SUPREME COURT OF QUEENSLAND

CITATION:	*DMS Maritime Pty Limited v Royal and Sun Alliance Insurance Plc* [2018] QSC 303
PARTIES:	**DMS MARITIME PTY LIMITED** ACN 078 359 065 (plaintiff) **v** **ROYAL AND SUN ALLIANCE INSURANCE PLC** ARBN 153 863 006 (defendant)
FILE NO/S:	SC No 6807 of 2016
DIVISION:	Trial Division
PROCEEDING:	Trial
DELIVERED ON:	14 December 2018
DELIVERED AT:	Brisbane
HEARING DATE:	19 – 21 March 2018
JUDGE:	Bond J
ORDER:	**The orders of the Court are:** **1. It is declared that the defendant is obliged to indemnify the plaintiff for the amount of the settlement sum which the plaintiff became liable to pay the Commonwealth of Australia under the Commonwealth Settlement Deed, pursuant to the terms of the Insurance Policies and the Indemnity Settlement Deed.** **2. The defendant must pay the plaintiff the sum of $15,852,453.75 as the amount of its liability to indemnify the plaintiff pursuant to the terms of the Insurance Policies and the Indemnity Settlement Deed, as declared in order 1.** **3. Pursuant to s 57 of the *Insurance Contracts Act* 1984 (Cth), the defendant must pay the plaintiff interest on the amount the subject of order 2, in the sum of $2,027,669.99 calculated to the date of judgment, and thereafter at the rate of $2,280.15 per day until the day on which payment is made.** **4. The parties will be heard on the question of costs.**
CATCHWORDS:	CONTRACTS – GENERAL CONTRACTUAL PRINCIPLES – CONSTRUCTION AND INTERPRETATION OF CONTRACTS – INTERPRETATION OF MISCELLANEOUS CONTRACTS

AND OTHER MATTERS – where the plaintiff and the Commonwealth entered into a contract pursuant to which the plaintiff supplied and provided in-service support for a patrol boat called the HMAS Bundaberg – where, whilst the HMAS Bundaberg was in the plaintiff's possession for the purpose of being worked on under the contract, the HMAS Bundaberg was destroyed by fire – where the plaintiff was liable to indemnify the Commonwealth against "any loss or damage" to the HMAS Bundaberg – where the plaintiff became liable to "promptly replace or otherwise make good any loss of" the HMAS Bundaberg – where the plaintiff and the Commonwealth settled the plaintiff's liability as to those obligations by way of settlement deed for $31.5 million – where the defendant insured the plaintiff for the plaintiff's contractual liability to the Commonwealth under the contract – whether the plaintiff's settlement with the Commonwealth fell within the proper construction of the plaintiff's obligation to indemnify the Commonwealth

INSURANCE – GENERALLY – CLAIMS GENERALLY – OTHER MATTERS – where the plaintiff and the defendant had a contract pursuant to which the defendant indemnified the plaintiff for its liability to a third party – where the plaintiff became liable to indemnify the third party for losses under the contract – where the plaintiff and the third party settled the plaintiff's liability by way of settlement deed for $31.5 million – where the plaintiff and the defendant entered into an indemnity settlement deed whereby the defendant accepted the obligation to indemnify the plaintiff for its liability to the third party but insisted on the plaintiff proving the quantum of that indemnity in accordance with the terms of the insuring clause – whether the plaintiff is entitled to establish the quantum of the defendant's liability to indemnify the plaintiff by reference to the settlement between the plaintiff and the third party – whether the plaintiff's settlement with the third party was reasonable in all the circumstances

Insurance Contracts Act 1984 (Cth) s 57

Clark v Macourt (2013) 253 CLR 1, cited

Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd (2015) 256 CLR 104, applied

Onley v Catlin Syndicate Ltd as the Underwriting Member of Lloyd's Syndicate 2003 [2018] FCAFC 119, applied

Ruckman v Nominal Defendant [2013] QCA 56, applied

*The Gazelle (*1844) 2 W Rob (Adm) 279, 166 ER 759, cited

Victoria v Tatts Group Limited (2016) 328 ALR 564, cited

White Industries Qld Pty Ltd v Hennessey Glass & Aluminium Systems Pty Ltd [1999] 1 Qd R 210, applied

COUNSEL:	R Douglas QC, with S McNeil, for the plaintiff S Couper QC, with G Coveney, for the defendant
SOLICITORS:	Herbert Smith Freehills for the plaintiff Norton Rose Fulbright for the defendant

Introduction

[1] In 2003 the plaintiff and the Commonwealth of Australia entered into a contract (**the Contract**) pursuant to which the plaintiff agreed to design, manufacture and supply Armidale Class Patrol Boats and to provide them with in-service support for a 15 year service period after commissioning.

[2] The HMAS Bundaberg was one of a fleet of 14 such boats built pursuant to the Contract. It was commissioned into service with the Royal Australian Navy in March 2007. Unfortunately, on 11 August 2014, whilst it was in the plaintiff's possession for the purpose of being worked on under the Contract, the Bundaberg was destroyed by fire.

[3] Pursuant to the Contract, the plaintiff became liable to indemnify the Commonwealth against "… any loss or damage to the [Bundaberg]" and also to "promptly replace or otherwise make good any loss of … the [Bundaberg]".

[4] For a period there was a dispute between the plaintiff and the Commonwealth as to what the plaintiff was required to do in order to discharge those obligations. That dispute was settled on 10 June 2016 when the parties entered into a settlement deed (**the Commonwealth Settlement Deed**) pursuant to which the plaintiff became liable to pay the Commonwealth a settlement sum of $31.5 million.

[5] The defendant (and other insurers) had insured the plaintiff for the plaintiff's contractual liability to the Commonwealth under the Contract. There was no dispute as to the various documents (**the Insurance Policies**) of which was comprised the insurance contract to which the defendant (and other insurers) were parties. By the relevant insuring clause in the Insurance Policies, the defendant (and the other insurers) had agreed:

> to indemnify [the plaintiff] for all sums which [the plaintiff] shall become liable to pay by reason of the legal liability of [the plaintiff] as shiprepairers for … (i) Loss of or damage to any vessel or craft which is in the care, custody or control of [the plaintiff] for the purpose of being worked upon ...

[6] By this proceeding, the plaintiff sought a declaration that the defendant is and was obliged to indemnify the plaintiff with respect to the $31.5 million settlement sum. It sought orders resolving the amount that the defendant should now pay to discharge its liability, together with interest thereon pursuant to s 57 of the *Insurance Contracts Act* 1984 (Cth).

[7] For the reasons which follow, in my view the plaintiff's liability to pay the $31.5 million settlement sum is and was to be regarded as falling within the insuring clause to which the defendant (and other insurers) had subscribed. The defendant is obliged to indemnify the plaintiff in respect of its liability to pay that sum and it should be so declared.

[8] It was common ground that if I formed that view, then, having regard to the defendant's share of the liability under the Insurance Policies and to a subsequent partial settlement between the plaintiff and the defendant, the plaintiff would be entitled to a judgment against the defendant in the amount of $15,852,453.75. Having regard to the findings which I will make as to the date as from which it was unreasonable for the defendant to have withheld payment of the amount which it owned under the Insurance Policies, the defendant is also obliged to pay the plaintiff interest calculated to the date of judgment in the amount of $2,027,669.99 calculated to the date of judgment, and thereafter at the rate of $2,280.15 per day until the day on which payment is made.

Factual background

The Contract

[9] The Contract was a written contract made on 17 December 2003. It was comprised of a number of parts, only four of which are presently relevant, namely (1) the conditions of contract; (2) Attachment A "Statement of Work" (or "SOW"); (3) Annexure A to the SOW "Ship Specification"; and (4) Attachment M "Glossary".

[10] By cl 1.6.1 of the conditions of contract, the plaintiff contracted to design, manufacture, produce and deliver the Patrol Boats. "Patrol Boats" was defined to mean the patrol boats described in the Ship Specification. Clause 3.2 of the conditions of contract set out the plaintiff's obligations in relation to design, development and production of the Patrol Boats, including that they be produced in accordance with the Ship Specification. Amongst other things, the Ship Specification required that the Patrol Boat would be capable of performing all of the specified functional and operational requirements "for an average life in excess of 20 years".[1]

[11] The Contract differentiated between a "Production Phase" and a "Support Phase". The Production Phase was defined as the period commencing on the "Effective Date" (namely the date the Contract was signed – 17 December 2003) and (unless the Contract was earlier terminated) ending on the date the last Patrol Boat was commissioned under the Contract. The Support Phase was defined as the period commencing on the date the first Patrol Boat was commissioned and ending (unless the Contract was earlier terminated) on the last day of the "Service Period" for the last Patrol Boat commissioned under the Contract. The Service Period for each Patrol Boat was defined as the period commencing on the date it was commissioned and ending 15 years after that date. As will appear, the Contract provided for the possible extension of that 15 year period by 5 years, which is consistent with the specification requirement for an average life in excess of 20 years. Also consistent with this was the contractual reference to the planned service life of the fleet being 20 years following acceptance of the last Patrol Boat.[2]

[12] During the Support Phase, the plaintiff was obliged to provide the "Integrated Support System" and to perform the "Integrated Support Activities" in such a way that the Commonwealth, in operating the Patrol Boats, could achieve the "Required Availability".[3] The "Integrated Support System" was defined as the planned system by which the fleet would be enabled to achieve the operational and performance outcomes provided for in the Contract as further described in annexure B to the SOW. "Integrated Support Activities" were any things or tasks which the plaintiff was, or may be, required to do to provide the Integrated Support System in accordance with the Contract. The "Required Availability" was defined by reference to the provisions in the SOW which specified certain operational availability outcomes.

[13] By the Glossary, the Contract defined "Supplies" as "the Patrol Boats, the Integrated Support System and any other goods and services including Intellectual Property and Technical Data required to be supplied under the Contract and included items acquired in order to be incorporated in the Supplies." The term was sufficiently widely drawn to incorporate the Integrated Support Activities. The conditions of contract also imposed the following obligations on the plaintiff:

(a) to ensure and warrant that any Supplies would be fit for purpose: cl 9.1.1; and

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[1] See cl 5.8.0-1 of the Ship Specification.

[2] See cl 5.3.6 of the conditions of contract and the definitions of "Life-of-Type"; "Mission System" and "Patrol Boat Force" in the Glossary.

[3] See cl 1.6.1 of the conditions of contract, read with applicable definitions in the Glossary.

(b) a warranty that the design, materials and workmanship in the Supplies conform with, and the Supplies meet the requirements of the Contract: cl 9.2.1.

[14] The Contract also addressed who bore the risk of damage occurring to a Patrol Boat or anything else which fell within the definition of "Supplies" during either the Production Phase or the Support Phase. As to this:

(a) By cl 6.8.1.1 the Contract provided (emphasis added):

> …, **[the plaintiff] 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**:
>
> i. **which occurs while [the plaintiff] or any Subcontractor is in possession of the Patrol Boat or other Supplies for the purpose of carrying out its Integrated Support Activities**;
>
> ii. to the extent it occurs as a result of [the plaintiff] or any Subcontractor carrying out its Integrated Support Activities to the Patrol Boat or other Supplies; or
>
> iii. which is caused by any act or omission of [the plaintiff] or any Subcontractor during the Production Phase, or by any damage to the Supplies which occurred prior to the delivery of the Patrol Boat or other Supplies.

(b) by cl 8.3.1, the Contract provided (emphasis added):

> **During the period in which [the plaintiff] bears the risk of loss or damage of anything under clause 6.8, [the plaintiff] shall promptly replace or otherwise make good any loss of**, or repair the damage to, **the thing at its cost** unless [there followed exceptions from that promise which are not presently relevant].

