

SOME CHARACTERISTICS OF RECTIFICATION AS AN EQUITABLE REMEDY AS SEEN THROUGH RECENT CASES CONCERNING INSURANCE CONTRACTS

N.B. Rao*

Abstract

This case note reviews three recently reported decisions concerning insurance contracts where the remedy of rectification was considered. This is done with the view of examining some of the salient features of the remedy. As much may be learned about the characteristics of this equitable remedy from instances where it was granted, when compared with other situations where it was not.

Introduction

When an insurer and insured record their agreement in writing, the policy of insurance may fail to reflect accurately some aspects of their common intention. This has important implications for both parties in that the scope of cover as contained in the policy may not reflect accurately what was agreed between the parties.¹

The party seeking rectification has to show what the common intention of the contracting parties was and that a mistake had been made in the written policy which failed to reflect their common intention.

This casenote is a study of the situations in which the equitable remedy of rectification will be granted as seen through recently decided cases concerning insurance contracts.

* LL.B.(London); LL.M. (Nottingham Trent); LL.M.(Wolverhampton); Barrister-at-law (Gray's Inn); Tutorial Fellow, T.C. Beirne School of Law, University of Queensland.

¹ Two such examples are the cases of *Braund v. Mutual Life and Citizens Assurance Co.Ltd* (1926) NZLR 529 and *West's Plumbing Services Pty Ltd v. Trade Indemnity Australia Ltd* (1994) 8 ANZ Insurance Cases 61-214. In the former case the word "accident" was set out without any exceptions whereas in the subsequent policy issued the word had stipulated exemptions from liability for various types of accidents, including those resulting from hernia. Rectification was granted on the basis that the insured had not been given any or any reasonable notice of the exemptions contained in the policy. In the latter case which involved credit risk insurance cover, the insured as a subcontractor incepted cover on the basis that it covered the main contractor's insolvency and also a breach of the "pay when paid" clause in the subcontract. Contrary to the insurer's verbal undertaking, the policy omitted cover against the risk of non-payment. It was held that the insured was entitled to rectification to reflect this.

Inferences from documents are insufficient for the award of rectification

In *Baulderstone Hornibrook Engineering Pty Limited v. Gordian Runoff Limited & others*² BHE successfully tendered for a Federal Airports Commission (FAC) project for the design and construction of the third runway at Kingsford Smith Airport. In particular, BHE was responsible for the design and construction of the retaining walls.

BHE's professional indemnity insurance cover was a multi-layered scheme in which HIH Casualty & General Insurance Limited (HIH) and AMPG were the primary layer insurers. HIH were responsible for the first \$20 million of any claim made against BHE. Gordian Runoff Ltd (Gordian) and CGU Insurance Pty Ltd (CGU) were the upper layer insurers. Gordian as an upper layer insurer was liable for the first \$10 million in excess of the \$20 million primary layer cover which was provided by HIH. The nature of cover was for BHE's legal liability to third parties.

Sydney Airports Corporation Ltd (SACL), the successor to the FAC, became the lessee and operator of the airport and initiated proceedings against BHE for the voids, sink holes and settlement which occurred as a consequence of sand loss from the retaining walls. Although it was held that the Gordian policy was not found to respond to claims against BHE the issue of whether the retroactive date for the policy should be the 26th August 1992 or the 7th August 1992 had to be determined for Einstein J. stated that there was 'a question of common intention and evidence put up for determination'³ in respect of the claim for rectification which had to be dealt with. Gordian's claim was that the retroactive date contained in the schedule of the HIH policy should have been the 26th August 1992 as that was the date on which the FAC entered into a contract with BHE. The 7th August 1992 was the original intended date of the contract between BHE and FAC.

