IN THE COURT OF APPEAL OF NEW ZEALAND

CA698/2014
[2015] NZCA 524

BETWEEN	JCS COST MANAGEMENT LTD First Appellant	
	STEPHEN ROY JOHNSTON Second Appellant	
AND	QBE INSURANCE (INTERNATIONAL) LTD Respondent	

Hearing:	11 August 2015
Court:	Miller, Courtney and Clifford JJ
Counsel:	I J Thain for Appellants PJ Napier for Respondent
Judgment:	25 November 2015 at 3.00 pm
Recalled and Reissued:	9 December 2015
Effective date of Judgment:	25 November 2015

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The respondent will have costs in this Court for a standard appeal on a band A basis with usual disbursements.

REASONS

Miller J (dissenting) [1]
Courtney and Clifford JJ [41]
Addendum (Miller J, for the Court) [66]

MILLER J (dissenting)

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[1] QBE Insurance (International) Ltd insured JCS Cost Management Ltd and its director, Stephen Johnston, for, among other things, the legal costs of defending a claim brought in connection with their professional business as quantity surveyors and project managers.

[2] In March 2009 Mr Johnston attended an open home at 18 O'Neills Avenue, Takapuna, with an existing client, Linda Johnson. He says that he did so in the expectation that JCS might project-manage any upgrade to the house should Mrs Johnson and her husband buy it. He had done similar work for them in the past. The Johnsons did buy the property through their family trust, and in due course JCS did manage renovations on the house.

[3] However, the home proved to be a leaky building. The Johnsons sued the Auckland Council, which joined Mr Johnston, pleading that the Johnsons bought the house in reliance upon his advice that it appeared to be watertight. The claim failed at trial, Woodhouse J finding that Mr Johnston did not give any such advice.[1] His

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[1] *Johnson v Auckland Council* [2013] NZHC 165. The Johnsons' appeal to this Court was allowed in part, in relation to a quantum issue: *Johnson v Auckland Council* [2013] NZCA 662.

legal costs, net of recovery from the Council in the High Court and the policy excess, were $52,950.50.[2]

[4] Mr Johnston claimed the defence costs from QBE, which declined cover, alleging that the costs were incurred in connection not with his quantity surveying and project management business but rather with a claim that Mr Johnston had given pre-purchase advice as a building appraiser.

[5] JCS and Mr Johnston brought a claim for damages in the High Court. QBE sought summary judgment and won.[3] JCS and Mr Johnston now appeal. The issue is whether it is arguable that the claim alleged civil liability "by any act, error, omission or conduct" that occurred in connection with quantity surveying or project management.

Summary judgment principles

[6] I begin by noting that the authorities establish that summary judgment — for either party — is inappropriate where material facts are disputed or not proved by the affidavits, or where for some other reason a final determination properly requires a full hearing of the evidence.[4] This does not mean that the Court must accept uncritically evidence that is inherently lacking in credibility.[5]

[7] This appeal addresses a defendant's summary judgment application, about which this Court added in *Westpac Banking Corporation v M M Kembla NZ Limited* that only in a clear case should the Court decide by summary process that none of the plaintiff's claims can succeed: it must bear in mind that the defendant may hold more of the facts, and it should not make its decision by balancing the evidence finely as it might do at trial.[6]

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2 Mr Johnston successfully recovered costs from the Council: *Johnson v Auckland Council* [2013] NZHC 1148.

3 *JCS Cost Management Ltd v QBE Insurance (International) Ltd* [2014] NZHC 2718.

4 These principles were affirmed in *Westpac Banking Corp v M M Kembla New Zealand Ltd* [2001] 2 NZLR 298 (CA) at [62] and were restated in *Krukziener v Hanover Finance Ltd* [2008] NZCA 187, [2010] NZAR 307 at [26].

5 *Krukziener v Hanover Finance Ltd*, above n 7, at [26].

6 *Westpac Banking Corp v M M Kembla New Zealand Ltd*, above n 4, at [63] and [64].

The policy language

[8] The policy contained two insuring clauses, one containing a primary indemnity for civil liability and the other a costs extension for costs and expenses:

> QBE shall indemnify the Insured for any Valid Claim subject to the terms of this Policy.
>
> In addition, QBE shall pay Costs and Expenses incurred with the written consent of QBE in the defence or settlement of any Valid Claim, up to the Limit of Indemnity or $1M, whichever is the lesser.

[9] Both insuring clauses provided cover for a "Valid Claim". That term was defined, relevantly, as any Claim made and notified during the period of insurance and:

> …alleging Civil Liability by any act, error, omission or conduct that occurred subsequent to the Retroactive Date in connection with the Insured's Professional Business Practice.

[10] "Claim" was defined to mean:

> Legal proceedings instituted and served on the Insured claiming damages; or
>
> Any allegation of wrongdoing by the Insured for which the Insured is legally liable, together with a demand for damages; or
>
> Any threat or intimation that legal proceedings will be issued against the Insured.