[15] By cl 1.7 of the conditions of contract, and subject to cl 1.8, the Contract commenced on the Effective Date, and would end on the 15th anniversary of the date the last Patrol Boat was commissioned under the Contract. Clause 1.8 provided for an optional 5 year extension of the Service Period for each Patrol Boat, and a concomitant extension of the term of the Contract. The option had to be exercised by the Commonwealth not less than 2 years prior to the end of the Service Period for the first Patrol Boat. The Contract also permitted the Commonwealth to terminate by notice in writing in the event of certain events happening or defaults by the plaintiff occurring, and also to terminate for convenience.[4]

[16] Thus, putting to one side the possibilities of extension of the contract period or early termination, the date on which the Contract would end was the end of the Service Period for the last Patrol Boat commissioned under its terms. At the time the Contract was entered into it would have been obvious that unless it was terminated early, it was likely to operate at least for the period of the Production Phase plus 15, and possibly 20, years.

[17] By the time that the Bundaberg was destroyed by fire, the following aspects of timing would have been apparent:

(a) The first Patrol Boat commissioned was the HMAS Armidale on 24 June 2005.

(b) The Service Period for the Armidale would, in the normal course, have ended in 2020.

(c) Accordingly, the deadline for contract extension would have occurred in 2018, so exercise of the option was still a possibility.

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[4] See cll 12.2 and 12.3 of the conditions of contract.

(d) The last Patrol Boat was commissioned in November 2007, therefore under clause 1.7 and other things being equal, the Contract would end in in 2022.

(e) If the option to extend was exercised that would have had the effect of extending the service life of the fleet to 2027.

[18] The only other matter to be noted is that by cl 12.1 the Contract contained a dispute resolution clause. It contemplated that in the event of any dispute arising from the Contract, the parties would, first, seek to negotiate a resolution; second, seek to agree on an alternative dispute resolution process; and, third, failing agreement about use of alternative dispute resolution process, the parties would be free to commence court proceedings.

The Armidale Class Patrol Boats required remediation

[19] As a result of the Commonwealth's border protection policies, between 2010 and 2013 the Armidale Class Patrol Boat fleet had been increasingly used in operational areas such as Christmas Island to intercept and turn back boats off the coast of Western and Northern Australia. These waters were characterised by high seas.

[20] Performance issues had been experienced in the Armidale Class Patrol Boat fleet, including corrosion to the internal and external areas of the boats; stern tube failures; structural cracking in certain parts of the hull; and propulsion system reliability issues.

[21] The cause, solution and responsibility for those performance issues had been the subject of ongoing discussion between the plaintiff and the Commonwealth from late 2012. The Commonwealth blamed the plaintiff for the problems. The plaintiff denied fault, contending that the Armidale Class Patrol Boat fleet had been subjected to operational requirements outside the contracted design parameters.

[22] Whoever was at fault, the result was an increased maintenance burden, which restricted availability and system reliability of the Armidale Class Patrol Boats. A remediation strategy was necessary.

[23] By early 2014, discussions between the plaintiff and the Commonwealth had turned to the possibility of their entering into a remediation deed with a view to adjusting the contractual relationship between them having regard to some form of agreed resolution of the remediation issues. There were communications between the two sides in late October 2014 and meetings thereafter with a view to reaching such an agreement by way of remediation deed, but ultimately those negotiations failed to achieve a result. By a letter dated 23 February 2015, the plaintiff terminated negotiations for a remediation deed.

[24] Negotiations for a settlement concerning remediation started up again between about August 2015 and November 2015, this time focusing on a "Contract Change Proposal". These negotiations were successful. By a deed dated 9 November 2015 (**the remediation deed**), the Contract was varied such that –

(a) the expiry date of the Contract was brought forward to 30 June 2017;

(b) the Commonwealth agreed to give the plaintiff a "not to exceed" budget for the carrying out of planned and corrective maintenance on the fleet until 30 June 2017; and

(c) the Commonwealth agreed to pay for the cost of remediating the fleet as an Ad Hoc Service in accordance with cl 7.9 of the conditions of contract[5] so long as the plaintiff managed the remediation process on its behalf at cost (i.e. no profit margin) until 30 June 2017,

[5] Clause 7.9 was the equivalent of a directed variation clause in a construction contract.

and otherwise, with one exception, the parties gave each other mutual releases from their obligations under the Contract.

[25] The exception to the remediation deed concerned "any obligation, Claim or liability arising out of, relating to or in any way in connection with the loss of HMAS Bundaberg on 11 August 2014." The parties had treated the resolution of that claim separately to the resolution of the remediation issues.

[26] As it transpired, during the period November 2015 to February 2017 the plaintiff by its subcontractors carried out and was paid for (1) the contemplated remediation work (at cost as provided for in the remediation deed); and (2) certain other additional work which was treated as not covered by that obligation. Some of the work was done by the plaintiff's subcontractor in Singapore and some was done by another subcontractor in Australia. The plaintiff's Mr Miller (of whom more later) deposed to an analysis of which part of the costs should be regarded as part of the contemplated remediation and which part should not. I accept his evidence.

The loss of the Bundaberg

[27] On 11 August 2014, the Bundaberg was in dry-dock in the possession of the plaintiff for the performance of routine scheduled repairs and maintenance pursuant to the provisions of the Contract.

[28] An employee of the plaintiff's subcontractor was welding on a vertical bulkhead in such a way as to cause a "blow through" which resulted in red hot metal slag falling onto combustible material behind the bulkhead, and out of sight of the welder. That caused a fire which quickly spread throughout the vessel, resulting in its destruction. The subcontractor had not taken reasonable precautions in the welding work, including by not having a fire sentry posted on the other side of the bulkhead in order to detect and extinguish fires caused in this manner.

[29] It was common ground before me that the circumstances in which the loss of the Bundaberg occurred meant that –

(a) by cl 6.8.1.1 of the Contract, the plaintiff became liable to indemnify the Commonwealth against "any loss or damage to the Patrol Boat"; and

(b) by cl 8.3.1 of the Contract, the plaintiff became liable to the Commonwealth to "promptly replace or otherwise make good any loss of … the [HMAS Bundaberg]".

[30] As at the time that the plaintiff became subject to those obligations to the Commonwealth under the Contract:

(a) There was no secondary market for Armidale Class Patrol Boats. Only 14 had ever been constructed and the other 13 were all in service with the Royal Australian Navy. In order to replace the Bundaberg with another Armidale Class Patrol Boat, the plaintiff would have had to build a new one. As Armidale Class Patrol Boats had been out of production for almost 7 years, the one-off construction of a replacement Armidale Class Patrol Boat would have been a very expensive proposition.

(b) The Bundaberg had been in service for about 7½ years. It would not have reached the end of the contractually-contemplated minimum 20 year service life until 2027. If the Contract was not terminated or extended, the Bundaberg would have been expected to be in service under the Contract for another 7½ years, until about March 2022. The deadline for extension of the Contract had not yet been reached, so the possibility of extension of the Service Period for 5 years beyond that still existed.

(c) It was known by both the plaintiff and the Commonwealth that, like the other Patrol Boats in the fleet, the Bundaberg required remediation for the problems which I have described under the previous heading.

[31] Further, although the remediation deed had not yet been made, there is no reason to think its terms would have been materially different if the Bundaberg had not been lost. Mr Miller suggested (and I would accept) that if the Bundaberg had not been destroyed, it is likely that the plaintiff would have scheduled its remediation under the remediation deed via the plaintiff's Australian subcontractor in the January-February 2017 timeframe. On the basis of the costs which were in fact incurred for remediation for each vessel Mr Miller opined (and I would accept) that it is fair to say that the Bundaberg's remediation would probably have cost $2.64 million.

The dispute with the Commonwealth as to the quantum of the plaintiff's liability

[32] The plaintiff's Mr Miller was an engineer with over 30 years' experience in senior management, engineering and consulting roles, primarily focused on the maritime defence industry. He was the plaintiff's Head of Operations between May 2014 and December 2015, with executive responsibility for the overall administration of the Contract. He was the plaintiff's officer in charge of examining the options by which the plaintiff could discharge its obligations to the Commonwealth consequent upon the destruction of the Bundaberg.

[33] I received evidence from Mr Miller in affidavit and testimonial form. His evidence was both credible and measured. I have no hesitation in accepting it. He knew that the plaintiff was insured, but had at an early stage been copied in on material which revealed that the insurer had not accepted liability. In my view his behavior and the judgments he formed during the course of negotiations with the Commonwealth were at all times consistent with how a prudent uninsured person in the position of the plaintiff would behave.

[34] In relation to the administration and management of the Contract, lines of communication had long been established between Mr Miller and the Commonwealth's Mr Evans, the Director General Specialist Ships for the Defence Materiel Organisation (a division of the Commonwealth's Department of Defence). Those lines of communication continued in relation to the resolution of the issues concerning the Bundaberg. Mr Evans was based in Canberra and Mr Miller in Melbourne. Mr Miller had regular ongoing contact with Mr Evans by way of emails and telephone calls approximately 2 or 3 times each week. He had known Mr Evans professionally since about 2006 when they each had roles in other companies which were in competition with each other. Mr Miller trusted what Mr Evans told him. There is no reason to think that was not a reasonable course of action.

[35] The plaintiff had, by its relevant officers, explored multiple options by which it could satisfy its contractual obligation to "promptly replace or otherwise make good" the loss of the Bundaberg. Mr Miller deposed to the analyses which were done and I accept his evidence.

[36] Mr Evans had from an early stage and on a number of occasions emphasized to Mr Miller the Commonwealth's preparedness to accept in principle that the plaintiff could meet its obligation to "promptly replace or otherwise make good" the loss of the Bundaberg by meeting the cost of the provision of an alternative vessel with acceptable functionality.

[37] Mr Miller took the view (and there is no reason to think that this was not a reasonable view) that the functionality provided by the Armidale Class Patrol Boats included at least the following requirements:

(a) To operate on continuous patrol, around the clock, for up to 42 days, in certain oceanic regions of interest to Australia, noting that some of these regions are

characterized by heavy weather and high sea states, all of which impose design requirements for range, endurance and "ride control" to ensure stability and seaworthiness in rough seas.

(b) To accommodate a Navy crew of a specified size plus a specified number of non-military passengers, such as asylum seekers or rescue survivors.

(c) To conduct secure, encrypted electronic communications regarding classified military matters using equipment that met demanding military specifications.

(d) To conduct gunnery operations at night or in low visibility, fire-control for which required a complex system of hardware and software including an electro-optical acquisition and control sensor.

[38] By September 2014, Mr Miller had considered and rejected the possibility of building a new Armidale Class Patrol Boat. The production line which had been used by the plaintiff's Australian subcontractor during the course of original construction had been closed for years, and equipment and other items essential for the vessels were no longer available. Mr Miller considered that a one-off new build was not a viable option. It might have been technically feasible, but would likely be cost-prohibitive. That view was later confirmed by expert reports dated 6 and 10 November 2014, which valued at $40,527,932 the cost to build a vessel with functionally identical to the Bundaberg in an Australian Shipyard using 2014 rates for labour and materials. Mr Miller did not see those figures until later, but when he did, thought that they were likely to be an under-estimate of what a rebuild would actually cost. As will appear, his view about likely cost was supported by the quantum of the claim eventually advanced by the Commonwealth on the basis of replacement.

[39] One possible option was a vessel referred to as an Inshore Patrol Vessel, which was in service with the Royal New Zealand Navy. That vessel was steel-hulled rather than aluminium-hulled but was dimensionally and operationally similar to the Armidale Class. The Commonwealth looked at this possibility but was unable to progress a long-term deal with New Zealand. Accordingly, this turned out not to be a feasible solution.

[40] Between September and November 2014, the plaintiff explored the possibility of procuring a commercial vessel with similar physical dimensions as an Armidale Class Patrol Boat and then modifying the vessel with a view to providing equivalent functionality. An approach was made to Clarksons Shipbrokers, but to no avail. The possibility of pursuing either of two vessel configurations offered by Damen Shipbuilders was explored. Initial cost estimates were $35.6 million for the first configuration and $48.9 million for the second. The problem with these options were, as the plaintiff later advised its insurers (and there was no challenge to the advice so given), (1) the cost was very high, and costs might increase when conversion started; and (2) the capability achieved would still be less than provided by an Armidale Class Patrol Boat.