Gordian's case was substantially based on a paper trail and in particular a Pro-Forma Insurance Schedule which showed the retroactive date as 26th August 1992. Gordian's submission was that the mistake occurred on renewal when a Marsh (Sedgwick) employee selected a superseded wording which had the original retroactive date of 7th August 1992 recorded on it. Gordian contended that none of the parties, namely, themselves, HIH or the brokers Marsh (Sedgwick) realised at the time that a mistake had been made. Gordian's claim failed for the following reasons:

- (i) Gordian did not call evidence to prove that a mistake had been made by FAC or BHE in respect of the selection of the retroactive date of 7th August 1992. Einstein J. summed up Gordian's claim for rectification in the following manner:

"... Gordian's rectification suit is reliant upon inferences from documents. The position disclosed in the documents is far too unclear to satisfy the well known tests for rectification."⁴

² (2006) 14 ANZ Insurance Cases 61-701.

³ At 75,522; para.1209 of the judgment.

⁴ At 75,526; para.1221.

To change the retroactive date would Einstein J. continued:

“... make commercial nonsense of the multi-layered scheme of insurance specifically underwritten with respect to the third runway project.”

This was because the first layer covers issued by HIH and CGU would have a retroactive date of 7th August 1992 whereas the retroactive date in the Gordian contract would be 26th August 1992;

- (ii) Further, Gordian had not pleaded or sought to prove that any mistake had been made on the part of HIH and FAC on the part of BHE in agreeing to a retroactive date of 7th August 1992;
- (iii) Gordian did not call any witnesses from HIH or FAC or Sedgwick (the brokers) to give evidence of any alleged mistake in the recording of the retroactive date at renewal as 7th August 1992 instead of 26th August 1992. This omission according to Einstein J was fundamental to the claim for rectification as the HIH policy had been specifically taken out for breach of professional duty in respect of the design and construction of the third runway project and a difference in the retroactive dates between Gordian’s policy and the first layer insurers would according to Einstein J:

“... clearly be wholly anomalous to the efficient and sensible operation of the project specific scheme of insurance”;⁵

- (iv) Even if parties had intended the retroactive date to be the 26th August 1992, Gordian’s failure to call oral evidence to substantiate this ‘would permit an inference that parties did not continue to hold such an intention’.⁶

The requirement of a common intention of the parties not being reflected in the agreement was reiterated.⁷ This common subjective intention of the parties should also be objectively discernible ‘from the words or actions of each party’⁸ and there was the need for convincing proof of such common intention. In touching upon the issue of the standard of proof in rectification cases, Einstein J stated that although it was a civil standard on a balance of probabilities, the evidential onus on the party seeking it was high, in that it had to be established in the clearest and most satisfactory manner.⁹

Another recent case where rectification was not granted as mere inferences from documents were considered to be insufficient was *Taylor v. Dexta Corp.Ltd.*¹⁰ at first instance. Taylor, the Plaintiff was a beneficiary under a home warranty insurance policy issued to a builder, Mortcom Group Pty Ltd (the company) which was at the time of this case known as BP Group Pty Ltd (in liq.). The building

⁵ At 75,526; para.1227.

⁶ Ibid., para.1219.

⁷ At 75,522; para.1219(iii).

⁸ Ibid., para.1210 (iv).

⁹ Ibid., at para.1210 (v). Einstein J. was citing from *Fowler v. Fowler* (1859) De G and J 250 at 265.

¹⁰ 55011/05, 2005 NSWSC 974; (unreported).

contract had been entered into on 27th September 2001 and the policy period was from 16th November 2001 to 16th November 2002. The policy also specified the retroactive date as 16th November 2001.

Part A of the policy entitled "Building Owners Indemnity" set out the scope of the indemnity including coverage for loss or damage arising from non-completion of work. The specified coverage periods were one year following the commencement date which was 16th November 2001 according to the schedule. The cover was for loss arising from cessation of work and seven years for other loss and damage. Part B entitled "The Contractor's Responsibility" stated in Clause 1 that the policy would cover contracts entered into between the retroactive date specified as 16th November 2001 in the schedule. The commencement date would be in accordance with Part A of the policy.

