NEWSLETTER

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Commercial Litigation Newsletter

Welcome to our August Commercial Litigation newsletter

This edition of the newsletter includes articles on:

- the application of the Insurance *Contracts Act 1984 (Cth)* in *Maxwell v Highway Hauliers Pty Ltd*
- a review of the new *Vexatious Proceedings Act* 2014 (Vic)
- an update on the impact of mortgage fraud on lenders in *Perpetual Trustees Victoria Limited v Xiao & Anor*
- the equitable right of contribution and shared liabilities of co-guarantors to a loan in *Lanvin v Toppi* [2015] HCA 4.

Please do not hesitate to contact us if you would like more information on any topic, whether covered in this newsletter or not. We hope you find the newsletter informative and useful.

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Application of the *Insurance Contracts Act* in *Maxwell v Highway Hauliers Pty Ltd*

Background

The *Insurance Contracts Act 1984* (Cth) (**Act**) was introduced to ensure that insurance contracts operate fairly and to strike a balance between the interests of insurers, insured parties and other stakeholders.

Section 54(1) of the Act provides that an insurer cannot refuse to pay a claim by reason of some act or omission of the insured where:-

1. the effect of the contract of insurance would, but for section 54(1), be that the insurer may refuse to pay a claim by reason of some act or omission;
2. the act or omission occurred after the contract of insurance was entered into;
3. the insurer is refusing to pay the claim by reason only of that act or omission; and
4. the act or omission could not reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover was provided by the contract of insurance.

Where section 54(1) applies, the insurer's liability is reduced by an amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of the relevant act or omission.

In the recent decision of *Australia in Maxwell v Highway Hauliers Pty Ltd* [2014] HCA 33, the High Court unanimously found that the plaintiff insurers could not deny indemnity to the defendant in respect of damaged vehicles by reason of the drivers' lack of qualifications.

Facts

Highway Hauliers Pty Ltd (**Insured**) owned a fleet of vehicles which included prime movers and trailers which could be linked together in combinations known as "B Doubles". The vehicles were insured under a contract of insurance with Lloyd's Underwriters (**Insurers**) for the period 29 April 2004 to 30 April 2005.

The insurance policy provided that the insurers would indemnify the insured for loss, damage or liability incurred subject to the conditions of the policy.

One section of the policy provided that no indemnity was available for a B Double unless the driver of the B Double "has a PAQs driver profile score of at least 36, or an equivalent program approved by [the Insurers]".

The PAQs driver profile referred to psychological testing of a driver's attitude towards safety conducted by People and Quality Solutions Pty Ltd.

During the period of insurance, two B Doubles were damaged in separate accidents. The Insurers refused to indemnify the Insured by reason of the fact that each of the damaged vehicles had been driven by a driver who had not undertaken the PAQs test or an equivalent test approved by the Insurers.

High Court Decision

The Insurers conceded that the fact that the vehicles were driven by untested drivers could not reasonably be regarded as being capable of causing or contributing to any loss incurred by the Insured as a result of each accident. The Insurers also conceded that their interests were not prejudiced.

The sole issue was whether section 54(1) of the Act applied. The Insurers argued that a claim for indemnity in respect of a vehicle driven by an untested driver was entirely outside the scope of cover and did not attract section 54(1). The Insurers submitted that the fact that the drivers were untested was a characteristic that removed the accidents from the scope of cover and therefore the operation of section 54(1).

The High Court agreed with the trial judge and the Court of Appeal in finding that no distinction could be made between provisions which define the scope of cover (such as the section in question) and other conditions affecting an entitlement to claim indemnity.

Comment

The High Court decision in *Maxwell v Highway Hauliers Pty Ltd* confirms that section 54(1) of the Act provides a high level of protection to insured parties and that it is difficult for insurers to deny indemnity where breach of a policy term occurs after the contract of insurance is entered into and the breach is not connected to actual loss. Section 54(1) will also apply regardless of the way in which a policy term is expressed.

