

Underinsured? An increasingly common problem caused by Section 3A of the Civil Liabilities Act 2002

Many businesses may currently be inadvertently underinsured due to a provision in the Civil Liabilities Act 2002 (**Act**) which allows parties to contract out of the Act.

When this occurs, it may result in a gap between their liability to a contracted party and the level of insurance coverage provided by their insurer. Any gap which may be considerable will have to be paid by the business out of its own pocket leaving it unknowingly exposed.

Civil Liabilities Act and Proportionate Liability

Since 1 December 2004 Part IV of the Act has been in force bringing in "*proportionate liability for apportionable claims*".

"*Apportionable Claims*" are defined by Section 34(1) to be claims in contract, tort or otherwise for economic loss or damage to property arising from a failure to take reasonable care (but excludes personal injury claims).

To put "*proportionate liability*" simply, a liable party in a damages claim in contract or negligence (which does not involve personal injury) only pays that % of the total of the loss that it contributed to. For example under proportional liability if a party's actions are found to have contributed 10% to damages of \$1M then it only has to pay \$100,000.

Prior to the Act coming into force, the law stated that wrongdoers in negligence were "*jointly and severally liable*". A party which contributed only 10% to damages of \$1M would instead be liable to the Claimant for the whole of the \$1M damages and would have to seek to enforce a contribution from the other jointly responsible defendants. If those other defendant's can't be found or were insolvent then the party which was 10% responsible would end up paying 100% of the damages despite the fact that it was not the major cause of those damages.

So what's the problem?

Based on the above, Section 35 of the Act and the imposition of proportionate liability seems logical, a benefit to defendants and a continuation of the modern user pays principle. Section 3A of the Act allows parties to contract out of the proportional liability provisions of the Act effectively reverting back to the common law obligations under contract and of joint and severable liability in negligence.

Contracts

It is becoming increasingly common for contracts to contain express provisions stating that the parties agree to contract out of the Act.

Contracting out of the Act creates the potential for greater liability for damages in contract and tort than would apply if proportional liability and Section 35 of the Act applied. This fact and its interaction with insurance policies and their terms create the problem of inadvertent underinsurance.

Insurance Companies

Insurance companies generally calculate their risks and premiums on standard risk profiles which would include the assumption that the Act and proportionate liability applies. Therefore standard policies may not cover any additional liability arising as a result of the Act being excluded. Many insurance policies contain express exclusionary provisions to this effect or state that notification and approval must be provided to the insurers of any contracting out of the Act, otherwise the additional risk is not covered.

If your business signs a contract which expressly states that the Act is excluded, it may be leaving itself underinsured and exposed.

Summary - What to Do

We suggest that businesses:

1. Be aware when signing contracts that it is possible to contract out of the Act and to look for such clauses and obtain legal review of contracts and advice before signing.
2. Perform an audit of their current contracts and insurance policies to identify whether current contracts contain provisions contracting out of the Act and whether insurance policies cover any additional liabilities.
3. Talk to your insurance broker about the issue and whether existing insurers should be notified, whether any variations to existing policies can be obtained or top up insurance can be obtained.
4. Remember that once a claim arises or is notified, it is too late to fix the problem. Your business is automatically exposed with no insurance to cover the additional gap in damages.

If you would like any further information on this topic, please contact Craig Blackwell, Senior Associate on 9230 6508 or craig.blackwell@kreissonlegal.com.au



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