Two things worthy of note were firstly that the total value of the contract works were declared by the company as \$1.4 million and although the Plaintiff's house was not specifically mentioned by the company to insurers, the company's brokers had advised insurers that the estimated contract value included a six unit residential development and (with reference to the Plaintiff's property) a \$300,000 home at Newport, Sydney. Accordingly, Plaintiff's counsel's contention was that as the six residential units had been declared at \$183,000 each and the Plaintiff's house (although not specifically identified) at \$300,000 and the premium had been calculated and paid for estimated contract value at \$1.4 million, the insurers had no basis for stating that the Plaintiff's property was covered. The Plaintiff's stance was that the policy period should commence on the 27th September 2001 or alternatively that this should be the retroactive date.

The Defendants relied heavily on the policy commencement date and retroactive date as 16th November 2001 and also submitted that when the certificates and the policy document were sent to the company's brokers there was acceptance by the company, without demur. This negated common intention as no specific mention had been made of the company's contract with the Plaintiff dated 27th September 2001. On the issue of the premium weighted against the contract value, the defendants contended that the relevant correspondence on behalf of the company gave only estimated values and no information was provided by the company as to actual contracts entered into and the estimated value.

In considering the documentary evidence, Nicholas J. stated:

"... In my opinion the documentary evidence negates the basis of the Plaintiff's claim, and makes plain the agreement of the parties as expressed in the terms and conditions of the schedule and the policy and, accordingly, the claim for rectification should be denied ... There is nothing in the evidence which indicates that the insurer intended to cover a contract entered into outside the policy period. This is not surprising as it was never informed by the company that there existed such a contract for which insurance was sought."¹¹

¹¹ Paragraphs 49 and 56 respectively of Nicholas J's judgment.

Another reason that Nicholas J. advanced as to why the plaintiff was unsuccessful was that no evidence was called to show what the subjective intention of the parties was. What was relied upon was documentary evidence in the form of the respective brokers' correspondence relevant to policy issuance. The plaintiff appealed.

Taylor v. Dexta Corporation Ltd. ¹² (on appeal)

The policy should be construed so as to give effect to the real intention of the parties as gathered from the instrument as a whole.

The above stated rule of construction was applied on appeal. The appeal was on the basis that it challenged the conclusion of the trial judge that the policy properly construed, did not cover the appellant's house construction. It is instructive to note that at this stage, the appellant abandoned the claim for rectification of the policy. The New South Wales Court of Appeal reversed the decision at first instance and held cover for the appellant. Five reasons may be discerned from the judgment of Santow JA. These are:

- (i) Allianz, the insurer, accepted the premium for the policy taking into account the fact that the appellant's house construction was included in the scope of cover;¹³
- (ii) it was not in dispute that the premium quoted and paid was calculated at 0.219% of the estimated value of all the projects for the relevant period at \$1.4 million. This necessarily included the appellant's building contract. Moreover, the builder's brokers had identified in the course of estimating the contract value of \$1.4 million, the appellant's building contract as well;¹⁴
- (iii) in interpreting the policy, attention had to be paid to the language used by the parties, the commercial circumstances which the document addresses and the objects which are intended to be secured. The objective in this particular instance, was for the builder with a statutory obligation to insure, with the insurer being advised of the construction work to be insured.

Santow J. stated:

" ... In short, such an interpretation addresses the circumstances to which the policy words were used, namely the mandatory requirement under the Act for such insurance, being the genesis of the transaction of entry into the policy in order to fulfill that purpose."¹⁵

- (iv) the trial judge had erred in concluding that the first paragraph of clause (1) of Part B of the policy provides the means for identification of the contract for which the insurer was liable to provide indemnity under Part A. As Part

¹² 40847/05, 2006 NSWCA 310 (unreported judgment). BC200609064.

¹³ at para.12.

¹⁴ at para.15.

¹⁵ at para.57.