[11] "Professional Business Practice" was defined as the Insured's business of quantity surveyor and project manager, and "Project Manager" was further defined to mean the provision of consultancy, certification or project co-ordination services for construction or development projects where the services were rendered for remuneration and the services fell within the Insured's Professional Business Practice:

> The term "Project Manager" means the provision of consultancy, certification or project coordination services for construction or development projects where:
>
> - those services are rendered for remuneration; and
> - the services fall within the insured's Professional Business Practice.

The last limb of the second of these definitions is circular, but nothing turns on that.

[12] "Costs and expenses" were defined as:

> 3.1 all necessary and reasonable legal costs, disbursements, witness costs, assessor costs or expert costs incurred by QBE solely in investigating, defending or settling any Valid Claim;
>
> 3.2 all necessary and reasonable expenses (other than loss of earnings or profits) that are incurred by the insured with the prior written consent of QBE solely in assisting QBE or its solicitors in the investigation, defence or settlement of any such Valid Claim;
>
> 3.3 any interest accruing after the date of entry of judgment against the insured and until the date QBE pays, tenders or deposits in court the judgment sum or such part of that judgment sum as is required to satisfy QBE's liability to the Insured in terms of the Limit of Indemnity.

The Council's claim against the insureds

[13] As noted, Mr Johnston was joined as a third party by the Auckland Council on the basis that he was "a consultant on property matters". The third party claim contained the following allegations:

> In or about late March 2009 the plaintiffs [the Johnsons] engaged the third party for the purpose of obtaining advice as to the condition of the house.
>
> In March 2009 the third party provided oral advice on the condition of the property to the plaintiffs.
>
> In reliance upon the advice the plaintiffs proceeded to purchase the property and on 28 April 2009 the plaintiffs became the registered owners of the house.

[14] Mr Johnston denied these allegations. His position was that he attended the open home because he wanted to secure any ongoing project management work if the Johnsons bought the property and he did not give any advice about its condition.

[15] Counsel agree that the policy did not extend to pre-purchase advice, given as a building appraiser, on the property's condition. However, it is not quite correct to suggest, as I understood Mr Napier to do, that Mr Johnston was sued in that capacity only, quite independent of his profession as a quantity surveyor and project manager. The pleadings certainly alleged that Mr Johnston was engaged to provide advice on

the condition of the house and that as a matter of fact the plaintiffs relied upon his advice to buy the property. But they did not specify in what professional capacity he was engaged or preclude the possibility that he was there to advise on the likely cost of renovations and assessed the property's present condition as an incident of that activity.

[16] In her evidence-in-chief, which was exchanged before trial, Mrs Johnson, upon whom the Council relied to make out its third party claim, said that she wanted Mr Johnston's opinion on whether there were any problems with the house and wanted to discuss any work that the Johnsons might do. She also acknowledged that he had looked at other properties to ascertain whether they were sound and suitable for renovations. She conceded in evidence that no arrangement had been made for payment of a fee and she did not expect to pay anything. So her account was generally consistent with Mr Johnston's claim that he was there in connection with his business, looking for future work.

[17] The Council's position evolved somewhat during the trial. It did not abandon its claim against Mr Johnston, but it adopted his account in important respects. He said that Mrs Johnson knew there was a risk the home might leak and he told her that if she had any concerns she must get an expert to inspect it. The Council relied on this evidence in support of a defence of contributory negligence against the plaintiffs.

[18] As noted, Woodhouse J resolved the conflicts of fact in favour of Mr Johnston, finding that he was there as a sounding board regarding internal alterations that Mrs Johnson already had in mind, and that he did not give her any assurance that there were no visible signs of leaks or any structural concerns;[7] further, Mrs Johnson did say to him that she knew the house might have weather-tightness issues and he responded that he could not advise on such matters.[8]

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7 *Johnson v Auckland Council*, above n 1, at [115]–[116] and [189].
8 At [116].

The insureds' claim against QBE

[19] The insureds say that Mr Johnston actually attended the open home in his professional capacity as a project manager, looking for and subsequently performing work of a kind to which the policy would have been responded had it been the subject of a claim against him. For summary judgment purposes it is not in dispute that this claim may be correct.

[20] The insureds say that the Council's claim against them was accordingly in connection with the insured business and therefore a Valid Claim for purposes of the policy. Cover depends not on the Council's pleadings but on the actual facts, which may need to be established at a trial of their claim against QBE. They say that it cannot be correct that a claim is valid only if the third party specifically alleges in its pleading that the relevant act, error or omission occurred in connection with the insured's business and regardless of what the insured was in fact doing.

[21] QBE responds that the initial pleading may not be dispositive, but in fact the claim made against the insured and pursued throughout, including at trial, was for a species of liability that the policy did not cover: at no time did the Council allege that the insureds acted as quantity surveyors and project managers or gave advice in that capacity. That being so, a trial would serve no purpose: the claim could never be valid, for it was not in connection with the insured business. If follows that defence costs are not payable even though the trial Judge ultimately decided that Mr Johnston was indeed acting in his professional capacity when he attended the open home.