[41] By letter dated 17 April 2015, the Commonwealth advanced a formal claim against the plaintiff on the hypothesis that the plaintiff was obliged to replace the Bundaberg with another Armidale Class Patrol Boat. It quantified the claim at $51,047,000, calculated by reference to the original build cost of the Bundaberg, indexed for inflation, together with a further $306,764.21 for other losses.

[42] On 20 April 2015, just after the Commonwealth had advanced its $51 million claim based on replacing the Bundaberg with another Armidale Class Patrol Boat, the Commonwealth (by Mr Evans) expressed to the plaintiff (by Mr Miller) its desire that the plaintiff indemnify it for the cost of a Cape Class Patrol Boat as a replacement for the Bundaberg rather than a modified Damen vessel. The Cape Class was a type of Patrol Boat then in production via a contractor named Austal. With some systems upgrades, a Cape Class

Patrol Boat could be made functionally equivalent to an Armidale Class Patrol Boat. Amongst other things, Mr Evans told Mr Miller that the Navy had formed a strong preference for the Cape Class vessels and proposed to acquire two such vessels, by a 3 year lease arrangement. It was not clear to Mr Miller why such a short term proposal was being advanced when the Bundaberg would have been in service for much more than 3 years, and he asked that question of Mr Evans by email the next day.

[43] Mr Evans' response made it clear that the Commonwealth had not finalized its plans as to how it would replace the functionality lost when the Bundaberg was destroyed. By email on 21 April 2015, he conveyed to Mr Miller that the 3 year lease proposal in respect of Cape Class vessels was only part of those plans. There would likely be a need to lease a further set of vessels for about the 7 year period from 2017 to 2024, where a new class of vessel (Offshore Patrol Vessels, or OPVs) would start to come in. Mr Evans referred to a need for a "White Paper" before plans could be finalized.

[44] The plaintiff's formal response to the Commonwealth's $51,047,000 claim was a letter of 15 May 2015. The plaintiff accepted liability to replace the Bundaberg. However, it contended the claim was excessive; it would be to "unjustly enrich" the Commonwealth if it were to be provided with the value of a new Patrol Boat in the place of a Patrol Boat which had been in heavy use for some 8 years; and that the realistic value of the Commonwealth's loss was the "pre-fire value" of the boat, namely between $16.245 million and $17.55 million. The quantum of the contention there advanced was based on an expert valuation opinion dated 6 November 2014, which valued the Bundaberg based on original cost of construction less an allowance for depreciation.

[45] In the meantime, by mid-late 2015, Mr Evans moved away from the position expressed in April 2015 and informed Mr Miller that the Commonwealth had settled on an arrangement whereby two Cape Class Patrol Boats were to be loaned to the Navy by the Australian Border Force for a period of two years until 2017, during which period the Commonwealth would then contract with Austal (a boat builder), via an arrangement whereby the National Australia Bank would own the vessels, to build two new Cape Class Patrol Boat expressly for the Commonwealth's use. The two Cape Class Patrol Boats on loan from the Australian Border Force would be returned to the Australian Border Force. The loan of vessels during the construction period came at a cost to the Navy.

[46] So far as the dispute between the Commonwealth and the plaintiff as to the quantum of the plaintiff's liability was concerned, the positions crystallized by the formal claim dated 17 April 2015 and the formal response dated 15 May 2015 were maintained when the Commonwealth delivered a formal position paper dated 31 July 2015 and the plaintiff responded on 3 August 2015. By that time the plaintiff had received advice from its solicitors that:

> There is a not insignificant risk that a Court could accept the Commonwealth argument that the obligation to 'make good' the loss requires [the plaintiff] to pay the full cost of the Commonwealth reinstating whatever equivalent Patrol Boat capacity it is able to find. If the only available replacement vessel is a new [Armidale Class Patrol Boat], the Commonwealth may be reasonable in contending that the present day value of reinstating the vessel is the minimum that will be sufficient to 'make good' the loss (although even if that be the appropriate measure of damages, we would query whether the original build cost indexed for inflation bears any relevance to the current cost of building another [Armidale Class Patrol Boat]).

<u>The dispute as between the plaintiff and its insurers</u>

[47] The plaintiff was insured against its contractual liability to the Commonwealth under the contract for the loss of the Bundaberg. The defendant was one of its insurers. Under the Insurance Policies the defendant agreed to indemnify as to 100% of a primary layer of $10 million and as to 50% of a first excess layer of $40 million in excess of the $10 million first layer.

[48] It is common ground that the clause of the Insurance Policies which operated as the insuring clause was in these terms:

> **Underwriters hereby agree**, subject to the limitations, terms and conditions hereinafter mentioned **to indemnify the Assured for all sums which the Assured shall become liable to pay by reason of the legal liability of the Assured as shiprepairers for**:-
>
> (i) **Loss of or damage to any vessel or craft which is in the care, custody or control of the Assured for the purpose of being worked upon** including shifting and moving within the limits of the port at which the work is being carried out and including trial trips but not exceeding 100 miles from such port;
>
> …
>
> (vi) Loss of or damage to third party property occurring in the course of or arising from the ship repairing operations of the Assured,
>
> **where such liability results from negligence of the Assured, his servants, agents or sub-contractors occurring during the period of this insurance.**

[49] An initial dispute between the plaintiff and the defendant as to whether the defendant should indemnify was settled on terms recorded in a deed dated 25 November 2015 (**the Indemnity Settlement Deed**). Relevantly, the Indemnity Settlement Deed provided:

> **Recitals**
>
> 1 On 17 December 2003, DMS entered into the APCB Contract with the Commonwealth of Australia (**Commonwealth**) for the supply and support of Armidale Class Patrol Boats (**ACPB Contract**).
>
> 2 On or about 20 February 2014 RSA agreed on certain terms set out in the Insurance Policies to indemnify DMS (among other things) in respect of any liability which DMS may incur to the Commonwealth under the ACPB Contract.
>
> 3 One of the vessels for which DMS was responsible under the APCB Contract, the HMAS Bundaberg, was destroyed by fire on 11 August 2014 whilst in the possession of a DMS subcontractor.
>
> 4 A claim has been made against DMS 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 DMS 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**).
>
> 6 A dispute has arisen between RSA and DMS in relation to whether RSA is obligated to indemnify DMS 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 RSA's liability for the HMAS Bundaberg Fire Claim.
>
> 8 The parties wish to enter this deed to record the terms of settlement and have effect in a manner that most effectively resolves any Claims of the parties against each other in relation to the HMAS Bundaberg Fire Claim.
>
> 9 RSA's obligations under this settlement and deed relate to its own liabilities under the Insurance Policies for its share or proportion of liability only. RSA has not acted for and does not act for and on behalf of any other insurer and nothing in this Deed shall constitute or be construed as constituting an attempt by RSA to bind any other insurer for its part.
>
> **1 Confirmation of coverage**
>
> (a) Subject to paragraph (b) and (c) below, RSA for its part and proportion alone confirms coverage for DMS of the HMAS Bundaberg Fire Claim under the insurance policies and specifically confirms that RSA:
>
> (1) will indemnify DMS 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 clause 1(c) below), waives any right RSA may have had to decline or reduce

payment of the HMAS Bundaberg Fire Claim, including as a result of any acts or omissions of DMS prior or subsequent to inception of the Insurance Policies.

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

…

2 Mutual Releases

Subject to clause 1 above being abided:

(a) each party releases and discharges the other party from any Claim that either party has or may have against the other in respect of the HMAS Bundaberg Fire Claim (the **Released Matters**).

(b) in support of the releases in (a) above each party covenants with the other party not to claim, sue or take any action against the other party in respect of the Released Matters. Each party acknowledges that the other party is entitled to enforce this deed directly and may plead this deed in bar to any Claim by the other party in respect of the Released Matters.

(c) the parties acknowledge that except as expressly dealt with by this deed, the terms of the Insurance Policies otherwise remain in full force and effect.

…[6]

4 Defence of Commonwealth Claim

The parties agree that:

(a) DMS will keep RSA fully advised of significant developments in the Commonwealth Claim. In particular, DMS will advise RSA 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 RSA, will be copied in to all advices from Herbert Smith Freehills relating to the dispute. All relevant advices already sent to DMS 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 DMS without RSA having been given reasonable opportunity to comment. For the avoidance of doubt, RSA acknowledges that it does not have the right to veto or (subject to clause 1(c) above) object to any settlement or compromise which DMS wishes to offer or accept based on legal advice.

Events leading up to the plaintiff's settlement with the Commonwealth

[50] At [41] to [46] above, I identified the way in which the respective positions of the plaintiff and the Commonwealth were crystallized and then formalized between April and August 2015.

[51] The next significant step was that a meeting occurred on 18 December 2015 between the plaintiff and the Commonwealth. Mr Evans represented the Commonwealth (although a Commonwealth lawyer was present by telephone). The plaintiff was represented by Mr Lantz, Mr Miller and Mr Makotsvana. Mr Lantz was general counsel of the plaintiff's parent company. He had first become involved after the receipt of the Commonwealth claim of 17 April 2015 and had been involved in drafting the response dated 15 May 2015. He was familiar with the competing positions there expressed and also as maintained in the Commonwealth's position paper dated 31 July 2015 and the plaintiff's response of 3 August 2015. Mr Makotsvana was a Financial Officer within the plaintiff's parent company.

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[6] Clause 3 expressed a confidentiality clause, the terms of which are unnecessary to record.

[52] Essentially three matters of note occurred, the last being the only matter of present significance. First, Mr Lantz conveyed that any settlement would require consultation with the plaintiff's insurers and sign off at parent company board level. Second, each party reiterated the positions which they had already conveyed during previous negotiations. In particular Mr Evans kept reiterating the proposition that the plaintiff had to replace or make good the loss of the Bundaberg by either replacing it with another Armidale Class vessel or with a vessel with equivalent operational capabilities, and the plaintiff's liability was not based on the depreciated value of the Bundaberg. Third, Mr Evans expressed what he described as the Commonwealth's best and final offer, namely that it would accept $31.5 million in full and final settlement of its claim.

[53] Mr Evans advanced the following explanation for the quantum of that offer:

(a) The Commonwealth had been in negotiations with Austal to build two Cape Class vessels, which would cost a base price of $31.5 million per vessel.

(b) The price of $31.5 million was a result of hard fought negotiations by the Commonwealth, was part of a 2 vessel build price, and did not take into account the costs of upgrading a Cape Class vessel with the necessary equipment to make it an equivalent in functionality and capability to the Bundaberg.

(c) Those costs would bring the base cost to over $40 million, but the Commonwealth was willing to absorb those additional costs if they could reach a settlement with plaintiff to pay the $31.5 million base build cost.

[54] Each of Mr Lantz, Mr Miller and Mr Makotsvana formed the view – based on the statements made by Mr Evans – that the $31.5 million offer was the lowest the Commonwealth was prepared to go in terms of compensation for the loss of the Bundaberg. They discussed it amongst themselves in another room. Mr Miller had the view that the Commonwealth offer of $31.5 million "was the lowest number of any feasible option that [the plaintiff] had considered". He saw no merit in trying to advance a contention that the figure should be further reduced by reference to the notion that the Commonwealth would not have to undergo the costs of remediation of the Bundaberg that they would otherwise have had to undergo, because he felt that such a course would simply cause the Commonwealth to return to the starting point of $40 million. The outcome of the internal discussion was that the plaintiff's representatives agreed that the position taken by the Commonwealth seemed to be a reasonable one.

[55] Following the private discussion, Mr Lantz conveyed to Mr Evans that the plaintiff understood the Commonwealth's position and the logic behind it and that it appeared reasonable. Mr Lantz explained that they would recommend acceptance of the offer but that it would be a matter for approval by the parent company board in consultation with their insurers. The meeting then ended with Mr Evans saying that he hoped to hear from them as soon as possible.

