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"WORDS THAT NEVER WERE TRUE"

INSURANCE POLICIES: WORDING AND INTERPRETATION

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1. Introduction

One of my favourite 60's bands was The Monkees. Although criticised at the time as being a pre-fabricated imitation of The Beatles, I think we can now recognise that The Monkees recorded some of the great pop songs of all time. It is little wonder that that is so when they had some of the greatest musicians and song writers working on their records– people like Neil Young, Glen Campbell, Harry Nilson, Carol King, Barry Mann and Cynthia Weil, Tommy Boyce and Bobby Hart and of course The Monkees themselves. Tommy Boyce and Bobby Hart wrote some of The Monkees' biggest hits – among them "The Monkees Theme", "Last Train to Clarkesville", "(I'm not Your) Steppin' Stone" and the perhaps lesser known "Words".

Some readers might recall the chorus from "Words":

> Words that never were true
>
> Spoken to help nobody but you
>
> Words with lies inside
>
> But small enough to hide 'til your playing was through

This paper is really all about words: words used in insurance policies and particularly how those words are interpreted by the Courts. Throughout this paper and throughout the analysis of the law and the cases considered by it I would like you to remember that chorus from the Boyce and Hart song made famous by The Monkees and think about the words under consideration:

- is the Court giving the words their natural meaning?
- were the words ever "true"?
- who do the words help?
- were they included "to help nobody" but the insurer?
- are they words "with lies inside"?

There is no magic which attaches to the construction of an insurance policy. An insurance policy is just another commercial contract and consequently all the usual rules of construction apply.

In Australia a range of matters relevant to insurance contracts have been codified in the *Insurance Contracts Act 1984 (Cth)*. The aim of this paper is not to explain the impact of that Act on contracts of insurance as that would restrict the relevance of this paper to Australian insurance contracts and claims; rather this paper discusses the primary rules of construction and then looks at some insurance cases (mainly Australian and English cases) where these rules have had a practical application.

This paper begins with an examination of some of the different factors and rules which apply in constructing a policy of insurance:

- the constitution of an insurance contract;
- giving words their "ordinary meaning";
- looking at context;
- considering the nature of the cover;
- the duty of utmost good faith;
- the indemnity principle;
- implied terms;
- rectification; and
- the contra proferentem rule.

The paper then considers exclusion clauses and some implications for policy drafting before drawing some conclusions.

2. Rules of Construction

2.1 Constitution of Contract

An insurance contract will often be constituted by a number of different documents. These documents will include the insurance proposal, the policy schedule and, not infrequently, an assortment of endorsements. It is therefore important to ensure that all of the documents comprising the contract have been identified before attempting to construe it.

While the documents that constitute the policy normally include the policy wording, schedule and endorsements depending on the facts the policy may also include less obvious documents such as brochures provided to the prospective insured. On 22 August 2001, the Full Court of the South Australian Supreme Court determined whether the terms of a certificate found in a brochure formed part of the offer containing the contractual terms. Although *Royal & Sun Alliance Life Assurance Australia Ltd v Feeney*[1] concerned a life insurance policy, the decision has clear implications for the consideration of contracts of general insurance also.

The widow Feeney was the nominated beneficiary of her late husband's superannuation fund. She claimed payment of death benefits said to be payable under the terms of "free Interim Cover" offered by Royal & Sun Alliance Life Assurance (***RSALA***) as a special cover pending the processing of an application by the deceased, Nigel Feeney, for Term Life Insurance.

Mr Feeney had been given by an insurance broker a 51 page booklet entitled "Risk Products Portfolio Customer Information Brochure" to which was attached a 20 page application for insurance to be completed by Mr Feeney, the trustee of a superannuation

fund (as it was to be the owner) and the broker. The deceased had signed the application form on 30 September 1999 for Term Life Insurance of $500,000 and he also signed an application for membership of the Royal & Sun Alliance Superannuation Fund. The deceased's broker completed the form and informed Mr Feeney that the premium would be $560 per annum. The broker sent the application to RSALA the following day. However, before the premium was paid or the application processed, Mr Feeney unexpectedly died by drowning whilst on holiday on 7 October 1999.

All parts of the application form had been completed save for the trustee's signature evidencing its acceptance of the deceased's application for membership. Immediately upon his return to Adelaide on 11 October 1999, the broker saw the deceased's employer, obtained a cheque for $560 from the employer for the first premium on the insurance policy and took it to RSALA's office. The cheque for $560 was banked by RSALA in Sydney on 14 October 1999. It never refunded the amount paid.

The length of the policy brochure was explained by the fact that it covered various forms of insurance. The policy that the deceased had applied for was Term Life Insurance. The brochure offered an additional optional benefit for total and permanent disablement. It also offered recovery insurance, income protection insurance and business expenses insurance. Each was explained in a separate colour-coded section. There were also two other sections entitled "Term Life Insurance Through a Superannuation Fund" and "Other Important Information". In relation to Term Life Insurance, the brochure stated at page 5:

> Other Information On Your Policy
>
> The Application Process
>
> - To apply for Term Life Insurance you will need to complete the application form which is at the back of this brochure. Once we receive your application we will commence the underwriting procedure. This may involve further information (for example on your health) to be provided prior to acceptance.
>
> Interim Cover
>
> - While your application is being processed, we provide free Interim Cover for death or TPD (if you apply for TPD cover) as a result of injury or illness. Please refer to pages 49 and 50 for further details.
>
> Cover Commences
>
> - Cover commences once we have accepted your application. We will send you a policy document which will confirm your acceptance. You should read this document carefully, as it contains important information.

