SUPREME COURT OF QUEENSLAND

CITATION:	*Royal and Sun Alliance Insurance Plc v DMS Maritime Pty Limited* [2019] QCA 264
PARTIES:	**ROYAL AND SUN ALLIANCE INSURANCE PLC** ARBN 153 863 006 (appellant) **v** **DMS MARITIME PTY LIMITED** ACN 078 359 065 (respondent)
FILE NO/S:	Appeal No 530 of 2019 SC No 6807 of 2016
DIVISION:	Court of Appeal
PROCEEDING:	General Civil Appeal
ORIGINATING COURT:	Supreme Court at Brisbane – [2018] QSC 303 (Bond J)
DELIVERED ON:	22 November 2019
DELIVERED AT:	Brisbane
HEARING DATE:	13 June 2019
JUDGES:	Fraser and McMurdo JJA and Boddice J
ORDERS:	**The appeal be dismissed, with costs.**
CATCHWORDS:	CONTRACTS – GENERAL CONTRACTUAL PRINCIPLES – CONSTRUCTION AND INTERPRETATION OF CONTRACTS – INTERPRETATION OF MISCELLANEOUS CONTRACTS AND OTHER MATTERS – where the respondent and the Commonwealth entered into a contract for the design, manufacture and supply of Armidale Class Patrol Boats – where one such boat was in dry dock, in the respondent's possession, whilst the respondent undertook routine scheduled repairs and maintenance, in accordance with its contract with the Commonwealth – where an employee of one of the respondent's subcontractors caused a fire destroying the vessel completely – where the primary judge found the appellant was obliged to indemnify the respondent, under contracts of insurance, in respect of a sum the respondent had become liable to pay to the Commonwealth under a deed of settlement – where declaratory and other orders were made in accordance with that finding – where the appellant appeals those orders – whether the primary judge erred in reaching the proper construction of the contract between the respondent and the Commonwealth, the proper construction of the deed of

settlement between the respondent and the Commonwealth, the proper construction of the insurance contract between the appellant and the respondent and the quantification of any loss to be indemnified by the appellant

British Westinghouse Electric and Manufacturing Company Limited v Underground Electric Railways Company of London Limited [1912] AC 673, cited
Delta Pty Ltd v Mechanical and Construction Insurance Pty Ltd [2019] QCA 62, cited
Distillers Co Bio-Chemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd (1974) 130 CLR 1; [1974] HCA 3, cited
Drayton v Martin (1996) 67 FCR 1; (1996) 137 ALR 145; [1996] FCA 1504, cited
Hurlock v Council of the Shire of Johnstone [2002] QCA 256, cited
Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd (2015) 256 CLR 104; [2015] HCA 37, cited
Post Office v Norwich Union Fire Insurance Society Ltd [1967] 2 QB 363, cited
Royal Insurance Fire & General (NZ) Limited v Mainfreight Transport Limited (1993) 7 ANZ Insurance Cases 61-172, cited
Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd (1998) 192 CLR 603; [1998] HCA 38, cited
Vero Insurance Ltd v Baycorp Advantage Ltd (2005) 13 ANZ Insurance Cases 61-630; [2004] NSWCA 390, cited
Victoria v Tatts Group Ltd (2016) 90 ALJR 392; (2016) 328 ALR 564; [2016] HCA 5, cited

COUNSEL: S Couper QC, with S Gibson, for the appellant
R J Douglas QC, with S N McNeil, for the respondent

SOLICITORS: Norton Rose Fulbright for the appellant
Herbert Smith Freehills for the respondent

[1] **FRASER JA:** I have had the advantage of reading in draft the reasons of Boddice J. I agree with those reasons and that the appeal should be dismissed with costs. I propose to give some additional reasons concerning what seems to me to be the central issue in the appeal, an issue about the construction of one clause of a contract, which is raised in appeal grounds 1 – 3.

[2] These reasons are intended to be read with reference to the explanation of the background and the trial judge's findings which are described in Boddice J's reasons, but I will briefly summarise that part of the background which is directly relevant to the construction issue. The respondent contracted with the Commonwealth to design, manufacture, produce, deliver and maintain a fleet of Armidale Class Patrol Boats. The appellant is one of the insurers who agreed to indemnify the respondent against sums for which it became liable by reason of its legal liability under its contract with the Commonwealth for loss or damage to any vessel in the care, custody or control of the respondent for the purpose of being worked upon. One such vessel, HMAS Bundaberg, was destroyed by fire.

[3] The issue discussed in these reasons concerns the nature of the respondent's legal liability to the Commonwealth under clause 8.3.1 of their contract. The material part of that clause provides:

> "During the period in which DMS bears the risk of loss or damage of anything under clause 6.8, DMS shall promptly replace or otherwise make good any loss of, or repair the damage to, the thing at its cost". (There follows a proviso which is not submitted to bear upon the issue.)

[4] Clause 6.8.1.1 relevantly provides:

> "Except where it arises from an Excepted Risk, DMS bears the risk of and shall indemnify the Commonwealth against:
>
> a. any loss or damage to a Patrol Boat or any other Supplies until delivery in accordance with the Contract; and
>
> b. after delivery of a Patrol Boat or any other Supplies, any loss or damage to the Patrol Boat or other Supplies…". (This paragraph goes on to describe the particular circumstances in which it applies, each of which was met in this case.)

[5] Grounds 1, 2 and 3 in the notice of appeal contend that the trial judge erred in:

> "1. …[C]onstruing clause 8.3.1 of the Contract between the respondent and the Commonwealth of Australia ("the Commonwealth") as obliging the respondent to purchase a replacement vessel for the HMAS Bundaberg or to pay for the purchase by the Commonwealth of a replacement vessel.
>
> 2. …[F]ailing to hold that the relevant effect of clause 8.3.1, when read with clause 6.8.1.1 of the Contract, was that the respondent was obliged only to indemnify the Commonwealth for its actual monetary loss occasioned by the destruction of the HMAS Bundaberg.
>
> 3. …[F]inding that replacing ownership of the HMAS Bundaberg with the lease of an equivalent or better vessel, thereby providing functional replacement for the intended lifespan of the HMAS Bundaberg, did not meet the obligation imposed on the respondent by clause 8.3.1 of the Contract, notwithstanding that:
>
> a. the expert evidence was that the HMAS Bundaberg had no market value immediately prior to its destruction and would have had no market value at any relevant time;
>
> b. the respondent's pleaded case was that there was no second hand market for purchase of Armidale Class patrol boats and that the value of the HMAS Bundaberg to the Commonwealth was as a vessel available for deployment in the course of activities of the Royal Australian Navy (Further Amended Reply [6E]);
>
> c. the evidence of Mr Dove, the plaintiff's expert witness, was that remediation and unplanned maintenance costs

> to extend the life of Armidale Class patrol boats beyond 2022 was of the order of many millions of dollars."