[56] Subsequent to the meeting, on 3 February 2016, Mr Evans followed up Mr Miller, reiterating the key points which he had made at the 18 December 2015 meeting, in these terms:

> Dave - I have not heard from you on the matter of the Bundaberg loss indemnification since our meeting on the 18th December last year with Robert Lantz. We have now spent a great deal of money setting up arrangements with Austal, Border Force, the Defence Minister's Office, not to mention Navy, to cover that loss, and we are going to need the recompense for that loss very shortly. To re-cap on only a couple of the major threads in those talks in your office prior to Christmas, I advised that -
>
> - The $31.5 Million figure provided is a floor level below which we will not go, and has had 8 months of hard fought negotiations with Austal to arrive at that replacement cost for the new-build boats which must replace Bundaberg, and the availability shortfalls arising from the hull

Remediation which could now cost $50 - $60 Mill, which the company should have covered and did not. We have not claimed that in our settlement discussions.

- As an indicator of how tough I've been on Austal in driving that cost down, you will find in the Australian National Audit Office report on the "Management of the Cape Class Patrol Boat Program" (in Customs & Border Protection), - ANAO Report No13 2014-15, that Customs paid $277.7 Million for 8 of the exact same Capes in August 2011. That cost does not include anything other than cash advances on the build, and equates to a vessel cost equivalent of $34.71 Million dollars each - over 4 years ago!! - the $31.5 Mill figure represents a cut of nearly 10% on significantly fewer boats to manufacture, and against an externally contested competitive tender process.
- The ANAO report is a matter of public record, and you will find the references at Pages 16 and 26 of that report. The Acquisition cost with spares ran to $316.5 Mill or just under $40 Million for each boat - to reiterate - in 2011 (see page 26). If you have trouble finding the ANAO report, give me a call and I will copy it for you. Note that on my initial approaches to then Austal Marketing Director - Dave Shiner, I was quoted $42 Million per boat as a "special favour" to Defence.
- Chief of Navy personally made the choice of replacement on the closet possible exemplar to the Armidales in selecting that replacement boat, despite other more readily available options being provided to him. The Cape Class boat is an Armidale family vessel.

We have covered a lot of ground in our discussions on this matter, and I won't repeat it all here, but there is no case for a market price on a specialised military asset like this, and the arguments over depreciated value have been had between the lawyers, and don't stack up. The $31.5 Million figure is the bottom figure, and it should be settled without delay, or I fear this set of discussions will be taken out of my hands, and head in a decidely [sic] different and sub-optimal direction.

Your attention to this matter will be most appreciated. - We have demonstrated our patience on a fire and catastrophic loss that occurred in August 2014, in quite unsatisfactory and frankly avoidable circumstances, and it is time to settle. Please bring this to a speedy conclusion for all our benefits.

[57] The offer, of course, was a lump sum offer, explained by reference to the costs of acquisition of Cape Class vessels. Yet, as I have already recorded, the plaintiff had been told that the Commonwealth intended to embark upon a lease rather than purchase arrangement. Mr Makotsvana asked Mr Miller to obtain details about the lease costs. On 12 February 2016, Mr Evans responded to the enquiry which Mr Miller had made of him in these terms (emphasis added):

Dave - Cape Class costs as follows -

- **Leasing for 3 years - $29.529 Mill for 2 boats - Required out to 2025 minimum!**
- ISS Costs for 2 Loan boats from Customs till early 2017 - $13.53 Mill for 2 years
- ISS Costs & Comms for Lease boats - ie, 2017 to 2020 - $27.21 Mill (detail list available)
- Crew Training - has been $640.8k - will repeat every 2 years.
- 2 x Ship managers funded at Customs (ACT) permanently, and 3 Project Staff at Henderson WA for the duration of CCPB Build and bring into Service & Close out (End of 2017) - $2.44 Mill annually
- Warehourse Spares & OAL - $1.2 Mill (per 12 mths)
- ICT Installation & Training - $417k for 2 years
- Extra Comms costs - FB500 data costs - $2.4 Mill (2 years) - List available
- 3G data costs - $480k (2 years)
- AMOS Licences, ECDIS Licences, MES & Liferaft, Change Certificate - ie, AMSA to Naval Flag - $200k+ at start

etc. These don't include all the bring into Navy service processes, re-run of SATs etc, nor the replacement of the Seaboat which can't handle 8 + 2 crew ($1 Mill per boat), etc

There is a variety of start-up, and then run costs which you'll be able to re-cipher from the list. **The costs need to be extrapolated out to 2025 which I have not had time to do (but can if you specifically need**

> **it), and we were not able to lease boats for a longer period by Minister Andrews - Had to be a 'stop gap' measure before replacement by OPVs from 2020.**
>
> Hope it helps - We are seriously out of pocket at a $31.5 Mill claim.

[58] Mr Miller reported on that information to Mr Lantz and Mr Makotsvana. Initially Mr Miller told them that he thought the Commonwealth was going to buy the two Cape Class vessels when the two boats on loan from the Border Force were returned. However he realized that was an error and he emailed them that:

> Current boats are loaners. The new boats being built now will be leased through NAB for 2-3 years and after that it gets very fuzzy due to uncertainty re the OPV program.

[59] Mr Miller was cross-examined on his understanding of the lease arrangements mentioned in various conversations with Mr Evans. He was also cross-examined on whether there was some inconsistency between the notion of costs being required out to 2025 minimum and the recognition that after the expiry of the NAB lease, it "gets very fuzzy due to uncertainty re the OPV program". His understanding was as follows:

(a) Of the two vessels the subject of the lease arrangements, one was intended by the Commonwealth as the replacement for the Bundaberg and the other was intended to replace the availability lost over the whole fleet because of remediation issues.

(b) He thought that Mr Evans' reference to "required out to 2025 minimum" was a reminder that the Commonwealth was entitled to expect that the Bundaberg would have been in service through to 2025.

(c) It was his understanding that the Commonwealth had not made any specific decision as to precisely how it would replace the loss of the capability of the Bundaberg after the leases expired.

(d) His reference to it getting "very fuzzy" after the expiry of the initial lease term was intended to convey that it was unclear to him whether the Commonwealth would extend the lease or pursue some other option for the replacement of the Bundaberg.

(e) He thought that none of this affected the extent of the plaintiff's obligation to replace or otherwise make good the loss of the Bundaberg.

[60] By letter dated 7 April 2016, Mr Evans confirmed the Commonwealth's position that it would not go below the $31.5 million offer in these terms:

> 1. It is now some months from our meeting on the 18th December 2015, where discussion and agreement was reached on the recompense of the Indemnity for the loss of HMAS BUNDABERG in a fire in Brisbane at August 2014.
>
> 2. We spent some hours in those talks where I covered the basis of the cost below which we cannot go, based on the capital costs of two new Cape Class Patrol Boats being built by Austal in Henderson, W.A. That capital cost of $31.5 Million was negotiated intensely over 8 months, and is substantially below the cost paid by Customs & Border Protection for their 8 Capes as contracted three years earlier in a competitive tender. Further, the Capes are the exemplar as judged by Chief of Navy, to be the boat most closely approximating the Armidale Class Patrol Boats.
>
> 3. It is now 20 months since the loss of BUNDABERG whilst under the control of [the plaintiff] at the ABA yard in Brisbane, and you advised that your insurer wanted the Revised In-Service-Support-Contract negotiations completed, before the Insurance claim on BUNDABERG would be considered. That time is now also well passed, and there will be no further negotiations on this matter.
>
> 4. We expect your payment of the settlement amount to us, by no later than the 31st May 2016. I would appreciate your confirmation that earlier verbal assurances on this matter will see the Indemnity cleared well inside the end of the current financial year.

[61] In further correspondence dated 28 April 2016, Mr Evans again put the Commonwealth position and requested payment by 31 May 2016. He was evidently frustrated at the lack of progress in resolving the matter, especially given what he thought had been a resolution

reached at the December meeting. Referring to that meeting he wrote (bold emphasis added):

> …
>
> 6. During those talks, **I discussed the three main methodologies of valuation of the loss, and believed that we achieved consensus by the end of the meeting that a "Market Value" methodology could not be validly applied to a bespoke design military asset, and I did relate to the gents that there were some 500 patrol boats on the world market at the time (I had personally checked!), and none would have made a satisfactory replacement, due to either being short, too long, too old, insufficient range, etc**.
>
> 7. **I demonstrated that the "Depreciated Value" methodology also had major shortcomings**, and noted that on Monday of the week of our December talks, Austal had advised the winning of the $63 Million dollar contract with Defence to build two Cape Class Patrol Boats. Chief of Navy, VADM Tim Barrett had personally selected these boats as the closest possible exemplar vessel to replace BUNDABERG. I advised the SERCO gents that the $31.5 million dollar unit price of those boats was significantly below the price that Customs had paid for their eight boat fleet two years prior. The Austal negotiations had taken eight months of my personal involvement, and one of those boats was the direct replacement of BUNDABERG. As a consequence, **I expressed the view that the "Replacement Cost" methodology of valuation most closely reflected our actual loss, and I specifically noted that the $31.5 Million dollar cost had no allowance for Spares & Consumables, etc, which would add millions of dollars**.

[62] Following receipt of the 7 April 2016 letter from the Commonwealth seeking demand of payment of $31.5 million by 31 May 2016, Mr Lantz decided to seek independent advice on the reasonableness of the Commonwealth's offer. Mr Lantz instructed a separate firm of solicitors who recommended that Mr Jackman SC be briefed to provide an opinion on the reasonableness of the offer. Mr Jackman SC and Ms Taylor of junior counsel were briefed on 3 May 2016 and their opinion was received on 10 May 2016.

[63] Counsel's opinion was that it would be reasonable for the plaintiff to accept an offer of $31.5 million in full and final settlement of the Commonwealth's claim.

[64] Counsel identified that there were, by the time of the Commonwealth's $31.5 million offer, at least four methods of valuing the loss of the Bundaberg, namely:

(a) the Commonwealth's initial claim of $51,047,000 based on cost of replacement with an another Armidale Class vessel;

(b) a Commonwealth claim based on the cost of making a Cape Class vessel functionally equivalent to an Armidale Class, which the Commonwealth had suggested was $40,500,000;

(c) replacement value on the same basis, but as valued by the plaintiff's own valuers in the sum of $40,527,932; and

(d) asset value of the Bundaberg as valued by the plaintiff's own valuers in the range of $16,245,000 to $17,550,000.

[65] Counsel considered that an analysis of the case law concerning the measure of damages when a vessel is lost due to actionable wrong was an appropriate means by which to assess the measure of the plaintiff's liability to indemnify the Commonwealth against the loss of its vessel.

[66] After an analysis of those authorities, Counsel expressed the following conclusions:

> 52. The Asset Value originally propounded by DMS in its negotiations with the Commonwealth (in the range of $16,245,000 to $17,550,000) is an inappropriate measure of damages, for at least the following reasons:
>
> a. The Asset Value range proceeds on the basis of an assumed market value, which (as the cases above establish) is not ordinarily the correct measure of damages for a destroyed vessel in respect of which there is no second-hand market;

b. The assumed market value on which the Asset Value range is based (ie. before the depreciation is applied) is unlikely to be made good on the evidence. There is no market for the vessels. Further, it is based on the cost of a new vessel when built with an economy of scale which is no longer available;

c. The Asset Value is likely to under-compensate the Commonwealth, as it cannot obtain the replacement vessel that it needs to carry out the functions of the HMAS Bundaberg for a price within that range. Where the vessel is a one-off (or, at least, was custom built as one of 14 vessels for particular navy purposes), the cost of reinstatement is a more reasonable measure of damages, as it was in *Randell*, and

d. …

53. On the other hand, the Replacement Value calculated by DMS' valuers significantly exceeds the Commonwealth's offer of settlement and is based on the cost of a newly built vessel (in the amount of $40,527,932). The cases referred to above are inconsistent as to whether the Commonwealth would be entitled to the cost of a newly built vessel without accounting for the benefit it receives by obtaining new for old. However, there are several cases which suggest that the concept of betterment would not apply in light of the fact that the Commonwealth arguably has no real choice in that there is no cheaper equivalent vessel available on the second-hand market. In any event, the Replacement Value is substantially higher than the Commonwealth's offer of $31,500,000, and on the basis of the limited information available we therefore consider that this figure provides adequate allowance for any hypothetical benefit to the Commonwealth as well as the uncertainty which arises in the case law on this issue.