In the Other Important Information section at the back of the brochure, it was explained that if an application was made for Term Life Insurance and the applicant died during the period of the Interim Cover, RSALA would pay the lesser of $500,000, the proposed sum insured or the sum insured acceptable under the insurer's underwriting guidelines. Benefits were not paid, the brochure explained, if the application was not one the insurer would normally accept under its standard underwriting guidelines. The information on page 50 of the

[1] (2001) 11 ANZ Insurance Cases ¶90-108.

brochure also referred to an Interim Cover Certificate on page 48. However, the information near the front of the brochure did not.

As it happened, because of the way in which the brochure was printed, page 48 appeared after pages 49 and 50, so that reading page 5 and being referred to page 49 would not necessarily mean that the reader would see page 48.

The Interim Cover Certificate itself included the following words:

> When Cover Begins
>
> This certificate is valid from the date we receive:
>
> * the completed application; and
>
> * the first premium or deduction authority at our head office or any state office.

Mrs Feeney brought an action in the District Court claiming the sum of $500,000 against RSALA alleging that the insurer was obliged, in accordance with the terms of the brochure, to provide free interim death cover whilst her late husband's application was being processed. Lunn J found that the fact that there was no reference on page 5 to interim cover being subject to the payment of any premium could not be contradicted by reference to the Certificate on page 48. Further, the terms of the Term Life Insurance made it clear that it was not a condition of granting permanent cover that the first premium be submitted with the application.

The trial judge found that it would be anomalous if the policy proper to which the premium amount related could come into effect without the premium being paid but the interim cover to which the premium amount did not relate would not come into effect if the premium was not paid. On this basis, the court found that it was not a term of the offer of interim cover as contained in the brochure that the premium amount was to be received before the death of the deceased. Accordingly, it did not matter whether the deceased or his broker knew of the contents of the Certificate.

On appeal, RSALA again sought to rely on the condition in the Certificate that receipt of the first premium would determine the commencement of interim cover. The Supreme Court was asked to determine whether the qualification on "When Cover Begins" formed part of the contract of insurance.

Bleby J (with whom Doyle CJ and Perry J agreed) agreed with the trial judge that in granting permanent cover RSALA did not require that the first premium accompany the application. His Honour suggested that there may be many sound reasons why the first premium might not or could not be properly paid until after the issue of the policy (and perhaps after a decision not to exercise the cooling off period of 14 days) yet nothing prevented the tendering of the first premium with the application.

In the present case, RSALA wrote to the deceased on the date of his death advising him that it required him to undergo a medical examination and pay the initial premium of $560.

Bleby J considered the meaning of the word "free" in the context of the offer of Free Interim Cover. He rejected RSALA's assertion that the word meant "without additional or marginal outlay over what is obviously being paid" He noted that there were numerous possible circumstances in which an application for permanent cover might be lodged and yet no

premium ultimately paid, for example, if RSALA rejected the application on underwriting grounds. Yet there was a period before the acceptance of the application when RSALA was on risk and for which no premium was required to be paid. If the Free Interim Cover was to have any meaning at all, he said, it had to be cover in the specified sum for a period for which no premium was payable. The only necessary consideration for the cover was the completion and lodgment of the application form.

Bleby J suggested that the absence of a reference in the brochure to a requirement to pay a premium for the interim cover might be explained by the fact that RSALA was likely not to have gained anything by requiring the early payment of the premium.

As for the effect of the certificate, Bleby J held that it was not a necessary part of the contract such that, without it, the contract lost its integrity. The certificate did not contain significant conditions of the Interim Cover found in the brochure. It was, he found, merely a certificate that RSALA had granted to the person named on the certificate the interim cover described in the brochure. It was a discrete document intended to benefit the applicant for insurance and not the insurer. It did not contain any contractual terms even though page 50 of the brochure referred to a claim being made "under the terms of this Interim Cover Certificate". To the extent of any ambiguity or obscurity produced by the certificate, his Honour cited the contra proferentem rule applied in *Halford v Price*[2] to construe it against the insurer.

Doyle CJ agreed with Bleby J's decision but took a slightly different approach. Bleby J found that RSALA's complete offer comprised pages 5, 49 and 50 of the brochure. However, Doyle CJ accepted RSALA's contention that the Certificate was intended to form part of the contract. He considered that the consequent issue for determination was whether RSALA gave Mr Feeney reasonable notice that it intended to rely on the terms of the Certificate at page 48. The only reference in the brochure to the Certificate being on page 48 was found in the sixth section of the table of contents on page 2 of the brochure. After considering the format of the brochure, his Honour found it difficult to say whether RSALA had done all that was reasonable to bring the Certificate to the attention of Mr Feeney. He concluded that it did not despite the relative ease with which it could have made reference to the certificate at other relevant parts of the brochure.

This decision confirms that courts will not be reluctant to employ the contra proferentem rule in determining the proper construction of insurance contracts. It highlights the need for insurers to carefully consider the adequacy of documentation provided to prospective insureds at the pre-contractual stage. Those documents need to be consistent with the intended policy terms.

2.2 Ordinary Meaning

An insurance policy should be construed in accordance with the natural and ordinary meaning of the words and phrases used in it. The natural and ordinary meaning of a word or phrase is its commonly understood or popular meaning from the perspective of "an

[2] (1960) 105 CLR 23 per Dixon CJ at 30.

ordinary intelligent person construing the words in a proper way in the light of the relevant circumstances": *Hutton v Watling*[3].

There are exceptions to this rule.

The first exception is where a word is defined in the policy. A defined term will be given its defined meaning even if the definition is inconsistent with the popular meaning of the word.

