Supreme Court of New South Wales

Chand v Zurich Australian Insurance Limited [2013] NSWSC 102 (25 February 2013)

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Supreme Court

New South Wales

Case Title:	Chand v Zurich Australian Insurance Limited
Medium Neutral Citation:	[2013] NSWSC 102
Hearing Date(s):	10 October 2012
Decision Date:	25 February 2013
Jurisdiction:	Common Law
Before:	Adams J
Decision:	Summons is dismissed with costs.
Catchwords:	Appeal from Local Court - action for part of damage - consent judgment - right of insurer which paid other damage to sue - whether consent judgment can be set aside - UCPR 36.15 - whether consent judgment irregular or against good faith.
Legislation Cited:	Civil Procedure Act 2005 Contracts Review Act 1980 District Court Rules 1973 Local Court Act 2007 Uniform Civil Procedure Rules 2005
Cases Cited:	Across Australia Finance Pty Ltd v Bassenger [2008] NSWSC 799 Baltic Shipping Co v Merchant "Mikhail Lermontov" (1994) 36 NSWLR 361 Coles v Burke (1987) 10 NSWLR 429 Harvey v Phillips [1956] HCA 27; (1956) 95 CLR 235

	Hoskins v Van Den-Braak (1998) 43 NSWLR 290 Irwin Johnston & Partners NSW Pty Ltd v Smith & Anor [1998] NSWSC 675; (unreported BC9807445, 18 December 1998) Kendell v Carnegie & Ors [2006] NSWCA 302; (2006) 68 NSWLR 193 Le v Williams [2004] NSWSC 645 Metwally v University of Wollongong [1985] HCA 28 Morganite Ceramic Fibres Pty Ltd v Sola Basic Australia Ltd (1988) 5 ANZ Ins Cas 60-883 Sola Basic Australia Ltd v Morganite Ceramic Fibres Pty Ltd [1989] NSWCA 187 Spies v Commonwealth Bank of Australia (1991) 24 NSWLR 691 State Government Insurance Office (Queensland) v Brisbane Stevedoring Pty Ltd [1969] HCA 59; (1969) 123 CLR 228 Sydney Turf Club v Crowley [1971] 1 NSWLR 724 Taylor v Johnson [1983] HCA 5; (1983) 151 CLR 422
Texts Cited:	Meagher, Gummow & Lehane, Equity, Doctrines & Remedies, 2nd Ed.
Category:	Principal judgment
Parties:	Anil Chand (plaintiff) Zurich Australian Insurance Limited (first defendant) Bazetta Holdings Pty Ltd (second defendant)
Representation	
- Counsel:	Counsel: K Oliver (plaintiff) M J Dawson (defendants)
- Solicitors:	Solicitors: CKB Partners (plaintiff) Vardanega Roberts Solicitors (defendants)
File Number(s):	2012/176985
Decision Under Appeal	
- Court / Tribunal:	Local Court
- Before:	Townsden LCM
- Date of Decision:	08 May 2012
- Court File Number(s):	2012/82536

JUDGMENT

Introduction

1. This case arises out of a car accident. Bazetta Holdings Pty Ltd claimed the cost of repairs from its insurer, Zurich Australia Insurance Limited. The repair bill was paid by Zurich, which demanded reimbursement from Mr Chand for this amount. In the meantime, Bazetta sued the driver of the other car, Mr Chand, who was insured by AAMI, in the Local Court for the payments it made to rent a car whilst its damaged vehicle was repaired. Evidently it was not insured in respect of this expense. AAMI's solicitors acted for Mr Chand in respect of both claims.

2. Zurich, having sent information about the repairs to AAMI and its solicitors, threatened to commence proceedings (of course, on Bazetta's behalf) against Mr Chand if the cost of repairs was not reimbursed. AAMI, through its solicitors, filed a defence to the action for the vehicle rental. Before Zurich commenced proceedings to recover the cost of repairs, AAMI settled the action for rental and filed a consent judgment in the Local Court.

3. Zurich, by summons in its own name against Mr Chand and Bazetta as defendants, sought to set aside the consent judgment on the ground that the settlement was void as against it because of its subrogation rights under the contract of insurance with Bazetta. It wished to amend Bazetta's Statement of Claim to add the claim for repairs, being concerned that, whilst the judgment was extant, it could not sue for the repairs. The application was opposed by Mr Chand (in reality, of course, AAMI) on the ground that the requirements for setting aside such a judgment had not been satisfied. The learned Local Court Magistrate set aside the judgment, leaving the path free for Zurich to make the amendments it sought. From this judgment Mr Chand has appealed to this Court, seeking leave in respect of any material factual findings.

The grounds of appeal

4. The appeal to this Court under the *Local Court Act* 2007 gives an appeal as of right on a question of law (s 39(1)) and, with leave, on a question of mixed law and fact (s 40(1)).