A, reasoned the Trial Judge, had set out the retroactive date as well as policy commencement date as 16 November 2001, the Appellant's building contract entered into prior that date, was thereby excluded. Santow J. indicated that Part A with reference to the retroactive, commencement and concluding dates of the policy was stating these dates as a "Period of Insurance" which did not preclude the insurance itself from applying to building contracts entered into prior to the policy period. Part B was a stand alone clause with no relationship to Part A, as the heading immediately above Part B was "Retroactive Date Applicable to Part B".¹⁶

- (v) the next issue dealt with was the inconsistency between the schedule and Part A. The schedule it should be noted bore the commencement and retroactive dates as 16 November 2001. Primacy was to be given to the operative provision of the policy, namely Part A. "Chitty on Contracts" was referred to as well as the relevant cases in Santow J's judgment.¹⁷

Ipp JA concurring with Santow JA stressed on the purpose for which cover was obtained, which was to fulfill the builder's statutory requirement and the fact that the total value of the building contracts at \$1.4 million included the contract for the appellant's building contract. The common intention of the parties rested in the fact that the insurer knew that builder was aware of the statutory requirement to obtain cover. Moreover, the premium was calculated taking into account cover for the appellant's building contract.¹⁸

Distinguishing features between *Taylor v. Dexta* and the *BHE v. Gordian Runoff* case

In *Taylor v. Dexta Corp.Ltd.* the plaintiff's plea for rectification at first instance was unsuccessful because no oral evidence was called to show the common intention of parties. The plea of rectification was not advanced at the appellate stage as it was thought that there were sufficient indicators from the policy as well as pre-contractual correspondence for cover to be found for the appellant. The Court of Appeal took into account the fact that there was no dispute that the premium had been calculated taking into account the estimated value of the builder's contract for the appellant's property, although the specific contract was not disclosed. There were sufficient indicators pointing towards coverage not the least of which was the statutory duty that the builder had to comply with by seeking the policy.

In the BHE case on the other hand, the common intention of the parties could not be established. In fact, the opposite was indicated by documents in relation to the

¹⁶ at para.60.

¹⁷ Para.66 of the judgment; The passage from "Chitty on Contracts" (2004) at para 12-078 states: "where the different parts of an instrument are inconsistent, effect must be given to that part which is calculated to carry into effect the real intention of the parties as gathered from the instrument as a whole, and that part which would defeat it must be rejected."

Some of the relevant cases to support the principle in Chitty and cited therein are *Love v. Rowtor Steamship Co.Ltd.* (1988) 2 Lloyd's Reports 18, *AMP Financial Planning Pty Ltd. v CGU Insurance Limited* (2004) 13 ANZ Insurance Cases 61-624 and *Sabah Flour and Feedmills Sdn.Bhd v. Comfez Ltd.* (1988) 2 Lloyd's Reports 18.

¹⁸ paras.90 and 91 of the judgment.

retroactive date which was held to stand at 7th August 1992 in line with primary cover. No proof was adduced to show that the recording of 7th August 1992 as the retroactive date at renewal of the Gordian policy was a mistake. A mere allegation of mistake it cannot be gainsaid, was insufficient.

Where rectification is unnecessary. *Green v. AMP Life Limited & Ors.*¹⁹

Where there is no common subjective intention that policy variations agreed upon orally only take effect after they have been reduced to writing, rectification is unnecessary. In this instance the trustees of the Income and Agency Protection Plan (the plan) had obtained an insurance policy with AMP Life Limited (AMP).

The scheme was that a person became insured under the plan by the trustees nominating that person to AMP. By 2nd November 1999 agreement had been reached between the trustees and AMP that the policy would be amended with effect from 1st January 2000 by introducing the mental illness limitation. These changes were also set out in Customer Information Brochure (CIB) Issue 5. The limitation was to the effect that if an insured suffered mental illness and as a consequence was totally disabled and prevented from carrying out his or her usual occupation, benefits under the plan would be restricted to two years. Green, an agent of AMP Life, marketed insurance policies underwritten by AMP.

