High Court of Australia

Selected Seeds Pty Ltd v QBEMM Pty Limited [2010] HCA 37 (3 November 2010)

Last Updated: 3 November 2010

HIGH COURT OF AUSTRALIA

FRENCH CJ,
HAYNE, CRENNAN, KIEFEL AND BELL JJ

SELECTED SEEDS PTY LTD APPELLANT

AND

QBEMM PTY LIMITED AND ORS RESPONDENTS

Selected Seeds Pty Ltd v QBEMM Pty Limited [2010] HCA 37
3 November 2010
B16/2010

ORDER

1. Appeal allowed with costs.

1. *Set aside the order of the Court of Appeal of the Supreme Court of Queensland made on 22 September 2009 and, in lieu thereof, order that the appeal to that Court be dismissed with costs.*

On appeal from the Supreme Court of Queensland

Representation

B W Walker SC with R S Ashton and L S Reidy for the appellant (instructed by Carne Reidy Herd Lawyers)

G A Thompson SC with K F Holyoak for the respondents (instructed by Barry & Nilsson)

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CATCHWORDS

Selected Seeds Pty Ltd v QBEMM Pty Limited

Insurance – Product liability insurance – Insurance policy – Indemnity – Exclusion clause – Appellant seed merchant sold contaminated seed – Planting of seed by third party resulted in damage to property – Exclusion of liability caused by or arising from "the failure of any Product to correctly fulfil its intended use or function" – Proper construction of exclusion clause – Whether liability for damage arose out of failure of product to fulfil its intended use or function – Distinction between product failing to fulfil intended use or function and causing positive harm.

Words and phrases – "intended use or function".

1. FRENCH CJ, HAYNE, CRENNAN, KIEFEL AND BELL JJ. The appellant, Selected Seeds Pty Ltd, is a grain and seed merchant carrying on business in Queensland. In December 2002 it purchased seed from a merchant in the Northern Territory, which was represented to be Jarra grass seed. At that time, the seed was substantially Summer grass seed or substantially contaminated with Summer grass seed, but the contamination was not identified in a certificate of analysis issued by an independent laboratory.

2. The appellant sold some of the seed to S and K Gargan and they supplied a portion of the seed to Michael Gargan. With each progressive harvest, the presence of Summer grass seed increased. By the time Michael Gargan sold some of the seed to Landmark Operations Limited ("Landmark"), a farming merchandise supplier, the seed was almost entirely Summer grass seed. Landmark sold a quantity of the seed to R and J Shrimp as Jarra grass seed in about December 2004. They grew only Summer grass.
3. Jarra grass is extremely palatable to all types of stock as green feed, dry feed or hay and is grown for these purposes. It is a perennial grass. Summer grass is fit only as low-quality stock feed and not for the production of commercial grass seed. Although an annual grass, Summer grass may be durable in subsequent seasons. It is regarded as a weed when present in commercial hay and seed crops.
4. The Shrimps brought proceedings claiming damages against Landmark in the Federal Court in April 2006. That part of the Shrimps' claim relevant to the appellant's policy of insurance, here in question, related to the damage to their land caused by planting the Summer grass seed. They claimed the costs of eradicating it from their land and the loss of use of the land during that period. Michael Gargan was joined to the proceedings by Landmark and he, in turn, joined the appellant to the proceedings. The appellant was subsequently given leave to defend the Shrimps' claim.
5. The proceedings were settled in March 2008. The appellant contributed $150,000 to the settlement of the Shrimps' claim. It was not disputed that the settlement was reasonable, but the appellant's insurers, the respondents, refused to indemnify the appellant for that loss.
6. The appellant had a Broadform Liability Policy ("the Policy") of insurance with the respondents, providing indemnity against public liability and product liability. The Policy schedule contained endorsements which formed part of the Policy. Endorsement 3 was an "Efficacy Clause", which had the effect of excluding liability arising from particular defined events. It is that clause which is the focus of this appeal.
7. The insuring clause (cl 2.1) relevantly provided that the respondents agreed to pay to the appellant:

"(a) all sums which You become legally liable to pay by way of

compensation;
(b) all costs awarded against You;
in respect of ... Property Damage happening during the Period of Insurance and caused by an Occurrence within the Territorial Limits in connection with Your Business."
An "Occurrence" was defined to include an event which results in property damage (cl 1.6) and the definition of "Property Damage" included "physical damage to or loss or destruction of tangible property including any resulting loss of use of that property" (cl 1.11).