54. Further, we consider that the Cape Class Alternative Replacement Cost put forward by the Commonwealth to justify its offer is calculated on a basis which is consistent with many of the above cases. We note our instructions that the Chief of Navy considered the Cape Class vessels to be the closest type to the HMAS Bundaberg. We have no reason to doubt the Chief of Navy's opinion on this issue, and in addition we consider it unlikely that DMS would be in a position to lead convincing evidence to dispute this claim. Nor have we, at this stage, any reason to doubt the Commonwealth's estimate for upgrading the Cape Class vessel to meet the requirements of the Armidale Class. If those assumptions are correct, the Commonwealth's claim to be entitled to a sum in the order of $40,500,000 is convincing. In forming this conclusion, we have had regard to the following:

a. The Cape Class Alternative Replacement Cost seems to us to be a reasonable calculation which would take account of the applicable principles such as those stated in *Randell v Atlantica Insurance Company Ltd* at 287 and *Port Kembla v Braverus* at [486]-[488], to the effect that the cost of reinstatement is appropriate where there is a vessel designed for the plaintiff's own use, and a plaintiff is not ordinarily obliged to account for any advantage or betterment which has been obtained by acquiring a new article for old in the case of a replacement after total loss; and

b. Further, and in any event, the offer of $31,500,000 makes a considerable allowance for any such benefit or advantage which might be obtained by the Commonwealth as a result of the reinstatement of a newly built vessel.

55. Each of the above bases for calculating damages does not make any allowance for the Commonwealth's other potential claims such as procurement, training, costs of maintaining a replacement vessel, and legal costs. As at 17 April 2015 the Commonwealth estimated these other potential claims at over $300,000. In addition, no allowance has been made for interest.

56. We are conscious of the fact that DMS might have arguments available to it to reduce the damages available from the Cape Class Alternative Value or the Replacement Value. For example, if further facts were available, in theory it might be possible to claim that the Commonwealth's claim to require a newly built upgraded Cape Class Patrol Boat is not reasonable in the circumstances (see, eg, *The "Maersk Colombo"* [2001] 2 Lloyd's Rep 275 and *Voaden v Champion* at [88], quoted above). However, any such argument would involve extensive factual inquiry, including the preparation of expert evidence, and would be the subject of contest in any final hearing. The reality is that a judge with no particular expertise in naval vessels and naval requirements would require compelling evidence before departing from what is *ex hypothesi* the view of the navy itself as to the suitability of the various vessels available and the operational requirements of the Navy. In the circumstances, we think that the figure of $31,500,000 provides ample allowance for the potential for the Commonwealth's best claim to be reduced on any such factual grounds which might be available.

> 57. We further note that litigation will be a lengthy, costly, and uncertain process. On balance, it is likely that the Commonwealth could be awarded damages greater than $31,500,000, together with interest on any award of damages. There is therefore a real benefit to DMS in obtaining a full and final settlement at this early time.
>
> 58. For all of these reasons, we consider that a settlement of $31,500,000 in final settlement of the Commonwealth's claim is reasonable.

[67] Obviously enough, Counsel's opinion supported the view which had been reached internally within the plaintiff and for which the plaintiff had expressed in-principle support at the December 2015 meeting with the Commonwealth.

[68] The plaintiff provided the opinion to the defendant and sought its support for a settlement in the terms proposed by the Commonwealth. That support was not forthcoming. There followed further correspondence between the plaintiff and the defendant culminating in an exchange of letters dated 27 May 2016. As to this:

(a) The defendant's letter of 27 May 2016 from the defendant included criticism that the plaintiff had not conducted adequate factual analysis of the differences between the Cape Class vessel and the Bundaberg, and because of this, "any settlement reached without a full factual enquiry as to the differences between the two types of vessels is not reasonable under Australian law." Further the defendant asserted that had this factual analysis been undertaken, it would have advanced a significantly lower settlement figure than $31,500,000.

(b) The plaintiff's letter dated 27 May 2016 rejected the defendant's approach; contended that any such "full factual enquiry" would be a waste of time and resources; pointed out various other alleged defects in the defendant's position (including that the defendant's conduct had been inconsistent with its obligations of good faith); and concluded with an advice that the plaintiff intended to accept the offer to settle the Commonwealth claim for $31,500,000.

[69] The Commonwealth Settlement Deed providing for the plaintiff to pay to the Commonwealth the sum of $31.5 million in 2 equal instalments was signed on 10 June 2016. The instalments were paid by the plaintiff on 23 June 2016 and 25 July 2016.

The list of agreed issues

[70] The plaintiff and the defendant agreed on a list of issues requiring determination by the Court. Subject to some re-wording for sense, I reproduce the list below.

1. In considering the quantum of the contractual liability of the plaintiff to the Commonwealth under the Contract, what is the proper construction and effect of cl 8.3.1?

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

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

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

5. In assessing the reasonableness of the Commonwealth Settlement Deed, in respect of the contractual liability of the plaintiff 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 (a), should that cost be reduced by reference to betterment, and if so, to what extent?

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

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

(e) in the alternative to (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 3, is the defendant's liability to the plaintiff under the Insurance Policies, as amended by the Indemnity Settlement Deed, to be calculated based on the defendant's share of the likely final judgment had the contractual liability of the plaintiff 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 3 and 4, or alternatively if yes to 6, what sum is payable by the defendant to the plaintiff in respect of the defendant's liability to the plaintiff under the Insurance Policies, as amended by the Indemnity Settlement Deed?

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

[71] I will address these issues under separate headings below.

Issue 1: In considering the quantum of the contractual liability of the plaintiff to the Commonwealth under the Contract, what is the proper construction and effect of cl 8.3.1?

[72] Relevantly the clause provided:

> **[the plaintiff] shall promptly replace or otherwise make good any loss of**, or repair the damage to, **[the Bundaberg] at its cost** …

[73] In *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104, French CJ and Nettle and Gordon JJ at [46]-[51] made the following statement of principle in terms which were subsequently approved by the High Court in *Victoria v Tatts Group Limited* (2016) 328 ALR 564 per French CJ and Kiefel, Bell, Keane and Gordon JJ at [51]:

> [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 inquiry 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.
>
> …[7]

[7] It is not necessary to quote the paragraphs which deal with the sometimes vexed issue of the use which may be made of extrinsic material, because that question does not presently arise.

> [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".

[74] The following observations may be made about the context within which cl 8.3.1 appeared and the likely purpose of the clause:

(a) The Contract was a contract to design, manufacture, produce and deliver Patrol Boats to be owned by the Commonwealth and to provide Integrated Support Activities over a contractual service life of at least 15 years.

(b) The Patrol Boats had to be capable of performing specified functional and operational requirements for an average service life in excess of 20 years, from the date they were commissioned. The relevant functionality and operational requirements are summarized sufficiently at [37] above.

(c) At the end of the contractual service life, although the plaintiff would no longer owe any contractual obligations to the Commonwealth under the Contract, the contractual contemplation was that the Commonwealth would still own the Patrol Boats.

(d) The cl 8.3.1 promise would apply for the whole of the contemplated life of the Contract. That means it would have applied during the Production Phase, but would also apply long after the Production Phase was completed.

(e) The promise would apply to cases in which there was fault by the plaintiff or its subcontractor (which might also give rise to a contractual remedy for damages)[8] and to cases in which there was not. In either case the promise to replace or otherwise make good applied.

(f) The promise to "replace or otherwise make good any loss of the thing at its cost" was a promise which, relevantly, applied to any "thing" falling within the conception of "Patrol Boat or other Supplies" after it had been delivered, where the damage to the thing occurred whilst the plaintiff or its subcontractor was in possession of the thing for the purpose of carrying out Integrated Support Activities.

(g) The thing which was lost could be as big a thing as the entire Patrol Boat, or as small a thing as a discrete item of equipment used by the Patrol Boat. Whatever it was, the evident object of the promise was that the Commonwealth would be promptly restored to the position of having the thing which had been lost.

[75] Against that background, relevant dictionary definitions of the text which the parties chose may be examined. They are as follows (emphasis added):

(a) The Macquarie Dictionary relevantly defines "replace" as follows:

> **2. to provide a substitute or equivalent in the place of**: *to replace a broken vase.*
>
> **3.** to restore; return; make good: *to replace a sum of money borrowed.*

(b) The Oxford English Dictionary relevantly defines "replace" as follows:

> **To provide a substitute for; to put an equivalent in place of** (something lost, broken, etc.).

(c) The Macquarie Dictionary relevantly defines "otherwise" as follows:

> **2. in another manner; differently**

(d) The Oxford English Dictionary relevantly defines "otherwise" as follows:

> **a. In another way or ways; in a different manner; by other means; in other words; differently. ….**

[8] See the warranties referred to at [13] above in relation to the performance of Integrated Support Activities.

(e) The Macquarie Dictionary relevantly defines the phrase "make good" as follows:

> **to make recompense for; pay for**

(f) The Oxford English Dictionary relevantly defines the phrase "to make good" as follows:

> a. **To put right a deficiency**.
>
> (a) ...
>
> (b) To repay (something that is owed); **to pay for; (more generally) to compensate** or atone for.
>
> (c) *transitive*. **To replace, repair, or restore to good condition (something damaged, faulty, or worn); to repair (damage)**. Also *intransitive*: to restore or repair something, esp. a surface; to fill or raise something up to a specified level. Frequently in *Building*.

[76] By adding "otherwise" to "make good", the text of cl 8.3.1 suggest a link between the conceptions of "replace" and "make good". It suggests that the making good must amount to an equivalent to replacement, a concept which itself required the provision of a substitute or equivalent thing to the thing lost.

[77] Accordingly, having regard to the plain English meaning of the text used and the context in which it appeared, the proper construction of the obligation is that if a thing is lost in a way which engages the promise, the plaintiff must, promptly and at its own cost, either provide a substitute thing in the place of the lost thing (the provision of an equivalent thing rather than an identical thing being permissible); or in some other equivalent way make recompense to the Commonwealth for the loss of the thing. Essentially the cl 8.3.1 promise is properly to be construed as a promise promptly to restore the Commonwealth to the position of having the thing lost, or its equivalent. The obligation could be discharged by the plaintiff either by itself promptly obtaining a replacement thing and providing it to the Commonwealth, or by paying the Commonwealth sufficient money to enable the Commonwealth to obtain the replacement thing itself and to make recompense for the fact of it having been lost.

[78] That articulation of the construction of cl 8.3.1 allows me to dispose of one argument advanced by the defendant.

[79] At the time the parties entered into the Contract, it would have been apparent that the only Armidale Class Patrol Boats in existence would be those which were going to be made under the Contract. In the event that one of them was lost during the period of the Contract in circumstances which engaged the cl 8.3.1 promise, there would never have been a way to provide an Armidale Class Patrol Boat equivalent in age and usage to the one which was lost, even if the loss occurred during the Production Phase of the Contract, and building a new one was a more feasible option. Replacing a lost Armidale Class Patrol Boat with another one (or even an equivalent), was always likely to carry with it an element of conferring some degree of benefit on the Commonwealth, in the form of betterment. What was the contractual contemplation in the event such betterment issues arose?

[80] Similar problems are well known in cases involving the assessment of damages where a commercial vessel has been lost due to a defendant's fault. Even though the present issue of construction cannot proceed on an assumption that the plaintiff was at fault, in light of the fact that I have construed the promise as being intended to provide for a prompt *restitutio*, I think the observations made by Dr Lushington in *The Gazelle* (1844) 2 W Rob (Adm) 279, 166 ER 759 are apposite:

> The right against the wrongdoer is for *restitutio in integrum*, and this restitution he is bound to make without calling upon the party injured to assist him in any way whatsoever. If the settlement of the indemnification be attended with any difficulty (and in those cases difficulties must and will frequently

> occur), the party in fault must bear the inconvenience. He has no right to fix this inconvenience upon the injured party; and if that party derives incidentally a greater benefit than mere indemnification, it arises only from the impossibility of otherwise effecting such indemnification without exposing him to some loss or burden, which the law will not place upon him.