[6] At the heart of the appellant's arguments under these grounds of appeal is a proposition that, if the market value of a lost ship is less than its replacement cost, the respondent satisfies its obligation under clause 8.3.1 by paying the Commonwealth the amount of the market value. In the course of rejecting that and related propositions the trial judge reasoned as follows:

> (a) The word "otherwise" in the expression "otherwise make good any loss of … the thing" in clause 8.3.1 suggests an equivalence between the making good and the replacement, the latter concept requiring a substitute or equivalent thing to that which was lost.
>
> (b) Consistently with that plain English meaning of the contractual text, clause 8.3.1 appears in a contract under which the respondent was obliged to supply Integrated Support Activities over a contractual service life of at least 15 years, the Patrol Boats were to be capable of performing in accordance with specified requirements for an average service life in excess of 20 years from the date of commissioning, at the end of the contractual service life the contractual contemplation was that the Commonwealth would have owned the Patrol Boats, clause 8.3.1 would apply for the whole of the contemplated life of the contract, that contractual promise applied to any "thing" within the contractual description "Patrol Boat" or other "Supplies" after it had been delivered and regardless of whether the thing was an entire Patrol Boat or a discrete item of equipment used by it and whether the damage occurred whilst the respondent or its subcontractor was in possession of it to carry out Integrated Support Activities.
>
> (c) Accordingly the proper construction of clause 8.3.1 was that the respondent must promptly and at its own cost either provide a substitute thing in the place of the lost thing or in some other equivalent way make recompense to the Commonwealth for the loss of the thing.
>
> (d) When the contract was made it would have been apparent to the parties that the only Armidale Class Patrol Boats to exist were those which would be made by the respondent under the contract, so that if one was lost during the period of the contract there would be no way for the respondent to provide such a boat of equivalent age and usage. Building a new boat was a more feasible option. Replacing a lost Armidale Class Patrol Boat with another one or with an equivalent boat would always likely confer a degree of benefit on the Commonwealth.
>
> (e) Since the only way of restoring the Commonwealth to the position of having a boat which was lost, or its equivalent, might result in a greater benefit being conferred upon the Commonwealth than if the boat had not been lost, the

contractual contemplation was that the respondent nevertheless would have to supply the lost boat or its equivalent.[1]

(f) Contrary to the appellant's argument, replacing the Commonwealth's ownership of a lost boat with a lease of a boat for the contractual term would not fulfil clause 8.3.1 because that would not give the Commonwealth something it would continue to own at the end of the contract. The underlying hypothesis in the appellant's construction, an assumption by the parties that at the end of the 20 year contractual service life the Patrol Boats would not have any possible value or utility to the Commonwealth, was not supported by evidence upon which the appellant relied for the proposition that they then had no market value.

[7] The appellant argued that the trial judge construed clause 8.3.1 too narrowly by proceeding upon the footing that "replace" connoted the respondent giving a boat to the Commonwealth and "otherwise make good" connoted the Commonwealth buying a boat and DMS paying the purchase price to the Commonwealth. In the appellant's submission that analysis construed "replace" too narrowly; that word was apt to comprehend both concepts the trial judge considered fell within the expression "replace or otherwise make good". That argument should not be accepted. In the context of a contract under which the respondent undertook to design, manufacture, produce, deliver and maintain the Patrol Boats, the ordinary meaning of "replace", in the contractual obligation that "DMS shall promptly replace or otherwise make good any loss of …" a Patrol Boat does not comprehend a payment by the respondent to the Commonwealth as compensation for an obligation assumed by the Commonwealth to purchase a Patrol Boat from a different entity. That would not be a replacement of the thing by the respondent, as clause 8.3.1 requires.

[8] The appellant also argued that the trial judge misconstrued "otherwise" in the same expression. In the appellant's submission, "otherwise" draws a distinction between "replacement" and "make good the loss", so that it should have been found that the loss was made good in this case by the Commonwealth using one of two vessels borrowed from the Australian Border Force for two years and thereafter by the Commonwealth entering into a bareboat charter agreement with National Australia Bank for a different class vessel for three years. As the trial judge considered, however, the word "otherwise" is used in clause 8.3.1 with its ordinary meaning of in another way or manner, or by other means; the making good of the "loss of … the thing" must involve something that differs from but is equivalent to the replacement by the respondent of the lost vessel. A lease of an equivalent or better vessel providing a "functional replacement" for the contractually intended lifespan of HMAS Bundaberg would not amount to the equivalent of a replacement of that vessel, which had been owned by the Commonwealth until it was lost.

[9] The appellant also argued that clause 8.3.1 should be regarded as detailing the means by which the indemnity promised in clause 6.8.1.1 is to be achieved. It was submitted that this construction was required to give meaning to the contract as a whole. The consequence was submitted to be that the construction preferred by the

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1 The trial judge applied by analogy observations made by Dr Lushington in a different context in *The Gazelle* (1844) 2 W Rob (Adm) 279; 166 ER 759.

trial judge should be rejected because that construction allowed the respondent something greater than an indemnity, thereby leaving no scope for the operation of clause 6.8.1.1. There is, however, no indication in clause 8.3.1 or elsewhere in the contract that the respondent's obligations are confined to an obligation to indemnify the Commonwealth in a way that falls short of the contractual promise to promptly replace or otherwise make good any loss of a vessel.

[10] To the extent that the contract contains any other indication upon that topic it indicates a contractual intention that accords with the trial judge's construction. Clause 8.7.4 obliged the respondent to effect and maintain a Ship Repairers' Liability Policy of Insurance in the name of the respondent and the Commonwealth which would insure the respondent for its liability for its own acts or omissions and the acts or omissions of certain others, including its sub-contractors. Clause 8.7.4d required that policy to include liability assumed by the respondent under clause 6.8.1.1b of the contract. Clause 8.8.2 of the contract provided that (with the directly relevant text emphasised):

> "If loss of or damage to any Patrol Boat or other Supplies, Materials, Plant and Equipment or GFM (for the purposes of this clause 8.8.2 only, the "Items") occurs whilst DMS bears the risk of loss of or damage for the same under clause 6.8 or 3.6.6:
>
> a. DMS shall:
>
> i. make the affected Item safe and secure;
>
> ii. notify the relevant insurers and comply with their instructions; and
>
> iii. promptly consult with the Project Authority to discuss the steps to be taken to:
>
> A. comply with its obligations under clause 8.3.1; and
>
> B. ensure that, to the greatest extent possible, DMS continues to comply with its other obligations under the Contract; and
>
> b. upon settlement of a claim under the relevant insurance policy relating to this loss or damage **the money received from this insurance will be paid to the Commonwealth and:**
>
> **i. be paid by the Commonwealth to DMS** in accordance with the procedure in clauses 7.2 or 7.3 (as applicable) **as and when DMS reinstates the loss of or damage to the relevant Item**; and
>
> ii. be the limit of DMS' entitlement to payment for reinstatement of the loss or damage.

(Clause 7.2 prescribes a procedure for the making, approving, and payment of claims by the respondent for Milestone Payments, and clause 7.3 prescribes a procedure relating to the payment of other contractual charges.)

[11] The appellant's submission that the expression in clause 8.8.2b(i) "reinstates the loss of … the relevant Item" is relevantly ambiguous should not be accepted. In so far as that provision contemplates that the Commonwealth is not obliged to pay insurance monies it has received to the respondent until the respondent "reinstates the loss of … the relevant Item" it is consistent with the trial judge's construction that "replace or otherwise make good any loss of … the thing" in clause 8.3.1 requires either replacement or another practically equivalent means of making good the loss.