The decision below

[22] Associate Judge Matthews accepted that at a trial of his claim against QBE Mr Johnston might establish that anything said at the open home was said in connection with his intended future services as a project manager and quantity surveyor, but held, in short, that that did not alter the nature of the Council's claim, which was all that QBE need respond to. The evidence at trial could not be used to redefine the Council's claim.[9]

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9 *JCS Cost Management Ltd v QBE Insurance (International) Ltd*, above n 3, at [23]–[24].

Has QBE shown that the insureds' claim cannot succeed?

[23] For QBE, Mr Napier argued first that the scope of cover is confined to the third party statement of claim, which I have quoted at [11] above. That claim alleged civil liability by negligent pre-purchase advice and, he submitted, such advice would not have been given in connection with the insured business because the two things were not "logically associated".

[24] Counsel argued in the alternative that if cover is not controlled by the specific third party pleading it must rest on the true nature of the third party claim. Here, he submitted, the reality of the claim was that Mr Johnston gave pre-purchase advice as to the condition of the house. That claim could not be pleaded in any substantively different way, and for that reason this case may be distinguished from those in which courts have recognised that a third party claim might have been pleaded in a way that allowed the insurer to invoke an exclusion.[10] Counsel accepted that the true nature of the claim might not be ascertained until the trial of the third party proceeding against the insured but submitted that in this case the claim has been resolved by judgment.

[25] I begin by accepting the uncontroversial proposition that this is a contract of indemnity and in order to recover under the primary cover the insureds must establish that they have suffered loss from some civil liability to a third party. It is not in dispute that the policy also responds for defence costs if the third party fails to make out its claim, so long as it is a Valid Claim as defined by the policy. I agree with the majority that cover for defence costs is available only where a hypothetical successful claim against JCS would have been covered under the primary indemnity.[11] The existence of such liability is ordinarily made out in a proceeding between the third party and the insured.[12]

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10 Such as *MDIS Limited v Swinbank* [1999] 2 All ER 722 (Comm).

11 See *Major Engineering Pty Ltd v CGU Insurance Ltd* [2011] VSCA 226, (2011) 16 ANZ Insurance Cases ¶61-903 at [28]; *Bank of Queensland Ltd v Chartis Australia Insurance Ltd* [2012] QSC 319, (2013) 17 ANZ Insurance Cases ¶61-975 at [40]–[42].

12 Compare above at [9] — any such determination is not necessarily final in terms of the liability as between insurer and insured.

[26] However, the other elements of the definition of Valid Claim must be made out in the proceeding between the insureds and the insurer. They are whether the third party claim alleged civil liability "by any act, error, omission or conduct" after a specified date and whether such act, etc occurred "in connection with" the insureds' Professional Business Practice (emphasis added).

[27] Dealing with the first of these requirements, I observe that the nouns "act, error, omission or conduct" and the preposition "by" are general words, capable of broad meanings. For example, "by" can impute causation but it may also indicate how something happens.[13] A similar point was made when dealing with analogous terms in *QBE Insurance Ltd v Nguyen*, a judgment of the full Court of the Supreme Court of South Australia.[14] The policy covered sums that the insured was legally liable to pay by way of compensation for damage happening "as a result of an Occurrence in connection with The Business". Delivering the leading judgment, Doyle CJ rejected a submission that the occurrence or event must cause the insured's liability to the plaintiff. Whether it did so might be the question in the plaintiff's claim, but not in the claim between the insured and the insurer. Indeed, the words used were capable of applying to circumstances that did not involve any act by the insured himself. Nor were the words "as a result of" synonymous with "caused by". The policy did require a link between the damage done to the third party and the business of the insured, but one would expect that to be a link of a kind that made the injury in question a risk that was associated with the insured's business and against which the insured would want cover. If QBE had wanted to define the necessary link in a narrow causative way, it could have done so.[15] The Court went on to define the occurrence or event by reference not to a single act or omission but to all the circumstances of the incident that led to the third party liability.

[28] The argument that QBE advanced in this case suffers from the same flaw that the Full Court identified in *Nguyen*. It seeks to limit the act, error, omission or conduct that is relevant for policy purposes to a central causal event upon which the

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13 See Tony Deverson and Graeme D Kennedy (eds) *The New Zealand Oxford Dictionary* (Oxford University Press, Auckland, 2008) definition of "by": see particularly definition 2 and 4(a)–(b) and 5.

14 *QBE Insurance Ltd v Nguyen* [2008] SASC 138.

15 At 574.

third party claim against the insured was based, namely the giving of advice about the property's present condition, but the general language used in the policy does not compel that narrow approach. QBE also adopted an assumption that the allegation made was that Mr Johnston attended as a building appraiser and gave advice in that capacity, not qua project manager, but as noted, I do not agree that the pleading was so specific, nor was the claim advanced at trial in that narrow way.[16] Nor do I accept that that was the only way in which a successful claim might be pleaded. It is necessary to recognise that JCS faced a third party claim, brought by a party with no direct knowledge of the insured-client relationship but with a strategic interest in characterising Mr Johnston as a professional building appraiser. For present purposes I think it necessary to consider how the claim might have been pleaded and proved had it been brought directly by the Johnsons, in whose shoes the Council purported to stand. It seems likely, if not inevitable, that such claim would have alleged that Mr Johnston addressed the building's present condition when advising on the scope and cost of renovations in his capacity as a project manager and quantity surveyor.