On the 18th December 2000 Green completed one of the application forms at the back of the CIB Issue 5 which also fully incorporated the changes brought about by 1 January 2000 amendments introducing the two year time limit for payment in instances of mental illness. Approximately 10 months after Green had obtained cover he was diagnosed as suffering from severe dysautonomia, depression anxiety and panic attacks. His mental condition rendered him completely unfit to carry on with his occupation. He sought payments under the Total Disablement Benefit, which he was paid for 2 years. Green brought proceedings against AMP on the basis of the policy document in its original form which contained no mental illness limitation. He sought benefits which would have accrued till the age of 65 or alternatively a declaration that the policy without the variations remained on foot. AMP in turn cross-claimed, seeking a declaration that the policy contained a two year limitation on benefits, or alternatively rectification of the policy to include the two year limitation in it.

There were two key findings of fact by Campbell J. The first was that the mental illness limitation had been put into effect from 1st January 2000. A clear indication that this was so was borne out by the fact that the Trustees were dissatisfied with the agreement and were seeking, unsuccessfully, to change it.²⁰ The second was that the plaintiff had a complete copy of the CIB Issue 5 which contained the two year limitation. As the plaintiff was an experienced agent, the insurer had every reason to believe that he had obtained cover on terms which included the mental illness limitation.²¹ As the plaintiff had sued on the original policy wordings which he had received, without the mental disability limitation clause it was necessary for Campbell J. to state that there was no statutory requirement under the Life

¹⁹ (2005) 13 ANZ Insurance Cases 90-124.

²⁰ At 86,653; para. 99.

²¹ At 86,656; para.109.

Insurance Act 1995 (Cth) for a policy of life insurance (such as this was) to be in writing, thus obviating the need for the mental disability limitation clause to be in writing.²²

With regard to the issue of rectification it was deemed to be unnecessary to grant it as a common subjective intention that the mental disability limitation was applicable with effect from 1st January 2000 had been formed by both the trustees of the Income Protection Plan and the insurers. Neither the trustees nor the insurers hold the notion that the mental disability limitation would only become effective after it was inserted into the policy itself. CIB Issue 5 had made the limitation amply clear.²³ Therefore the subsequent Memorandum of Alteration to the policy was not designed to limit the plaintiff's claim but to facilitate what had been agreed to between the trustees and insurers in October 1999.²⁴

Consequently, as there was no common subjective intention that policy variations, namely the mental disability limitation, would only take effect after it had been reduced to writing and incorporated in the policy document, rectification was unnecessary. Green appealed and the first instance decision was upheld by the New South Wales Court of Appeal.²⁵

Conclusion

The salient features of the equitable remedy of rectification which emerge from the above cases are:-

- (i) the common subjective intention of the parties that a certain aspect which should have been included, has been omitted, is an assertion that the party seeking rectification should be able to establish. The common subjective intention should be capable of being ascertained objectively;
- (ii) evidence has to be called as to the relevant words or actions of the respective parties at the pre-contract stage which substantiate objectively that the omitted aspect ought to be included. Mere inferences from documents are insufficient;
- (iii) although the standard of proof that is required is on a balance of probabilities, proof of the common subjective intention has to be established in the clearest terms;
- (iv) where the common subjective intention of the parties can be made out from the policy itself, it is unnecessary to invoke rectification;

²² At 86,651, para.87.

²³ At 86,667; para.179 of Nicholas J's judgment:

"... It was not the subjective intention of any of them, however, that no such amendment to the terms on which insurance was offered under the Plan would be effective until such a document had been executed."

²⁴ At 86,666; paragraphs 175 and 176 of the judgment dealing with the evidence of Kevin McClean, one of the trustees.

²⁵ (2005) 13 ANZ Insurance Cases 90-125.

- (v) rectification will not be granted if the aspect that is claimed to have been omitted, has been agreed orally and parties have been acting in a manner tending to indicate this. Reducing such an agreement is then a mere formality and the grant of rectification is unnecessary.

Rectification has evolved as an equitable remedy. Where originally it was meant to rectify errors on the face of the record, it has advanced through time to be awarded in instances of common mistake and unilateral mistake. This would, however, be a matter worth separate analysis.