[81] The observations which Dr Lushington made about the right of the injured party against the wrongdoer are entirely consistent with what the reasonable business person standing in the shoes of the present contracting parties at the time of contract would have thought about the intended content of the right of the Commonwealth against the plaintiff as obligor under cl 8.3.1, in the event that the lost thing was one of the Patrol Boats. If the only way of putting the Commonwealth in the position of having the lost boat, or its equivalent, was a course of action might have the effect of conferring a greater benefit on the Commonwealth than if the boat had not been lost in the first place (because a newer and less costly to maintain boat was provided), then the Contract contemplated that the plaintiff would nevertheless have to take that course of action.

[82] Another argument advanced by the defendant was that if one of the Patrol Boats was lost, at least in theory it would have sufficed, in effect, to lease an equivalent boat for the duration of the remaining service life of the Patrol Boat (or to pay the Commonwealth the monetary equivalent of the cost of such a lease). I reject that argument. 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. That hypothesis would involve attributing to the parties an assumption that at the end of the 20 year contractual service life, the Patrol Boats would have no possible value or utility to the Commonwealth. There is no evidence which supports that hypothesis and I reject it. The hypothesis is not supported by expert opinion evidence as to the absence of a market value of the Patrol Boats.

[83] In summary, on the proper construction of cl 8.3.1, in the event that one of the Armidale Class Patrol Boats was lost in circumstances which engaged the indemnity promise, the plaintiff became obliged, promptly and at its own cost, to restore the Commonwealth to the position of having the lost boat, or its equivalent. The plaintiff could fulfil its obligation by –

(a) promptly providing the Commonwealth with ownership of a substitute Armidale Class Patrol Boat in the place of the one which 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 the replacement thing itself and to make recompense for the fact of it having been lost).

Issue 2: In considering the quantum of the defendant's liability to the plaintiff under the Insurance Policies, as amended by the Indemnity Settlement Deed, what is the proper construction and effect of cl 1(c) of the Indemnity Settlement Deed?

[84] The Indemnity Settlement Deed is a commercial compromise agreement between an insured and an insurer. The relevant clauses are recorded at [49] above. The deed does, ultimately, re-express an indemnity obligation in an insurance context. But the construction of insurance policies does not call for any different approach to the approach identified in *Mount Bruce Mining Pty Ltd*. Thus, in *Onley v Catlin Syndicate Ltd as the Underwriting Member of Lloyd's Syndicate 2003* [2018] FCAFC 119 at [33], Allsop CJ, Lee and Derrington JJ referred to the "well-established principles concerning the

construction of policies of insurance as commercial contracts" in these terms (emphasis added):

> …. **Necessarily, a policy of insurance is assumed to be an agreement which the parties intend to produce a commercial result:** *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* (2014) 251 CLR 640 at [35]: **as such, it ought to be given a businesslike interpretation being the construction which a reasonable business person would give to it**: *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 343 ALR 58 at [17]; *Simic v New South Wales Land and Housing Corp* (2016) 260 CLR 85 at [78]; *Todd v Alterra at Lloyd's Ltd* (2016) 239 FCR 12 at 22–23 [42]; *Weir Services Australia Pty Ltd v AXA Corporate Solutions Assurance* [2018] NSWCA 100, [52]. **The contract is naturally enough interpreted, in a temporal sense, as at the date on which it was entered into**: *Ecosse Property Holdings* at [16] per Kiefel, Bell and Gordon JJ; *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 at 116 [47]; *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at [40]. **The Courts frequently have regard to the contextual framework in which a contract is formed, to the extent to which it is known by both parties, to assist in identifying its purpose and commercial objective**: *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 per Gleeson CJ at 589 [22]; *Mount Bruce Mining* at 117; *Franklins Pty Ltd v Metcash Ltd* [2009] 76 NSWLR 603 per Allsop P at 618 [19]. **It goes without saying that a construction that avoids capricious, unreasonable, inconvenient or unjust consequences, is to be preferred where the words of the agreement permit**.

[85] In my view a reasonable business person standing in the shoes of the plaintiff and the defendant just prior to entering into the Indemnity Settlement Deed would have been aware of at least this context:

(a) The respective parties had entered into the Contract and the Insurance Policies, and those documents contained the terms to which I have referred.

(b) Events had occurred on 11 August 2014 such that pursuant to cll 6.8.1.1 and 8.3.1 of the Contract the plaintiff had become the subject of the onerous contractual liabilities to the Commonwealth to which it had not previously been subject, namely:

(i) the obligation to indemnify the Commonwealth against the loss of the Bundaberg; and

(ii) the obligation to promptly replace or otherwise make good the loss of the Bundaberg at its own cost.

(c) The only open question as between the plaintiff and the Commonwealth was the quantum of that liability. As to that, negotiations had occurred and would occur in the future, but unless they were successful, the quantum of the liability would have to be resolved by an agreed alternative dispute resolution process, or in Court, in which the Commonwealth asserted a claim for damages for breach of the promise to indemnify.

(d) The plaintiff had made a claim on the insurers under the insuring clause seeking indemnity in respect of its liability to the Commonwealth, but the plaintiff and the defendant were in dispute as to whether the defendant was obliged to indemnify. Until the deed was entered into, as between the plaintiff and the defendant both liability and, necessarily, quantum were still live issues.

[86] Such a person would have reached the view that the purpose of the Indemnity Settlement Deed was to make it clear that the defendant accepted the obligation to indemnify, but intended to insist on the plaintiff proving the quantum of that indemnity in accordance with the terms of the existing insuring clause. That agreement and the extent of the compromise which was made are recorded in cll 1(a) and (b) of the Indemnity Settlement Deed.

[87] If the defendant had authorized the plaintiff to settle with the Commonwealth on a particular amount or within any particular range, then the settlement in that amount or within that range would have been determinative of the quantum to which the plaintiff was entitled to be indemnified. The possibility of such authority being given at some future

time existed, because cl 4 of the Indemnity Settlement Deed obliged the plaintiff to keep the defendant informed and to give it an opportunity to comment before striking any settlement. To my mind, the evident purpose of cl 1(c) was to make it clear that there was no such authority at the time of entering into the Indemnity Settlement Deed and that, absent such authority being given, the plaintiff would have to prove the amount it was entitled to be indemnified in accordance with the insuring clause and it could not prove that amount simply by proving the fact of settlement of the Commonwealth claim at a particular amount. I think that is its proper construction.

[88] The plaintiff does not suggest that proving the fact of settlement at a particular amount is determinative of the amount of the indemnity to which it is entitled. It accepts that it must prove more, and contends that it must prove the settlement was reasonable.

[89] The defendant attributes a much greater operative effect to cl 1(c). It contends that the purpose of the clause was to exclude the possibility that proof of a reasonable settlement by the plaintiff might be determinative of the quantum of the amount for which the plaintiff was entitled to be indemnified, so as to put the plaintiff in the position of having to prove what was the actual amount it was in fact legally liable to the Commonwealth. As to this:

(a) 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]

(b) These principles are and were well-known. Both parties to the Indemnity Settlement Deed were legally advised. If they had intended to exclude the operation of the "reasonable compromise" possibility of crystallizing indemnity, it would have been easy to add the adjective "reasonable" in front of "settlement" in cl 1(c). However they did not.

(c) In my view there is nothing in the text which the parties chose to express their intention which supports the defendant's construction. Indeed, on the defendant's construction, the plaintiff would have made it harder for itself to obtain indemnity than was the position before entering into the deed. The defendant's construction runs contrary to what seems to me to be the purpose of the deed. The reasonable business person standing in the shoes of the plaintiff and the defendant at the time of entering into the Indemnity Settlement Deed would not have thought the clause had the meaning which the defendant now attributes to it. Such a person would not have thought that the Indemnity Settlement Deed was intended to alter the means by which the quantum of the defendant's liability could otherwise be proved.

(d) I reject the defendant's construction of the clause.

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

[90] In my view the answer to this question requires a close focus on the terms of the insuring clause, quoted at [48] above.

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[9] See *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363 at 373-374 per Lord Denning MR, 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 (Bio-Chemicals) (Aust) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 26 per Stephen J; *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603 at [64], 626 per Gummow J.

[91] The elements of the insuring clause (eliminating words which are irrelevant for present purposes) are:

(a) Underwriters agree to indemnify the Assured;

(b) for all sums which the Assured shall become liable to pay;

(c) by reason of the legal liability of the Assured as ship-repairers for loss of any vessel which is in the care, custody or control of the Assured for the purpose of being worked upon;

(d) where such liability results from negligence of the Assured, his servants, agents or sub-contractors.

[92] Under the insuring clause the insured's right to an indemnity from the insurers will accrue on the happening of the insured event. In this case the insured event is the insured becoming subject to a liability of a particular character. It must (1) be a liability to pay a sum; and (2) the liability to pay the sum must have arisen in a particular way, namely "by reason of" a legal liability of a particular character, where that legal liability was caused in a particular way.

[93] The insured can establish the happening of the insured event by whatever evidence will prove on the balance of probabilities that the insured event has occurred. That there is a liability to pay a sum will usually be easily established, and in this case there was no dispute that the plaintiff had reached a deed of compromise with the Commonwealth which imposed a liability on it to pay a sum of $31.5 million to the Commonwealth.

[94] More difficult is the means by which the insured establishes that the liability to pay arose in the requisite manner. Under the insuring clause, what would be needed from the insured's point of view was evidence which explained how the liability to pay the sum arose, that evidence being such as would establish on the balance of probabilities that the liability to pay the sum met the description required by the insuring clause, in this case as set out in [91](c) and [91](d) above.

[95] I make the following observations:

(a) There was no dispute between the plaintiff and the defendant as to the terms of the Contract between the plaintiff and the Commonwealth, or that the Bundaberg was being worked on under the terms of that Contract.

(b) There was no dispute between the plaintiff and the defendant that the Bundaberg was in the plaintiff's care for the purpose of being worked upon by the plaintiff's subcontractor in discharge of the plaintiff's in-service support obligations under the Contract.

(c) There was no dispute between the plaintiff and the defendant that on 11 August 2014 a fire occurred in that context, destroying the Bundaberg.

(d) Nor was there any dispute between the plaintiff and the defendant that consequent upon those events, cll 6.8.1.1 and 8.3.1 of the Contract were engaged and the plaintiff became the subject of the onerous contractual liabilities to the Commonwealth to which it had not previously been subject, namely:

(i) the obligation to indemnify the Commonwealth against the loss of the Bundaberg; and

(ii) the obligation to promptly replace or otherwise make good the loss of the Bundaberg at its own cost.

(e) Further, the recitals to the Indemnity Settlement Deed note the Commonwealth had advanced a claim and that only quantum was disputed and the operative terms record that the defendant insurer agreed to indemnify the plaintiff.

(f) The foregoing were sufficient to establish that the plaintiff had a legal liability to the Commonwealth, and that the legal liability met the description of "a legal liability as shiprepairers for loss of any vessel which is in the care, custody or control of the Assured for the purpose of being worked upon".

(g) Further the terms of the Indemnity Settlement Deed (by accepting liability under the insurance claim and disputing only quantum) rendered it unnecessary to prove that the legal liability to the Commonwealth had resulted from "negligence of the Assured, his servants, agents or sub-contractors" (although the evidence before me established that fact anyway).

[96] If the plaintiff's case had stopped there, the plaintiff would have proved that it had become liable to pay a $31.5 million sum, but it would not have put the Court in the position to form the view that the liability to pay the $31.5 million sum arose "by reason of" the legal liability, the other requisite characteristics of which it had established.

[97] Of course the plaintiff's case did not stop there. It sought to prove the course of events which led up to the striking of the compromise, including the investigations which it made, the legal advice which it obtained, the decision-making process which it took, and the risks to which it was subject, to justify the proposition that the settlement was reasonable in all the circumstances.

