HIGH COURT OF AUSTRALIA

GUMMOW, KIRBY, HEYDON, CRENNAN AND KIEFEL JJ

CGU INSURANCE LIMITED APPELLANT

AND

ANTHONY PORTHOUSE RESPONDENT

CGU Insurance Limited v Porthouse [2008] HCA 30
30 July 2008
S530/2007

ORDER

1. *Appeal allowed.*

2. *Set aside the order of the Court of Appeal of the Supreme Court of New South Wales made on 11 April 2007 and, in its place, order that:*

   (a) *the appeal to that Court be allowed;*

   (b) *orders 3 and 8 made by Judge Balla in the District Court of New South Wales on 23 March 2006 be set aside and in their place order that judgment be entered for the appellant on the respondent's cross-claim; and*

   (c) *the respondent pay the appellant's costs at trial and in the Court of Appeal of the Supreme Court of New South Wales.*

3. *The appellant pay the respondent's costs of the appeal to this Court.*

On appeal from the Supreme Court of New South Wales

Representation

M A Pembroke SC with G Lucarelli for the appellant (instructed by Kennedys)

A J Meagher SC with A J Payne and D F C Thomas for the respondent (instructed by Langes Lawyers)

CATCHWORDS

CGU Insurance Limited v Porthouse

Insurance – Professional indemnity – Barrister's liability policy conforming with *Legal Profession Act* 1987 (NSW) – "Known Circumstance" exclusion – "Known Circumstance" defined to include any fact, situation or circumstance which a reasonable person in the insured's professional position would have thought, before the policy began, might result in someone making an allegation against an insured in respect of a liability that might be covered by the policy – Denial of liability by insurer – Meaning of exclusion clause – Relevance of what insured actually thought – Whether exclusion clause operated by reference to an objective standard.

Legal practitioners – Barristers – Barrister's liability policy conforming to *Legal Profession Act* 1987 (NSW) – "Known Circumstance" exclusion – Meaning of exclusion clause – Whether operated by reference to objective standard – Whether a reasonable person in the insured barrister's professional position would have thought a fact, situation or circumstance known to him might result in someone making an allegation in respect of a liability that might be covered by the policy – Relevance of insured's state of mind – Proper approach to construction of the exclusion clause – Whether error on the part of primary judge demonstrated.

Words and phrases – "a reasonable person in the insured's professional position", "would have thought might result in".

Insurance Contracts Act 1984 (Cth), ss 21, 40(3).
Legal Profession Act 1987 (NSW), s 38R.

1 GUMMOW, KIRBY, HEYDON, CRENNAN AND KIEFEL JJ. This appeal concerns the interpretation and application of an exclusion provision in a policy of professional indemnity insurance. CGU Insurance Limited ("the appellant"), the insurer under the policy, denied liability to indemnify Mr Anthony Porthouse ("the respondent"), a barrister, for losses arising from a successful claim made against him. The insurer alleged that an exclusion from insurance cover (the "Known Circumstances" exclusion) applied.

The policy

2 The policy conformed with requirements set by the *Legal Profession Act* 1987 (NSW) which provided that the Bar Council in New South Wales may not issue a practising certificate to an insurable barrister unless it is satisfied that there is, or will be, in force a professional indemnity insurance policy of a type approved by the Attorney-General[1].

3 The appellant's obligation, as insurer, was to indemnify the insured from 30 June 2004 (the "inception" date) until 30 June 2005, up to the policy limit "for any Claims [made and notified] for Civil Liability to any third party which is incurred by the Insured in the conduct of the Insured Professional Business Practice" (Section 3.1)[2].

4 Cover in respect of specified types of claims for civil liability included claims in respect of a "breach of duty" (Section 3.2(a)), claim investigation costs (Section 3.3) and the legal costs and expenses of disciplinary proceedings or enquiries (Section 3.4). The policy defined "Civil Liability", "Claim", "Covered Claim" and "Proposal". The information given by the insured in the proposal was included in the policy (Section 11.13(d)) and was part of the insurance contract (Section 2.2).

5 Section 6 of the policy contained an exclusion from cover in the following terms:

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1 Sections 38R(1) and 38R(2)(b). Section 403 of the *Legal Profession Act* 2004 (NSW), now in force, is to the same effect and came into operation on 1 October 2005.

2 The use of "Section" follows the policy document.

"What is not covered

We do not cover any of the following Claims (or losses):

6.1 Known Claims and Known Circumstances

(a) …

(b) Claims (or losses) arising from a Known Circumstance, or

(c) Claims (or losses) directly or indirectly based upon, attributable to, or in consequence of any such Known Circumstance or known Claims (or losses) …"

6 "Known Circumstance" is defined in Section 11 ("Words with special meanings") as follows:

"11.12 Known Circumstance

Any fact, situation or circumstance which:

(a) an Insured knew before this Policy began; or

(b) a reasonable person in the Insured's professional position would have thought, before this Policy began,

might result in someone making an allegation against an Insured in respect of a liability, that might be covered by this Policy."