[12] I record my agreement with McMurdo JA's additional reasons.

[13] **McMURDO JA:** I agree with the reasons which Boddice J has given for this appeal to be dismissed with costs, to which I will add what follows.

[14] I will discuss first those grounds of appeal which challenge the trial judge's reasoning and findings about the contractual position between the respondent and the Commonwealth of Australia. It is critical to understand the basis upon which the respondent was liable to the Commonwealth, before that liability became merged in the settlement between them, in which the respondent agreed to pay $31.5 million. The respondent's liability to the Commonwealth was, relevantly, to perform its promise within cl 8.3.1 of the contract. By the events which had occurred, the respondent was bound to "promptly replace or otherwise make good [the] loss of [the vessel] at its cost …". Conversely, the Commonwealth's entitlement was to have the contract performed. Its entitlement was not to an award of damages for the non-performance of the contract, or for the loss of the contact, nor was it a claim for damages for the loss of the vessel.

[15] Consequently, the respondent's liability to the Commonwealth was not according to the amount by which the Commonwealth was worse off for not having the vessel. The respondent was liable to perform its contract, by promptly replacing or otherwise making good the loss of the vessel.

[16] The first question was whether, on the proper interpretation of cl 8.3.1, the respondent was obliged either to supply the Commonwealth with a replacement vessel, or to pay for the purchase by the Commonwealth of a replacement vessel. The trial judge answered that question in the affirmative. That conclusion is challenged by the first ground of appeal. For the reasons given by Boddice J, and the additional reasons given by Fraser JA, that ground cannot be accepted. I need not add to what their Honours have said about the issue.

[17] By ground 2 of the appeal, it is contended that the trial judge erred in not holding that the effect of cl 8.3.1, when read with cl 6.8.1.1 of the contract between the respondent and the Commonwealth, was that the respondent was obliged only to indemnify the Commonwealth "for its actual monetary loss occasioned by the destruction of [the vessel]". This ground of appeal misconceives the nature of the respondent's liability to the Commonwealth, under cl 8.3.1 as I have described it. Of course, cl 8.3.1 had to be interpreted in the light of the contract as a whole, and, in particular, cl 6.8.1.1. But that did not mean that cl 8.3.1 was to be in some way given a meaning by which, like cl 6.8.1.1, provided an indemnity against a loss. The effect of the appellant's arguments, in this respect, would be to have cl 8.3.1 read so that it entitled the Commonwealth to no more than the performance of cl 6.8.1.1. That cannot be accepted, nor can ground 2 of the appeal.

[18] By ground 3, it is contended that the trial judge erred in finding that the provision of a leased vessel would not satisfy the obligation imposed by cl 8.3.1. In the way in which that ground was developed, again it involved a misconception of the respondent's liability under that clause. The respondent was not liable under that clause for damages; its liability was to perform the promise which was there expressed. Once it is accepted that, as the trial judge did, the respondent was obliged either to supply a replacement vessel or to pay what the Commonwealth required to acquire a replacement vessel, it can been seen that the promise within cl 8.3.1 could not have been performed by paying to the Commonwealth the cost of leasing an equivalent vessel.

[19] Ground 4 is a contention that the judge ought to have found that the Commonwealth's "loss by reason of the respondent's breach of [cl] 8.3.1" was measured by "the amount actually expended by the Commonwealth in obtaining [a] functional replacement of [the boat]". Again, the Commonwealth's entitlement was to the performance of cl 8.3.1 of its contract with the respondent, which, the Commonwealth ultimately accepted, was done by the respondent's payment of the sum of $31.5 million.

[20] What I have just said about ground 4 applies equally to grounds 8 and 9. Once it is concluded that the respondent was contractually obliged to supply a replacement vessel, or to pay for the purchase by the Commonwealth of a replacement vessel, it was irrelevant to consider whether the Commonwealth intended to renew the lease of the Cape Class vessels beyond 2020 (ground 8). Ground 9 is effectively a complaint of a specific legal error in considering whether the Commonwealth had mitigated its loss from what is put as the respondent's breach of cl 8.3.1. That ground must fail for the same reason for which ground 4 fails.

[21] By ground 10, it is contended that the judge erred in finding that the cost of replacing the vessel, after 2020, with one of the newly commissioned Offshore Patrol Vessels, "represented a compensable loss to the Commonwealth", because this was negated by the circumstance that the entire fleet of patrol boats was to be replaced with the new vessels because the fleet was not adequately performing its function. Again, it was not a matter of determining a compensable loss; rather, what had to be assessed was the likely cost of the purchase by the Commonwealth of a replacement vessel.

[22] Ground 11 is as follows:

> "The learned trial judge erred in holding that where the reasonableness of a settlement depends upon a determination as to whether the claimant against the insured had mitigated its loss and to what extent, the onus of proving the fact of mitigation and its extent lay upon the insurer, the appellant."

This ground challenges his Honour's reasoning as follows:[2]

> "If, contrary to my view of the law, the [appellant's] "mitigation" hypothesis should have been brought into account, in my view the onus of demonstrating the validity of the hypothesis would have been on the [appellant], and because the hypothesis does not account for

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2 [2018] QSC 303 ('Primary Judgment') at [115](c).

> the complete means by which the [boat's] functionality will be replaced, the theory is incomplete and I am not persuaded by it."

The correctness of that observation, which was not essential to his Honour's reasoning and his conclusion, need not be discussed. It is sufficient to say that the appellant's "mitigation" hypothesis proceeded upon the same misunderstanding of the interpretation of cl 8.3.1 and the nature of the Commonwealth's entitlement under it.

[23] I go then to some of the grounds of appeal which challenge the judge's reasoning about the contractual position between the appellant and the respondent. By ground 5 it is contended that the judge erred in construing cl 1(c) of the so-called Indemnity Settlement Deed, between the appellant and the respondent in November 2015, as permitting the respondent to establish the amount to which it was entitled to be indemnified by the appellant, by proving the amount which it had paid under a reasonable settlement with the Commonwealth.

[24] The appellant (and other insurers) had insured the respondent under policies in which, in each case, the insuring clause obliged the insurer:

> "[T]o indemnify [the respondent] for all sums which [the respondent] shall become liable to pay by reason of the legal liability of [the respondent] as shiprepairers for …
>
> (i) Loss of or damage to any vessel or craft upon which is the care, custody or control of [the respondent] for the purpose of being worked upon …
>
> …
>
> where such liability results from negligence of [the respondent], [its] servants, agents or sub-contractors occurring during the period of this insurance."

[25] As the trial judge explained, initially there had been a dispute between the parties about whether the appellant was obliged to indemnify the respondent for this occurrence at all, and it was that dispute which was resolved in the terms of the Indemnity Settlement Deed.[3] Relevantly, this deed provided as follows:

> "**Recitals**
>
> …
>
> 4. A claim has been made against [the respondent] under the ACPB Contract in respect of the fire and discussions with the Commonwealth are ongoing, although the quantum of liability has yet to be determined (**Commonwealth Claim**).
>
> …
>
> 5. [The respondent] has made a claim under the Insurance Policies seeking indemnity in respect of its liability to the Commonwealth for the damage to the HMAS Bundaberg (**HMAS Bundaberg Fire Claim**).