[98] Whether the settlement was to be so regarded is the subject matter of issue 4, to which I will next turn, but the present question is whether the plaintiff was entitled to establish its claim under the insuring clause, having regard to the Indemnity Settlement Deed, by proving that the settlement was reasonable in all the circumstances.

[99] In my view the question posed by issue 3 must be answered in the following manner:

(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

(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.

[100] I reach the foregoing conclusion by reference to what seems to me to be the proper construction of the particular insuring clause in this case, bearing in mind the issues about which there was no dispute. The conclusion also finds support in the case law which has considered equivalent questions under different forms of liability insurance policies: see [89](a) above.

Issue 4: Was the Commonwealth Settlement Deed a reasonable settlement of the contractual liability of the plaintiff to the Commonwealth under the contract in all the

circumstances, having regard to the matters pleaded in paragraphs 18 to 37 of the Statement of Claim, paragraphs 18 to 37 of the Defence and paragraphs 4 to 18 of the Reply?

[101] Broadly speaking, the referenced paragraphs in the statement of claim pleaded the course of events which led up to the striking of the compromise, including the investigations which the plaintiff made, the legal advice which it obtained, the decision-making process which it took, and the risks to which it was subject, to justify the proposition that the settlement was reasonable in all the circumstances.

[102] The following observations may be made concerning the matters pleaded in the referenced paragraphs in the defence and the reply:

(a) The defendant contested the reasonableness of the settlement.

(b) The defendant pleaded that the Bundaberg had a number of defects that would have required ongoing maintenance and extensive remediation work. The plaintiff accepted the existence of the defects which would require remediation.

(c) The defendant contended that at the date of its destruction the market value of the Bundaberg was nil and it would have remained so, had it not been destroyed by fire. The plaintiff rejected that argument, contending that the fact that there was no second-hand market did not mean the Bundaberg had no value, and that its value to the Commonwealth could be measured by the amount which it would cost the Commonwealth to replace it.

(d) The defendant contended (and the plaintiff agreed) that –

(i) the Commonwealth had in fact covered the gap in availability caused by the loss of the Bundaberg by borrowing a Cape Class Patrol Boat from the Australian Border Force between 2015-17 while a new vessel was being constructed and then leasing a Cape Class Patrol Boat from the National Australia Bank between 2017 to 2020;

(ii) by in or about February 2016, the Commonwealth had decided that it would replace the Armidale Class Patrol Boat fleet with a new class of Offshore Patrol Vessels (OPVs) commencing in 2020.

(e) The defendant contended and the plaintiff did not admit that the three year term of the lease would not or was unlikely to be extended by the Commonwealth. The plaintiff rejected the relevance of the proposition in any event.

(f) The defendant contended and the plaintiff disputed that the borrowing of the Cape Class Patrol Boat from the Australian Border Force was at nil cost to the Commonwealth, despite the fact that the Navy incurred a cost to the Border Force, because both the Navy and the Border Force were instruments of the Commonwealth.

(g) The defendant contended and the plaintiff disputed that in those premises the maximum amount of the Commonwealth's loss was the net present value of the actual costs incurred by the Commonwealth to lease a Cape Class Patrol Boat from the National Australia Bank from 2017 to 2020 to replace the operational capability lost by the destruction of the Bundaberg at a cost of around $14.9 million.

[103] It is appropriate first to identify the approach which should be taken in assessing whether the settlement was reasonable.

[104] In *Ruckman v Nominal Defendant* [2013] QCA 56 at [16], White JA (with whom Fraser JA and Applegarth J agreed) applied the following summary of the leading High Court authority which had been made by the judge below (Martin J):

The primary judge considered *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603. The issues in that case were different from the present, however, an aspect of the litigation between that insured and the broker was whether the settlement reached between the insurer and the insured was a reasonable one. The primary judge summarised the following propositions:

(a) The test of reasonableness is an objective one. (Brennan CJ at [6] and Hayne J at [29])

(b) Evidence of the advice which the insured received to induce it to enter into the settlement is not proof in itself of the reasonableness of the settlement advised. (Brennan CJ at [6])

(c) Evidence of the receipt of advice is relevant but what will usually be much more important is the reasoning that supported that advice because that will usually disclose why it was thought reasonable to compromise the claim. (Hayne J at [129])

(d) The reasonableness of a settlement depends on the circumstances existing at the time, provided the plaintiff has acted reasonably in discovering the circumstances material to the settlement at that time. (Brennan CJ at [7])

(e) Reasonableness is not to be judged according to whether material which was obtained later shows that a different result might have been obtained. (Hayne J at [130])

(f) Consideration will often be required of whether the party maintaining that the settlement was reasonable had made sufficient inquiries and had sufficient information available to it to warrant reaching the compromise. (Hayne J at [131])

(g) In making that inquiry attention may need to be given to whether the cost of seeking further information would outweigh the benefit that it was reasonable to expect may be obtained from doing so. (Hayne J at [131])

(h) What is a reasonable compromise of the claim will almost always require consideration of the chances of the parties succeeding in their respective claims or defences and that prediction of likely outcomes must always be imperfect and imprecise. (Hayne J at [132])

[105] The point made at (e) is also the subject of direct authority in the Court of Appeal. In *White Industries Qld Pty Ltd v Hennessey Glass & Aluminium Systems Pty Ltd* [1999] 1 Qd R 210, Pincus JA observed at 218:

> A settlement which is reasonable, in the sense of being entered into in good faith after careful consideration and on proper advice, may later be proved to have been quite unnecessary, for example because some evidence comes to light which shows that the claim settled was in truth unsustainable. But such evidence would not displace the presumption that the settlement was reasonable, which was held to apply in *Wong v. Hutchison* (1950) 68 W.N. (N.S.W.) 55 at 58, nor show that the party agreeing to pay under the settlement acted unreasonably in doing so.[10]

[106] Against that background of the law, what assessment should be made as to the objective reasonableness of the settlement?

[107] In my view an assessment of the evidence leads plainly to the conclusion that the settlement was a reasonable one. And my view of the reasonableness of the settlement is such that I find that the liability to pay the $31.5 million settlement sum to the Commonwealth arose by reason of the legal liability of the plaintiff to the Commonwealth for the loss of the Bundaberg.

[108] First, the process by which the options were examined, advice taken, and the settlement reached was carried out by the plaintiff in good faith. It is common ground that the Commonwealth Settlement Deed was the culmination of a lengthy process of communications, negotiations and settlement discussions over a period of approximately 12 months, including the exchange of legal submissions in respect of the parties' respective settlement positions. Mr Miller's evidence was perfectly clear: he regarded the plaintiff's role in the negotiations to try to get the best deal (in the form of the lowest overall cost) which it could and still stay within the bounds of its contractual obligation.

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[10] Derrington J also expressed the view at 227 that "Even if it be shown that the loss was actually less in certain respects than the amounts allowed in the compromise of the claim, that will not necessarily mean that the settlement was not reasonable."

[109] Second, the research which was done under the supervision of Mr Miller into potential options was considerable. The conclusion that Mr Miller reached that the quantum of the Commonwealth's offer was "was the lowest number of any feasible option that [the plaintiff] had considered" was reasonable and rational, and well supported by evidence which the plaintiff then had. The plaintiff had made sufficient inquiries and had sufficient information available to it to warrant forming that view. Indeed it was common ground that the plaintiff had made reasonable sufficient inquiries and had sufficient information available to it to determine an appropriate compromise.

[110] Third, it was reasonable for the plaintiff to act on Counsel's opinion. Although Counsel's analysis of the content of the indemnity obligation did not replicate my own, in that Counsel considered that an analysis of the case law concerning the measure of damages when a vessel is lost due to actionable wrong was an appropriate means by which to assess the measure of the plaintiff's liability to replace or otherwise make good the loss of the Bundaberg, I think that was a reasonable approach to take. The fact that I have interpreted the promise to "replace or otherwise make good any loss of the thing at its cost" as a promise promptly to restore the Commonwealth to the position of having the thing lost, or its equivalent, means that there is and was a real corollary between the approach which should be taken to the assessment of the content of the promise to restore and the approach which is to be taken to the assessment of compensatory damages for actionable wrong. Both my analysis and that of Counsel reject the conclusion that there should be any adjustment for betterment.

[111] Fourth, the analysis contained in Counsel's opinion recorded at [66] above was objectively a reasonable approach to take and it was reasonable for the plaintiff to act on it. In my view, by the time of settlement, there was not a significant risk that the Commonwealth would obtain a judgment based on the cost of replacement with a new Armidale Class Patrol Boat, if it was forced to litigate its claim for indemnity. On the other hand, the asset value measures for which the plaintiff had contended were flawed, for the reasons which the Commonwealth argued and as Counsel concluded. There was a strong likelihood that any judgment would be based on the cost of replacement with a Cape Class Patrol Boat, modified so as to become functionally equivalent to the Armidale Class Patrol Boat. At the time of settlement, all the evidence pointed to a liability well above $31.5 million – because that figure was only the bare cost of the replacement vessel – suggesting a lack of merit in further and more detailed examination of the precise amount of the judgment which the Commonwealth would obtain at a trial.

[112] Fifth, it was common ground in the expert opinion evidence adduced by both the plaintiff and the defendant at the trial before me, 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. When one factors in the fact that any judgment obtained by the Commonwealth for such an amount would be inclusive of interests and costs, that conclusion alone provides further objective support for the reasonableness of the settlement at the bare cost of the replacement vessel without the requisite upgrades. It is not necessary further to delve into the differences between the expert opinions.

[113] Sixth, I reject the defendant's argument concerning the impact of the fact that the Bundaberg had a number of defects that would have required ongoing maintenance and extensive remediation work. First, the evidence at the time of settlement suggested that the difference between a reasonable assessment of the cost of a Cape Class Patrol Boat, modified so as to become functionally equivalent to the Armidale Class Patrol Boat, was so far above the $31.5 million settlement sum as to make it reasonable to ignore the issue. In this regard, I have already indicated that I accept Mr Miller's assessment that the likely amount which would have been spent on the Bundaberg for the remediation program was

$2.64 million. Second, the plaintiff's own thinking about not raising that issue was reasonable, namely that raising it might have caused the opportunity to settle at the base cost to be lost. Third, my assessment of the law (and that of Counsel in the opinion which the plaintiff obtained) is that the argument that an allowance for betterment (or costs savings consequent upon notionally receiving a newer non-defective boat) should be deducted was flawed.

[114] Seventh, I reject the defendant's argument against the inclusion in any assessment of notional liability to the Commonwealth of the cost to the Commonwealth of securing replacement vessels during the period of construction of the replacement vessels. The defendant's argument was that monies which the Royal Australian Navy paid to the Australian Border Force could not be regarded as part of the cost of replacement, because they were entirely internal to the Commonwealth. But the Commonwealth would undoubtedly be entitled to assert that the loss of its patrol boat for the period of construction of a replacement was a real loss to it for which it was entitled to be compensated: *McGregor on Damages* (19th ed., 2014) at 35-042 to 35-059. Had there been no settlement, and the Commonwealth had been forced to sue for damages for breach of the obligation promptly to replace or otherwise make good the loss of the Bundaberg, the Commonwealth would have been entitled to a substantial component of damages reflecting the loss of use. Using the hire charges which the Border Force charged the Navy may have been a sufficient basis for measuring that loss, giving a claim for of the order of $3 million over 2 years. Alternatively, the assessment may have been performed by reference to an interest on the capital value of the replacement vessel at the time of loss. It is unnecessary to be precise in working out how much that would have been: this factor is another reason why the settlement at $31.5 million (which was a bare cost figure and paid no regard to loss of use damages) was a reasonable settlement.