The second exception is where a word has both a popular meaning and a technical meaning. As a general rule, the courts will apply the most usual and natural meaning of a word in the context in which it is used. Consequently, in a commercial contract of insurance that has been negotiated between the parties, particularly where the policy is not written in a " plain English style" but uses technical and legalistic drafting, a court is likely to apply a legal or technical meaning as this would be the natural outcome in the context of the document. This is particularly so where lawyers have been involved in the drafting process. This is not an irrebuttable presumption as "even in a document drawn up by lawyers, . . . a word capable of bearing meaning as a legal term of art will be construed in a popular sense if the instrument shows that the parties intended to use it in that sense": *Schuler AG v Wickman Machine Tool Sales Limited*[4].

The majority of insurance business (certainly for such businesses conducted in Australia), even for major corporations, is based upon insurers' wordings. It is not usual for there to be a true negotiation in respect of insurance wordings. In these cases, insurers which do not define words and phrases which have both popular and technical meanings run the risk that the construction which they prefer will not be preferred by a Court.

In *King v McKean & Park and Ors*[5], the Supreme Court of Victoria per Osborn J considered the issue of when a claim is made for the purpose of a claims made and notified professional indemnity policy.

Mr King issued a writ in the Supreme Court of Victoria against a number of parties, including Mr McKean, a barrister. The writ was issued on 19 May 1999, but was not served on Mr McKean until 17 May 2000. Mr McKean issued a third party notice against his professional indemnity insurer, AMP General Insurance Limited. The relevant insurance policy was current when the writ was issued but had expired by the time of its service. The third party proceedings were determined separately by Justice Osborn, who was asked to decide whether the liability asserted arose from a claim made during the period of insurance.

Justice Osborn considered what constitutes the making of a claim in the context of a "claims made and notified" policy such as that held by Mr McKean.

The court found that the institution of proceedings is not the same as the making of a claim against a person. No order can be made against a defendant named in a writ without notice of the writ having been provided.

[3] [1948] Ch 398 at 403.

[4] [1974] AC 235; [1973] 2 All ER 39; [1973] 2 WLR 684.

[5] (2002) 12 ANZ Insurance Cases 61-534.

The court considered the argument that the issue of a writ constitutes notice to the world at large of the making of the claim. However, Justice Osborn rejected that argument, citing a 1984 Canadian decision that had been approved in more recent Australian decisions. In that case, the majority held that a claim is "made" by being notified or brought to the attention of the person against whom it is asserted.

Considering more recent decisions, Justice Osborn found in favour of the insurer's argument that no claim had been made based on the ordinary meaning of the words, on the weight of judicial authority, and on commonsense. If Mr McKean was correct, the court held, it would create a category of claims that could be made but never notified within the terms of the policy.

This case applies a commonsense approach to the interpretation of when a claim is made for the purposes of a "claims made" policy. The commencement of proceedings is neither notice to the world at large, nor to the insured in particular, of the making of a claim.

A very recent decision of the Victorian Court of Appeal, *Manren Limited v Royal & Sun Alliance Insurance Australia Limited* considered the meaning of a policy where a term for which a description should have been included in the Schedule was left blank. This is something that you do come across from time to time.

The Victorian Court of Appeal was not prepared to read into the definition terms which did not form part of the policy and the insured found that its claim was not covered by the incomplete definition.

Manren Limited (***Manren***) claimed indemnity from its insurer, Royal and Sun Alliance Insurance Australia Limited (***Royal***), under a public liability policy. Manren, previously know as Hudson Conway Management Ltd, was one of the defendants in a proceeding with respect to injuries, damage and losses suffered by the plaintiff in a fall over a balustrade rail on a residential building development site. Manren was found to be negligent, through the actions of one of its employees involved in the development, and it claimed indemnity from Royal under a policy taken out by its parent company Hudson Conway Limited (***Hudson***) for the Hudson group of companies (***the Group***).

The policy provided, amongst other things, that Royal:

> …will indemnify the Persons Insured in respect of all sums which they shall become legally liable to pay as compensation for … [p]ersonal injury … happening … as a result of an Occurrence and in connection with the Business.

The main issue before the Court was the meaning of the term, "The Business". The policy set out the meaning as follows:

> "The Business" shall mean that ***described in the Schedule and shall also include*** (emphasis added)
>
> …
>
> 3. the ownership or occupation of, the carrying out of repairs maintenance alterations and additions to, or the demolition of, the Policyholder's premises to which this Policy applies.
>
> …

Unfortunately both in 1995 and 1996 the Schedule where the description of the business was to be entered was left blank.

The matter was heard by Justice Eames in the first instance.

Royal submitted that there having been no description of "The Business" inserted in the Schedule the only business covered by the policy was that defined in paragraph 3 of the general definition, that is the "ownership or occupation of … the policyholder's premises to which the policy applies".

Manren noted that the Proposal form submitted by it clearly and expressly stated "[p]roperty investment, development, construction" as the "[f]ull description of business or occupation including all subsidiaries". Accordingly, Manren argued that Royal could only maintain its preferred construction by virtue of its own failure to insert the words "property investment, development, construction" in the relevant Schedule and that omission should not be allowed in defiance of the clear intention demonstrated by the Proposal Form to cover all aspects of the Group's business. Alternatively, it was argued that since the Schedule was left blank the policy meant that the business in fact carried on by the insured, which includes property development and construction.