5. The amended summons enumerates 16 grounds of appeal, many simply being different ways of making the same complaint. Fortunately, in written submissions on behalf of the plaintiff, the grounds were refined. Accordingly, I propose to deal with this matter, chiefly by reference to those submissions. The focus of the argument concerned the contention that the Local Court erred in its construction or application of the Uniform Civil Procedure Rules 2005, r 36.15(1). This issue raised the additional question whether the Local Court had jurisdiction or power to set aside the consent judgment otherwise than under r 36.15. The plaintiff contended that, in dealing with the significance of Zurich's rights of abrogation, the Magistrate erred in applying the principle enunciated by Smart J in *Morganite Ceramic Fibres Pty Ltd v Sola Basic Australia Ltd* (1988) 5 ANZ Ins Cas 60-883, or if the principle applied, that *Morganite* was wrongly decided.

Factual findings

6. The Magistrate found that, at all times before entry of the consent judgment, Zurich was unaware of the proceedings for the car rental. Also, his Honour found that at and before the consent judgment was entered Mr Chand or, more significantly, AAMI was aware that Zurich was seeking to recover the costs of repairs and had played no role in the proceedings to recover the hire car expenses. Furthermore, at that time AAMI was aware that Zurich intended to sue to recover the cost of repairs. I

should add that it was implicit in his Honour's findings that Zurich had paid the cost of repairs and that AAMI was aware that Zurich had done so before it settled the claim for rental and filed the consent judgment. It was submitted that the evidence did not justify this conclusion. However, on 3 August 2011 Zurich emailed a quote and invoices to AAMI for the sum of $11,609.72 seeking reimbursement within 14 days. The email attaching the relevant material described as "our proof of *loss*" and asked AAMI to "*reimburse* our office" (emphasis mine). Since this is purely a question of fact, it cannot be raised at this stage but, even if leave could be given to do so, I would refuse it upon the ground that there was ample evidence before the Magistrate to justify this finding, indeed for all the findings mentioned.

The need to set aside the consent judgment

7. The jurisdictional obstacle placed in the path of the attempt by Zurich to recover the costs of repairs is s 24 of the *Civil Procedure Act* 2005 which, in effect, enacts in statutory form the common law rule against splitting a cause of action in order to bring a series of actions. The effect of s 24 is not controversial in this case. In short, had the matter not been complicated by the subrogated rights of the insurers, there could be no doubt that Bazetta could not sue Mr Chand for the cost of renting a vehicle pending repair and, in a separate proceeding, sue for repairs to the vehicle. Furthermore, if it recovered a judgment (as was indeed the case) in the first action, Mr Chand was entitled, in defence to the second action, to plead that judgment as a complete defence. It is inescapable that at all material times AAMI was aware that, in respect of the action for rental, Bazetta had sued for itself as distinct from the action having been undertaken in its name by Zurich and that Zurich, having paid for the repairs, would sue Mr Chand, AAMI's insured, if it were not reimbursed. Indeed, the defence filed in the former action stated, amongst other things -

"[21] The defendant will rely on s 24 of the *Civil Procedure Act* 2005 in relation to this and any other or future proceedings arising from or out of the cause, the subject of this proceeding".

Whilst the consent judgment remained on foot, this would have been a good defence to an action for repairs (subject to the qualification mentioned at the end of this judgment). Thus it was that Zurich needed to set it aside.

UCPR r 36.15(1)

8. This rule, which applies to the Local Court, is in the following terms -

A judgment or order of the court in any proceedings may, on sufficient cause being shown, be set aside by order of the court if the judgment was given or entered, or the order was made, irregularly, illegally or against good faith.

Plainly enough, nothing that was done by the plaintiff amounted to an illegality. The question is whether the consent judgment was irregular or against good faith.

9. The meaning of the phrase "against good faith" in Pt 31, r 12A of the District Court Rules 1973 (in the same terms as UCPR r 36.15 (1)) was considered in *Kendell v Carnegie & Ors* [2006] NSWCA 302; (2006) 68 NSWLR 193. The trial judge, who

set aside the judgment, relied on the following passage from *Taylor v Johnson* [1983] HCA 5; (1983) 151 CLR 422 at 432 (Mason ACJ, Murphy & Deane JJ) -

The particular proposition of law which we see as appropriate and adequate for disposing of the present appeal may be narrowly stated. It is that a party who has entered into a written contract under a serious mistake about its contents in relation to a fundamental term will be entitled in equity to an order rescinding the contract if the other party is aware that circumstances exist which indicate that the first party is entering the contract under some serious mistake or misapprehension about either the content or subject matter of that term and deliberately sets out to ensure that the first party does not become aware of the existence of his mistake or misapprehension.

10. Bryson JA (with whom Hodgson and McColl JJA agreed) considered that the following passage from *Taylor v Johnson* (at 432 - 433) should also be noticed -

[29] ... Moreover, and perhaps more importantly, it is a principle which is best calculated to do justice between the parties to a contract in the situation which it contemplates. In such a situation it is unfair that the mistaken party should be held to the written contract by the other party whose lack of precise knowledge of the first party's actual mistake proceeds from wilful ignorance because, knowing or having reason to know that there is some mistake or misapprehension, he engages deliberately in a course of conduct which is designed to inhibit discovery of it. Our comment can, for present purposes, be limited in its application to the case where the second party has not materially altered his position and the rights of strangers have not intervened.