Authored by: **Katherine Wangmann**

Contact: **Joe Naccarata**, Partner and Head of Insurance & Risk

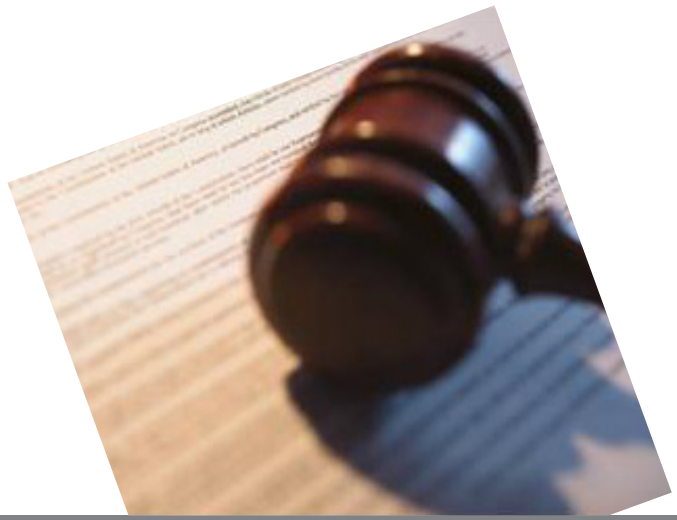
Review of the *Vexatious Proceedings Act 2014*

The new *Vexatious Proceedings Act 2014* (Vic) (**Act**) commenced on 31 October 2014 and outlines a new regime for the courts and VCAT to deal with vexatious litigants.

What is vexatious litigation?

Vexatious litigation is legal proceeding is designed to harass, annoy, delay or cause detriment to another, is an abuse of process, commenced or pursed without reasonable grounds, or is brought for another wrongful purpose.

Traditionally, the Courts have focussed on the nature and substance of the particular proceeding in determining whether a proceeding is vexatious. The Act broadens the definition of vexatious litigation to include proceedings to allow the Court to look at the conduct of the litigant in a particular proceeding, which may be vexatious regardless of the intentions of the litigant.



Previous regime

Previously, only the Supreme Court had the power to make declarations to prevent a person from commencing or continuing proceedings without leave of the Court, where a person had habitually, persistently or without reasonable grounds commenced vexatious legal proceedings.

The application of this provision was limited, as only the Attorney General could make application to the Court for an order under the provision. Further, the threshold for making such a declaration was high, and consequently could only be issued after numerous proceedings have been issued by the subject vexatious litigant.

New Act

The new Act provides all Victorian Courts and VCAT to intervene in the early stages of a proceeding and provides suitable barriers to prevent further vexatious litigation.

The Act provides three tiers or levels of order that can be made in respect of a vexatious litigant, to provide flexibility to the Court in dealing with varying degrees of vexatious behaviour, depending on the litigation history and past behaviour of the vexatious litigant. These provisions of the Act expand on the previous regime, allowing the Court to take into account interlocutory applications and appeals from interlocutory decisions when determining the person's litigation history, where previously, this could not be considered.

In contrast to the previous regime, a party to the proceeding or any person with a sufficient interest in the proceeding is able to make an application for a litigation restraint order. To prevent any abuse of this feature, the Court must grant leave to these parties to make the application, but leave will be granted by the Court provided there is merit to the application and it would not be an abuse of process.

Litigation Restraining Orders

Limited Litigation Restraint Order

This order can be made by any Victorian Court or VCAT pursuant to section 11(1) of the Act where a person has made two or more vexatious applications in a proceeding. The effect of this order is to restrict a vexatious litigant from making or continuing an interlocutory application for the duration of the proceeding without leave of the Court. However, the litigant is not precluded from commencing other proceedings.

Extended Litigation Restraint Order

Pursuant to section 17(1) of the Act, an Extended Litigation Restraint Order can be made against an individual who has persistently brought vexatious litigation against a specific person or entity. This order restricts the vexatious litigant from continuing or commencing proceedings against the person or entity specified in the order without leave of the Court.

General Litigation Restraint Order

A General Litigation Restraint Order prevents a vexatious litigant from continuing or commencing a proceeding in a Victorian Court or tribunal (section 30(1) of the Act) for a period specified by the Supreme Court. This order can only be made by the Supreme Court pursuant to section 30(1) of the Act when it is satisfied that a person persistently and without reasonable grounds commenced or conducted vexatious proceedings.

Other features of the Act

Leave to Proceed with Litigation

A vexatious litigant that is subject to a Litigation Restraint Order would need to seek the leave of the Court or tribunal to commence another proceeding or interlocutory application. The Act imposes a strict threshold test for granting leave, which will only be granted where the court is satisfied that the proposed application or proceeding is not vexatious and that is has reasonable grounds.

The other parties to the proposed proceeding or application will not be notified of the application unless the Court is considering granting leave, at which time they will be given an opportunity to oppose the application. The applications will, except in exceptional circumstances, will be done on the papers, which will result in a significant cost saving to the parties.

Acting in Concert Orders

The Court will also have the power to make any orders it sees fit in respect of people acting in concert with a person who is subject to a Litigation Restraining Order. This will include making a Limited or Extended Litigation Restraining Order against those persons. These orders are designed for example to prevent a vexatious litigant commencing proceedings in the name of a company they control rather than in their own name.