[29] Further, the nature and sufficiency of the connection between an actual or alleged civil liability to a third party and the insured's business are ordinarily determined at trial after all the facts are known.[17] The pleadings are not dispositive, and the decision about cover may turn on findings of fact and degree.

[30] So, for example, in *MDIS v Swinbank* a third party sued the insured, alleging misrepresentation and breach of contract but not fraud, and the claim was settled before trial.[18] MDIS sued its insurer, which had agreed to indemnify it against any claim "alleging" neglect or omission arising out of the professional conduct of the insured's business and for which the insured might become legally liable. The policy excluded any claim or loss resulting from certain dishonest acts. It was common ground that although the third party claim did not allege dishonesty, certain employees had lied to the third party. The insured contended that it need not prove the proximate cause of its loss was an insured event, neglect; it sufficed that the

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16 At any rate, the insurer should not be bound by how the claim was advanced at trial.
17 *Major Engineering Pty Ltd v CGU Insurance Ltd*, above n 11, at [29]–[30].
18 *MDIS Ltd v Swinbank*, above n 10.

third party claim alleged neglect and did not allege fraud. The insurer responded that the exclusion applied because the third party claim was in substance a claim for dishonesty.

[31] The Court of Appeal accepted the insurer's argument, holding that cover depended on the true proximate cause of the insured's third party liability. The insured's argument placed too much weight on the word "alleging" by suggesting that allegations emanating from the third party were all that mattered. The word "alleging" did not limit the Court's inquiry. It was used because the policy was concerned with third party claims and its meaning was broad enough to allow consideration of the real nature of any such liability.

[32] As Clarke LJ explained, the Court's conclusions in *MDIS* were consistent with *West Wake Price & Co v Ching*, in which Devlin J held that an insured would not be liable if a third party claim appeared to be covered by the policy but turned out in reality, when all the facts were known, to be in respect of fraud.[19]

[33] The same approach was taken in *Clasper v Duns*, in which the insurer, QBE, moved to strike out a claim by its insured on the ground that a third party claim alleged dishonest conduct, cover for which was excluded.[20] Panckhurst J accepted that the terms chosen by the plaintiff in formulating the claim did not determine its substance; what mattered was the real basis of the claim.[21] Actual fraud or dishonesty was required, and the question whether either was a proximate cause of loss must await resolution of the third party claim.[22] A similar approach was taken to a strike-out application in *Fussell v Broadbase Christchurch Ltd*[23] and in *Campbell v Stoneman Financial Services Ltd*.[24]

[34] Mr Napier argued that *MDIS* and like cases can be distinguished because the courts there were identifying the true scope of cover by reference to the nature of the claim. In our opinion, that is a distinction without a difference. As the Court in

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19 *West Wake Price & Co v Ching* [1957] 1 WLR 45 (QB) at 51.
20 *Clasper v Duns* [2008] NZCCLR 32 (HC).
21 At [102]–[104].
22 At [117].
23 *Fussell v Broadbase Christchurch Ltd* [2011] NZHC 751, (2011) 16 ANZ Insurance Cases ¶61-913.
24 *Campbell v Stoneman* [2012] NZHC 392, (2012) 17 ANZ Insurance Cases ¶61-945.

MDIS observed, a restrictive approach might disadvantage either party depending on the facts; it might disadvantage the insurer by precluding it from identifying the true proximate cause of the insured's liability, or it might disadvantage the insured by alleging some wrong that the policy did not cover. The outcome would be fortuitous; it might also depend on ill-informed or tactical decisions.

[35] I understood Mr Napier's submission that the third party claim has been resolved by judgment to mean that it was decided by reference to the pleadings at trial. So it was, but I do not accept the premise that in a claim between insured and insurer the court is necessarily confined to the third party pleading. Rather, the court will decide what was the true nature of the claim. That is what the Victorian Supreme Court did, after trial of the action between insurer and insured, in *Major Engineering Pty Ltd v CGU Insurance Ltd*.[25]

[36] Once it is accepted that the court need not take a restrictive approach to the question whether the third party claim alleges a liability "by any act, etc", two points follow. The first is that the context of the policy as a whole may influence the trial court's decision in ways that we cannot presently know. For example, the proposal may prove material. Indeed, Mr Napier recognised this. He pointed to evidence that had QBE appreciated that the insureds might claim cover in connection with leaky buildings, an express exclusion would have been incorporated into the policy. That may prove to be so, but the accuracy and contextual significance of this evidence are matters for trial.