7 Section 2.2 of the policy stated that the insurer relied on the information provided by the insured in the proposal "to decide whether to enter into this contract and on what terms".

The facts

8 The events which give rise to the respondent's claim for indemnity occurred in 2001 and the basic facts are not in dispute.

9 On 17 April 1999 Mr James Bahmad sustained an injury while performing work pursuant to a community service order under the supervision of the Probation and Parole Service. While raking grass on a steep embankment he slipped and fell, injuring his right shoulder. On 16 December 1999 he consulted Cameron Gillingham Boyd, solicitors, concerning his rights to compensation for that injury. In May or June 2001 the respondent was briefed to advise whether

Mr Bahmad had a claim under the *Workers Compensation Act* 1987 (NSW) ("the Workers Compensation Act") or a claim in respect of negligence against the Department of Corrective Services.

10 In a memorandum of advice dated 12 June 2001 the respondent advised wrongly that the Workers Compensation Act did not apply to Mr Bahmad's claim as there had been "no employment for wages". The advice did not refer to the *Crimes (Administration of Sentences) Act* 1999 (NSW) which governed Mr Bahmad's potential action and set limits on common law damages for injuries to offenders undertaking community service[3].

11 As part of a comprehensive programme of tort reform, from about June or July 2001, the New South Wales government foreshadowed proposed restrictions on common law claims for injuries governed by the Workers Compensation Act. The proposed amendments included transitional provisions having the effect that proceedings brought before the commencement date of the legislation would not be affected by the restrictions. It was not contested that it became well known in New South Wales that the commencement date of amendments to the Workers Compensation Act was to be 27 November 2001.

12 On 26 November 2001 the respondent was instructed to draft a statement of claim on behalf of Mr Bahmad.

13 Immediately before 27 November 2001, s 151H of the Workers Compensation Act prohibited damages for economic loss from being awarded unless the injured worker had suffered a serious injury. It is not contested that Mr Bahmad had suffered a serious injury within the meaning of s 151H(2A) as it stood before 27 November 2001.

14 Section 151H was amended[4] to prohibit the awarding of damages unless the injury suffered resulted in a degree of permanent impairment of the injured

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3 Section 122, which commenced on 3 April 2000 and has since been repealed, provided that Divs 1 and 3 of Pt 5 of the Workers Compensation Act applied to any award of damages in respect of personal injuries, incurred while involved in community service work, in the same way as they applied to an award of damages referred to in those Divisions.

4 Item 7 of Sched 1.1 to the *Workers Compensation Legislation Further Amendment Act* 2001 (NSW).

worker that was at least 15% ("the 2001 amendment"). The amendment took retrospective effect on the day the Bill for the 2001 Act[5] was introduced into State Parliament which was 27 November 2001.

15 On 6 December 2001 the respondent provided a draft statement of claim, which was filed on 11 December 2001, naming the State of New South Wales ("the State") as the defendant.

16 On 30 October 2002 the Crown Solicitor's Office wrote to Mr Bahmad's solicitor and for the first time raised the point that the Workers Compensation Act was applicable to Mr Bahmad's claim and that as his injury did not reach the 15% threshold required by the 2001 amendment to that Act, he was not entitled to an award of damages[6].

17 On 4 November 2002 Mr Bahmad obtained an award at arbitration for the sum of $120,687.15 plus costs. Following an application by the State, the matter was listed for a re-hearing in the District Court on 15 May 2003. On that day, the respondent became aware that the State intended to argue that the 2001 amendment to the Workers Compensation Act applied to bar Mr Bahmad's claim. On an application by the respondent, an adjournment of the hearing was granted.

18 On 19 May 2003 Mr Bahmad's solicitor advised him that by reason of the proceedings not having been commenced prior to 27 November 2001 "[i]t may be that the operation of the law shuts you out of any entitlements to claim under any legislation". In the Court of Appeal, Hodgson JA found that in late May and early June 2003 the respondent researched the point raised by the State and satisfied himself that if it were correct Mr Bahmad would lose the case.

19 The case proceeded on 29 August 2003. It was common ground between the parties that if the 2001 amendment to the Workers Compensation Act applied to the circumstances of Mr Bahmad he would be unable to recover any damages. Graham DCJ delivered judgment in favour of Mr Bahmad on the basis that his claim was covered by the provisions of the Workers Compensation Act as it

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5 Section 2(2) of the *Workers Compensation Legislation Further Amendment Act* 2001 (NSW).