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[3] Ibid [49].

6. A dispute has arisen between [the appellant] and [the respondent] in relation to whether [the appellant] is obligated to indemnify [the respondent] under the Insurance Policies (**Dispute**).

7. On a without admissions basis, the parties have settled the Dispute on the terms set out below in full and final settlement of [the appellant]'s liability for the HMAS Bundaberg Fire Claim.

…

1 Confirmation of coverage

(a) Subject to paragraph (b) and (c) below, [the appellant] for its part and proportion alone confirms coverage for [the respondent] of the HMAS Bundaberg Fire Claim under the insurance policies and specifically confirms that [the appellant]:

(1) will indemnify [the respondent] in accordance with the terms of the Insurance Policies for the HMAS Bundaberg Fire Claim; and

(2) save for amounts/categories of claim that are not covered by the terms of the Insurance Policies (see [cl] 1(c) below), waives any right [the appellant] may have had to decline or reduce payment of the HMAS Bundaberg Fire Claim, including as a result of any acts or omissions of [the respondent] prior or subsequent to inception of the Insurance Policies.

(b) In consideration of the confirmation of coverage set out in paragraph (a) above, [the respondent] has agreed to accept 80% of the quantum to which it would otherwise have been entitled to be paid by [the appellant] under the terms of the Insurance Policies in full and final settlement of [the appellant]'s liability under the Insurance Policies.

(c) The parties agree that settlement of the Commonwealth Claim shall not be determinative of the amount to which [the respondent] is entitled to be indemnified for the HMAS Bundaberg Fire Claim under the Insurance Policies. Such amount to be indemnified shall be determined in accordance with the terms of the Insurance Policies alone.

…

…

4 Defence of Commonwealth Claim

The parties agree that:

(a) [The respondent] will keep [the appellant] fully advised of significant developments in the Commonwealth Claim. In particular, [the respondent] will advise [the appellant] without delay of any offers or proposals made in the Commonwealth Claim and shall without delay be offered the opportunity to

participate in any meetings or conferences (in person, by videocon, or by telephone as appropriate).

(b) Stephenson Harwood, for and on behalf of [the appellant], will be copied in to all advices from Herbert Smith Freehills relating to the dispute. All relevant advices already sent to [the respondent] will be provided to Stephenson Harwood within 14 days of the execution of this deed.

(c) No agreement on settlement of the dispute, or compromises shall be concluded by [the respondent] without [the appellant] having been given reasonable opportunity to comment. For the avoidance of doubt, [the appellant] acknowledges that it does not have the right to veto or (subject to clause 1(c) above) object to any settlement or compromise which [the respondent] wishes to offer or accept based on legal advice."

[26] The Indemnity Settlement Deed did not replace the insurance policy. Rather, it compromised a dispute between the parties about the operation of the policy, by expressing, with some qualifications, an acknowledgment by the appellant that the policy did provide coverage for the respondent in respect of this occurrence. Consequently, the Indemnity Settlement Deed must be read with the policy, and it is necessary to consider first its terms.

[27] By the insuring clause,[4] the policy indemnified the respondent for all sums which it should "become *liable to pay by reason of the legal liability of [the respondent]* … for … [the] loss of or damage to any vessel or craft … where such liability results from the negligence of [the respondent], [its] servants, agents or sub-contractors …" (emphasis added).

[28] By that clause the respondent had to establish that, prior to agreeing to pay the Commonwealth $31.5 million, it was under a legal liability to the Commonwealth for the loss of a vessel in its care, custody or control, for the purpose of being worked upon, and that this liability had resulted from the negligence of the respondent, its servants, agents or sub-contractors. His Honour found there was such a legal liability to the Commonwealth,[5] a finding which is unchallenged.

[29] What then had to be proved, according to the insuring clause of the policy, was that the respondent's liability to pay the $31.5 million sum arose "by reason of" that preceding legal liability of the respondent.

[30] The trial judge answered that question as follows:[6]

"(a) The plaintiff is entitled to establish the obligation to indemnify in respect of the $31.5 million settlement sum, by whatever manner of evidence establishes that the relationship between –

(i) the legal liability of the plaintiff to the Commonwealth for the loss of the Bundaberg; and

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4 Set out above at [24].
5 Primary Judgment [95].
6 Ibid [99].

(ii) the liability to pay the $31.5 million settlement sum to the Commonwealth,

was one of cause and effect so that the latter could be said to arise "by reason of" the former.

(b) In the circumstances of this case, proof of the reasonableness of the settlement in the sense contended for by the plaintiff would establish that the relationship between the legal liability and the settlement sum was such that the latter arose "by reason of" the former. It would negate possible factors that would interfere with that conclusion.

(c) Accordingly, the question should be answered in the affirmative."

[31] His Honour said that this conclusion found support "in the case law which has considered equivalent provisions under different forms of liability insurance policies",[7] where his Honour had said earlier in his reasons that:[8]

> "The usual meaning of a contract of insurance providing indemnity against sums which the insured becomes legally liable to pay to a third party is that the obligation to indemnify will arise when liability to pay the third party is established by judgment, arbitral award or reasonable compromise, and not before."[9]

[32] For the appellant, it is argued that the trial judge was wrong to say that his conclusion found support in the case law which had considered equivalent provisions under different forms of liability insurance policies. The appellant submits that the law in this respect is accurately described in this extract from *Colinvaux's Law of Insurance*, 11th Edition:[10]

> "The insured must, in order to recover from his insurers, demonstrate that he has incurred an actual liability within the scope of the policy, and that his liability has been established and quantified by a judgment, arbitration award or a binding settlement. The rule here is that a settlement is not binding on the insurer unless the insured can demonstrate that, had the matter been litigated, the amount of the settlement would not have exceeded the amount of the judgment."

The appellant's submission is that this statement reflects the effect of the authorities.[11]

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7 Ibid [100].

8 Ibid [89](a).

9 The trial judge citing *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363 at 373-374 per Lord Denning MR and at 378 per Lord Salmon LJ; *Bradley v Eagle Star Insurance Co Ltd* [1989] 1 AC 957 at 966 per Lord Brandon of Oakbrook (with whom Lord Keith of Kinkel, Lord Oliver of Aylmerton and Lord Jauncey of Tullichettle agreed); *Distillers Co Bio-Chemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 26 per Stephen J; [1974] HCA 3; *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603 at 626 [64] per Gummow J; [1988] HCA 38.