[37] Second, it must follow that the act, etc may prove to have been done in connection with the insured business. I observe that, as this Court held in *IAG New Zealand Ltd v Jackson*, the phrase "in connection with" requires a nexus between one thing and another but the nature and closeness of the required connection always depends on context and purpose.[26] Writing the judgment of the Court in *Jackson*, I went on to say that the connection must be causal or consequential.[27] On reflection, "consequential" may mislead. The term is apt if it is taken to mean, as we did, a

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25 *Major Engineering Pty Ltd v CGU Insurance Ltd*, above n 11, at [36].
26 *IAG New Zealand Ltd v Jackson* [2013] NZCA 302, (2013) 17 ANZ Insurance Cases ¶61-982 at [29].
27 At [29].

connection that need not be causal but which the court decides is of sufficient consequence or significance in the circumstances of the case.[28] Not every temporal or other connection will do. Derrington and Ashton describe the necessary connection as a "discernible and rational link",[29] and greater precision may not be possible in the abstract.

[38] I conclude that QBE cannot establish at this stage that the third party claim is not a Valid Claim for purposes of the policy. Whether that is so should await trial. I would allow the appeal.

Result

[39] In accordance with the views of the majority, the appeal is dismissed.

[40] The respondent will have costs in this Court for a standard appeal on a band A basis with usual disbursements.

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28 *Rian Lane v Dive Two Pty Ltd* [2012] NSWSC 1041, (2012) 17 ANZ Insurance Cases ¶61-924.

29 D K Derrington and R S Ashton *The Law of Liability Insurance* (2nd ed, LexisNexis, NSW, 2005) at [3-127] and 227.

COURTNEY AND CLIFFORD JJ

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[41] We consider that the appeal should be dismissed. We consider that this matter is suitable for summary judgment and that the Associate Judge was right to grant QBE's application. Our reasons are, however, different from those of the Associate Judge.

Insurance for defence costs where liability not proven

Nature of cover for defence costs

[42] The primary purpose of liability insurance is to respond to actual liability since only actual liability can produce any loss that would require indemnity.[30] In comparison, indemnity for defence costs is usually available in response to allegations, so that the insured can benefit from the indemnity as the costs are incurred rather than waiting until the outcome of the litigation is known. However, cover for defence costs is usually ancillary to the indemnity provided for liability to third parties and depends on the claim against the insured being within the scope of the policy.[31] Whether cover for defence costs is ancillary is a question of interpretation but in the context of professional liability policies (and given the availability of separate cover for legal expenses) this is usually the position. That necessarily means that the insurer must make an assessment as to whether the substantive claim against the insured would, if successful, be indemnified.

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30 *AstraZeneca Insurance Co Ltd v XL Insurance (Bermuda) Ltd* [2013] EWCA Civ 1660, [2013] 2 CLC 1029 at [21]–[22].

31 Robert Merkin *Colinvaux's Law of Insurance* (10th ed, Sweet & Maxwell, London, 2014) at [20-086]; *Silbermann v CGU Insurance Ltd* [2003] NSWCA 203, (2003) 12 ANZ Insurance Cases ¶61-571; *Wilkie v Gordian Run Off Ltd* [2003] NSWSC 1059, (2004) 13 ANZ Insurance Cases ¶61-619; *Bank of Queensland Ltd v Chartis Australia Insurance Ltd*, above n 11, at [40]–[42], affirmed on appeal in *Bank of Queensland v Chartis Australia Insurance Ltd* [2013] QCA 183.

[43] In the present case counsel agreed that Mr Johnston's defence costs would not be recoverable if there was not a substantive claim to which the policy would have responded. Therefore, the policy will only respond to meet defence costs and expenses if the claim by the Council against Mr Johnston would, if successful, have fallen within insuring clause 1.

[44] The indemnity provided by insuring clause 1 is for any Valid Claim and the indemnity provided by insuring clause 2 is for costs and expenses "incurred with the written consent of QBE in the defence or settlement of any Valid Claim". It is implicit that QBE would not withhold its consent unreasonably but in order to give its consent, it had to be able to assess the claim as falling within the scope of the insuring clause.

[45] How an insurer assesses whether the claim against the insured is within the scope of the policy for the purposes of the defence costs cover is critical to JCS's appeal. In arguing that the Council's claim was a Valid Claim, Mr Thain relied on the principle that whether a claim against an insured falls within the scope of a liability policy is not to be determined simply by the manner in which the third party claimant elects to plead its claim but by the facts that show the true nature of the claim. That principle is uncontroversial and is articulated in the decisions of *West Wake Price & Co v Ching*[32] and *MDIS Ltd v Swinbank*,[33] on which Mr Thain placed considerable weight.

[46] However, the contexts in which *West Wake Price* and *MDIS* were decided were quite different to the present case. They concerned claims that were brought, ostensibly, in negligence and breach of contract/misrepresentation but where the underlying facts actually indicated dishonesty by the insured. In each case, if allegations of dishonesty had been pleaded and proved the claim would have fallen outside the scope of the policy.

[47] The present case is different because the true nature of the Council's claim was not (and still is not) in dispute. The claim always was, and could only ever have

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32 *West Wake Price & Co v Ching*, above n 19, at 53.
33 *MDIS Ltd v Swinbank*, above n 10, at [22].

been, asserted in negligence. This is not a case where underlying facts would show the true nature of the claim against JCS to be different to that pleaded and JCS does not suggest that. Its appeal is brought instead on the basis that the underlying facts would show that Mr Johnston's conduct was "in connection with" JCS's business. But, even if that were so, it would not be sufficient to prove that the Council's claim was a Valid Claim.