6 The letter incorrectly referred to the *Community Service Orders Act* 1979 (NSW), s 26O, rather than the *Crimes (Administration of Sentences) Act* 1999 (NSW), s 122.

stood prior to the 2001 amendment. Graham DCJ ordered an unconditional stay of the proceedings pending an appeal by the State. In opposing the State's request for a stay, the respondent conceded that the State had an arguable appeal point. The State appealed to the Court of Appeal from the judgment of Graham DCJ.

20 Shortly before 2 April 2004, senior counsel retained to appear for Mr Bahmad in the forthcoming appeal from the decision of Graham DCJ conferred with the respondent and indicated that there were reasonable prospects of success in the Court of Appeal.

21 On 20 May 2004 the respondent completed a "Barcover Professional Indemnity Proposal Form" ("the Proposal") for the period 30 June 2004 to 30 June 2005. Question 4 of the Proposal, relevantly to Section 11.12 of the policy, asked: "Are you aware of any circumstances, which could result in any Claim or Disciplinary Proceedings being made against you?" The respondent answered "No". The Proposal contained a statement that the policy did not provide cover in relation to "facts or circumstances [of] which you first became aware prior to the period of cover, and which [you] knew or ought reasonably to have known had the potential to give rise to a claim under this policy".

22 That reference to "the potential" of facts and circumstances to give rise to a claim makes it clear that what is enquired about is the possibility, not the certainty, of a claim being made. Answering that enquiry does not call for the proponent to make any judgment, or draw any conclusion, about the prospects of success of a possible claim or the strength of possible defences to it.

23 It should be noted that it is only the insured's knowledge of these events prior to the commencement of the policy, which needs to be considered when determining whether the exclusion from cover applied.

24 However, for the sake of completeness, it can be noted that on 19 July 2004 the State's appeal was heard and Mr Bahmad then raised with the respondent the question of the negligence of his solicitors. The following day the respondent wrote to his instructing solicitors noting that:

> "The plaintiff has already raised the issue of whether his former solicitors were negligent in failing to file the Statement of Claim prior to 27 November 2001. As I was briefed at that time, and in fact drafted the Statement of Claim, I am obviously in no position to advise on this issue due to a conflict of interest. The plaintiff will need to seek independent advice on this issue."

25 On 27 August 2004 the Court of Appeal allowed the State's appeal and set aside the verdict in favour of Mr Bahmad[7].

26 On 3 March 2005 Mr Bahmad commenced proceedings in the District Court of New South Wales against his former solicitors and the respondent (as second defendant), alleging negligence. The case advanced on behalf of Mr Bahmad was that had his legal representatives acted with reasonable diligence and filed a statement of claim earlier, his claim would not have been caught by the 2001 amendment to the Workers Compensation Act, which commenced on 27 November 2001 and reduced his entitlement to damages to nil. A claim for civil liability arising from the conduct of the respondent's professional practice was thus made and it was duly notified. The insurer, who had declined the respondent's claim for an indemnity, was joined in the proceedings by the respondent (then, the cross-claimant) as a cross-defendant.

The decision of the primary judge

27 The primary judge in the District Court in these proceedings was Balla DCJ. She made numerous findings of fact[8] and held that both the solicitors and the present respondent, the barrister, had been negligent. Her Honour found that the respondent breached his duty of care to Mr Bahmad. Her Honour gave judgment against the respondent and his instructing solicitors for $170,000 plus costs. She apportioned responsibility equally between the solicitors and the barrister, considering that it was just and equitable for them to share Mr Bahmad's loss equally.

28 In relation to the respondent's cross-claim against his insurer, her Honour found that the exclusion in Section 6.1 of the policy, relied upon by the insurer, did not apply.

29 Evidence of the respondent's state of mind as at 20 May 2004, when he completed the Proposal, was elicited during his cross-examination before the primary judge. The cross-examiner asked whether it was the respondent's view, as at 20 May 2004, that whatever happened in the Court of Appeal the plaintiff was never going to make an allegation against him. He responded "I didn't

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7 *State of New South Wales v Bahmad* (2004) 2 AWR 2313.

8 *Bahmad v Gillingham* unreported, District Court of New South Wales, 17 March 2006.

believe I'd done anything wrong and I had no belief at that time that a claim would be made against me no matter what happened in the Court of Appeal." When asked whether he had turned his mind on 20 May 2004 to the question of whether the plaintiff was going to make a claim against him, the respondent answered "[t]here was no cause for me to turn my mind to something which didn't exist, which was the notion that I'd done something wrong in the conduct of this case." These answers show the respondent's concentration upon blameworthiness, rather than upon the possibility of a claim arising.