Bryson JA went on to say -

[42] No basis has been suggested and in my opinion there is no basis for bringing under consideration whether the consent judgment was given irregularly or illegally. The relevant matter to decide was whether Mr Kendell showed that the judgment was given against good faith. This is not a closely defined test, and is not to be equated with a test whether the Terms of Settlement were void at common law for mistake, or were open to be rescinded in equity for a mistake of the kind described in *Taylor v Johnson* [(1983) [1983] HCA 5; 151 CLR 422], or for a mistake of some other kind. [The trial judge] was not asked to grant equitable relief...

After discussing the common law test for the influence of mistake on contract formation, his Honour said -

[60] There is not and could not, I would think, ever be an exhaustive judicial definition of what is against good faith; only very broad limits are set by proceeding by analogy from circumstances in which judicial remedies are based on good faith, unconscionability, or other concepts closely related to good faith. I would include the passage cited from *Taylor v Johnson* among the many conceivably available sources from which to proceed by analogy. "Against good faith" is an expression which requires the impeachment of the intention or behaviour of the person whose good faith is impugned.

11. The operation of this rule was considered in *Coles v Burke* (1987) 10 NSWLR 429. Kirby P (with whom Samuels & McHugh JJA concurred) said (at 437) -

The genus which is involved in the phrase "irregularly, illegally or against good faith" appears to me to be misconduct or dishonourable conduct of the person who procured the judgment which it is suggested undermines the authority of that judgment warranting the exceptional course for which r 12A provides. Here, there was no such lack of good faith on the part of the claimants. The signing of the judgment was made in accordance with the authority of the order earlier consented to and after a warning had been given by the letter to which I have referred. It is perhaps undesirable, in the modern practice of the legal profession (where much give and take is required) that judgment should be signed in this way without a final telephone call or other warning. However, the failure to give such a final and further warning could not, on any view, amount to a lack of good faith. Therefore, r 12A, likewise, has no application to these circumstances.

The *Morganite* principle

12. Zurich relied on the principle enunciated by Smart J in *Morganite* (for convenience, called the *Morganite* principle) to make its case for setting aside the judgment as demonstrating that it had been entered into either irregularly or against good faith. Counsel for Mr Chand submitted that *Morganite* did not apply in the circumstances here, since it concerned a settlement agreement and not a judgment, that at all events the prerequisite facts were not present and, lastly, that *Morganite* was wrongly decided.

13. In *Morganite* the defendant sold to the plaintiff equipment which broke down, causing significant loss to production and sales. The plaintiff sought to return the unit and, in substance, be reimbursed for the purchase price together with the additional cost of buying a replacement. The plaintiff's proposal was explicitly limited to the reimbursement and additional cost of the replacement and it expressly stated that this did not affect any claim that its insurer might have against the defendant under its rights of subrogation in respect of the loss of profits and material damage for which it had indemnified the plaintiff. The defendant proposed a return of the equipment with a refund of the sums paid in respect of it "with the result that we each will bear our own not inconsiderable losses which have otherwise resulted from this venture" (*Morganite* at 75,617). The plaintiff responded by noting the proposal and arranging for the unit to be returned, requesting a refund of its payments. The plaintiff's insurer, (as it happened) Zurich Australia Insurance Limited, had paid substantial sums for material damage and consequential loss. It sued the defendant in the plaintiff's name pursuant to its rights of subrogation, seeking damages under these heads.

14. One of the defences pleaded was that the parties had agreed that the defendant would accept return of the unit and refund the sums paid by the plaintiff in full satisfaction and discharge of the plaintiff's causes of action of all damages and costs and that such agreement had been performed. This defence of accord and satisfaction was raised by the defendant as a preliminary point. The plaintiff argued that, if a tortfeasor or party in default under a contract settles with the insured without the consent of the insurer and with knowledge of the insurer's payments and rights of subrogation, such rights are not defeated by any settlement or release. Smart J held that, on the correct construction of the negotiations and ultimate settlement, the settlement dealt only with the replacement of the equipment and refund of the purchase price, so that there had been no settlement of the other claims. However, his Honour went on to consider the question of insurance and subrogation in the event that he had erred in his construction of the settlement. As a starting point, his Honour found that the defendant was aware that the plaintiff had suffered very substantial

consequential loss due to failure of the equipment, that the plaintiff was insured and the settlement proposal would affect any claim which the plaintiff's insurer might have against the defendant under its rights of subrogation. The defendant also had what amounted to actual knowledge of the fact that the insurer had made payments under the policy, although not the actual sum.

15. Smart J cited the general rule as stated by Mason JA in *Sydney Turf Club v Crowley* [1971] 1 NSWLR 724 at 734 -

Where an insurer is subrogated to the rights of the insured against a third party, the insured [sic but it is clear that this a typographical error for "insurer"] does not acquire an independent cause of action in his own right. He succeeds to the insured's cause of action against the third party, in this case a right of action on the policy issued by the Jockey Club. That right of action remains in all respects unaltered; it is brought in the name of the insured and it is subject to all the defences which would be available if the action had been brought by the insured for his own benefit. Thus payment in full by the Government Insurance Office on account of

the risk is a defence to the action by the appellant against the Jockey Club and it is no answer to that defence that the action is brought for the benefit of the insurer.