Justice Eames held that:

- Manren carried the onus of establishing that its business was covered by the policy;
- the policy did not provide professional indemnity coverage, nor coverage for purposes of construction;
- the policy did not address the two additional occupations of "development" and "construction" specified in the Proposal Form;
- the omission of a description of "The Business" in the Schedule lead to the result that the only business which was covered was stated in the general definition and was confined to ownership and occupation of premises;
- Manren did not itself own nor occupied the relevant residential development, which was owned by another subsidiary in the Group; and
- consequently the claim for indemnity must fail.

Manren appealed the decision of Justice Eames to the Court of Appeal.

The Court of Appeal dismissed Manren's appeal and held that:

- no narrow or pedantic approach is to be taken in the construction of commercial contracts, including insurance policies;
- contracts are to be construed in a fashion that accords with common sense, facilitates commerce, contains costs and secures public confidence in the courts;
- the view taken by Justice Eames was obviously right as a matter of common sense and the natural meaning of words and such a construction should be unhesitatingly upheld;

- whatever Hudson may have subjectively intended, objectively "The Business" means the business set out in the policy, which is the general description and the business defined in the Schedule;
- although the Proposal Form disclosed that the business of the Group included property development and construction as well as property investment, that Proposal Form was merely descriptive of the proposer and did not convey to Royal that the insurance was to cover property development and construction; and
- given that the Schedule was left blank, "The Business" meant the business of owning and occupying property.

This case is a reminder for both insurers and insureds that although insurance policies will be interpreted with common sense and a view to commercial realities the Court will not always be willing to insert "missing" words to assist an insured. Insureds should always assure that the policy contains the correct wording and provides for cover in all the intended circumstances. It is not enough that an insured intends to be covered for certain events, which may be alluded to in the Proposal Form; that intention must be carried over into the express terms of the policy in order for cover to be provided.

In *Pioneer Road Services Pty Limited v QBE Insurance Limited & Anor*[6] Wood CJ considered the meaning of "design and consulting/advisory services" and the meaning of "professional services" in the context of Pioneer's general liability policy which became worthless after the collapse of HIH. It tried to bring liability arising out of a supply and lay contract under its professional indemnity policy with QBE on the grounds that the contract involved matters of planning or decision-making.

Pioneer was sued by Miss Palmer for injuries sustained in a car accident. Miss Palmer had had an accident while driving on a section of road on which road works were being carried out by Pioneer in the Evans Shire in NSW.

Pioneer had contracted with the Evans Shire Council (the ***council***) to carry out the road works.

Pioneer was held to be negligent and liable to Miss Palmer for:

1. failing to prepare and submit a traffic control plan to the council before commencing the relevant road works;
2. deciding to defer the sweeping of gravel off the road; and
3. failing to ensure that sufficient signage was erected at the site once gravel was spread on the new surface.

Pioneer cross claimed against QBE, alleging that it was entitled to be indemnified under its professional indemnity insurance policy with QBE.

QBE had issued insurance policies each year in response to a proposal from Pioneer. The proposal for the relevant year (***claim year policy***) indicated that the nature of Pioneer's business was "principally the manufacture, design and construction of asphalt surfaces".

[6] (2002) 12 ANZ Insurance Cases 61-520.

Pioneer stated that it was occasionally engaged in providing advice associated with manufacture, design and construction of road services in return for a consulting fee, and that it was this occasional, extra business for which it desired insurance from QBE.

The claim year policy and succeeding policies contained an endorsement limiting the cover to "design and consulting/advisory services" only.

At the time of Miss Palmer's accident, Pioneer held two policies of general liability insurance issued by HIH. These would have indemnified Pioneer, but were ineffective because of HIH's collapse.

Pioneer submitted that its negligence fell within the concept of "design and/or advisory services", since they involved matters of planning or decision-making about what was required for the safe execution of the work to be performed under its contract with the council.

The issues at trial were:

- Whether Pioneer's liability arose out of "design and consulting/advisory services".
- Whether Pioneer and QBE had intended to insure liability arising in connection with Pioneer's contract with the council.
- Whether the liability was "incurred in the Professional Business Practice" of Pioneer, ie whether Pioneer's conduct had to be of a "professional" nature and what that meant.

The Supreme Court of NSW, comprising Chief Judge Wood, dismissed the cross claim, denying indemnity.

Guidance on whether any relevant act or omission fell within the cover was to be obtained from the description of the work that Pioneer agreed to provide under its contract with the council.

Pioneer's contract was to perform road work in accordance with the design and specifications laid down by the road traffic authority. Pioneer's work was more properly to be regarded as the execution of that design, rather than the provision of design, or advisory/consulting services.

The policy was unclear as to whether Pioneer was indemnified. Where the language of a contract is ambiguous or susceptible to more than one meaning, the court can consider the circumstances surrounding the making of the contract to ascertain the parties' intentions.

As the claim year proposal formed the basis of the policy, and was incorporated into the contract, it was appropriate to have regard to it in interpreting the policy.

Normally, the court cannot consider anything done *after* the contract is made in interpreting it. However, later conduct and statements of the parties are admissible to identify the things that the contract deals with. Therefore, the subsequent proposals could also be considered.

The party's intentions needed to be understood in the context of the work Pioneer undertook, and in light of the proposals. Each proposal showed that its principal relevant source of revenue was "contracting revenue"; and that design or consulting/advisory

services occupied a small proportion of its work, arising where it was "occasionally" called on to provide specific advice, or accepted specific responsibility for pavement design. The thrust of the proposals was that insurance was sought only in relation to the occasional, specific advice or design contracts.

Subsequent proposals did not disclose any difference in approach.

In relation to cover for tort liability, the expression "professional business practice" was used to define the ambit of Pioneer's business, and, as such, did not confine the cover to a breach of "professional" duty.