30 In relation to the first limb of the definition of "Known Circumstance" in Section 11.12(a) of the policy, the primary judge found that:

> "the [respondent] did not know, before the policy commenced, that [Mr Bahmad] might make an allegation of negligence that might be covered by the policy. Accordingly, the first limb of the definition relating to the exclusion does not apply."

31 No appeal was brought from this finding on the respondent's state of mind and, accordingly, the subsequent appeal to the Court of Appeal of the Supreme Court of New South Wales was only concerned with the construction and application of the second limb of the definition in Section 11.12(b).

32 As to the second limb of the definition of "Known Circumstance", her Honour accepted the submission put by counsel for the respondent that it "does not necessarily impose an entirely objective test since it involves a consideration of whether the [respondent's] actual state of mind was unreasonable". In a somewhat elliptical statement, her Honour referred to her findings about the respondent's state of mind at the relevant time and then concluded that "a reasonable person in [the respondent's] position would not have thought otherwise". Her Honour ordered that the insurer indemnify the respondent. The insurer appealed to the Court of Appeal against the order requiring indemnity.

The appeal to the Court of Appeal

33 The Court of Appeal by a majority (Hodgson JA and Young CJ in Eq; Hunt AJA dissenting) dismissed the appeal by the insurer[9]. The essential issue, as framed by the insurer before the Court of Appeal, was whether the primary judge erred by considering the subjective state of mind of the respondent when construing and applying Section 11.12(b) of the policy.

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9 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727.

34 A second issue arose in relation to the proper construction of the conditional expressions in the formulation in Section 11.12: "[a]ny fact, situation or circumstance which … a reasonable person in the Insured's professional position *would have thought*, before this Policy began, *might result in* someone making an allegation …" (emphasis added). The members of the Court of Appeal considered that the formulation containing the conditional expressions referred to a possibility which was "realistic" (Hodgson JA), "reasonable" (Young CJ in Eq), or "real" (Hunt AJA)[10]. Each of those epithets served to distinguish correctly a real possibility from a possibility which is fanciful or remote, or a certainty.

35 Hodgson JA considered that the primary judge had not fallen into error by assessing whether the respondent's actual state of mind was unreasonable[11]. He considered that the question of what a reasonable person in the insured's professional position would have thought before the policy began could be approached by considering what the actual insured did think and asking if this was unreasonable so long as that approach did not distract attention from the ultimate question posed in Section 11.12(b), namely whether that reasonable person would have thought there was a realistic possibility of a claim being made[12].

36 Young CJ in Eq rejected the approach taken by the primary judge but took the view that while the Section 11.12(b) test was objective, "how people in the relevant industry are accustomed to act and even how the actors in the drama before the court behaved forms part of the material to be considered by the tribunal of fact in making the objective assessment"[13]. His Honour concluded that even if the primary judge had fallen into error, any such error did not affect

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10 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,956 [30] per Hodgson JA, 75,958 [46] per Young CJ in Eq and 75,965 [91] per Hunt AJA.

11 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,956 [31].

12 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,956 [31]-[32].

13 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,958 [51].

the result[14]. If required to make his own finding of fact (if the primary judge had erred) his Honour would not have found, on the facts found by the primary judge, that a reasonable person in the respondent's professional position would have had the thought identified in Section 11.12(b)[15].

37 Hunt AJA, in dissent, considered that the test posed by the second limb of the exclusion provision was "solely an objective one"[16] and that the primary judge had erred in her interpretation of the exclusion clause. He said[17]:

> "This clause requires the insurer to establish that a reasonable person in the insured's professional position would have contemplated the real possibility that an allegation of negligence that might be covered by the policy might be made against him."

38 In determining the position for himself, Hunt AJA concluded[18]:

> "In my opinion, the reasonable person in the respondent's professional position would, upon the reflection required by his insurance policy which was at that stage about to commence, have contemplated the real possibility that the plaintiff would, at the very least, make an allegation of negligence against his barrister."

The appeal to this Court

39 There were two main issues of construction before this Court. The first was whether, upon a proper interpretation of the phrase "a reasonable person in

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14 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,959 [58].

15 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,959 [61].

16 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,966 [97].

17 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,967 [98].

18 *CGU Insurance Ltd v Porthouse* (2007) 14 ANZ Insurance Cases ¶61-727 at 75,968 [103].

the Insured's professional position", one was confined to taking into account the insured's experience and knowledge and was not permitted to take into account the insured's state of mind, as to whether "[a]ny fact, situation or circumstance" known to the insured might give rise to an allegation against the insured.

40 The second main issue of construction concerned the correct interpretation to be given to the conditional expressions italicised below, when determining whether the hypothetical reasonable person "*would have thought* [any fact, situation or circumstance known to the insured] *might result in*" someone making an allegation against the insured.