Appeal Restriction Orders

The Supreme Court, and to a lesser extent the other Courts and VCAT, also has powers to limit the rights of a vexatious litigant to appeal a decision of the Court to refuse leave to commence or proceed with a proceeding or interlocutory application. The Court can only make such orders where it is satisfied that the person has frequently made vexatious applications for leave to proceed, and it is in the interest of justice to make the orders.

First Use

The first decision under the Act was in respect of an application brought by the notorious Hoddle Street murderer Julian Knight, who had previously been declared a vexatious litigant pursuant to the provisions of the *Supreme Court Act 1986* (Vic).

Pursuant to the Act, any person who was previously declared a vexatious litigant under the old regime is deemed to be subject to General Litigation Restraint Orders, and requires leave of the Court to proceed with any interlocutory application or new proceeding.

Ginnane J denied leave to Knight to commence proceedings to challenge various powers of the Secretary of the Department of Justice in relation to prisoner separation and removal of privileges. In doing so, His Honour confirmed that the test for leave under the Act required Knight to convince the Court that the proceeding was not a vexatious one as defined by the Act, and that there are reasonable grounds for the proceeding. Knight did not have to demonstrate to the Court that he would succeed in the proceeding. This threshold for leave is considered significantly higher than under the previous regime.

His Honour also found that his decision to refuse leave would not have been different under the old test applicable under the *Supreme Court Act 1986* (Vic).

Potential developments include whether the Act will be used by civil litigants seeking the less restrictive restraint orders available, and the sorts of proceedings for which litigants may be refused leave under the new test.

Authored by and Contact: **Bianca Quan**, Senior Associate, Commercial Litigation

An update on the impact of mortgage fraud on lenders

Background

In the case of *Perpetual Trustees Victoria Limited v Xiao & Anor* [2015] VSC 21, Mr Fitzgerald transferred property to his wife, Ms Xiao, which was then used to secure a loan procured from Perpetual in Xiao's name. Fitzgerald was not eligible to obtain the finance in his own name due to his poor credit history.

Fitzgerald forged his wife's signature on the mortgage, the loan agreement and all accompanying documents, including a transfer of the property back to Fitzgerald from Xiao, and a declaration of trust. The mortgage was an "all monies" mortgage, with the covenant to pay included in the loan agreement and determined by reference to all present or future amounts owing under any agreement between Xiao and Perpetual.

Following default under the loan and mortgage, Perpetual commenced proceedings against Xiao seeking possession of the mortgaged property and repayment of the amounts advanced.

The Position in Victoria

There is no disputing that on registration, the mortgage is indefeasible, and the mortgagee is entitled to rely on the registered mortgage. The indefeasibility of the mortgage will not be lost in the case of fraud, unless the mortgagee has knowledge of the fraud or is somehow a party to it. The question in the case of fraud is what, if anything, is secured by the mortgage.

In circumstances where the mortgage document which is registered with the Land Registry specifically states the amount lent and the obligation to repay (the covenant to pay), the Courts

have found that the mortgage is effective security for the amount in the document. A difficulty arises however in the case of an "all monies" mortgage, where the covenant to pay is not specified on the mortgage document itself, but is contained in and determined by reference to forged loan documents.

Until *Xiao*, the decision in *Solak v Bank of Western Australia Limited* [2009] VSC 82 served as authority in Victoria that where the loan agreement and mortgage documents are forged by the same person, the documents could be construed as being effective security for the loan.

Decision in Xiao

In determining whether the mortgage forged by Mr Fitzgerald was effective security for Perpetual's loan, Hargrave J departed from the reasoning in *Solak*. His Honour held that where a lender relies on a mortgage containing a covenant to pay by reference to monies owing under another agreement, and that agreement is forged, there can be no 'secured agreement' for the purposes of the mortgage and therefore, no 'secured amount'. In such instances, the amount that the mortgage secures is nil and the mortgagee is unable to enforce the mortgage to recover the amount advanced to the borrower.

Whilst Perpetual was unable to enforce its mortgage to recover the amount owed, Mr Fitzgerald was ordered to repay the amount owing to Perpetual, with the Court also finding that the property was held by Xiao on trust for Fitzgerald, such that Fitzgerald had a beneficial interest in the property.

An application by Xiao for leave of the Court to appeal the decision of Hargrave J has recently been refused.

Moving Forward

The case of Xiao has changed the legal landscape when it comes to dealing with mortgage forgeries, pulling Victorian jurisprudence in line with what has been settled law in NSW for some time.