However, cover for a breach of contract was only available where the contract was one that was for "professional services".

The term "professional", in relation to insurance contracts, is to be construed broadly. Pioneer would be covered for breach of contracts calling for the provision of design or consulting or advice services that were "of a skilful character according to an established discipline". This was not such a contract.

This case contains a useful illustration of the guiding principles where an insured seeks to rely on a favourable interpretation of the policy wording to expand cover beyond that which the insured and the insurer had clearly intended.

The New South Wales Court of Appeal considered the scope of a waiver clause in *Larson-Juhl Australia LLC v Jaywest International Pty Ltd*[7].

Jaywest International Pty Limited (***Jaywest***) sold its picture framing business to Larson-Juhl Australia LLC (***LJA***). The business was carried out in leased premises and ultimately LJA was forced to vacate the premises after the roof started to sag and the local council deemed the building unsafe. At that time, Jaywest continued to occupy part of the premises for the purpose of storing its stock. Accordingly, Jaywest's fire and business interruption policy remained in force after completion of the sale to LJA and LJA was added to the policy.

Following the enforced vacation of the premises, LJA claimed on the policy and the claim was met. The insurer, MMI General Insurance Limited (***MMI***), brought a subrogated action in LJA's name against Jaywest alleging breach of warranties in the contract of sale and alleging misleading and deceptive conduct prior to the sale. In its defence, Jaywest sought to rely on the waiver of subrogation clause in the policy as a complete defence, despite the fact that the policy did not cover it for liabilities for breach of warranty or for misleading and deceptive conduct.

At first instance, Master Macready upheld the defence and dismissed the proceedings. He considered that a waiver of subrogation could only be restricted by limiting the person in whose favour there was a waiver or, alternatively, the nature of the claims that are waived. As for the latter case, Macready M found that a limitation on the nature of the claims that are waived must be expressed either as a limitation as to time, as to the nature of the cause of action, or as to the facts on which the cause of action is founded. None of those limits were present in the circumstances of these proceedings.

[7] (2000) 11 ANZ Insurance Cases 91 61-499.

On appeal, Handley JA (with whom Stein JJA and Ipp AJA agreed) agreed with the submission of the insurer that the waiver of subrogation clause was being invoked in unusual circumstances, thus distinguishing the leading cases on subrogation[8]. However, his Honour also found that the rights to which MMI sought to be subrogated were also unusual since they did not arise from conduct which caused the loss to LJA.

MMI was attempting to invoke rights that pre-dated the policy year and "arose under warranties or representations that were collateral to its subject matter"[9]. Handley JA commented that for that reason any recovery by MMI would be a windfall and he was therefore reluctant to put a strained construction on the language of the waiver of subrogation clause.

Rejecting submissions by MMI that the Court import certain words into the clause in order to limit its scope, his Honour found that the duty of the Court was to construe the language of the clause fairly and simply. The clause was broadly worded, waiving "any rights and remedies or relief" and the Court found no reason to limit the generality of this expression. Giving the clause its ordinary meaning, the appeal was dismissed.

Another example of an appellate court affirming a first instance decision, this judgment shows that a waiver of subrogation clause may provide a benefit to the insured, or a disadvantage to an insurer, beyond that contemplated at the time of entering into the policy. If insurers wish to limit the scope of such waiver clauses, they will need to take care in drafting appropriate limitations to avoid the clause operating in an unintended manner.

In *De Vito v Commercial Union Assurance Co Ltd*[10] the Full Court of the South Australian Supreme Court held that the insured under a commercial motor vehicle policy was not entitled to assert a particular intention on the part of his insurer based on a potentially ambiguous wording.

Mr De Vito ran a transport depot at Waikerie. In October 1997 he instructed Mr Eaton, an employee, to drive one of his prime movers to Brisbane. Mr Eaton was accompanied on the journey by his partner, Ms Good. In fact, Ms Good drove at least part of the way and it was whilst she was driving that the prime mover was involved in an accident. The vehicle overturned, causing damage for which repair work costing $90,000 was required. At the time of the accident, Ms Good held a heavy transport licence, although she had held it for less than two years. It was not the first occasion on which she had driven the truck, however. She had driven it within Mr De Vito's depot and elsewhere. Her name also appeared in log books on a number of dates as a "two-up" driver and evidence was adduced at the trial that the spotlights on the truck had been damaged when the truck, previously driven by Ms Good in Western Australia, had hit kangaroos.

Mr De Vito held a "Heavy Transport Insurance" policy issued by Commercial Union Assurance Company Limited (*CUA*). The policy provided indemnity under two insuring clauses, firstly for loss of or damage to the insured vehicle and secondly for third party

[8] *Woodside Petroleum Development Pty Ltd v H&R-E&W Pty Ltd* (1999) 20 WAR 380; followed in *GPS Power Pty Ltd v Gardiner Willis and Associates Pty Ltd* [2000] QCA 495.

[9] at [12].

liability. The policy separately defined the terms "Insured" and "Driver". The "Insured" was defined to mean:

> the person(s), company(ies) or firm(s) named as the Insured in the Schedule of this Policy and subsidiary companies, only if also named in the Schedule.

The "Driver" was defined to mean:

> the Insured or any person with the Insured's permission driving, using or in charge of the Insured Vehicle or Substitute Vehicle.