[48] The correct approach to the assessment by the insurer of whether a claim against the insured falls within the scope of the policy for the purposes of defence costs cover is that discussed in *Major Engineering Pty Ltd v CGU Insurance Ltd*.[34] The insured in *Major* held a policy covering legal liability to third parties arising out of its business, which included designing, manufacturing and installing hydraulic equipment. It fitted two hydraulic cylinders to the keel of a racing yacht. The cylinders failed during the 2004 Sydney to Hobart Yacht Race. The yacht owner, Timelink, sued, alleging breaches of contractual terms relating to the fitness and suitability of the hydraulic system. Major was ultimately successful in defending the claim. It sued its insurer for indemnity under the defence costs extension of the policy, claiming the difference between the costs it had recovered from Timelink and its actual defence costs.

[49] The policy provided cover for public liability and product liability (both defined) and for defence costs "for which indemnity is or would be available under this Policy"[35] and which were incurred with the insurer's consent. The insurer successfully defended the action at first instance on the ground that the claim brought against Major did not fall within the scope of the policy and, in any event, would have been excluded. On appeal the insurer conceded that Timelink's claim fell within the operative clause but maintained that exclusion clauses applied. Speaking for the Court, Bongiorno JA said:[36]

> *… where a claim has remained no more than a claim, whether because it has not been the subject of completed litigation or because it has been the subject of litigation which has failed, as in this case, the policy holder is*

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34 *Major Engineering Pty Ltd v CGU Insurance Ltd*, above n 11.

35 This wording simply reflects the general principle that defence costs are ancillary to the substantive liability and the fact that this point is not made expressly in the QBE wording does not alter the application of the general principle.

36 At [27] (emphasis added).

> *entitled to its costs of defending the claim in accordance with the costs extension if indemnity "is, or would be, available under this Policy"*. Thus, the costs extension is available when the claim is one in respect of which the insurer has already admitted liability to indemnify (so that indemnity "*is*" available) or where the claim is a claim which, if successful, would be such as to entitle the policy holder to indemnity. Because, in this case, Timelink's claim failed, no question of actual indemnity arises. *To access the costs extension Major must prove that Timelink's claim against it, if it had been successful, would have resulted in a liability in respect of which Major would have been entitled to indemnity under the Policy.*

[50] Despite the insurer's concession that Timelink's claim fell within the scope of the policy, Bongiorno JA still considered it necessary to address the real nature of that claim in order to reach a conclusion on the application of the exclusion clauses:[37]

> *Having regard to the fact that the claim ultimately failed, that process of characterisation must be undertaken on the hypothetical basis that it succeeded. This, in turn, involves a consideration of the reasons for its failure.* Here, Timelink's claim failed for lack of proof of what was held to be an essential element of its cause of action – namely that the hydraulic cylinders failed at a static load not more than that specified in Timelink's contract with Major. *Major's access to the costs extension must accordingly be considered on the hypothetical basis that Timelink proved its case so that a liability was imposed on Major.*

[51] We agree with this approach. In determining whether an insured is entitled to defence costs after having successfully defended a claim, two questions arise. Both are hypothetical. The first is: if the claimant had succeeded, what is the factual and legal basis on which the insured would have been held liable? The second is: having regard to the true nature of the claim, as identified by the answer to the first question, would the claim against the insured have fallen within the scope of the policy?

[52] In some cases it might be necessary for the court to hear further evidence and argument in order to determine the answers to these hypothetical questions. However, we do not consider that it is necessary in the present case. Counsel advised that, in the event of a trial, neither party would require further evidence to be called and, whilst they are not to be held to that indication, it is difficult to imagine what other evidence might be adduced. The factual and legal basis of the underlying claim has been determined and JCS does not dispute any of Woodhouse J's findings, nor does it suggest that there is any further information that might alter the nature of

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[37] At [28] (emphasis added).

the Council's claim as it appears from the judgment. The only scope for further evidence could relate to the policy. But evidence adduced by QBE without objection on the summary judgment application showed that, had cover been sought for liability arising from pre-purchase advice the policy would have excluded claims resulting from weather-tightness issues. The sole issue is the interpretation of the policy. That is a question of law, well-suited to summary judgment. There is no need for the parties to incur the cost of a trial.

On what basis could the Council's claim have succeeded?

[53] We turn, then, to the first of the hypothetical questions: if the Council's claim against Mr Johnston had succeeded, on what legal and factual basis would it have done so? The Council's claim was for contribution as a joint tortfeasor pursuant to s 17(1)(c) of the Law Reform Act 1936.[38] For the Council to have succeeded on that claim it would have had to prove that Mr Johnston "is or would if sued in time, have been liable in respect of the same damage" as the Council.