And observed that it was subject to the qualifications stated in *State Government Insurance Office (Queensland) v Brisbane Stevedoring Pty Ltd* [1969] HCA 59; (1969) 123 CLR 228 per Barwick CJ (at 240 - 241) -

It is settled law that an insurer who has paid the amount of a loss under a policy of indemnity is entitled to the benefit of all the rights of the insured in the subject matter of the loss and by subrogation may enforce them. This right of subrogation is inherent in the contract of indemnity...

and

It is also settled law that an insured may not release, diminish, compromise or divert the benefit of any right to which the insurer is or will be entitled to succeed and enjoy under his right of subrogation. On occasions an attempt by the insured to do so will be ineffective against the insurer because of the knowledge of the circumstances which the person under obligation to the insured may have. On other occasions when the insured's act has become effective as against the insurer, the insured will be liable to the insurer in damages, or possibly, on some occasions for money had and received...

Following a lengthy discussion of the arguments submitted by the parties and describing the various alternative responses available to answer the problem, Smart J went on to say (*Morganite* at 75,625)

I have found the judgment of the New York Court of Appeals *(Hiscock* C.J., with *Cardozo, Pound, Crane, Andrews* and *Lehman* JJ. concurring) in *Ocean Accident and Guarantee Corp. v. Hooker Electrochemical Co.* (1925) 147 N.E. 351 and that of the Supreme Court of Illinois in *The Home Insurance Co. v. Hertz Corp.* (1978) 375 N.E. (2d) 115, from both of which I have quoted in my earlier judgment, illuminating. The United States Courts have looked at the substance of the matter and held that an unlimited general release by an insured of all claims against a delictor does not bar a subrogation action by an insurer-subrogee against that

delictor where the delictor procures the release from the insured-subrogor with knowledge of the insurer's interest.

The approach of the United States Courts and that of *Barwick* C.J. have much in common. I agree with this apt and persuasive passage from *Ocean* at p. 354:

"when the (defaulting contractual party), chargeable with notice of (the insurer's) rights which largely had become detached from and independent of those retained by the (insured), made a settlement with the latter to which the insurer was not a party, it must be regarded as having made such settlement subject to and with a reservation of the rights possessed by (the insurer), and with the implication of a consent that the rights of the two parties should become separated even though originally part of an indivisible cause of action ..."

There is no binding Australian authority directly in point. I have borne in mind the English authorities and that the application of the decisions of the superior courts of other countries depends upon the degree of persuasiveness of their reasoning. While acknowledging the differences between Australian and United States insurance and subrogation law I have found the United States authorities in the area under consideration convincing. The principle applied by them leads to fewest anomalies of consequence and the path taken by the United States Courts appeals to me. If I were to follow that path it would follow that the present proceedings are incorrectly constituted and that the insurer should be a plaintiff.

The observations of *Mason* J.A. and *Barwick* C.J. should not be treated as though enshrined in a statute and neither was dealing with the present situation. However, the observations of *Mason* J.A. that the insurer does not acquire an independent cause of action in his own right, that the right of action remains unaltered and that it is subject to all the defences which would be available if the action had been brought by the insured for his own benefit state the position as it has usually been understood in Australia. This probably precludes an independent action by the insurer in this case. Despite the difficulties, I would give effect to the qualification or principle propounded by *Barwick* C.J. by holding that in the action as presently constituted dealing with the losses covered by the insurance policies and paid by the insurer the release is ineffective.

16. Dealing with the contention of the defendants that the plaintiff had to prove actual knowledge as distinct from constructive knowledge of payment and knowledge that the claims had been paid in full, his Honour concluded that "actual knowledge involved directly knowing the facts and/or wilful blindness or wilful shutting of the eyes to the obvious and... that it was not necessary for... [the defendant] to know the precise details of the insurer's rights nor how much had been or would be paid" (*Morganite* at 75,626). His Honour held, implicitly, as I think, that it was sufficient if the defendant "knew that an effective release would seriously invade or infringe the insurer's rights" (*Morganite* at 75,626).

17. His Honour concluded that, if the crucial communication of the proposed settlement in fact sought to obtain a comprehensive release (as argued by the defendant) then that communication "was craftily worded" (*Morganite* at 75,626). Although his Honour did not expressly say so, it seems to me, implicit in his statement of the contentions on both sides that he concluded that, in this event, the defendant had been guilty of sharp or questionable conduct in drafting the terms of its offer.