The policy referred to the verb "to drive" in lower case and, notwithstanding the defined terms, also used the word "driver" (with a lower case "d") in several clauses. An example is Important Notice 6 to the policy, which explains the process of acceptance of Driver Questionnaires thus:

> 6. Acceptance of Driver Questionnaires
>
> You must notify the Company of all drivers prior to them driving any Insured Vehicle. This notification must be given on the Company's standard Driver Questionnaire form. Cover will not be effective until each driver has been accepted by the Company and you have been notified of the Company's acceptance.
>
> Failure to submit a Driver Questionnaire will result in any claim being denied if the Driver does not satisfy our underwriting guidelines.
>
> If a Driver Questionnaire is submitted after an event giving rise to a claim, and the Company accepts the driver, a penalty excess of $3,000 will apply in addition to any other excess. [underlining added]

The policy contained exclusions specific to each insuring clause in addition to 11 separate generally applicable exclusion clauses. Pursuant to Exclusion 8 of the general exclusions to the policy, CUA refused to indemnify the Insured for:

> 8. any destruction, loss, damage, fire or liability caused, sustained or incurred where the Insured Vehicle is driven by or in control of any person who is under 25 years of age or has held the relevant class of drivers licence for less than 2 years;

Further, Exclusion 10 excluded claims for:

> 10. any destruction, loss, damage, fire or liability caused, sustained or incurred by a Driver who is not acceptable by the Company.
>
> Note
>
> If we do not have a completed Driver Questionnaire at the time an event giving rise to a claim occurs, the claim will be denied if the Driver does not satisfy our underwriting guidelines.

The acceptance of Driver Questionnaires was set out in Important Notice 6, reproduced in clause 6.7 above.

At first instance, Bright J held that Exclusion 8 entitled CUA to decline indemnity under the policy. The Court then considered whether section 54 of the Insurance Contracts Act restricted the insurer's right to refuse to pay the claim and found that in the circumstances it did not. The appeal decision did not, however, turn on the application of section 54 but rather the ambiguity of the words appearing in the policy.

[10] (2001) 11 ANZ Insurance Cases ¶61-486.

Mr De Vito, both parties agreed, was an "Insured" for the purposes of Section 1 of the policy. Accordingly, he was entitled to indemnity unless one of the exclusions applied.

Since a "Driver" under the policy was a person driving with the insured's permission, CUA would be entitled to reject the claim under Exclusion 10 only if Mr De Vito had given permission to drive the truck. Mr De Vito had not authorised Ms Good to drive the truck, however at the trial CUA alleged that Mr De Vito knew that Ms Good had driven the truck on previous occasions. Although Mr De Vito denied the allegation, Bright J found it unnecessary to make a specific finding while stating that the case in favour of the allegation was "very weak".

Accordingly, the trial judge did not make a finding on the application of Exclusion 10. However, he found that Exclusion 8 applied, entitling CUA to deny the claim.

On appeal, counsel for Mr De Vito cited the well known passage from the dissenting judgment of Gibbs J in *Australian Broadcasting Commission v Australasian Performing Rights Association Limited*[11]:

> It is trite law that the primary duty of a court in construing a written contract is to endeavour to discover the intention of the parties from the words of the instrument in which the contract is embodied. Of course the whole of the instrument has to be considered, since the meaning of any one part of it may be revealed by other parts, and the words of every clause must if possible be construed so as to render them all harmonious one with another. If the words used are unambiguous the court must give effect to them, notwithstanding that the result may appear capricious or unreasonable, and notwithstanding that it may be guessed or suspected that the parties intended something different. The court has no power to remake or amend a contract for the purpose of avoiding a result which is considered to be inconvenient or unjust. On the other hand, if the language is open to two constructions, that will be preferred which will avoid consequences which appear to be capricious, unreasonable, inconvenient or unjust, even though the construction adopted is not the most obvious, or the most grammatically accurate…"[12]

Counsel for the insured argued that CUA could refuse to pay a claim on the basis of a general exclusion when the relevant clause related to something done by the driver **only** if the insured knew that that person was or would be the driver at the relevant time and had acquiesced in that. In his submission, the words "any person" in Exclusion 8 were tantamount to "a Driver".

In the insured's submission, the policy was intended to provide indemnity except in circumstances where the event giving rise to the exclusion was authorised by the insured.

Doyle CJ (with whom Olsson and Bleby JJ agreed) cited with approval the principles of construction of insurance policies found in Halsbury's Laws of Australia[13], which he said were consistent with the principles stated by Gibbs J and relied upon by the insured. He found that the insured had begged the question by presuming that the policy operated in an expected way and then interpreting specific clauses of the policy to coincide with that expectation. Further, the insured was attempting to force the policy into this "strait jacket of a presumed expectation" in circumstances where the literal interpretation of the exclusion was clear.

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[11] (1973) 129 CLR 99.

[12] at 109.

[13] Vol 15, Insurance, ¶235-370.

Relevantly, other exclusions contained in the policy made no reference to any requisite knowledge on the part of the Insured.

Doyle CJ also found no disharmony was produced by the literal interpretation of Exclusion 8 and that when the general exclusions referred to "a Driver" it was appropriate for them to do so and when they did not it was understandable that they should not do so. Applying the principles stated by Gibbs J, Doyle CJ held that if the words are clear, the court must give effect to them. In the present circumstances, he found no ambiguity in the meaning of Exclusion 8 nor any irrationality in its operation. Nor did he find any presumed expectation of the parties as to the operation of the policy that would require the words in the exclusion clause to be given a meaning other than their literal meaning. Although his Honour did concede that there were some aspects of the policy that caused problems of interpretation, he said that there were probably few policies of insurance intended to cover a wide range of events that did not give rise to some problems of interpretation.

This decision reaffirmed the well-established principles of policy construction espoused by Gibbs J in the decision cited in this case. A party should not attempt to seek out ambiguities in a policy clause in order to mould its meaning to a presumed expectation of the parties to the contract in circumstances where the literal meaning of the clause is clear. If the words used are unambiguous, the court will give effect to them notwithstanding the presumed intention of the parties.