[54] The Council was sued in negligence for the cost of repairing the property and consequential losses resulting from the purchase. To succeed against Mr Johnston the Council would have had to show that, had Mr and Mrs Johnson sued Mr Johnston he, too, would have been liable in tort for the same loss; that is, that Mr Johnston owed a duty of care to Mr and Mrs Johnson to give correct pre-purchase advice regarding the condition of the house. It could have done that only by showing that Mr Johnston attended the open home in a capacity that gave rise to a duty to give such advice. The Council's claim failed because Mr Johnston did not make any statements regarding the weather-tightness of the house and the circumstances of his visit did not impose any duty of care to do so. Had Mr and Mrs Johnson sued Mr Johnston their claim would have failed for the same reasons.

Would the Council's claim (had it succeeded) have been a Valid Claim?

[55] If the Council's claim had succeeded on the basis that Mr Johnston had given pre-purchase advice in circumstances that imposed a duty of care, that claim would

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[38] The claim was not specifically pleaded on this basis but the pleading makes it clear that this was the nature of the claim and it is specifically referred to in Woodhouse J's judgment, above n 1, at [5].

not have been indemnified because such conduct would not have fallen within the definition of "Professional Business Practice". That is not to say that Mr Johnston's actual conduct was not in connection with JCS's Professional Business Practice; we consider that it was.

[56] The definition of "Professional Business Practice", although somewhat circuitous, is very specific as a result of the endorsement. In particular, the term "Project Manager" covers only "consultancy, certification or project coordination services" that are rendered "for construction or development projects" and where the services are "rendered for remuneration". However, in the context of an insuring clause the phrase "in connection with" does not require a direct causal link, as explained in *Rian Lane v Dive Two Pty Ltd*.[39] That case concerned a policy covering liability for claims made "in connection with the Insured's Business", which was defined as "Scuba Diving". That term was, in turn, defined narrowly by reference to specific activities. Adamson J said:[40]

> In my view, the words "in connection with the Insured's Business" are apt to include the promotion of the business, whether by way of thanking persons for referring business or by entertaining people with a view to obtaining further business. It is well established that the words "in connection with" ought to be read as extending the scope of the noun they precede and ought not be read narrowly. The words merely require a relationship between one thing and another; *Selected Seeds Pty Ltd v QBEMM Pty Ltd* [2009] QCA 286 at [22]; *Drayton v Martin* (1996) 67 FCR 1 at 32, per Sackville J; *Our Town FM Pty Ltd v Australian Broadcasting Pty Ltd* (1987) 16 FCR 465 at 479 per Wilcox J. Although the connection must be real and not tenuous, I consider that this threshold would be met in this case if I were satisfied that the purpose of the trip was the promotion of Dive Two's scuba diving business.

[57] Taking the same approach, we consider that Mr Johnston's presence at the house for the purpose of securing future work for JCS was sufficiently connected with JCS's business as to fall within the definition of Professional Business Practice. Nevertheless, that is insufficient to prove a Valid Claim because the relevant enquiry is not about what Mr Johnston actually did. It is about his notional liability to the Council and whether such notional liability would have been causally connected to

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39 *Rian Lane v Dive Two Pty Ltd*, above n 28. Compare *IAG New Zealand Ltd v Jackson*, above n 26, which concerned the phrase used in an exclusion clause.

40 At [68].

the conduct that Mr Johnston engaged in as part of his Professional Business Practice. The answer is that it would not.

[58] It is a fundamental principle of insurance law that an insurer is liable only for loss proximately caused by an insured peril,[41] though parties can agree that a causal connection less than proximate cause will suffice.[42] The causal link is typically identified by the use of prepositions or prepositional phrases that carry recognised meanings in the context of insurance policies. The subject matter of the cover, the insured peril and the nature of the causal link required between them are ordinarily identified in the insuring clause.

[59] Insuring clause 1 uses the defined term "Valid Claim" as shorthand to identify these components. The subject matter of the insurance was "legal proceedings … alleging civil liability" (in reality, actual liability, as discussed at [42]). The insured peril was any "act, error, omission or conduct that occurred … in connection with the Insured's Professional Business Practice". The causal link between the two was "by". Proving conduct in connection with its business would only enable JCS to prove the existence of the insured peril. But to prove a Valid Claim JCS also needed to show a link between that peril and Mr Johnston's notional liability, which is represented by the word "by".

[60] In ordinary language "by" is capable of several meanings. One meaning is "through the … means, instrumentality, or causation of".[43] The context of this case requires that meaning to be taken, rather than any of the other possible meanings, because the definition of Valid Claim performs the function of and is structured as an orthodox insuring clause. In order to operate as such it must provide for the fundamental requirement for causation, either by proximate cause or some lesser nexus; that is, there must be a recognisable link between the subject matter and the insured peril. Interpreting "by" in any other way would fail to recognise the context in which it is used.

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41 John Birds, Ben Lynch and Simon Milnes *MacGillivray on Insurance Law* (12th ed, Sweet & Maxwell, London, 2012) at [20-001].

42 At [20-004].

43 Tony Deverson and Graeme D Kennedy (eds) *The New Zealand Oxford Dictionary* Oxford University Press, Auckland, 2008) at 152.