41 The third issue in the appeal concerned the correct application of Section 11.12(b) and whether evidence of what the insured actually thought could be taken into account when determining what the hypothetical reasonable person "would have thought".

42 It is convenient to deal with the main construction issues first.

Applicable principles

43 There was no disagreement about the principles to be applied to the task of interpretation. Gleeson CJ in *McCann v Switzerland Insurance Australia Ltd* said[19]:

> "A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation. Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure." (footnotes omitted)

44 As mentioned, professional indemnity insurance policies, which are compulsory for barristers, are regulated and must be of a type approved by the Attorney-General under legal practice legislation governing the legal profession. An important object of the compulsory scheme is to provide a fund to cover the claims of successful claimants against barristers. Another important object of the

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19 (2000) 203 CLR 579 at 589 [22], see also at 600-603 [74] per Kirby J; [2000] HCA 65; *Wilkie v Gordian Runoff Ltd* (2005) 221 CLR 522 at 528-529 [15] per Gleeson CJ, McHugh, Gummow and Kirby JJ; [2005] HCA 17.

scheme is to cover the costs to barristers of defending claims, including unsuccessful claims, to the extent to which insured barristers would otherwise be out of pocket. A third important object of the scheme is to cover the costs to barristers of defending disciplinary proceedings.

45 Both the respondent and a reasonable person in the same professional position as the respondent would know the nature, scope and objects of the policy under consideration.

"a reasonable person in the Insured's professional position"

46 The language of Section 11.12 is disjunctive, not cumulative. Both sides agreed that the second limb (Section 11.12(b)) provides the objective standard of "a reasonable person". Where the parties differed was on the meaning to be given to the additional words describing "a reasonable person".

47 The appellant submitted that the additional words describing "a reasonable person" as one "in the Insured's professional position" meant that the hypothetical reasonable person would have the same experience as the insured and the same knowledge of any facts and circumstances as the insured had, and the same opportunity to react to such facts or circumstances. The respondent contended that the additional words introduced a subjective element with the effect that the hypothetical reasonable person "stood in the shoes" of the insured[20].

48 In developing the submission that the reasonable person stood in the shoes of the insured, the respondent urged that this meant that the reasonable person had the insured's knowledge of material facts, matters and circumstances, together with the insured's professional qualifications and experience, and that the reasonable person had, in addition, a capacity to draw conclusions which were plain and obvious. Support for this interpretation was based, in part, on s 40(3) of the *Insurance Contracts Act* 1984 (Cth) ("the Insurance Contracts Act"), which refers to the insured's knowledge in providing that an insured under successive "claims made" policies should not be precluded from claiming under both of them. It was submitted that if the appellant's interpretation of Section 11.12(b) were correct, there could be a gap in what was intended to be continuous cover.

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20 *Mount Isa Mines Ltd v Pusey* (1970) 125 CLR 383 at 397 per Windeyer J; [1970] HCA 60. Windeyer J was considering the construct of "the reasonable man" as relevant to the tort of negligence.

49 An insurance contract is a contract requiring the utmost good faith (*uberrimae fidei*) of both parties[21] and it was the law for centuries that a person seeking insurance had a duty to make full disclosure of all material circumstances[22]. The *Marine Insurance Act* 1906 (UK), which codified the common law concerning marine insurance, provided that a circumstance was material if it would influence the judgement of a prudent insurer in fixing the insurance premium, or determining whether the insurer would take the risk[23].

50 In 1980, in the context of an EEC Directive concerning harmonisation of insurance contract law in the European Community, and manifold criticisms of the English law of disclosure, particularly the "prudent insurer" test of materiality, as applied to all classes of insurance[24], the English Law Commission suggested replacing that test. The Commission proposed a test which obliged a person seeking insurance to disclose a fact "if it would have been ascertainable by reasonable enquiry and if a reasonable man applying for the insurance in question would have ascertained it"[25].

51 The Australian Law Reform Commission gave similar consideration to reforming the law of disclosure in insurance contracts in a Report which preceded the Insurance Contracts Act[26]. That Act replaced the common law test of "materiality", assessed by reference to the common law construct of the "prudent insurer".

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21 *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 81 ALJR 1551 at 1556 [15] per Gleeson CJ and Crennan J; 237 ALR 420 at 425; [2007] HCA 36.

22 *Rozanes v Bowen* (1928) 32 Ll L Rep 98 at 102 per Scrutton LJ.

23 *Marine Insurance Act* 1906 (UK), s 18(2).

24 Exemplified in *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep 485.

25 Law Commission, *Insurance Law: Non-disclosure and Breach of Warranty*, Law Com No 104, (1980) Cmnd 8064 at [4.50].

26 Australian Law Reform Commission, *Insurance Contracts*, Report No 20, (1982). See also Sutton, *Insurance Law in Australia*, 3rd ed (1999), Ch 3 esp at [3.65]-[3.71].

