Global settlement agreements can cut both ways: consider the recovery

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AAI Insurance Limited trading as Vero Insurance v Technology Swiss Pty Ltd [2021] FCA 95

AT A GLANCE

- Earlier this month the Australian Federal Court provided helpful guidance to insurers entertaining 'full and final' settlement agreements with their insureds.
- The Full Court in *AAI Insurance Limited trading as Vero Insurance v Technology Swiss Pty Ltd* [1] considered the doctrine of subrogation, how it applies when entering 'full and final' settlement agreements before recovery is commenced, and when the indemnity amount of the settlement payment is unclear.
- While the Federal Court decision is unlikely to set the world on fire, we expect the guiding principles to take up residence in court houses in New Zealand soon enough.
- It is a reminder to insurers that commercial settlements still require planning and careful consideration of the implications for recovery efforts.

CASE BACKGROUND

In December 2014, Technology Swiss Pty Ltd (**Technology Swiss**) shipped fog cannons from Melbourne to Bangkok. Technology Swiss insured the cannons with AAI Insurance Limited, trading as Vero Insurance (**Vero**). During the voyage, the cannons were damaged due to insufficient strapping and Technology Swiss lodged a claim against its policy.

Vero's view was that the cannons could be repaired for approximately $200,000, but Technology Swiss considered them a constructive total loss as they required shipping to Italy for repairs, costing up to EU€756,000.

On a without prejudice basis, Vero agreed to indemnify Technology Swiss in the sum of $200,000 for the loss. Vero then:

- made a further payment of $26,000 for storage of the damaged cannons while the claim was ongoing; and
- offered to settle the claim on a full and final basis for an additional $50,000.

Technology Swiss rejected Vero's offer. The claim was eventually settled following mediation for $425,000 (the **Settlement Sum**). Vero and Technology Swiss entered a deed of release, which notably recorded:

- the settlement was on a "full and final" basis;
- the Settlement Sum included a contribution from Vero for the storage costs incurred by Technology Swiss;
- in consideration for the Settlement Sum, Technology Swiss would release Vero from any future demands; and
- Vero maintained its rights of subrogation under the policy, should it wish to exercise those rights.

Following the settlement, Technology Swiss issued proceedings against the shipping company, Famous Pacific Shipping (**FP Shipping**). Technology Swiss proposed a fee-sharing arrangement with Vero however they were unable to agree on apportionment of any recovery proceeds.

Technology Swiss eventually obtained judgment against FP Shipping for $863,758. Technology Swiss filed proceedings in the Federal Court seeking a declaration that:

- it was entitled to the full amount recovered from FP Shipping; and
- Vero was not entitled to recuperate the claim payments it had paid to Technology Swiss. [2]

ALLOCATION

Technology Swiss submitted that Vero was only entitled to indemnity funds paid under the policy. As the payment of the Settlement Sum was made under a deed following mediation, it argued that it was not a true indemnity payment.

Vero argued it was entitled to any funds it had paid out under the policy in good faith and it ought to recoup all the money it paid to Technology Swiss.

Allsop CJ rejected the insured's submission that the none of the Settlement Sum was attributable to reducing its loss by way of indemnity. Vero's submission that it was entitled to the full $425,000 was also rejected.

Instead, Allsop CJ found that as the parties had not allocated or made any division of the Settlement Sum in the deed, the Court had to infer the parties' intention for allocation of the recovery funds.

Allsop CJ concluded that the test was fundamentally to determine whether a payment between an insurer and insured was intended to represent a "reduction of the insured's loss, covered by the policy", therefore representing an indemnity payment. Considering this, Allsop CJ found:

- the recovered amount from FP Shipping was the full amount of the "cost, insurance and freight" loss;
- Technology Swiss had been overcompensated for its loss with payments from Vero and FP Shipping;
- Technology Swiss had spent almost $300,000 in its initial claim against Vero and should recover those costs;
- Technology Swiss and Vero had agreed on the amount of the storage costs; and
- when Technology Swiss' costs and the storage costs were deducted from the Settlement Sum, it left $116,770.42. This amount could only represent a payment "in the nature of an indemnity under the policy".