18. An appeal against the judgment of Smart J was dismissed: *Sola Basic Australia Limited v Morganite Ceramic Fibres Pty Limited* [1989] NSWCA 187. The majority concluded that the settlement agreement dealt only with the return of the equipment and reimbursement of the costs associated with its purchase and return. It was therefore not necessary to consider the alternative case based upon the insurer's right of subrogation and the majority did not do so. Meagher JA dissented on the interpretation of the settlement agreement and therefore considered the question as to the survival of the insurer's right to sue for the other losses. On this question his Honour disagreed with both the analysis and conclusion of Smart J. His Honour characterised Morganite's submission as "fundamentally misconceived" and went on to say -

It is undoubtedly true, as Sir Garfield Barwick pointed out [in *GIO (Qld) v Brisbane Stevedoring Pty Ltd* [1969] HCA 59; (1969) 123 CLR 228]... as between the insurer and his insured that the latter will not do anything to diminish the former's right to subrogation. It does not emerge clearly from the cases what is the source or the nature of that obligation. It may be, and I think it is, a term of the contract of insurance which is implied by law. It could also conceivably be, although I doubt if this be the case, an equitable obligation arising independently of contract. If it be the former, it is a negative stipulation, which has the same consequence as any other negative stipulation; that is to say, the insurer may enjoin any apprehended breach of the stipulation, may subsequently sue for any actual breach in damages, may plead the breach as a defence if the insured claims under the relevant policy of insurance, and may sue for an injunction or damages any third person who induces a breach of the stipulation. But one thing is clear; it does not enable an insurer to treat as void a transaction which has been completed in breach of the stipulation. Just as if A covenants with B not to sell Blackacre to C and he subsequently does sell Blackacre to C, B cannot allege that the sale is void, and this is so whether C knew of the covenant or not. Likewise, if the obligation in question is not a consequence of an implied term but is the consequence of some independent equity, the doctrine of *Dematttos v Gibson* (1858) 4 De G and J 45 ER 108, produces the same result.

19. Having noted but disagreed with the support in the textbooks for the argument and the American and Canadian Authorities to which Smart J referred his Honour went on (at 12) -

... However, as I have explained, the submission is both contrary to principle and unsupported by authority in this country. It must therefore be rejected.

The submission also offends the principle firmly established in this country, that an insurer could not sue in his own name and is subject to all of the defences available if the action were brought by the insured for his own benefit: see *Sydney Turf Club v Crawley* [1971] 1 NSWLR 724 at 734.

(Although it may be somewhat impertinent to do so, I am unable to refrain from mentioning that, as his Honour himself observed with regret, amongst the textbooks supporting the argument was Meagher, Gummow & Lehane, *Equity, Doctrines & Remedies*, 2nd Ed, para 937.)

20. Meagher JA noted also that the principle was based upon the existence of an insurer's right to subrogation and therefore "the principle could hardly operate before

the right of subrogation arises" concluding that it was clear on the facts that the insurer had not paid the claim in full until after the accord and satisfaction had been completed.

21. In *Baltic Shipping Co v Merchant "Mikhail Lermontov"* (1994) 36 NSWLR 361 the Court of Appeal considered the significance for the insurer of claims of passengers arising from the sinking of a cruise ship where both personal injuries and loss of baggage was suffered and the passengers, dealing with claims for lost baggage released the carrier, in terms, from all possible claims. Since, if s 16 of the *Contracts Review Act* 1980 applied, consideration of whether the releases should be treated as partly effective and partly ineffective and to vary them to exclude claims other than for baggage, could be dealt with by reference to that Act and it was therefore perhaps not necessary to form a final view on the correctness of *Morganite*. Handley JA, with whom Kirby P & Mahoney JA agreed, having found that the defendant had sought to take advantage of the co-plaintiffs' baggage insurance by encouraging them to claim on their insurers and, when paying out the excess obtaining a full release, although aware of the subrogation principle, stating (at 369) -

The company was therefore attempting to put the co-plaintiffs in a false position with their insurers. An insured is not free to deal with rights against third parties to the prejudice of an insurer who would become entitled, wholly or partly, to the benefit of that right upon paying the insured under its policy.

His Honour then referred to summary of the principles by Barwick CJ in *Brisbane Stevedoring* (which I have set out above) and discussed the complication caused by the fact that the co-plaintiffs were under-insured. His Honour went on (at 370) -

In these cases the company was attempting to induce breaches by the passengers of their contracts with the baggage insurers. If the releases had bound insurers the passengers would have lost the benefit of their insurance. It may be inferred that the co-plaintiffs were not aware of the legal position and would not have signed the releases if they had been. If the releases had been binding on the insurers this conduct of the company, without more, would, in

my opinion, have entitled the co-plaintiffs to relief under the [Contracts Review] Act. However since the company was on notice the releases were ineffective against the insurers: see *State Government Insurance Office (Queensland) v Brisbane Stevedoring Pty Ltd* and *Morganite Ceramic Fibres Pty Ltd v Sola Basic Australia Ltd* [(1987) 11 NSWLR 189]. This decision was affirmed by this Court on other grounds but compare the dissenting judgment of Meagher JA ...

...

[At 371] Although the releases were ineffective as releases or accords and satisfaction they were enforceable against the co-plaintiffs in equity, subject to the [Contracts Review] Act, as agreements not to sue. However such agreements were not binding on the insurers or on the co-plaintiffs when suing for the benefit of insurers (see above).

And (at 372) his Honour stated -

"The releases were not binding on insurers under the general law..."