52 The statutory test for disclosure now to be found in s 21 of the Insurance Contracts Act focuses on the "reasonable insured", not the "prudent insurer", and operates, first, by reference to the actual knowledge of the insured (s 21(1)(a)), and secondly, by reference to what "a reasonable person in the circumstances could be expected to know" (s 21(1)(b)). That latter statutory phrase has been interpreted as meaning that one should take into account only factors which are "extrinsic" to the insured, such as the circumstances in which the policy was entered into, rather than "intrinsic" factors such as the individual idiosyncrasies of the insured[27]. Whilst it is possible to take into account the circumstances of the insured, the ultimate question under s 21(1)(b) turns on consideration of a reasonable person's state of mind, not the insured's state of mind[28].

53 A test of disclosure, which operates by reference to both the insured's actual knowledge and the knowledge of a reasonable person in the same circumstances, is calculated to balance the insured's duty to disclose and the insurer's right to information. The insurer is protected against claims where the insured's disclosure is inadequate because the insured is unreasonable, idiosyncratic or obtuse and the insured is protected from exclusion from cover, provided he or she does not fall below the standard of a reasonable person in the same position.

54 Whilst Section 11.12 of the policy issued to the respondent by the appellant does not replicate s 21 of the Insurance Contracts Act, it employs a technique for identifying a "Known Circumstance" made familiar by s 21 in that it contains a subjective test in the first limb (Section 11.12(a)) and an objective standard in the second limb (Section 11.12(b)). The objective standard moderates a purely subjective test, and the difficulties of proof to which a wholly subjective test might give rise. It does so by reference to a standard of disclosure of "a reasonable person in the Insured's professional position". The intention of the second limb is to prevent insured persons from avoiding the exclusion provision (Section 6.1) by saying that they did not disclose facts and circumstances because they did not *know* that the facts and circumstances might

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27 *Twenty-First Maylux Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [1990] VR 919 at 925 per Brooking J. This decision was followed in *Dew v Suncorp Life and Superannuation Ltd* [2001] QSC 252 at [21] per Jones J. On appeal this point was not dealt with: *Dew v Suncorp Life and Superannuation Ltd* [2001] QCA 459.

28 *GIO General Ltd v Wallace* (2001) 11 ANZ Insurance Cases ¶61-506 at 75,866 [23] per Heydon JA.

give rise to an allegation against the insured in respect of a liability which might be covered by the policy, even though a reasonable person in the same professional position *would have thought* the same facts and circumstances *might* give rise to such an allegation.

55 The respondent's submission that the second limb was intended to guard the insurer against an obtuse proponent is correct, in the sense that the second limb is directed, not to the state of mind of the insured, but to the state of mind of the reasonable person in the same professional position as the insured. It is that hypothetical person's conclusion as to the possibility of an allegation being made at the relevant time which needs to be ascertained under Section 11.12(b). For this purpose the advantages of hindsight need to be put to one side. To give effect to Section 11.12(b), the conclusion of the hypothetical person needs to be ascertained independently of the subjective test in Section 11.12(a). The error of the primary judge, which was not corrected by the majority in the Court of Appeal, was that she gave no consideration to the Section 11.12(b) standard, which was independent of the respondent's subjective appreciation of the facts and circumstances known to him.

56 The phrase "a reasonable person in the Insured's professional position" in Section 11.12(b) posits an objective standard, with a modification relating to professional, not personal, matters. The phrase describes a hypothetical reasonable person with the experience and knowledge of the insured coupled with the capacity of such a reasonable person to draw a conclusion (whether it is plain and obvious or not) as to the possibility of someone making an allegation against the insured.

57 There is nothing in the context or language of the policy to suggest that there is to be imputed to the hypothetical person the insured's personal idiosyncrasies or the insured's state of mind, which may reflect an unreasonable assessment of "[a]ny fact, situation or circumstance" known to the insured or an unreasonable conclusion about the possibility of an allegation being made.

58 There is also nothing in the language to support reading down a reasonable person's capacity to draw conclusions as limited to conclusions which are plain and obvious. A reasonable person's conclusions may involve matters of judgement. For such conclusions to be reasonable, in the relevant sense, they may need to command a consensus, among those in the same professional position as the insured, that they are reasonable conclusions.