1. In the proceedings brought by the appellant in the Supreme Court of Queensland, the respondents argued that the appellant's supply of the seed was too remote from the damage suffered by the Shrimps and so did not come within the insuring clause. That issue was determined against the respondents, the primary judge (McMurdo J) holding that the occurrence which caused the property damage was the planting of the seed on the Shrimps' land[1]. This aspect of his Honour's judgment was upheld on appeal to the Court of Appeal[2].
2. The issue on this appeal concerns the operation of the Efficacy Clause endorsed upon the Policy. Excluding the heading, as the Policy requires, the Clause was in these terms:

"The following additional EXCLUSION is added to this Policy:–
This Policy does not cover any liability arising directly or indirectly from or caused by, contributed to by or arising from:–

1. the failure of any Product to germinate or grow or meet the level of growth or germination warranted or represented by the Insured; or
2. *the failure of any Product to correctly fulfil its intended use or function* and/or meet the level of performance, quality, fitness or durability warranted or represented by the Insured." (emphasis added)
3. The respondents have consistently contended that the second limb of the clause was engaged because the appellant's liability arose from the failure of the seed planted by the Shrimps to "fulfil its intended use or function"; namely, to produce Jarra grass and Jarra seed.
4. Strictly speaking, seeds might not be thought to have a "use" or "function"; rather, they may germinate and grow. The failure of a product to germinate and grow is dealt with in the first limb of the Efficacy Clause. The parties, however, accepted that the second limb

might apply and that seeds, as a product, have a use or function. The proceedings were conducted on this basis. McMurdo J accepted that the production of Jarra grass and seed could qualify as the intended use or function of the seeds which were planted.

5. The "intended use or function" of the seed being to produce Jarra grass and seed, the product that was sold did not fulfil that use or function. But the product sold not only failed to produce Jarra grass and seed, it produced a weed crop: Summer grass. It was the effect worked on the land by the introduction of the weed which was the property damage of which complaint was made. The effect on the land was not a "failure of [the] Product to correctly fulfil its intended use or function".
6. McMurdo J was not persuaded that the appellant's liability did in fact arise from the failure of the seeds to fulfil that intended use or function. His Honour reasoned that the appellant's legal liability was for property damage, being the damage to the Shrimps' land. That damage resulted from what was done to the land; namely, the planting of the Summer seed and the subsequent growth of the grass[3].
7. In concluding that the Efficacy Clause did not apply, his Honour drew the following distinction between what the clause excluded and how the appellant's liability arose:

"The present plaintiff's liability for damages for the losses from what was done to the land arose not from what the product failed to do (grow Jarra grass) but what it did do to the claimants' property."[4]

1. A similar distinction, his Honour observed[5], had been drawn in *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV*[6].
2. Wyeth claimed indemnity from its insurers for the substantial legal costs it had incurred in unsuccessfully defending claims brought by third parties who had taken the drug "Benzodiazepine", which was manufactured and sold by it. The drug was prescribed for, and intended to alleviate, symptoms of anxiety and insomnia and was promoted by Wyeth as suitable for these purposes[7]. The loss and damage claimed in the litigation was of harm, in the form of physical injury and mental distress, including the effects of addiction and withdrawal[8], as a result of ingesting the drug over time.
3. There were two policies involved in the *Wyeth* litigation. Each policy

had endorsed upon it an "Efficacy Exclusion Clause". One clause provided, in those parts relevant for present purposes:

"This policy shall not apply to liability incurred by the Insured in respect of ... bodily injury resulting from the failure of the ... insured's products ... to perform the function or serve the purpose intended by the ... insured, if such failure is due to a mistake or deficiency in any design, formula, plan, specification, advertising material or printed instructions prepared or developed by any insured; but this exclusion does not apply to bodily injury ... resulting from the active malfunctioning of such products"[9].

1. The other clause was in substantially the same terms, although it was expressed to exclude "bodily injury ... resulting from the failure of the named Insured's products"[10] rather than "liability incurred by the Insured in respect of ... bodily injury". The clauses were treated by Langley J as substantially the same[11] and were held to have no application to the claims[12]. Langley J construed the clauses to exclude from cover claims that the drug failed to make a claimant better, or to prevent some condition arising. That was their evident purpose[13]. But of the claims made in the litigation his Lordship said:

"They are not claims for injury because the drugs failed to perform their function or serve their purpose. They are claims for injuries because the drugs caused dependency and injury which either did not pre-exist or did not do so to the same degree."[14]

1. The Court of Appeal held that construction to be "clearly right"[15].
2. The concern of the Efficacy Clause here under consideration is to exclude warranties and representations made by the insured about what their product might do or achieve. It has this much in common with the Efficacy Exclusion Clauses in *Wyeth*. The Efficacy Clause utilises the language of sale of goods, which is now also to be found in consumer protection legislation[16]. Some representations need not be express. This may be the case where a product has an obvious use or function. Thus in the present case, the parties were agreed that the appellant could be taken to have represented that the seed sold was Jarra grass seed.
3. More relevantly, the second limb of the Efficacy Clause here in question, like the clauses in *Wyeth*, intends to exclude liability when a product fails to achieve its intended purpose. In *Wyeth* that purpose, or use or function, was to benefit persons by alleviating

their pre-existing condition. In the present case, the purpose of the seed was simply to become Jarra hay and seed.