10 At 21-107.

11 Citing *Vero Insurance Ltd v Baycorp Advantage Ltd* (2005) 13 ANZ Ins Cas 61-630 at [48]–[49]; *Drayton v Martin* (1996) 67 FCR 1 at 14-15; *Enterprise Oil Ltd v Strand Insurance Company Ltd* [2000] EWHC 58 (Comm) at [167]; *Kernaghan v Corrections Corporations of Australia Staff Superannuation Pty Ltd (No 2)* [2007] FCA 1040 at [19]; *Metricon Homes Pty Ltd v Great Lakes Insurance SE* [2017] VSC 749; *Re Akron Roads Pty Ltd (In Liq) (No. 3)* (2016) 348 ALR 704 at 740

[33] In the respondent's submissions, it is said that the law is otherwise. It is submitted that, in a case such as the present, where there was no issue between the insurer and the insured that the insured had become liable to the claimant, and where the insurer had admitted its obligation to indemnify,[12] the quantum of the insurer's liability to the claimant may be established, as against the insurer, by a reasonable settlement with the claimant. It is said that this is the effect of recent decisions, even where the insurer has not repudiated the contract of insurance.[13]

[34] In *Vero Insurance Ltd v Baycorp Advantage Ltd*,[14] Tobias JA (with whom Giles and McColl JJA agreed) said that there were divergent lines of authority as to what, in this context, the insured must prove where there has been a settlement without the insurer's consent. He said:

> "[48] One line of authority favours the insured and establishes that provided the settlement is reasonable, the insurer is liable to pay the settlement sum: eg, *Edwards v Insurance Office of Australia* (1933) 34 SR (NSW) 88; *General Omnibus Company v London General Insurance Company Ltd* [1936] IR 596; *Distillers* at 9, 25. However the cases, which favour this approach, would seem to do so on the basis that the insurer has wrongfully repudiated liability.
>
> [49] The other line of authority favours the insurer and requires the liability of the insured to be established before the insurer is liable to indemnify. It holds that the insured's liability cannot arise by any compromise reached between the insured and the claimant without the insurer's consent. Actual liability of the insured must be established: see, for example, *Royal Insurance Fire & General (NZ) Limited v Mainfreight Transport Limited* (1993) 7 ANZ Insurance Cases 61-172 at 77, 976; *Drayton v Martin* (1996) 137 ALR 145 at 157."

Tobias JA said that the authorities on both approaches were collected and analysed in what he described as an illuminating and helpful article by Ms Kirsty Sutherland in (1998) 9 ILJ 257.[15]

[35] This divergence in the authorities was noted recently by Fraser JA in *Delta Pty Ltd v Mechanical and Construction Insurance Pty Ltd*.[16]

[36] In a judgment of this Court in 2002, *Hurlock v Council of the Shire of Johnstone*,[17] Williams JA (with whom White and Wilson JJ agreed) was of the view that the compromise of a third party's claim against the insured is "binding on the insurer,

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[244]; [2016] VSC 657 at [244]; *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1; [2007] HCA 36.

12 Albeit in this case to the extent of 80 per cent of its original exposure.

13 Citing *Weir Services Australia Pty Ltd v AXA Corporate Solutions Assurance* (2018) 359 ALR 314; [2018] NSWCA 100 and *Southern Classic Group Pty Ltd (t/as Southern Classic Cars) v Arch Underwriting at Lloyd's (on behalf of Syndicate 2012)* [2018] NSWSC 1272.

14 (2005) 13 ANZ Ins Cas 61-630; [2004] NSWCA 390 at [48]–[49].

15 Ibid at [50]; see also Marshall and Potts "Indemnity for Settlements: Proof of Underlying Liability?" (2008) 19 ILJ 97 and Traves "In what circumstances is an insurer bound by a judgment or settlement against its insured?" (2015) 26 ILJ 209.

16 [2019] QCA 62 at [13].

17 [2002] QCA 256.

… unless it is demonstrated that the compromise was unreasonable or that there was some other valid defence available" to the insurer as against the insured.[18] His Honour said that it made no difference that in that case, the insurer had not repudiated liability, but that there had been "a mere standing by (with full knowledge) on the [insurer's] part leaving the conduct of the antecedent proceedings [by the third party] to the [insured]".[19]

[37] On the authority of *Hurlock*, the trial judge was correct in his statement which I have set out above at the end of paragraph [30]. But the appellant argues that the trial judge was incorrect on that question and that his reasoning about the effect of cl 1(c) of the Indemnity Settlement Deed is thereby eroded. This was because it was the view of the trial judge that the cl 1(c) was intended merely to reflect the pre-existing situation under the policy. His Honour noted[20] that "on the [appellant's] construction, the [respondent] would have made it harder for itself to obtain indemnity than was the position before entering into the [Indemnity Settlement Deed]".

[38] The appellant further submits that if, absent the Indemnity Settlement Deed, the respondent was entitled to prove its loss by proving a reasonable settlement, the effect of cl 1(c) of that deed was to remove that entitlement. That argument cannot be accepted. In the second sentence of cl 1(c), the parties agreed that the amount to be indemnified was to be determined in accordance with the terms of the insurance policies alone. The parties thereby confirmed that the position between them, as to what was necessary in the proof of an entitlement to indemnity in a certain amount, was unaffected by the deed. If, as a matter of law, the respondent could prove that entitlement, in a certain sum, by proving the reasonableness of its settlement with the Commonwealth, then that position was confirmed, rather than precluded, by cl 1(c). By ground 5, it is contended that the judge erred in construing cl 1(c) as permitting the respondent to establish the amount of its entitlement in that way. That ground must be rejected.

[39] By ground 6, it is contended that the respondent could not prove the amount to which it was entitled to be indemnified, simply by proving that it had entered into a reasonable settlement with the Commonwealth. This is a more general contention, which does not depend upon the interpretation of cl 1(c) which I have just rejected. The appellant's submissions, as to the position under the policy (unaffected by the Indemnity Settlement Deed) are advanced in support of this ground. The effect of those submissions is that this Court should now hold that, in this context, the insured is not entitled to an indemnity in the amount of a settlement with the claimant, unless the insured can demonstrate that, had the matter been litigated, the amount of the settlement would not have exceeded the amount of the judgment.

[40] However, on the findings of the trial judge, and on the way in which the appeal has been argued, it is unnecessary to determine that question of law, and, more particularly, to decide whether this Court should depart from what was said in *Hurlock v Council of the Shire of Johnstone*. To explain that, it is necessary to say something about ground 7.

[41] By ground 7, it is contended that the judge erred in finding that the sum of $31.5 million represented a reasonable settlement in the circumstances. As the appellant's argument properly concedes,[21] if the trial judge's construction of the obligation

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18 Ibid at [31].
19 Ibid at [30].
20 At [89](c).
21 Appellant's Amended Outline of Argument, para 44.

under cl 8.3.1 was correct, settlement for a sum of $31.5 million was reasonable, "because that sum represented the construction cost of a replacement Cape Class vessel." That concession is consistent with the unchallenged findings by the trial judge that the amount of $31.5 million "was only the bare cost of the replacement vessel"[22] and that, "the cost of replacement with a Cape Class Patrol Boat, when evaluated with an assessment of the cost of modification so as to become functionally equivalent to the Armidale Class Patrol Boat, would have been a figure well above $31.5 million."[23] On his Honour's findings, not only was the settlement with the Commonwealth a reasonable one, this was a case where it was proved that the amount of the settlement would not have exceeded the amount of a judgment, had the matter been litigated. It follows that the question of law, sought to be raised by ground 6, is of no consequence. And this is a further reason for rejecting ground 5.