[115] Eighth, I also reject the defendant's argument that the evidence concerning the leasing transaction and the commencement of the replacement of the Armidale Class Patrol Boat fleet with a new class of vessels commencing in 2020, meant that any liability which the plaintiff had to the Commonwealth was capped at the net present value to the Commonwealth of the lease costs for the 3 year period of the lease. I make the following observations:

(a) The evidence before me suggested the details of the lease arrangements and the proposed replacements for the Armidale Class Patrol Boats were as follows:

(i) The Commonwealth financed the acquisition of the two Cape Class Patrol Boats by way of a Bareboat Charter Agreement through the National Australia Bank, which it entered into on 1 December 2015.

(ii) The Bareboat Charter Agreement was for a 3 year period (2017-2020) following delivery of each vessel, with a 2 year option (2021-2022). At the end of the period, the Commonwealth will not own the vessels and does not have any right to acquire the vessels under either the Master Bareboat Charter Agreement or the Shipbuilding Contract.

(iii) The charter of the first vessel commenced on 27 April 2017 and the charter of the second vessel commenced on 31 May 2017.

(iv) In 2017, the Naval Shipbuilding Plan, issued by the Department of Defence, indicated that the Offshore Patrol Vessels will be constructed from 2018. They will progressively replace the Armidale Class Patrol Boats. Known timelines suggest the first of the vessels will likely enter service in the early 2020s, with the last entering into service by 2030.

(b) Even if the plaintiff had known at the time of settlement that the Commonwealth had finally decided that it would replace the Armidale Class Patrol Boat fleet with a new class of vessels commencing in 2020 and that it definitely would not renew the lease of the Cape Class vessels, that fact would have been legally irrelevant[11] to the proper measure of the plaintiff's contractual obligation to the Commonwealth, or of the plaintiff's liability to the Commonwealth for damages for failure to perform its obligation promptly to replace or otherwise make good the loss of the Bundaberg. The obligation had to be performed promptly after 11 August 2014. The defendant argued that the Commonwealth must be regarded as having mitigated the loss which it suffered consequent upon the failure of the plaintiff promptly to replace or otherwise make good the loss of the Bundaberg. I reject that analysis. The pecuniary value of performance of that obligation had to be measured as at that the date it had to be performed, if the Commonwealth was to get the benefit of its bargain. What the Commonwealth did subsequent to receipt of the proper discharge of the obligation would be a matter for the Commonwealth and could have no bearing on its entitlement or the liability of the plaintiff under the Contract: cf *Clark v Macourt* (2013) 253 CLR 1 at [109] – [110] per Keane J.

(c) I also think that there are at least two other conceptual flaws in the defendant's argument. The logic seems to be this: (1) the contractual obligation was to replace the Bundaberg's functionality for the period in which it would have been available; (2) it may be accepted that the contractual contemplation was that the Bundaberg's functionality would have been expected to be available until 2022, and, at the option of the Commonwealth, until 2027; (3) however the Bundaberg's functionality has in fact been replaced by a combination of a vessel loaned from the Border Force and by a 3 year lease which is unlikely to be renewed; (4) therefore all that is required is to measure the cost of the 3 year lease. In the first place, I have already explained that one cannot ignore the fact that the replacement obligation required the replacement of the lost Bundaberg with a replacement which would be owned by the Commonwealth: see [82] above. But more importantly, the identification of the way the Commonwealth has replaced the Bundaberg's functionality over the contractually contemplated period is too limited. If part of the Bundaberg's functionality is being replaced over the period contemplated by the Contract by the functionality made available by bringing forward the construction of Offshore Patrol Vessels so that one or more of those vessels does the job which would have been done by the Bundaberg during the period in which the Bundaberg should have been available, then that must come at a cost to the Commonwealth, yet the defendant's theory pays no regard to that cost. If, contrary to my view of the law, the defendant'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 defendant, and because the hypothesis does not account for the complete means by which the Bundaberg's functionality will be replaced, the theory is incomplete and I am not persuaded by it.

(d) And even if I am wrong about the points made in the previous two subparagraphs, the reasonableness of the settlement is not to be judged according to material which was obtained later which shows that a different result might have been obtained: see [104] and [105] above. I observe:

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[11] This conclusion is not gainsaid by the fact that Mr Lantz, at least, would have regarded such a fact to be commercially relevant. We are here concerned with measuring the value of legal rights, not with arguments which might have been capable of being deployed in a commercial negotiation. That the point made no difference to the legal assessment is consistent with the evidence before me which demonstrates that such information would not have altered Mr Jackman SC's opinion if he had known it at the time.

(i) The evidence of the witnesses before me did not justify a finding that at the time of the settlement the plaintiff knew that the lease would not or would probably not be renewed, because the Commonwealth's plans in relation to the Offshore Patrol Vessels were not sufficiently clear to the plaintiff. Certainly that was Mr Miller's position, and he was the plaintiff's officer who its decision makers relied on for factual and costing detail. In any event, his evidence was the most persuasive of the witnesses from whom I heard. He said he never had the understanding that the Commonwealth would have a 3 year lease, and otherwise not seek to replace the Bundaberg.

(ii) The defendant sought to rely on – as an admission justifying such a finding – the statement made in the plaintiff's solicitors instructions to Mr Jackman SC in November 2017 (when seeking a follow up opinion). Their instructions were that a summary which they recorded of the defendant's allegations was "largely accurate … and mostly known to [the plaintiff] (without the minute details) at the time it accepted the settlement offer – However [the plaintiff] did not ever consider this to be relevant (and still does not consider it to be relevant)".

(iii) But I do not regard the fact and wording of those instructions to be a secure basis to make such a finding: the summary of the defendant's case was expressed in the present tense and incapable of being known at the time of settlement; there is too much imprecision in the alleged admitting words; and I do not know how precise the solicitors were in formulating the instruction. I accept Mr Miller's position and regard it to be demonstrating the reasonable extent of the plaintiff's knowledge at the time of settlement.

(e) In any event, even now it is not clear that there definitely will not be a renewal of the lease. The lease provides for one renewal and a further renewal could be negotiated. Further, the replacement vessels will be commissioned over a period of years, so presumably there will continue to be a need for Armidale Class Patrol Boats (or their replacements) for some time.

[116] For the foregoing reasons, I conclude that the settlement was a reasonable one and the question posed by issue 4 should be answered in the affirmative. My finding as to the reasonableness of the settlement also justifies my conclusion that the liability to pay the $31.5 million settlement sum to the Commonwealth arose by reason of the legal liability of the plaintiff to the Commonwealth for the loss of the Bundaberg.

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

Issue 5(a): Was the measure of the liability the cost to the Commonwealth to purchase a Cape Class Patrol Boat as at 11 August 2014?

[117] I have explained my conclusion that, on the proper construction of cl 8.3.1, on 11 August 2014 the plaintiff became obliged, promptly and at its own cost, to restore the Commonwealth to the position of having the Bundaberg, or its equivalent. The plaintiff could have fulfilled its obligation by –

(a) promptly providing the Commonwealth with ownership of a substitute Armidale Class Patrol Boat in the place of the Bundaberg; or

(b) promptly providing the Commonwealth with ownership of some other vessel with functionality and characteristics which were the equivalent of the Bundaberg; or

(c) in some other equivalent way promptly making recompense to the Commonwealth for the loss of the Bundaberg.

[118] The prompt payment of money was an obvious way to make recompense to the Commonwealth for the loss of the Bundaberg. In order for that way to be equivalent to prompt restoration of the Bundaberg, the requisite amount of money would have to be at least the same as the cost as at 11 August 2014 of acquisition of a Cape Class Patrol Boat and of making such improvements to it as would make it equivalent in functionality to an Armidale Class Patrol Boat. It would also have to include an amount representing general damages for loss of the use of a Patrol Boat equivalent to the Bundaberg, for the period it would take to have a replacement built.

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

[119] No, for the reasons discussed at [79] to [81], [110] and [115](b).

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

[120] There was no secondary market for Armidale Class Patrol Boats. Any attempt to reach a market value unless by reference to replacement cost of an equivalent vessel, would inevitably under-compensate the Commonwealth. This question must be answered in the negative.

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

[121] No, the provision of depreciated value would not have been sufficient to discharge the obligation owed under the Contract. That measure would inevitably under-compensate the Commonwealth.

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

[122] The measure pleaded in the referenced paragraph of the defence was "the net present value of part of the actual costs incurred by the Commonwealth to charter a Cape Class vessel from the National Australia Bank from 2017 to 2020, but only insofar as those costs were directly attributable to replacing operational availability lost by the destruction of HMAS Bundaberg".

[123] The question should be answered in the negative for the reasons discussed at [115] above.

Issue 5(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?

[124] The referenced paragraphs of the defence provide as follows:

> 22U. By in or about November 2015, and before the entry into the Commonwealth Settlement Deed, the Commonwealth had assumed the financial obligation for the costs of ongoing maintenance and remediation works in respect of the remaining Armidale Class Patrol Boats.
>
> 22V. If HMAS Bundaberg had not been destroyed, the Commonwealth would have assumed the financial obligation for the cost of the ongoing maintenance and remediation works for HMAS Bundaberg.
>
> 22W. The ongoing maintenance and remediation cost to the Commonwealth over the remaining service life of HMAS Bundaberg if it had not been destroyed would have been $17.58 million, or alternatively, a lesser sum of several million dollars. Particulars will be supplied after disclosure and non-party disclosure.

[125] No, the incurrence of costs savings is to be treated in the same way as betterment issues and for the same reasons.

Issue 6: If "no" to Issue 3, is the defendant's liability to the plaintiff under the Insurance Policies, as amended by the Indemnity Settlement Deed, to be calculated based on the defendant's share of the likely final judgment had the contractual liability of the plaintiff 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)?

[126] This question is unnecessary to answer because Issue 3 was answered in the affirmative.

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

[127] The sum to be paid to the plaintiff is $15,852,453.75 (being the agreed calculation of the defendant's adjusted share of a $31.5 million sum paid by the plaintiff to the Commonwealth).

Issue 8: What sum, if any, is payable by the defendant to the plaintiff by way of interest on account of the defendant paying the $31.5 million settlement sum to the Commonwealth?

[128] The plaintiff has claimed interest pursuant to s 57 of the *Insurance Contracts Act* 1984 (Cth) in respect of its claim for $15,852,453.75. That section obliges an insurer in the position of the defendant to pay interest on the amount of its liability under a contract of insurance at a prescribed rate for the period commencing on the date from which it was unreasonable for the defendant to have withheld payment of the amount.

[129] The parties provided me with a spreadsheet which would give rise to an agreed calculation, once I made a finding as to the date from which it was unreasonable for the defendant to withhold payment.

[130] The plaintiff submits, and I agree, that the dates on which it was unreasonable for the defendant to withhold payment were the dates on which the payments were made by the plaintiff. Whilst an insurer is entitled to a reasonable time to conclude its examination of the issues relating to the claim and of the amount which it should pay on the claim, such a time had expired by the time that the plaintiff determined to enter into the Commonwealth Settlement Deed. The defendant's reasons for withholding payment at that time were reasons the validity of which I have rejected. No submission that I should find some other dates as the dates appropriate for the calculation was advanced by the defendant.

[131] Accordingly, the two payments being made on 23 June 2016 and 25 July 2016, the application of the spreadsheet gives rise to the conclusions that the interest owed to the date of this judgment is $2,027,669.99 and interest will continue to accrue at a daily rate of $2,280.15 until payment.

The orders which should be made

[132] I would make the following orders:

1. It is declared that the defendant is obliged to indemnify the plaintiff for the amount of the settlement sum which the plaintiff became liable to pay the Commonwealth of Australia under the Commonwealth Settlement Deed, pursuant to the terms of the Insurance Policies and the Indemnity Settlement Deed.

2. The defendant must pay the plaintiff the sum of $15,852,453.75 as the amount of its liability to indemnify the plaintiff pursuant to the terms of the Insurance Policies and the Indemnity Settlement Deed, as declared in order 1.

3. Pursuant to s 57 of the *Insurance Contracts Act* 1984 (Cth), the defendant must pay the plaintiff interest on the amount the subject of order 2, in the sum of

$2,027,669.99 calculated to the date of judgment, and thereafter at the rate of $2,280.15 per day until the day on which payment is made.

4. The parties will be heard on the question of costs.