4. These purposes may be contrasted with the liabilities which arose. In each case, liability arose because of damage inflicted by the product. As Langley J pointed out in *Wyeth*, it could not be doubted that the claimants were alleging that the drugs had caused them positive harm[17].

5. To illustrate the proper application of the second limb of the Efficacy Clause, McMurdo J gave the example of a claim for loss of profits[18]. A liability for such a loss may be effectively excluded by an Efficacy Clause. Such liability was not the subject of insurance cover in this case, because an "Occurrence" was not defined so as to include a loss of profits. However, had such liability been included, a liability for loss of profits, on anticipated sales of Jarra grass, hay or seed, might have been said to arise out of the failure of the seeds to produce Jarra grass. The causal relationship of which Fraser JA spoke would be present in such a situation[19]. This example shows how removed a liability for loss of profits may be from one where damage is inflicted upon property.

6. The Court of Appeal of the Supreme Court of Queensland upheld the appeal brought from his Honour's decision in favour of the appellant, on what was said to be a broad, literal construction of an unambiguous clause[20]. In the judgment of Fraser JA, with whom Holmes JA and White J agreed, the distinction in *Wyeth*, between causing positive harm and failing to achieve an intended purpose, was regarded as irrelevant to a consideration of the operation of the Efficacy Clause[21]. This was because of certain perceived textual differences, between the Efficacy Exclusion Clauses in *Wyeth* and the Efficacy Clause, and because of a difference relating to the respective products[22].

7. The respondents had made a submission to the Court of Appeal to the effect that the proper focus of the exclusion in the Efficacy Clause was upon the content of the liability there referred to, not the nature of the damage caused. This submission appears to have been accepted. Fraser JA pointed to the exclusion of liability in the *Wyeth* clauses as being for liability in respect of "bodily injury", whereas the Efficacy Clause relevantly, and more broadly, excluded liability connected with the failure of the product to fulfil its intended use or

function. This was the causal relationship arising from the terms of the Efficacy Clause, read literally, his Honour said[23].

8. Fraser JA considered that the opening words of the Efficacy Clause also connoted a broader causal relationship. His Honour contrasted the words which there follow the reference to "liability"; namely, "arising directly or indirectly from or ... contributed to by", with the phrase in the *Wyeth* clause, "resulting from"[24]. However, the different breadth of these two phrases would not appear to be a difference by which the decision in *Wyeth* can be distinguished. That decision did not depend upon any notion of proximate cause nor any degree of causal connection.

9. More telling, with respect to his Honour's acceptance of a broad operation of the exclusion effected by the Efficacy Clause, was the comparison drawn by his Honour between that clause and the insuring clause. His Honour contrasted the causal relationship referred to in the Efficacy Clause with the "more narrowly expressed causal relationship in the insuring clause ('Property Damage ... caused by an Occurrence') and in the definition of Occurrence ('event which results in ... Property Damage')."[25]

10. This comparison highlights the difficulty in the approach taken by his Honour to the construction of the Efficacy Clause. In reaching a conclusion that the liability there intended to be excluded is wide, being liability having any connection with the failure of the product to fulfil its use, the Efficacy Clause has been read independently of the balance of the Policy and without regard to the terms of the insuring clause. As a result a wrong causal relationship is identified.

11. According to general rules of construction, whilst regard must be had to the language used in an exclusion clause, such a clause must be read in light of the contract of insurance as a whole, "thereby giving due weight to the context in which the clause appears"[26]. This is consistent with the statement contained in the Schedule to the Policy, that an endorsement is to both attach to and form part of the Policy.

12. When regard is had to the Policy as a whole, and the Efficacy Clause is read with the insuring clause, as it should be, it is evident that the liability to which the Efficacy Clause refers is that for which the appellant may become legally liable by way of compensation for property damage. It is not some broader notion of liability which has some connection with the failure of the product to fulfil its use or

function. So understood, the perceived textual differences with *Wyeth* fall away.

13. An argument put by the respondents to the Court of Appeal did attempt to address the relevant liability as the damage to the Shrimps' land, but it did so in a way which inverted the true question posed by the Efficacy Clause, as will shortly be explained.

14. The proposition put by the respondents was: if the seeds had functioned as intended and fulfilled their intended use, there would have been no damage to the land. A similar argument was put in *Wyeth*. In rejecting it, Langley J said:

"However it is presented, this submission in reality amounts to giving to the Efficacy Exclusion the effect of excluding from cover any injury on the basis that the drug has failed to serve its purpose if it should not have caused that injury"[27].