[42] The appellant's argument conceded that, like ground 7, the outcome on the remaining grounds of appeal depended upon whether the trial judge was correct in his construction of cl 8.3.1.

[43] In summary, none of the grounds of appeal can be accepted and I agree that the appeal should be dismissed with costs.

[44] **BODDICE J:** On 14 December 2018, the primary judge found the appellant was obliged to indemnify the respondent, under contracts of insurance, in respect of a sum the respondent had become liable to pay to the Commonwealth of Australia under a deed of settlement following the loss of a patrol boat destroyed by fire whilst in the respondent's possession. Declaratory and other orders were made in accordance with that finding.

[45] The appellant appeals those orders. At issue is the proper construction of a contract entered into between the respondent and the Commonwealth, the proper construction of the deed of settlement entered into between the respondent and the Commonwealth, the proper construction of the insurance contract entered into between the appellant and the respondent and the quantification of any loss to be indemnified by the appellant.

Background

[46] In 2003, the respondent and the Commonwealth entered into a contract for the design, manufacture and supply of Armidale class patrol boats. Pursuant to that contract, the respondent designed, manufactured and supplied a number of Armidale Class Patrol Boats over several years. One such boat was the HMAS Bundaberg.

[47] On 11 August 2014, the HMAS Bundaberg was in dry dock, in the possession of the respondent, whilst the respondent undertook routine scheduled repairs and maintenance, in accordance with its contract with the Commonwealth. Whilst doing so, an employee of one of the respondent's subcontractors caused a fire which spread quickly through the vessel, destroying it completely.

[48] It was common ground at trial that the circumstance of that loss meant the respondent became liable to indemnify the Commonwealth against "any loss or damage" to the vessel pursuant to clause 6.8.1.1 of its contract and, further, that the

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22 At [111].
23 At [112].

respondent became liable to the Commonwealth to "promptly replace or otherwise make good any loss of" the vessel pursuant to clause 8.3.1 of that contract.

[49] The calculation of that loss required consideration of the terms of the contract entered into between the respondent and the Commonwealth. One of the respondent's obligations under that contract was to provide integrated support services in respect of all vessels supplied pursuant to the contract, for the period of the contract. Those support services include ensuring the vessels were available for specified service hours per annum.

[50] At the time of the destruction of the HMAS Bundaberg, the respondent had valid, current policies of insurance, insuring the respondent for its contractual liability to the Commonwealth under the contract. Relevantly, for present purposes, by those contracts the appellant (and other insurers) agreed to indemnify the respondent "for all sums which [the respondent] shall become liable to pay by reason of the legal liability of [the respondent] as shiprepairers for … (i) loss of or damage to any vessel or craft which is in the care, custody or control of [the respondent] for the purpose of being worked upon …".

[51] On 10 June 2016, the Commonwealth and the respondent entered into a deed of settlement in respect of the Commonwealth's claimed losses under the contract as a consequence of the destruction of the HMAS Bundaberg. The terms of that settlement deed provided for the respondent to pay the Commonwealth a settlement sum of $31.5 million. That figure was reached on the basis that the loss of the HMAS Bundaberg necessitated its replacement by the Commonwealth purchasing a new Cape Class Patrol Boat.

Trial

[52] The trial was conducted on the basis of an agreed list of issues requiring determination. Those issues were:

1. In considering the quantum of the contractual liability of the respondent to the Commonwealth under the contract, what is the proper construction and effect of clause 8.3.1?

2. In considering the quantum of the appellant's liability to the respondent under the Insurance Policies, as amended by the Indemnity Settlement Deed, what is the proper construction and effect of clause 1(c) of the Indemnity Settlement Deed?

3. Is the respondent entitled to establish the quantum of the appellant's liability to the respondent under the Insurance Policies, as amended by the Indemnity Settlement Deed, by reference to a settlement of the contractual liability of the respondent to the Commonwealth under the contract provided that the respondent proves such settlement is reasonable in all the circumstances?

4. Was the Commonwealth Settlement Deed a reasonable settlement of the contractual liability of the respondent to the Commonwealth under the contract in all of the circumstances?

5. In assessing the reasonableness of the Commonwealth Settlement Deed, in respect of the contractual liability of the respondent to the Commonwealth under the contract:

(a) Was the measure of the liability the cost to the Commonwealth to purchase a Cape Class Patrol Boat as at 11 August 2014?

(b) If "yes" to 5(a), should that cost be reduced by reference to betterment, and if so, to what extent?

(c) In the alternative to 5(a), was the measure of the liability the market value of HMAS Bundaberg as at 11 August 2014?

(d) In the alternative to 5(a), was the measure of the liability the depreciated value of HMAS Bundaberg as at 11 August 2014?

(e) In the alternative to 5(a), was the measure of the liability that pleaded in paragraph 28(d)(iv)(C) of the defence?

(f) With respect to each of the above alternatives, was the measure of the liability to be determined by taking into account any costs savings to the Commonwealth of the kind pleaded in paragraph 22U to 22W of the defence?

6. If "no" to Issue 3, is the appellant's liability to the respondent under the Insurance Policies, as amended by the Indemnity Settlement Deed, to be calculated based on the appellant's share of the likely final judgment had the contractual liability of the respondent to the Commonwealth under the contract been determined at trial based on replacement of HMAS Bundaberg as pleaded in paragraph 48 of the statement of claim (capped at the defendant's share of the $31.5 million settlement sum)?

7. If "yes" to Issues 3 and 4, or alternatively if "yes" to Issue 6, what sum is payable by the appellant to the respondent in respect of the appellant's liability to the respondent under the Insurance Policies, as amended by the Indemnity Settlement Deed?

8. What sum, if any, is payable by the appellant to the respondent by way of interest on account of the appellant paying the $31.5 million settlement sum to the Commonwealth?

[53] The primary judge determined those issues as follows:

1. Clause 8.3.1 was properly to be construed as a promise promptly to restore the Commonwealth to the position of having the thing lost, or its equivalent. In reaching this conclusion, the primary judge observed that at the time of entering into the contract it would have been apparent to the parties that there would never have been a way to provide an Armidale Class Patrol Boat equivalent in age and usage to the one lost and that building a new one was a more feasible option. Whilst that form of replacement was always likely to carry with it an element of conferring some degree of benefit on the Commonwealth, in the form of betterment, the contract contemplated that course of action. Further, replacing ownership of a boat with a lease of a boat could not be that which the promise contemplated because it would not give the Commonwealth something which it continued to own at the end of the contract.

   The primary judge held that the respondent could fulfil its obligation on the proper construction of clause 8.3.1 by:

(a) Promptly providing the Commonwealth with ownership of a substitute Armidale Class Patrol Boat in the place of the one that was lost; or

(b) Promptly providing the Commonwealth with ownership of some other vessel with functionality and characteristics which were the equivalent of the lost Armidale Class Patrol Boat; or

(c) In some other equivalent way promptly making recompense to the Commonwealth for the loss of the boat (including by paying sufficient money to enable the Commonwealth to obtain a replacement thing itself and to make recompense for the fact of it having been lost).