22. The correctness of the *Morganite* principle was, so far as I know, last discussed in *Le v Williams* [2004] NSWSC 645 by Campbell J (as his Honour then was) -

[40] In *Morganite Ceramic Fibres Pty Ltd v Sola Basic Australia Ltd* (1987) 11 NSWLR 189, Smart J reviewed legal authority relating to a contention that a release given to a tortfeasor or party in default under a contract will not bind a subrogated insurer if, at the time of the release, such tortfeasor or party was aware that payments had been made by the insurer to the insured and of the rights of the subrogated insurer. His Honour appears to have been of the view that there was such a legal principle. On appeal to the Court of Appeal (*Sola Basic Australia Ltd v Morganite Ceramic Fibres Pty Ltd* (NSWCA, 11 May 1989, unreported), Meagher JA held no such principle existed, but Priestley JA (with whom, it appears, Hope JA agreed) did not need to decide the question. In *Baltic Shipping Co v Merchant "Mikhail Lermontov"* (1994) 36 NSWLR 361 at 370, Handley JA (with whom Kirby P and Mahoney JA agreed) appears to have accepted the proposition. In circumstances where I have come to the view, as a matter of construction, that the release does not extend to the insurer's claim, it is not necessary for me to decide which of Smart J and Meagher JA I should follow, nor what is the precise import of the passage in Handley JA's judgment in *Baltic Shipping Co v Merchant "Mikhail Lermontov"* to which I have referred, nor whether that passage was part of the ratio of the case, and therefore binding upon me.

23. In my respectful view the passages in the judgment of Handley JA which I have set out above are part of the ratio of the case since it was a step in the process of considering the extent to which, if at all, the *Contracts Review Act* 1980 applied to the releases in question. Even if it were *obiter dicta*, noting that his Honour's judgment was agreed by Kirby P and Mahoney JA, I think that I, as a first instance judge, should follow it. Furthermore, I respectfully agree with Campbell J that Handley JA agreed with Smart J.

24. Regrettably, in *Irwin Johnston & Partners NSW Pty Ltd v Smith & Anor* [1998] NSWSC 675; (unreported BC9807445, 18 December 1998) Kirby J was able to avoid the need to resolve the disagreement between Smart J and Meagher JA in respect of the *Morganite* principle.

The effect of the judgment

25. In the present case, whilst the consent judgment is extant it is clear that Zurich in the exercise of its right of subrogation cannot sue for the cost of repairs, either in Bazetta's name, or its own. Hence the necessity to seek to have it set aside. Although the *Morganite* principle would permit Zurich, through Bazetta, to sue for the repairs if the only obstacle were the settlement agreement even if it released all claims, it does not in terms deal with the obstacle created by the ensuing consent judgment.

26. There is no inherent power in the Local Court to set aside a judgment; such a power is conferred by Pt 36 Div 4, UCPR: see *Coles v Burke* (supra), which dealt with the powers of the District Court but the principle stated there is equally applicable to the Local Court. This was a case in which orders by consent providing for a timetable requiring the defendants to comply with certain interlocutory requirements, in default of compliance with which the defence and cross-claim was to be struck out and the plaintiff have judgment. The defendants did not comply with the terms of the orders and, without warning, the plaintiff applied for judgment, which was duly entered by

the Registrar. The defendants obtained an order setting aside the judgment. Kirby P (with whom McHugh JA agreed) said (at 437) -

The power of the District Court to set aside judgments was relevantly exhausted by the explicit provisions of the *District Court Act* and rules.

Samuels JA agreed generally with Kirby P's reasons and his Honour's orders, but did not need to consider "whether the circumstances were capable of attracting the provision of Pt 31, r 12A, or the inherent power of the District Court" (at 439).

27. In *Hoskins v Van Den-Braak* (1998) 43 NSWLR 290 a judgment had been given in the Local Court in respect of a claim which had not been served. The Magistrate declined to set aside the judgment. An appeal by way of stated case was dismissed upon the ground that the only power vested in the Local Court to set aside its own judgments and orders is provided by the legislation and rules and that the circumstances fell outside those provisions. Mason P with whom Priestley and Beazley JJA agreed said (at 296) -

In my view *Coles v Burke* does not stand for the categorical proposition that the Local Court has no inherent powers outside its Act and Rules... In my view [the judge below] was in error if he read... [the remarks of Kirby P] as stating a universal principle negating any power in a statutory inferior court to set aside default judgments unless explicit authority could be found within the statute or rules defining the jurisdiction and procedure of that court... In *Coles v Burke*, the proceedings had been regularly commenced and the original procedural directions had been duly consented to by the party's solicitor. Rule 12A addressed the field within which an application to set aside the subsequent default judgment was to be considered. In those circumstances the relevant power was constrained by the limitations and procedures spelled out in that rule.

His Honour concluded that -

[The] injustice suffered by [the appellant] resides in the Local Court as an incident of its function as a court of justice... [and] the duty to set aside and/or relieve against the consequences of a default order or judgment exists *ex debito justitiae* (that is, not as a matter of discretion, or subject to terms).