2.3 Context

Words and phrases need to be construed in the context in which they appear. Words and phrases can take on different meanings depending on the context in which they appear. "Context" in this sense is not limited to the words immediately surrounding the word or phrase in question, or indeed to the same paragraph or section of the contract[14].

In *Ashmore v Cigna*, the plaintiff's premises were flooded as a result of heavy rain. The rain had fallen in the local catchment area, collected and flowed along its usual course but spilled beyond its natural confines. Water then spread over the plaintiff's property, entering the plaintiff's buildings and causing extensive damage.

The plaintiff made a claim under its Industrial Special Risks insurance policy for the damage caused to the property. Cigna rejected the claim relying on clause 6(d) of the policy exclusion which provided that:-

> The Company … shall not be liable in respect of …
>
> 6. Physical loss, destruction or damage directly or indirectly caused by or arising out of:
>
> …
>
> (d) water from or action by the sea, tidal wave, high water or flood.

Macrossan J in the Supreme Court of Queensland held:

[14] *Young v Sun Alliance and London Insurance Ltd* [1977] 1 WLR 104 and *Ashmore Aged Care Centres Pty Ltd v Cigna Insurance Australia* (1988) 5 ANZ Insurance Cases 60-860.

- that exclusion 6(d) had to be construed restrictively;
- the earlier words in clause 6(d) strongly conveyed the impression that the word "flood" was to be construed with reference to phenomena possessing a marine element; and
- as some floods would result from the direct action of the sea or the extension of the waters of the sea in estuaries, tidal rivers and creeks, it was these floods to which the clause referred.

Ashmore was cited by Mandie J in *Barwon Region Water Authority v CIC Insurance Ltd*[15]. In *Barwon v CIC*, naturally occurring floods caused damage to structures which were the property of the Barwon Water Authority. The Authority made an insurance claim in relation to this damage.

One of the exclusions in the policy related to physical loss, destruction or damage to "bridges, canals, roadways and tunnels, railway tracks …". One of the issues at trial was whether a steel pipe bridge and a suspension pipe bridge fell within this exclusion.

The steel pipe bridge ran across a creek. The structure included a platform which provided regular vehicular access to the whole of the pipeline for the authority's employees.

The suspension pipe bridge consisted of concrete piers on both sides of the bank of a river, with cables running between the piers. The pipeline was supported by cross-bracing under the pipe, attached to rods which hung from the supporting cables.

The insurer contended that both structures were "bridges" within the meaning of the relevant exclusion. It was submitted that each structure spanned a waterway and was a bridge in the ordinary sense of the word.

Counsel for the plaintiff submitted that "bridge" bore a narrower meaning upon a proper construction of the Policy and in the context in which the word was used. The relevant context was the group of words "bridges, canals, roadways and tunnels, railway tracks …" Counsel for the plaintiff submitted that all of these words shared a common feature, namely, use for transportation. It was further submitted that bridges used for transportation were covered by the exclusion and bridges used to support pipelines were not.

Justice Mandie held that both structures were a bridge in ordinary Australian usage. His Honour then went on to consider whether "bridge" bore a narrower meaning within the context of the Policy. His Honour cited *Ashmore* as authority for the principle that the words of a policy need to be construed in the context in which they appear.

His Honour held that the plaintiff's submission (that the words used all shared a characteristic of usage for transportation and, primarily, for transport by the public) was correct. This interpretation was supported, according to His Honour, by the rationale for the exclusion. This rationale was the "increased risk of damage to property which is used for such transportation and the risk of substantial rectification costs."

His Honour ultimately held that neither structure was a "bridge" within the meaning of the exclusion, as use of the structures for private access to the pipelines was ancilliary to their

[15] Unreported, Supreme Court of Victoria, No. 2013/97, 19 December 1997

support of the pipeline. Moreover, use of the structures to support the pipelines was not usage for the purpose of transportation in the sense underlying the exclusion.

Another example of the application of the principle that words in a contract should be interpreted in context is the decision of the Supreme Court of Victoria Court of Appeal decision in *Pacific Dunlop v Swinbank*[16]. This decision considered the issue of whether the definition of an occurrence in a product liability excess layer policy extended cover beyond the period of insurance.

At first instance Pacific Dunlop Limited sought a declaration against Christopher Swinbank as a member, and representative of other members, of a Lloyd's syndicate that it was entitled to indemnity pursuant to a product liability policy for certain personal injury claims.

A Pacific Dunlop subsidiary in the United States of America had produced coronary pacemaker leads. Between October 1988 and October 1994 it manufactured three models of a device known as Accufix atrial "J" pacing leads. Through its various subsidiaries, Pacific Dunlop distributed the devices around the world, 40,500 of which were implanted in cardiac patients. Each device incorporated a J-shaped wire welded to the pacemaker end of the lead designed to transmit signals from a generator to wall of the heart. In October and November 1994 Pacific Dunlop's subsidiary announced a voluntary recall of all unimplanted leads following information that the J-wires had a potential to fracture and migrate within the heart, causing death or injury to the patient.

Personal injury claims were made against Pacific Dunlop seeking compensation for injury caused by the need to remove implanted J-wires. The first claim was brought in Victoria relating to an injury caused by a defective J-wire on 20 November 1992.