2. The proper construction and effect of clause 1(c) of the settlement deed was that the appellant accepted an obligation to indemnify but insisted on the respondent proving quantum in accordance with the terms of the existing insuring clause. If the appellant had authorised the respondent to settle with the Commonwealth on a particular amount or within a particular range, the settlement in that amount or within that range would have been determinative of the quantum. Absent such authority, the respondent was obliged to prove the quantum in accordance with the insuring contract and that the settlement amount was reasonable.

   In reaching this conclusion, the primary judge expressly rejected that the operative effect of clause 1(c) was to exclude the possibility that proof of a reasonable settlement by the plaintiff might be determinative of the quantum.

3. The respondent was entitled to establish the quantum of the liability under the insurance policies by reference to the settlement of its contractual liability under the contract, provided the respondent proved such settlement was reasonable in the circumstances. Proof of the reasonableness of the settlement, in the circumstances of the case, would establish the requisite relationship between legal liability and the settlement sum as the latter arose by reason of the former.

4. The settlement deed was a reasonable settlement of the liability of the respondent to the Commonwealth under the contract. The settlement process was carried out by the respondent in good faith, after considerable research as to the appropriate options. A conclusion that the quantum of the Commonwealth's offer was "the lowest number of any feasible option" was reasonable, rational and well supported by evidence. It was also reasonable for the respondent to act on counsel's opinion, as that opinion contained, objectively, a reasonable approach. Further, the expert evidence supported a conclusion that the cost of replacement with a Cape Class Patrol Boat would have been a figure well above the settlement sum.

   In reaching this conclusion, the primary judge rejected contentions that an allowance for betterment should be deducted from a settlement sum; that moneys paid by the Royal Australian Navy to Australian Border Force could not be regarded as part of the cost of replacement; and that the respondent's liability to the Commonwealth was capped at the costs for the three year period of the lease.

5. The measure of the liability was the cost to the Commonwealth to purchase a Cape Class Patrol Boat, as at 11 August 2014. That cost should not be

reduced by reference to betterment and the measure of liability was not determined by the market value of the HMAS Bundaberg as at 11 August 2014, or its depreciated value as at that date, or as to the costs to charter a Cape Class vessel for the remaining period of the lease, or the ongoing costs of maintenance and remediation works.

6. This question was unnecessary to answer.

7. The sum to be paid to the respondent by the appellant was its agreed, calculated, adjusted share of the settlement sum.

8. Interest was payable in respect of sums withheld from payment to the respondent.

Appellant's submissions

[54] The appellant submits that the primary judge's construction of clause 8.3.1 was too narrow, rendering the words "otherwise make good" surplusage. The concept of otherwise making good a loss involves a recognition that there are ways in which the loss can be made good without the need to purchase a substitute vessel. The contractual obligation properly was to be regarded as relating to the availability of the vessels to perform their patrol functions during their service life. This construction would also give proper scope to the operation of clause 6.8.1.1, which required the respondent to indemnify the Commonwealth.

[55] A reading of that clause, with clause 8.3.1, supported the conclusion that the respondent was not obliged to pay the Commonwealth a sum greater than its actual loss, represented by the amount of its actual expenditure as a result of the loss of the Bundaberg. The expert evidence was that at the date of the loss the market value of the HMAS Bundaberg was nil. Further, the Commonwealth caused a Cape Class vessel in the possession of Australian Border Force to be made available to the Royal Australian Navy for a period of two years and thereafter entered into a lease of two Cape Class vessels for a three year period, with provision for an extension for a further two years. Those events demonstrated how the Commonwealth actually made good the loss. The cost of those steps represented the extent of any monetary liability of the respondent.

[56] If the primary judge's construction of clause 8.3.1 was correct, the appellant submits that the Commonwealth had an obligation to mitigate its loss, which it did by taking the steps referred to in the previous paragraph. There was an onus on the respondent to establish the quantum of the loss to the Commonwealth. Should it be alleged the HMAS Bundaberg had some scrap value, that onus was not met by the respondent.

[57] The appellant submits the primary judge erred in finding that the onus was on the appellant to demonstrate the validity of its hypothesis in respect of mitigation. The respondent was required to prove the amount of its liability to the Commonwealth. In that respect, it was relevant that there was no causal link, on the evidence, between the Commonwealth's decision to construct off-shore patrol vessels to replace all of the Armidale class vessels and the destruction of the HMAS Bundaberg. The cost of construction of those off-shore patrol vessels did not constitute part of the damages for which the respondent was liable to the Commonwealth.

[58] The appellant further submits that the primary judge erred in the construction of clause 1(c) of the settlement deed. That deed settled a dispute between an insured and the insurer as to whether the insurer was liable to indemnify at all. In that context, it was unsurprising an insurer would insist that the quantum of the loss be rigorously proven. The effect of clause 1(c) was to remove any entitlement the respondent had to prove its loss by proving a reasonable settlement. Accordingly, the settlement was not binding on the appellant unless the respondent established that, had the matter been litigated, the amount of the settlement would not have exceeded the amount of the judgment.

[59] Finally, the appellant submits that the settlement sum was not reasonable. The HMAS Bundaberg had no market value. Remediation and unplanned maintenance costs to extend its life beyond 2022 would have been many millions of dollars. The respondent knew that the lease would probably not be renewed beyond the existing three year period. Further, failure to accept the settlement offer would have had a long-term detrimental effect to the respondent's relationship with the Commonwealth.

Respondent's submissions

[60] The respondent submits the primary judge's construction of clause 8.3.1 was correct. First, the construction occurred against a background of unchallenged findings about "the context" in which the clause fell to be construed. Second, the service life of the HMAS Bundaberg was 2027, not 2022 as contended by the appellant. Third, the HMAS Bundaberg was destroyed in fact, meaning the Commonwealth no longer possessed the vessel as an asset and did not continue to enjoy the flexibility of a full vessel fleet.

[61] Against that background, providing a leased vessel for three years did not in any way adequately make good the loss to the Commonwealth of one of its vessels from the fleet. The provision of a vessel to the Commonwealth only for a period to the expiration of its service life is not making good the loss. Other options existed for the Commonwealth, such as an extension of the service life by re-fit, or scrap value. The HMAS Bundaberg was destroyed when it was about seven years through its service life of twenty years.

[62] Further, the actual expenditure incurred by the Commonwealth after the destruction of the HMAS Bundaberg was not determinative of the Commonwealth's entitlement to damages. There were a range of possibilities for calculation of the respondent's liability to the Commonwealth, consideration of which established that the settlement sum was reasonable. The settlement sum was also reasonable, taking into account the litigation risks at the time of settlement.

[63] The primary judge's findings properly recognised that the parties to the contract had agreed the remedy which was to follow destruction of the HMAS Bundaberg. The primary judge correctly rejected the appellant's contentions in respect of mitigation and as to the onus of proof. Whilst the onus of proof of proving a reasonable settlement lay on the respondent, once that was established, the onus of proof lay on the appellant to establish its allegations in respect of avoidable loss.

[64] The respondent submits the primary judge correctly held that the purpose of the settlement deed was to insist on the respondent proving the quantum of any established obligation to indemnify in accordance with the terms of the existing insuring clause. Clause 1(c) of that settlement deed provided that the mere fact of

settlement alone did not suffice to qualify the policy response. That did not exclude an entitlement to establish that the settlement was reasonable. On the evidence, that settlement was reasonable.