59 The general knowledge and experience of barristers in relation to policies of professional indemnity insurance has already been mentioned. The

respondent's specific knowledge of the facts and circumstances at the relevant time included the following facts: the State did not rely on the argument based on the 2001 amendment until 15 May 2003; the State failed before Graham DCJ; senior counsel briefed on the appeal told the respondent that there were reasonable prospects of succeeding on the appeal; and as at 30 June 2004 Mr Bahmad had not made any allegation against the respondent. These matters were relied upon by the respondent to support an argument that the possibility of an allegation being made against the respondent was not "plain and obvious". The respondent also had knowledge, at the relevant time, of the potential effect of the 2001 amendment to the Workers Compensation Act on his client's case, the pending appeal in Mr Bahmad's case and his own role in creating the problem which gave rise to the State's appeal. The appellant relied principally on those matters to support its position. All of these facts and circumstances known to the respondent are to be imputed to "a reasonable person in the Insured's professional position".

"would have thought … might result in"

60 Once the hypothetical "reasonable person in the Insured's professional position" is established as above, it is then necessary to determine whether the hypothetical person "would have thought [any fact, situation or circumstance known to the insured] might result in" someone making an allegation against the insured.

61 Three preliminary matters can be noted. First, the reference in Section 11.12(b) to "allegations", not claims, emphasises that the expression "Known Circumstance" is not confined to claims likely to be successful. Having regard to the policy as a whole, "allegations" means allegations in respect of claims (successful or not) or in respect of disciplinary proceedings.

62 Secondly, the phrase "before this Policy began" in Section 11.12(b) is a temporal expression meaning earlier in time, no matter how much earlier in time. There is no justification for reading down that expression as suggested by the respondent to mean that the insurer was only intending to exclude cover in respect of what was known *immediately* before the policy was entered.

63 Thirdly, the reference to "[a]ny fact, matter or circumstance" in Section 11.12 is plainly a reference to objective matters and is not a reference to a state of mind or belief.

64 In the context of the policy, the conditional expression "would have thought" is a reference to a supposed conclusion reached by the hypothetical

"reasonable person". Once that person satisfies the condition of being "in the Insured's professional position" and once knowledge of "[a]ny fact, situation or circumstance" known to the insured is imputed to that person, the phrase "would have thought" coupled with the expression to which we give emphasis "might result in" requires a conclusion by the hypothetical person that there was a real (not a fanciful or remote) possibility (not a certainty) of an allegation being made.

Application of Section 11.12(b)

65 It was contended by the appellant that the respondent's "thought processes" were not relevant to any application of the objective standard. The respondent took a different tack and submitted that the question what "a reasonable person in the Insured's professional position would have thought" was capable of yielding different answers. Therefore it was contended that the effect of the second limb of the definition of "Known Circumstance" was that the insurer must prove that no reasonable person in the insured's professional position could have thought otherwise than he did.

66 As both Hodgson JA and Young CJ in Eq remarked, correctly, it is not necessarily an error for a primary judge to take into account evidence of what an insured actually thought in seeking to determine what a reasonable person in the insured's professional position "would have thought". That is a consideration entirely separate from the issue of whether the insured's state of mind in respect of "[a]ny fact, situation or circumstance" known to the insured is to be imputed to the hypothetical person.

67 The evidence of what the insured thought, without more, could hardly suffice as evidence of what a reasonable barrister in the insured's professional position would have thought in circumstances where Section 11.12, read as a whole, includes two separate reference points: the insured's actual knowledge and the standard of "a reasonable person in the Insured's professional position" which moderates the subjective test.

68 While each of the insured and the insurer called expert evidence from senior counsel, their evidence did not go beyond the issue of negligence. A third senior counsel called by the respondent gave evidence limited to issues relevant to Section 11.12(a), namely the respondent's actual knowledge at the relevant time. The primary judge rejected an attempt to tender opinion evidence on the question of what a reasonable person in the insured's professional position "would have thought", partly because of late service.

69 By reference to *Warren v Coombes*[29] the appellant submitted that this Court was in as good a position as the primary judge to make a finding of fact as to what a reasonable person in the respondent's professional position, imputed with knowledge of the facts and circumstances known to the respondent, "would have thought". In supplementary written submissions the respondent, correctly, accepted that the governing principles entitle this Court to draw its own inferences from facts which are relevantly undisputed.

70 The respondent submitted that it was open to the primary judge (and the majority in the Court of Appeal) to conclude that a reasonable person in the insured's professional position would not have reached the conclusion required by Section 11.12(b). It was contended that the appellant had not established otherwise, that the conclusion was not plain and obvious and that the evidence of the insured alone did not provide a basis on which Section 11.12(b) could be applied.

71 There is no doubt that where a claim falling within the policy has been made and notified the evidentiary onus or burden of proof or persuasion is on an insurer that wishes to rely on an exclusion clause[30]. Whether the burden of proof is sustained here, given the state of the evidence, turns on whether there could possibly be any doubt as to what a reasonable person in the insured's professional position would have thought.

