied. Knowing that there was on-going litigation it took no steps itself whether to defend or otherwise become involved in the conduct of the litigation. It does not seem right that it can now effectively adopt the stance that it was up to ADLS to pursue it for cover under the policy. That, it seems to me, would be an unreal requirement having regard to what the underwriter had said, and in the context of its failure to take any steps itself.

[146] Relevant New Zealand authorities on the issue of repudiation are collected and discussed in Burrows, Finn & Todd *Law of Contract in New Zealand* (3rd ed; 2007) at para 18.2.1. Among the cases mentioned is *Starlight Enterprises Ltd v Lapco Enterprises Ltd* [1979] 2 NZLR 744, where the Court of Appeal held that what was necessary was an unequivocal assertion by the repudiating party of its intention not to perform the contract according to its true interpretation. In *Construction Fasteners Ltd v Omark (Australia) Ltd* (CA 62/89, 19 September 1989) there was a purported termination of a contract relying on a mistaken belief that there was an entitlement to do so. It was held that to purport to rescind on the ground of a *bona fide* misinterpretation of a clause in a contract was not a wrongful repudiation.

[147] Another case referred to was *The Edge Buying Group (Queenstown 2000) Ltd v Coca Cola Amatil (NZ) Ltd* (CA 145/02, 25 November 2002) in which Hammond J observed at [40]:

> [T]he *bona fide* assertion (without more) by one party as to their interpretation of a contract, cannot be a proper reason to be seized upon by the other party as a justification for terminating a contract. As a matter of legal principle, parties should not be exposed to a danger "that any forthright assertion of [their] view of their relative rights and duties could, if it turned out to be wrong, justify rescission by the other party. This would be particularly unfortunate if one of the parties had acted on legal advice which was later held by the Court to be mistaken". (Treitel, Law of contract, 9th Edition at page 722, in the context of commentary on *Woodar Investment Development Ltd v Wimpey Construction (UK) ltd* [1980] 1 WLR 277 (HL).

[148] In that case, as Hammond J went on to observe, Coca Cola had expressed a particular view of the contract but at no point did it stop performing the contract and the Judge had not found that it even threatened to do so. The facts in the circumstances simply afforded an example of a reasonably common occurrence of parties disagreeing as to the meaning of contractual terms with one party feeling constrained to observe the contract until the legal position was clarified.

[149] The present case is different. Here, faced with valid claims for indemnity under the contract the defendant indicated that no such cover was available except for the very small concession that was made at the 20 November 2001 meeting. This was not a case in which it could be said that the underwriter had continued to perform its obligations. On the contrary, it took no steps to do so.

[150] The fact that the defendant held out the possibility of meeting the claims for damages and of costs which could be isolated in respect of the damages claims does not detract from my conclusion that there was repudiation. Repudiation may exist in respect of part of a party's obligations under a contract as was recognised by the House of Lords in *Ross Smyth & Co. Ltd v T D Bailey Son & Co* [1940] 3 All ER 60. In that case, Lord Wright with whom the other members of the House agreed, said at 72:

> I do not say that it is necessary to show that the party alleged to have repudiated should have an actual intention not to fulfil the contract. He may intend in fact to fulfil it, but may be determined to do so only in a manner substantially inconsistent with his obligations, and not in any other way.

[151] Those words are apt to describe the present case. By wrongfully adopting the stance that there would be cover only for the damages claims, in circumstances where it was thought that s 137 of the Law Practitioners Act would provide an easy answer and the basic facts and legal issues would still remain in contest between the parties to the three proceedings, the defendant plainly departed from its obligations under the policy in a very substantial way. Obviously, any wrong decision by an underwriter to exclude claims properly payable under a policy of insurance goes to the very essence of the contract from the insured's point of view. In the circumstances it was inconsequential that the underwriter invited ADLS to let it

know what costs could be isolated out in respect of the damages aspects of the second and third proceedings.

[152] In *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd* (1993) 7 ANZ Insurance Cases 77,972 the insured advised the insurer about a claim made against it by the claimant who had left containers with it for storage. The contents of the containers were damaged as a result of fire, smoke and water used to put out the fire. Having sought the underwriter's consent to negotiate a settlement, the insured simply received an acknowledgement from the underwriter. Thereafter it proceeded to negotiate a settlement of the claim. At p 77,975 the Court of Appeal referred to an argument raised by the underwriter that the reasonableness of the settlement concluded by the insured could be contested by evidence at the trial on the basis of a policy provision that:

> This Policy does not apply to liability assumed by the Insured by agreement unless and insofar as the liability would have attached to the Insured notwithstanding the agreement.

[153] The Court rejected the argument as impracticable. At pp 77,975 – 77,976 Gault J (for himself and Casey and McKay JJ) said:

> It would mean that where the insurer has breached the contract by denying liability the insured could never settle and would need to have liability and quantum determined before claiming against the insurer. 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.

[154] Mr Galbraith pointed out that the Headnote records that the insured had denied liability on the ground amongst other things, that the damage to the property was not accidental. Consequently, the reference in the judgment to the insured having "received no more than an acknowledgement" must be presumably confined to the particular stage at which consent to negotiate and settle the claim was sought. However, the decision illustrates that circumstances may arise where it is insufficient for an underwriter simply to stand back, knowing that the insured is proceeding on a path likely to incur costs that will in fact be covered under a policy.

[155] In the present case I do not consider that it was possible for the defendant to rely on Condition 2 having regard to the stance that it adopted when specifically asked to provide cover to ADLS and it knew that ADLS was involved in ongoing litigation. 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 with its contractual obligations together, I consider that there was repudiation.

[156] That repudiation relieved ADLS of its obligation to continue to comply with the terms of Condition 2 of the policy. It entitled ADLS to proceed with the litigation and to settle it as it did after the adverse decision of the Privy Council was delivered. A further consequence of the repudiation was that once it had occurred the defendant was not in a position to assert that the conduct of the litigation by ADLS, defence costs that were incurred and the settlement liability which was assumed were at ADLS's "own risk". Having wrongfully denied cover the defendant effectively put itself outside an ability to rely on ADLS's obligations under Condition 2. Nor, in the circumstances, can it avail the defendant to point to mixed motives that ADLS might have had for not pursuing the question of cover more vigorously.

[157] I reject also Mr Galbraith's submission that the failure to communicate denied the defendant an opportunity to "more formally consider and protect its position". On the view I take the opportunity to formally consider and protect its position had already arisen in the case of the second and third proceedings by the time of the meeting of 20 November 2001, and earlier in the case of the first proceeding.

Conclusion

[158] For these reasons, I hold that Condition 2 of the policy was repudiated by the defendant and ADLS was not required to comply with the condition.

Result

[159] For the reasons I have given ADLS is entitled to judgment in accordance with the amended statement of claim as further amended at the hearing. Judgment will accordingly be in the sums of $850,679.69 in respect of defence costs and $657,131.29 in respect of the costs paid on the settlement reached with the other parties to the three proceedings. The total is $1,507,810.98.

[160] ADLS is also entitled to interest under the Judicature Act 1908 on that amount as pleaded in the amended statement of claim. If there is any dispute as to the calculation of interest I will receive memoranda from counsel.

[161] ADLS is also entitled to its costs. If costs cannot be agreed I will again receive memoranda from the parties.