On the respondents' proposition, a purpose of the seeds appears to have become – that they would not injure.

1. McMurdo J correctly observed that if the exclusion were to apply whenever the appellant's product had some impact upon a person or property, which it would not have had if it had fulfilled its intended use, then the extent of the exclusion would be far-reaching[28]. Such an effect was evident from the explanation provided by the respondents, in argument on this appeal, of the cover which would remain were that construction to be upheld.

2. It is not necessary to resort to the result of the respondents' construction of the Efficacy Clause upon the extent of the cover which would remain in order to determine its true construction. Its proper operation and effect may be determined by construing its words according to their natural and ordinary meaning[29], read in light of the Policy.

3. The question posed by that part of the Efficacy Clause under consideration is whether the liability of the appellant for the damage to the Shrimps' land arose out of the failure of the seeds to fulfil their use or function. The answer must be "no". That liability was not caused by the failure of the seeds to produce Jarra grass. It arose by reason of the direct effect of the seeds upon the land. The seeds were so contaminated that Summer grass only was produced. The Efficacy Clause does not apply.

4. It remains to mention two further matters.
5. The factual difference with *Wyeth*, identified by Fraser JA, had to do with the nature of the drug. Since the personal injury claimed involved dependency and associated effects, his Honour considered that allegations must necessarily have been made of the existence of some inherent vice in the drug. Such a circumstance was far removed from injuries resulting from a failure of the drug to fulfil its intended purpose, of curing or preventing illness[30]. It may be observed that in this respect the proper operation of the Efficacy Exclusion Clause has been identified.
6. His Honour distinguished the present case from *Wyeth* on the basis that there was nothing inherently harmful in the seeds supplied[31]. The appellant took issue with this observation, given the extent of the contamination. It is not necessary to resolve that issue, for nothing turns upon it. The reasoning in *Wyeth* did not depend upon what caused the drug to produce the effects complained of. The point is that the injuries complained of, and Wyeth's liability for them, could not be said to have arisen by reason of the failure of the drug to perform its function or serve the purposes intended.
7. Reference has earlier been made to the representation, which it was agreed had been made by the appellant, that the seed was Jarra grass. It may be taken to incorporate the further representation that Jarra grass and seed would be grown.
8. The respondents sought to characterise the representation as one as to the quality, fitness or performance of the seeds, and so bring it within the latter part of the second limb of the Efficacy Clause. Such a contention had been raised in the Court of Appeal, but the Court, understandably, did not take it up in its reasons. The representation says nothing about specific attributes of the seed, which is what representations as to quality may be taken to convey. It says nothing of the fitness or performance of the seed. Moreover, the Efficacy Clause makes it plain that what it is concerned to exclude are representations which concern "the level" of the product's quality, fitness or performance. No such representation was made.

Conclusion and orders

1. McMurdo J was correct to hold that the appellant's liability was for damage to the Shrimps' land by the introduction of the weed,

Summer grass. The Policy responds to such a claim. It was not damage caused by the seed sown failing to fulfil its intended use or function. The liability to the Shrimps was for what the seed did; not what it failed to achieve. That is the literal construction to be given to the Efficacy Clause.

2. The appeal should be allowed with costs and the orders of the Court of Appeal should be set aside and in lieu thereof it be ordered that the appeal to that Court be dismissed with costs.

[1] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,424 [23].

[2] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,725 [24].

[3] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,424 [25]-[27].

[4] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,424 at [28].

[5] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,424-77,425 [29]-[30].

[6] [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420.

[7] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 433.

[8] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 433, 434.

[9] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 430.

[10] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 432.

[11] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe*

SA/NV [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 432.

[12] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 443.

[13] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 443.

[14] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 443.

[15] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 448 per Waller LJ, Dyson LJ and Sir Murray Stuart-Smith agreeing.

[16] For example, *Trade Practices Act* 1974 (Cth), s 71(2).

[17] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 434.

[18] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,424 [28].

[19] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727 [32].

[20] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727 [32], 77,730 [38].

[21] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,730 [39].

[22] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727-77,728 [32]-[33].

[23] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727 [32].

[24] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727 [32].

[25] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,727 [32].

[26] *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500 at 510; [1986] HCA 82.

[27] *John Wyeth & Brothers Ltd v Cigna Insurance Company of Europe SA/NV* [2001] EWCA Civ 175; [2001] Lloyd's Rep IR 420 at 443.

[28] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-799 at 77,425 [30].

[29] *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500 at 510.

[30] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,728 [33].

[31] *Selected Seeds Pty Ltd v QBEMM Pty Limited* (2009) 15 ANZ Insurance Cases ¶61-821 at 77,728 [33].

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