Accordingly, lenders will need to consider their lending practices, balancing the flexibility of all monies mortgages with the risk of such mortgages being ineffective security in the case of fraud. Lenders must take particular care to have robust processes and procedures in place, not only to minimise any possibility of fraud, but also to ensure compliance with the verification requirements imposed by recent amendments to the *Transfer of Land Act 1958* (Vic).

Authored by and Contact: **Bianca Quan**, Senior Associate, Commercial Litigation

The equitable right of contribution and shared liabilities of co-guarantors to a loan

In the recent case of *Lavin v Toppi* [2015] HCA 4, the High Court considered the equitable right of contribution and shared liabilities of co-guarantors to a loan. In unanimously dismissing the appeal, the High Court affirmed the NSW Supreme Court of Appeal's ruling and held that a creditor's covenant not to sue a co-guarantor did not extinguish the rights of a co-guarantor to recover from another co-guarantor.

Background

Ms Lavin and Ms Toppi were directors of, and equal shareholders in, a photography company named Luxe Studios. In 2005, Luxe purchased a property in Sydney which was funded by loans from the National Australia Bank (**NAB**), secured by a guarantee from Ms Lavin and Ms Toppi and other associated parties. The loan contained a clause whereby the co-guarantors agreed to repay the balance of the loan when due, or on demand in the event of default under the loan agreement.

Receivers were appointed to Luxe in November 2009, being an event of default under the loan agreement. In March 2010, NAB demanded payment from the co-guarantors for payment of the loan balance outstanding. Luxe sold the Sydney property but remained indebted to NAB for over $4 million for which NAB commenced action against Ms Lavin and Ms Toppi. In July 2010, Ms Lavin filed a cross-claim seeking a declaration that the guarantee was unenforceable on the basis that it had been procured in unconscionable and unjust circumstances. Ms Lavin settled the proceeding with NAB on the basis that she pay NAB

$1.35 million. In return, NAB agreed not to pursue Ms Lavin for the remainder of the debt owed.

Terms of settlement between NAB and Ms Lavin, provided that NAB could still recover payment from the co-guarantor Ms Toppi. In early 2011, Ms Toppi and her husband sold their family home and used the proceeds of the sale to pay the balance of the guaranteed debt of approximately $2.9 million. The net result was that Ms Toppi paid NAB nearly $1.55 million more than the co-guarantor Ms Lavin.

The Contribution Proceedings

Ms Toppi commenced proceedings in the NSW Supreme Court claiming contribution from Ms Lavin for nearly $775,000, an amount equal to half the difference between the respective amounts paid by the co-guarantors. Both the NSW Supreme Court and the NSW Supreme Court of Appeal found Ms Toppi was entitled to recover that amount from her co-guarantor, Ms Lavin.

High Court Decision

The High Court unanimously affirmed the decision of the NSW Supreme Court of Appeal and held that a creditor's covenant not to sue a co-guarantor did not extinguish the rights of a co-guarantor to recover from another co-guarantor. The court held the equitable doctrine of contribution requires co-guarantors to share the burden equally. If guarantors share a common obligation then they should contribute proportionately to satisfy that obligation. The obligation for the co-guarantors to pay the guaranteed debt arose at the time Luxe defaulted on the loan or when NAB demanded payment. The co-guarantors were jointly and severally liable to NAB, but shared equal liability to each other.

The High Court held it was a settled principle that once a creditor calls upon co-guarantors to pay the guaranteed debt, the right of a co-guarantor to recover proportional payment from another co-guarantor cannot be defeated by any acts of creditors. NAB granting Ms Lavin a covenant not to sue did not extinguish Ms Toppi's right to recover proportional contribution from her co-guarantor.

Practical Implications

This case serves as a reminder for guarantors of loans there are important considerations when dealing with creditors. Any settlement reached between a single co-guarantor and a creditor does not extinguish the equitable rights of contribution between co-guarantors. If a co-guarantor is granted a covenant not to sue, they are only protected on one front and still face liability to their co-guarantor.

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Team Member Profile

Joe Naccarata, Partner and Head of Insurance & Risk

Joe has 30 years' legal experience. The breadth and depth of Joe's expertise in the insurance industry means he is adept at analysing insurance claims and devising strategies to place his clients in superior bargaining positions. He advises and assists clients in dealing with claims against them, and is skilled at delivering the best possible legal and commercial results.

Joe's experience also enables him to provide clients with monetary projections of potential claims at an early stage. He is therefore able to give accurate advice before litigation commences, affording his clients an early opportunity to make adequate provision for potential losses.

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