[61] In terms of conveying the necessary causal nexus between the subject matter of the indemnity and the insured peril, "by" has not been the subject of the same level of judicial consideration as have other words used for that purpose. Nevertheless there is some assistance to be had: Derrington and Ashton refer to it as conveying a wide causal connection.[44] In *McCann v Switzerland Insurance Australia Ltd*,[45] the High Court of Australia considered the phrase "brought about by" in the context of a dishonesty exclusion in a professional indemnity policy which covered claims made against the insured in respect of liability incurred in connection with its practice. Kirby J, identifying "by" as the critical word in that phrase said:[46]

> In the modern approach to the construction of contested language, it is usual to look beyond the critical word ("by") or phrase ("brought about by") or sentence (the exclusion clause) to the whole policy. Because the exclusion clause refers back to "liability" it incorporates, by reference, the insuring clause. It is that to which the exclusion is addressed. The insuring clause affixes the liability of the insurers, relevantly by reference to civil liability incurred "in connection with the Practice". Thus there are two large phrases of connection at work … There is nothing in the words of the exclusion clause to require that liability of the kind posited must have been brought about *directly* by the dishonest or fraudulent acts or omissions of a partner. Yet Allens contend that a true interpretation of the exclusion clause includes this adverb. The exclusion clause makes no mention of "direct", "immediate", "proximate" or "effective" cause, but requires only that the liability should have been "brought about by" the act or omission hypothesised.

[62] In a concurring judgment Haynes J said:[47]

> It may be accepted that "brought about by" is an expression which requires a connection between the two elements that are mentioned in the exclusion: a dishonest or fraudulent act or omission being one and the liability being the other. It is necessary to identify the nature of that connection, lest the application of the dishonesty and fraud exclusion be thought to depend upon nothing more than the amount of evidence that is assembled to show that the insured, or a partner or former partner of the insured, acted discreditably.
>
> The language, although redolent of causation, identifies a different kind of connection between the two elements. One of those elements (the liability) is "brought about by" the other (a dishonest or fraudulent act or omission) if the latter is a component of the former. A liability is brought about by a dishonest or fraudulent act or omission only if the liability is one in which

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44 Desmond Derrington *The Law of Liability Insurance* (3rd ed, LexisNexis, Sydney, 2013) at [8-278].

45 *McCann v Switzerland Insurance Australia Ltd* [2000] HCA 65, (2001) 11 ANZ Insurance Cases ¶61-479.

46 At [83]–[84].

47 At [129]–[130].

> that dishonest or fraudulent act or omission could be a material fact in pleading the claim. It is not brought about by such an act or omission simply because there were dishonest or fraudulent acts or omissions committed at about the time of the events giving rise to liability or because those acts or omissions were committed in the course of some overall relationship between the insured and the claimant. To say that there were "circumstances of dishonesty" attending the relationship between insured and claimant does not identify how or why those circumstances bore upon the nature or extent of the liability giving rise to the loss against which the insured seeks indemnity. It is to assert the application of the exclusion without revealing the connection which is said to exist between the liability and the dishonest or fraudulent act or omission. That is why it is necessary to examine the way in which, in the circumstances of the case, the insured was, or could have been, rendered liable to the complainant.

[63] In the present case "by" is used in the insuring clause rather than in an exclusion clause. But even allowing for that, it is plain from the comments made in *McCann* that "by" connotes a causal connection. That means that JCS must show a causal connection between Mr Johnston's notional liability and the conduct alleged by the Council, namely giving pre-purchase advice and failing to identify defects associated with water-tightness issues in circumstances that gave rise to a duty of care.

[64] Whilst Mr Johnston's marketing efforts to obtain project management work can be viewed as being connected with JCS's business, any liability could only have arisen from pre-purchase advice. Such advice would not have fallen within the definition of Professional Business Practice, which identifies very specific parameters. In particular, the only consultancy services that are covered are those provided "for construction or development projects where the services were rendered for remuneration". It is not in dispute that when Mr Johnston attended the property there was no construction or development project on foot, let alone one for which services were rendered. The undisputed facts as to the circumstances in which Mr Johnston attended the property mean that there could never have been an allegation (whether by Mr and Mrs Johnson or by the Council) that he gave advice in a capacity that would satisfy this definition.

[65] For these reasons there is no basis on which Mr Johnston could ever have been liable because of conduct in connection with JCS's Professional Business Practice. It follows that the Council's claim against Mr Johnston was not and never

could have been a Valid Claim under the policy. Had Mr Johnston been held liable, insuring clause 1 would not have responded. That being so, insuring clause 2 does not respond either.

Addendum

[66] Following delivery of our judgment on 25 November 2015, Mr Thain reminded us that we had omitted to deal with an issue raised by the appeal, namely a complaint that the High Court ought to have fixed costs in that Court by reference to the District Court scale. The Associate Judge awarded costs by reference to the High Court Rules, and did so without hearing submissions on costs.

[67] We accept that the Associate Judge ought to have heard the parties on costs. Because they were not heard, we have considered the question afresh. Having done so, we are satisfied that an award on the High Court scale was appropriate, for two reasons. First, as our judgments make clear the issues were not without difficulty. Second, the issues are of some wider significance. The proceeding was properly heard in the High Court.

[68] We accordingly decline to interfere with the award of costs made in the High Court.

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