28. In the present case, there was no denial of natural justice or some other fundamental flaw which could give rise to an entitlement *ex debito justitiae* to have the judgment set aside. But it does not follow, as it seems to me, that this exhausts the inherent powers of the Local Court. It plainly has power, subject to its legislation, to govern its own procedures and may decline to act in a way that constitutes an abuse of its process. However, the setting aside of judgments such as that obtained in the present circumstances is within the terms of UCPR 36.15 and, as I think, is governed by the requirements of that rule. Thus, the exercise of an inherent power of a court such as envisaged in *Harvey v Phillips* [1956] HCA 27; (1956) 95 CLR 235 is not within the remit of the Local Court. However, a secondary power, as it were, might be available. In *Harvey v Phillips* an action for damages was settled by counsel on each side, who signed the terms, but the plaintiff claimed she had never consented to the settlement and sought to set aside the judgment. In upholding the judgment of the Full Court dismissing the motion, the High Court, having noted that there was no

misapprehension or mistake made by counsel who was authorised to settle the matter, said (at 242-243, omitting references) -

But in the circumstances of this case it does not appear to us that the court possesses a discretion to set aside the compromise or to intercept the formal entry of judgment. It is not a case of misapprehension or mistake made by counsel in consenting to an order or settlement ... It is not a case where the assistance of the court is sought or invoked to carry a compromise into effect which otherwise could not be enforced by the party relying upon it. In such a case the assistance may be refused on grounds not necessarily sufficient to invalidate a simple contract ... But in the case of a compromise which is made within the actual as well as apparent authority of counsel a court does not appear to possess a discretion to rescind it or set it aside. The question whether the compromise is to be set aside depends upon the existence of a ground which would suffice to render a simple contract void or voidable or to entitle the party to equitable relief against it ... [There] is a dictum of Lindley LJ which is distinct enough: "... nor have I the slightest doubt that a consent order can be impeached, not only on the ground of fraud but upon any grounds which invalidate the agreement it expresses in a more formal way than usual ... To my mind the only question is whether the agreement on which the consent order was based can be invalidated or not. Of course if that agreement cannot be invalidated the consent order is good." *Huddersfield Banking Co Ltd v Henry Lister & Son Ltd* (1895) 2 Ch 273, at p 280.

29. This passage was referred to by White J in *Across Australia Finance Pty Ltd v Bassenger* [2008] NSWSC 799 where his Honour considered whether orders made by consent should be set aside. The proceedings concerned applications for possession of mortgaged properties, leave to issue writs of possession and orders for judicial sale. The basis upon which the application to set aside the judgment was made was that instructions had not been given to the relevant legal advisors to compromise the claim as embodied in the consent judgment and there was an arguable defence under the *Contracts Review Act* 1980. Counsel submitted that the orders should be set aside under UCPR 36.15. White J held that the legal representative had at least ostensible authority to bind the applicant and that therefore there was no irregularity in the making or entering of the orders. His Honour added, however -

[25] Nonetheless, the Court has inherent jurisdiction to set aside orders made by consent, even after entry, on grounds on which the contract embodied in the orders could be set aside. Further, where the Court's assistance to carry the compromise into effect is required, the Court may decline that assistance if to provide it would lead to injustice, although the grounds may not be sufficient to invalidate the contract between the parties (*Harvey v Phillips* [1956] HCA 27; (1956) 95 CLR 235 at 242-243).

Thus, in the present circumstances, the Local Court might have declined to permit Mr Chand to raise the defence of merger to an action by Zurich (through Bazetta) to sue Mr Chand for the repairs, in the exercise of an inherent jurisdiction to control its own proceedings and prevent an injustice. However, this is hypothetical since the proceedings below were not cast in this form. I therefore express no concluded view on the point.

The application of UCPR 36.15

30. The question of what is irregular or against good faith for the purpose of this rule is plainly a matter of fact and degree and cannot be determined abstractly but

must always, of course, be in the context in which the question arises. As mentioned above, the conduct of the defendant in *Morganite* - if the settlement acceptance were given the construction contended for by the defendant - was crafty (to adapt the submission of the plaintiff). An attempt to obtain a comprehensive relief of all claims by an exchange of correspondence which was drafted to avoid alerting the plaintiff to this object would certainly justify the conclusion that the defendant was not acting in good faith. As mentioned above, the defendant, at the very least, thought it was probable that the insurer had made payments and, whilst the amount of the payments was unknown, that the insurer had rights of subrogation which would be affected by a settlement of all claims was known. In the present case, the information supplied in connection with the repair claim, prior to the consent judgment, was such as to demonstrate, to any reasonable mind, that payment had been made.

31. The plaintiff contends that the Magistrate did not find that payment had been made. It is true that his Honour did not express this finding in explicit terms. However, in its written submissions in the Local Court Zurich relied on, amongst other decisions, on the judgment of Smart J in *Morganite*, in particular his Honour's findings that the insurer's right of subrogation will not be defeated where "the wrongdoer was aware: (1) that payments had been made by the insurer to the insured; and (2) of the rights of the subrogated insurer." It was submitted by counsel for Zurich in this Court that at the time that the consent judgment was entered both Mr Chand and his insurer AAMI were aware that Zurich had paid the cost of repairs. Counsel for the plaintiff in this Court disputed the applicability of *Morganite* in the circumstances here, also taking issue with the correctness of Smart J's enunciation of the rule. However, he did not submit to the Local Court that the assertion by Zurich's counsel as to knowledge of payment was either an error or otherwise not justified by the evidence. Furthermore, the correspondence with AAMI's solicitors to which I have already referred shows that Zurich had paid the repair bill before the consent judgment was entered into.