Notice of contention

[65] The respondent delivered a notice of contention asserting an alternative basis for a judgment in its favour, that had the Commonwealth commenced proceedings against the respondent and gone to trial, the Commonwealth would have recovered a likely final judgment of at least $43.29 million plus interest and costs, rendering acceptance of the settlement money reasonable in all the circumstances.

[66] The appellant submits that basis for the judgment ought to be rejected as the notice of contention depends upon, as a starting point, acceptance of the erroneous proposition that the Commonwealth's damages fell to be calculated by reference to the cost of purchase of the replacement vessel.

Consideration

Contract

[67] Construction of contractual terms is not to be undertaken in isolation. In *Victoria v Tatts Group Limited*[24] the plurality approved the enunciation of these relevant principles by French CJ, Nettle and Gordon JJ in *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd*:

> "[46] The rights and liabilities of parties under a provision of a contract are determined objectively, by reference to its text, context (the entire text of the contract as well as any contract, document or statutory provision referred to in the text of the contract) and purpose.
>
> [47] In determining the meaning of the terms of a commercial contract, it is necessary to ask what a reasonable businessperson would have understood those terms to mean. That enquiry will require consideration of the language used by the parties in the contract, the circumstances addressed by the contract and the commercial purpose or objects to be secured by the contract.
>
> …
>
> [51] Other principles are relevant in the construction of commercial contracts. Unless a contrary intention is indicated in the contract, a court is entitled to approach the task of giving a commercial contract an interpretation on the assumption "that the parties … intended to produce a commercial result". Put another way, a commercial contract should be construed so as to avoid it "making commercial nonsense or working commercial inconvenience". (***citations omitted***)"[25]

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24 (2016) 328 ALR 564.

25 (2015) 256 CLR 104 at [46] – [51].

[68] These principles render significant the observations of the primary judge as to the context within which clause 8.3.1 appeared and as to its likely purpose.[26] Those observations included the fact that the contract was not only for the design, manufacture, production and delivery of patrol boats to be owned by the Commonwealth and the provision of integrated support services over a contractual service life of at least 15 years, but a requirement that those patrol boats have a capability of performing specified functional and operational requirements for an average service life in excess of 20 years from the date they were commissioned. Further, at the end of the contractual service life it was contemplated that the Commonwealth would still own the patrol boats.

[69] As the primary judge correctly observed, the addition of the word "otherwise" suggests a link between the concepts of "replace" and "make good". That link, in the context of a contractual requirement for a lengthy average service life with the Commonwealth to retain ownership of the patrol boats, amptly supported the primary judge's conclusion that the proper construction of the obligation in clause 8.3.1 was, in the event of destruction of one of the relevant patrol vessels, a requirement that the respondent either provide a substitute equivalent vessel or in some other equivalent way make recompense to the Commonwealth for that loss.

[70] The fact that a consequence of the agreed promise may result in conferring a benefit on the Commonwealth, in the form of betterment, does not render that construction untenable. Reasonable business people, understanding the context of the agreement reached between the parties, would interpret the obligation in clause 8.3.1 as requiring nothing less. The primary judge rightly concluded that the contract contemplated that the plaintiff had that obligation notwithstanding that it might, in the circumstances, confer a form of betterment on the Commonwealth.

[71] That conclusion also disposes of the further contention of the appellant that the obligation to otherwise make good could be met by replacing ownership of a vessel with a leased vessel. The provision of a vessel which would not be owned by the Commonwealth at the conclusion of the lease would not constitute otherwise making good in the event of a loss of the vessel within the terms of clause 8.3.1. Such an interpretation gives proper force to the indemnity provided for in clause 6.8.1 of the contract.

[72] Grounds 1, 2 and 3 of the appeal fail for these reasons.

Settlement deed

[73] As the primary judge correctly observed, the settlement deed was a commercial compromise agreement entered into by corporate entities in the context of existing, operative insurance policies. That framework provides the context in which the proper construction and effect of clause 1(c) of the settlement deed was to be determined by the primary judge. In that context, the conclusion reached by the primary judge that clause 1(c) did not exclude proving that the settlement was reasonable was correct.

[74] Clauses 1(a) and 1(b) of the settlement deed confirmed the appellant's obligation to indemnify the respondent, in accordance with the terms of the existing current insurance policies, in respect of the claim for the loss occasioned by the destruction of the

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26 ARB 27 at [74].

HMAS Bundaberg. Against that background, clause 1(c) properly is to be interpreted as confirming an obligation on the respondent to prove the quantum of that loss.

[75] Generally, an obligation to indemnify under a contract of insurance will arise not only from a liability by the insured third party, as established by judgment or arbitral award. It includes an obligation arising as a consequence of a reasonable compromise of a legal proceeding.[27] Nothing in the context in which the settlement deed was entered into or in the text of that settlement deed supports a construction which would exclude proof of quantum by proving that the settlement entered into was reasonable in the circumstances.

[76] Grounds 5 and 6 also fail.

Mitigation

[77] Whilst it may be accepted that the principles of mitigation of loss, as enunciated in *British Westinghouse Electric and Manufacturing Company Limited v Underground Electric Railways Company of London Limited*, may be relevant to a claim for loss under the contract of insurance, the obligation must always be viewed in the context of the particular obligation and the relevant loss in question.[28] The observations of the primary judge in respect of mitigation must be viewed in that context.

[78] First, those observations occurred in the context of the proper rejection of the appellant's contention that any liability the respondent had to the Commonwealth was capped at the net present value to the Commonwealth of the lease costs for the three year period of the lease. Second, the primary judge correctly observed that the obligation imposed upon the respondent was to promptly replace or otherwise make good the loss of the HMAS Bundaberg, which had to be performed promptly after 11 August 2014.

[79] That obligation, properly understood in the context of all of the circumstances, required the provision of a replacement vessel or its equivalent value. Steps taken by the Commonwealth to address, in the interim, the loss of that vessel had no relevance to the liability of the respondent under the contract to meet those obligations.

[80] This conclusion renders unnecessary consideration of the appellant's grounds for appeal relevant to the question of onus of proof and the factual basis of any mitigation.

[81] Grounds 4, 8, 9, 10 and 11 also fail.

Reasonable settlement

[82] The appellant concedes that if the primary judge's construction of the obligation under clause 8.3.1 of the contract, and as to the relevance of any obligation to mitigate were correct, the settlement sum was reasonable in the circumstances.[29]

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27 *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603 at 626 [64].

28 [1912] AC 673 at 689-690.

29 Appellant's amended outline, paragraph 44; Transcript 1-67/20.

[83] On the basis of that concession, it is unnecessary to consider grounds 7, 12, 13 and 14. They, as a consequence of the conclusions in respect of those other grounds, must fail.

Conclusions

[84] The appellant has failed to establish any ground of appeal warranting interference with the reasons or orders of the primary judge. It is therefore unnecessary to consider the Notice of Contention.

Orders

[85] I would order that the appeal be dismissed, with costs.