

# CAPTIVE INSURER AVOIDS INDEMNITY UNDER AMBIGUOUS POLICY

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In a unanimous decision, the NSW Court of Appeal has affirmed that the proper construction of an ambiguously worded clause in an employer's liability policy led to indexation of the policy deductible, and defeated a claim for indemnity under the policy.

## IN ISSUE

- Whether the indexation was intended to apply to the deductible or the sum insured.
- Whether reference to extrinsic material could be had in considering the proper construction of the policy.

## THE BACKGROUND

The respondent was a captive insurer operated by BHP to provide cover to certain entities (including the appellant) for, among other things, losses arising from common law damages claims made against those entities by their employees. It was also required to arrange reinsurance for those entities. The appellant settled a common law damages claim by a former employee who was exposed to asbestos fibres in the course of his employment. The appellant sought indemnity from the respondent under the policy in respect of those losses.

The policy was first issued on 10 May 1977 and was renewed over several years. An endorsement to the policy contained an indexation clause designed to retain the value of the policy as it existed at the time of its inception. Syntactical errors led to ambiguity as to which sum the indexation clause was intended to apply: the deductible or the sum insured. If the former, it was common ground that the indexed deductible (\$1,060,750) would exceed the sum insured (\$1,000,000) at the relevant time and defeat the appellant's claim under the policy.

## THE DECISION AT TRIAL

Hammerschlag J found that, having regard to the subject matter of the policy, the commercial object of the indexation clause (by reference to extrinsic material) and the policy wording itself, the indexation applied to the deductible and the respondent was not required to indemnify.

## THE ISSUES ON APPEAL

The Court of Appeal reconsidered the proper construction of the policy, in particular, the application of the indexation clause, and whether it was appropriate in the circumstances to consider extrinsic material when interpreting the policy.

## THE DECISION ON APPEAL TO THE NSW COURT OF APPEAL

In a unanimous decision, the Court of Appeal affirmed the trial judge's decision. It held that the policy documents were "clearly ambiguous" and that Hammerschlag J was correct in referring to extrinsic material in considering the proper construction of the policy. Material relating to negotiations as to the terms of the policy showed the commercial objective of the indexation clause was to secure reinsurance for certain entities within the BHP group, which would not have been available without indexation of the policy deductible. Further, it was shown that both parties had knowledge that the subject matter of the indexation clause was the deductible.

## IMPLICATIONS FOR YOU

Whilst the respondent successfully avoided indemnity and was awarded costs, this case is a reminder that litigation over policy interpretation can be avoided altogether by clear and unambiguous policy wordings. It confirms that the courts will apply the same principles of construction to resolve ambiguity when interpreting all commercial contracts, including policies of insurance.

*Commonwealth Steel Company Limited v BHP Billiton Marine & General Insurance Limited*  
[2018] NSWCA 242

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