32. It is also contended by the plaintiff that the Magistrate made no finding as to whether the judgment was affected by irregularity or lack of good faith. The argument that such a finding was a prerequisite to setting aside the consent judgment was not addressed to his Honour. It seems to have been accepted on both sides that the question was whether the *Morganite* principle was correct and applied in the circumstances of this case. No reference was made by either counsel to the provisions of UCPR 36.15. His Honour raised during argument the significance of this rule, commenting that judgments can be set aside under that provision. It is true that his Honour then referred to the "inherent injustice of a party who has legitimate rights that would be effectively... [extinguished]" but I would not read his Honour's language as implying a different test to that required by UCPR 36.15 but rather, assuming that it were satisfied, the court's discretion would be exercised to avoid an injustice. The Magistrate stated his conclusion in the following terms -

"Although I accept there is a significant costs implication in relation to the course of action I intend to take, in my view it is ultimately in the interests of justice that the final orders of the court in fact be set aside. In such circumstances when [scil. then] the summons is granted and the orders sought."

I do not accept that his Honour was here purporting to exercise some inherent power. Rather, having found that the *Morganite* principle applied, considered that UCPR 36.15 was satisfied and that the interests of justice justified the order. In my view, the Magistrate implicitly found

that the consent judgment had been irregularly obtained by AAMI acting through Mr Chand by virtue of his holding that the *Morganite* prinicple applied. This conclusion was amply justified on the evidence. Furthermore, a finding that it had obtained judgment against good faith was, in my view, also justified.

> 33. The plaintiff's grounds, as specified in the amended summons also allege error in the Magistrate's failure to make findings or give reasons as to Zurich's standing to bring the application to set aside the judgment.
> 34. It was submitted in this Court that a good deal of the argument in the Local Court concerned the issue of Zurich's *locus standi* to institute a proceeding that relied on the *Morganite* principle. It is true that it was argued that the rights of Zurich could not be greater than those of Mr Chand and that this contention was repeated in various ways through the oral argument. However, the procedural point that Zurich was unable to make the application in the form that it did, that is making the application in its own name and Mr Chand as a defendant was impermissible, was not taken.
> 35. Where an application is made to set aside a consent order for fraud, the court's jurisdiction should be invoked by a fresh action brought for that purpose and not by notice of motion in the original proceedings: *Spies v Commonwealth Bank of Australia* (1991) 24 NSWLR 691, Handley JA (with whom Mahoney and Clarke JJA agreed) noting that an objection to proceedings by way of notice of motion must be taken at the outset or will have been waived. No such objection was taken in the present case. I think it is reasonably clear that Zurich could indeed have made this application in Bazetta's name even though it was attempting to vindicate its claim (through Bazetta) for reimbursement of the repair bill. The Local Court is not a court of strict pleading and it seems to me that no injustice or inconvenience arises from the form in which the application to set aside the consent judgment was made. At all events, it seems to me that the principle enunciated in *Metwally v University of Wollongong* [1985] HCA 28 applies -

[7] It is elementary that a party is bound by the conduct of his case. Except in the most exceptional circumstances, it would be contrary to all principle to allow a party, after a case had been decided against him, to raise a new argument which, whether deliberately or by inadvertence, he failed to put during the hearing when he had an opportunity to do so...

Accordingly, it is not appropriate that this ground be relied on in this appeal.

> 36. It is contended by the plaintiff that the Magistrate misconstrued the decision of Kirby J in *Irwin Johnson & Partners NSW Pty Ltd v Smith.* This submission is correct. But, since I have held that his Honour was correct in accepting the application of the *Morganite* priniciple to circumstances before him, this error is immaterial.
> 37. A number of other grounds complain that the Magistrate failed to give reasons for concluding that the consent judgment should be set aside. In my view, his Honour clearly indicated that the *Morganite* principle applied because the factual basis for its application was present and his reasons referred to the history of the events in sufficient detail to indicate why this was so.

Costs

> 38. It was submitted to the Magistrate by counsel for the plaintiff that, if the consent orders were set aside, there should be no order as to costs. He also submitted

that Zurich should pay Mr Chand's costs in respect of the initial proceedings on an indemnity basis because those costs had been thrown away by the order setting aside the consent judgment. In the result, his Honour, in setting aside the consent judgment (as I understand it), reserved the question of all the costs in respect of the proceedings to that point on the basis that there would now be a hearing of the entire proceedings, which was the appropriate context for determining this question. The amended summons asserts that his Honour erred in making a costs order against the plaintiff in favour of Zurich. If I am mistaken and the assertion is correct, I would not be disposed to hold that this was an error. The question of costs is plainly discretionary. The succeeding party is usually entitled to its costs. It is true that, in a sense, Zurich sought the indulgence of the Court but that was not because of any oversight on its part.

Conclusion

39. The summons is dismissed with costs.

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