72 Evidence of a particular practice or standard of conduct, whether laid down by a professional body or sanctioned by common usage, may be relevant to establishing a standard of care in a case of professional negligence[31], although expressions of personal opinion about what an individual would have

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29 (1979) 142 CLR 531 at 551 per Gibbs ACJ, Jacobs and Murphy JJ; [1979] HCA 9; see also *Fox v Percy* (2003) 214 CLR 118 at 126-127 [25] per Gleeson CJ, Gummow and Kirby JJ, 145-146 [87] per McHugh J and 159-160 [134] per Callinan J; [2003] HCA 22.

30 See, for example, *Alex Kay Pty Ltd v General Motors Acceptance Corp* [1963] VR 458 at 461 per Sholl J.

31 *Boland v Yates Property Corp Pty Ltd* (1999) 74 ALJR 209 at 219 [47]-[48] per Gleeson CJ, 229 [99] per Gaudron J and 230 [110] per Gummow J; 167 ALR 575 at 588, 601, 603; [1999] HCA 64; *Rosenberg v Percival* (2001) 205 CLR 434 at 439 [6]-[7] per Gleeson CJ; [2001] HCA 18.

hypothetically done, if in the same position as a defendant in a negligence action, might be thought to be of little assistance[32]. While the legal criterion here is not the standard of care for professional conduct, similar considerations might arise. It is not inconceivable that an occasion, or set of facts, could arise where it is necessary for an insurer to prove common practices or attitudes in order to prove what a hypothetical reasonable person "would have thought" so as to establish that it is not liable to indemnify the insured.

73 However, the inferences to be drawn from the undisputed facts and circumstances known by the insured in this case are so obvious that the Court is able to evaluate for itself the correct application of the objective standard in the second limb of Section 11.12 of the policy. Given the nature and objects of this particular policy, there can be no real doubt that a reasonable barrister (unable to practise without a policy of professional indemnity insurance), who knew of the potential effect on his client's case of the 2001 amendment to the Workers Compensation Act, and who knew of the pending appeal and of his role in creating his client's problem, would have thought that there was a real possibility that an allegation might be made in respect of a liability which might be covered by the policy. Accordingly, evidence on that issue was not essential and may well have been superfluous.

74 The error of the primary judge, which was not corrected by the majority in the Court of Appeal, was that she gave no independent consideration to the alternative, additional and objective standard stated in Section 11.12(b) of the policy, namely what a "reasonable person … would have thought". In particular, there was no clear foundation for the primary judge's finding that the respondent's knowledge coincided with what a reasonable person in the insured's professional position would have thought and concluded, in respect of the undisputed facts and circumstances known to the insured. Yet the reference in the policy to that consideration afforded an essential criterion that had to be applied. Moreover, it was an important practical protection for insurers. It protected the insurer from a genuine but unreasonable or unrealistic estimate or

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32 *Hawkins v Clayton* (1988) 164 CLR 539 at 573 per Deane J; [1988] HCA 15. See also *Cross on Evidence*, 7th Aust ed (2004) at [29105]-[29125]. Distinctions between the differing uses which might be made of expert evidence, and the differing approaches to the admissibility of such evidence in cases concerning negligence by members of the legal profession, are usefully summarised by Young J in *Permanent Trustee Australia Ltd v Boulton* (1994) 33 NSWLR 735 at 738-739.

understanding of the insured. It introduced a necessary element of objectivity into the final conclusion to be reached. It had to be given proper application in the present case. This, with respect, is where the primary judge and the majority in the Court of Appeal erred.

Conclusions

75 Section 11.12(b) sets an objective standard, with the modification that the insured's professional experience and the insured's knowledge of facts and circumstances are imputed to "a reasonable person in the Insured's professional position". An enquiry about what a reasonable person "would have thought" enquires about real (not remote or fanciful) possibilities; it does not enquire about certainties. When applying Section 11.12 it is not wrong to take into account what an insured thought, as a piece of possibly relevant evidence, but the standard described in Section 11.12(b) is an objective standard, and a question of fact to be determined independently of the insured's state of mind.

Orders

76 The appeal should be allowed. The order of the Court of Appeal of the Supreme Court of New South Wales of 11 April 2007 should be set aside and in lieu thereof it should be ordered that:

(a) the appeal to the Court of Appeal be allowed;

(b) orders 3 and 8 made by Judge Balla in the District Court of New South Wales on 23 March 2006 be set aside and in their place order that judgment be entered for the appellant on the respondent's cross-claim; and

(c) the respondent pay the appellant's costs at trial and in the Court of Appeal.

77 In accordance with an undertaking given by the appellant on the application for a grant of special leave to appeal, the appellant should pay the respondent's costs of the appeal to this Court.