As Vero had provided a total indemnity of $316,770.42 it was entitled to a proportionate share of the sum recovered from FP Shipping.

Vero appealed this decision to the Full Court. Technology Swiss filed a cross-appeal.

APPEAL TO THE FULL BENCH

Vero appealed on the basis that the wrong test had been applied on the insurer's entitlement to subrogation. Technology Swiss cross-appealed on the basis the Settlement Sum (in part) was incorrectly considered an indemnity payment.

The Full Court upheld Allsop CJ's earlier decision and provided some useful guidance in correctly identifying the indemnity payment.

Peeram J based his reasoning on equity, finding the doctrine of subrogation (and by extension, recoupment) arises to achieve fairness between the parties. Here, the assessment of fairness included the parties' dispute on the value of the indemnity, which was not resolved and was "submerged" beneath the global sum they agreed. Vero could therefore say part of the Settlement Sum formed an indemnity payment but was wrong to say 100% of the payment was an indemnity payment under the policy.

Jagot J emphasised that the equities of subrogation and recoupment depend on substance and not form. She confirmed the relevant question in *Wellington Insurance Co Ltd:*[3]

"can [it] be taken (whether from express words or inferred or implied from the circumstances) that the payment or some part of it was mutually intended to be an indemnity for the insured loss and in that sense be under the policy?"

Finally, Derrington J concluded with reference to the various authorities that an insurer's entitlement to subrogation is "underpinned by three quintessential elements":

- the undertaking by an insurer of an obligation to provide indemnity
- a claim by the insured on the indemnity, and
- a payment for the purpose of "reducing a loss through the promised indemnity".

Where the nature of the payment is unclear, the payment may be "coloured" by the claim itself and the context in which the claim is settled.

> **It is a reminder to insurers that commercial settlements still require planning and careful consideration of the implications for recovery efforts.**

HOW IS THE PIE CURRENTLY APPORTIONED IN NEW ZEALAND?

In New Zealand, where policies are silent regarding the order of payment of any recovered funds, insurers will sometimes seek to agree a pro rata apportionment with the insured before commencing a recovery action. Otherwise, the usual position is to "recover down" in line with the *Lord Napier & Ettrick v Hunter* decision as follows:[4]

- the uninsured portion will be paid to the insured;
- the insurer will be repaid for the indemnified loss amount; and
- the balance, if any, will reimburse the insured's excess.

WHERE TO FROM HERE?

While the decision does not alter the fundamental principles of subrogation, it is a reminder for insurers when resolving claims to:

- document cash settlements where possible in an agreement with the insured;
- record their recovery rights and any expectations on the insured and insurer; and
- clarify where payments (or parts of payments) are intended to reflect an "indemnity payment" (while the Court may infer an "indemnity" amount in a global settlement later on, this will no doubt be a costly exercise).

Insurers should also seek to agree on the sharing of costs and the apportionment of any proceeds before commencing a recovery action. In our experience this encourages an informed, engaged approach from all parties at the outset and avoids any ambiguity following a result down the track.

REFERENCES:

[1] [2021] FCAFC 168.

[2] *Technology Swiss Pty Ltd vs AAI Insurance Limited trading as Vero Insurance* [2021] FCA 95.

[3] *v Armac Diving Services Ltd* (1987) 38 DLR (4th) 462.

[4] [1993] AC 713.

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Need to know more?

For more information please contact us.

Katie Shanks
Partner (Auckland)
T: +64 9 600 5653
E: katie.shanks@wottonkearney.com

Luke Knights
Senior Associate (Auckland)
T: +64 9 600 5656
E: luke.knights@wottonkearney.com

Johnson Zhuang
Solicitor (Auckland)
T: +64 9 280 1499
E: johnson.zhuang@wottonkearney.com