Pacific Dunlop was insured pursuant to primary insurance cover issued by Zurich Australian Insurance Limited (***Zurich***) and excess liability policies underwritten by the Lloyd's syndicate for the period 30 September 1992 to 30 September 1993. The primary policy indemnified Pacific Dunlop pursuant to four sections: general indemnity, product liability, employers liability and products recall expense. Pacific Dunlop sought indemnity under the product liability section of the policy, which provided an indemnity:

> …against such sums as the Insured shall become legally liable to pay in respect of Personal Injury or Property Damage caused by an Occurrence happening:
>
> (a) during the Period of Insurance, or
>
> (b) after the Retroactive Date [30 June 1977, in effect until 30 June 1990] in respect of which a claim is first made against the Insured during the Period of Insurance, and which Occurrence was not known to the Insured's officer responsible for insurance prior to the inception date of this Policy
>
> arising out of or in connection with any Products.

It was not disputed in the proceedings that the J-wires were "products" as defined by the primary policy. The primary policy also contained the following clause:

[16] (2001) 11 ANZ Insurance Cases ¶61-496.

> 5. OCCURRENCE
>
> The term "Occurrence" shall mean an event including continued or repeated exposure to substantially the same conditions which results in such Personal Injury, Property Damage or Advertising Injury neither expected nor intended by the Insured.
>
> …
>
> An Occurrence or series of Occurrences arising directly from a common cause or condition shall be deemed to be one Occurrence regardless of the number of persons or organisations who sustain Personal Injury, Property Damage or Advertising Injury. All such Occurrences shall be deemed to have occurred on the day of the first of such Occurrences. [the aggregation clause]

The Lloyd's policies undertook to indemnify Pacific Dunlop against products liability claims "as contained in the Primary Policy" up to limits, respectively, of 18% of $8,000,000 and 15% of $10,000,000 any one Occurrence and in the aggregate for all Occurrences in excess of underlying insurances.

Pacific Dunlop sought indemnity under the primary policy for personal injury claims in the period up to 30 September 1993 and after that period had expired. Zurich indemnified Pacific Dunlop on the basis that the "Occurrence" was deemed to have occurred on the date of the first incident involving any injury to a patient, namely October 1992. Zurich also advised that it would deem as one occurrence all third parties suffering personal injury from the one common cause and that policy liability would be limited to the 1992/93 year only irrespective of when the claim was notified.

As the limit of liability under the primary policy was nearly reached, Pacific Dunlop sought indemnity under the Lloyd's policies. In February 1997 the Lloyd's syndicate declined to accept the interpretation of the aggregation clause applied by Zurich. The syndicate asserted that all of the claims after 30 September 1993 did not form a "series of occurrences" in terms of the aggregation clause. Pacific Dunlop and Zurich separately brought proceedings against the Lloyd's syndicate for declaratory relief.

It was agreed, for the purpose of the trial, that all personal injury claims fell into one of four categories, being those suffered:

(a) during the period of insurance caused by the fracture of a J-wire;

(b) after the expiry of the period of insurance caused by the fracture of a J-wire;

(c) after the expiry of the period of insurance caused by surgical removal of an unfractured J-wire; and

(d) after the expiry of the period of insurance caused by fear of a fracture of J-wire.

The critical issue at trial was whether the primary policy properly provided that a series of Occurrences included Occurrences happening after the expiry of the period of insurance, 30 September 1993. Pacific Dunlop relied on the common cause or condition argument, submitting that the single occurrence was deemed to have happened on the first day of the first Occurrence of the series. The Lloyd's syndicate responded that no part of the definition of "Occurrence" extended the cover provided by the primary policy beyond the period of insurance.

Mandie J found in favour of the Lloyd's syndicate, ruling that if it had been intended that a series of Occurrences should include occurrences after policy expiry, it would have been

expressly stated in the policy. His Honour held that the deeming provision in the definition of "Occurrence" was subject to the definition of the policy period in the contract. Despite the fact that the trial judge found that there was, in fact, a series of Occurrences arising from a common cause or condition, the Lloyd's syndicate was not bound to indemnify Pacific Dunlop.

On appeal, Pacific Dunlop submitted that the indemnity clause was expressly subject to the definition of "Occurrence" and subject to the operation of the aggregation clause. It asserted the existence of an interaction between the indemnity clause, the definition of "Occurrence", the aggregation clause and the date deeming clause to provide a mechanism by which Pacific Dunlop was afforded an indemnity in respect of events not happening with a period of insurance but being part of a series unified by reason of its arising directly from a common cause or condition. Counsel for Zurich advanced a separate argument with different emphasis but to the same general effect.

Tadgell JA (with whom Charles and Chernov JJA agreed) stated that while the policy was to be interpreted according to the ordinary and popular meaning of its words, the words were to be construed in their context. That context was, in the circumstances, a commercial one and sound business principles therefore applied. On the basis of good business sense, the Court found that Pacific Dunlop and Zurich had overlooked the essential nature of the policy as being calculated to afford an indemnity over a distinct, limited and finite period of time, marked out at each end to the very minute and designated as "the Period of Insurance".

His Honour cited remarks made by Hobhouse LJ in *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd & Ors*[17] to the effect that when the relevant cover is placed on a time basis, the stated period of time is fundamental and must be given effect. The premium payable is assessed for that period, irrespective of whether the cover is defined by reference to losses occurring or claims made. The definition of the period of cover is basic and clear and provides a temporal limit to the cover outside of which the insurer is not on risk.

Tadgell JA described Pacific Dunlop's assertion that the scope of the policy is controlled by the aggregation clause as "a sustained and elaborate attempt to cause the tail to wag the dog."[18] He agreed with the argument relied upon by the Lloyd's syndicate that the meaning of the word "Occurrence" in the insuring clause was governed by the temporal limitations that the clause imports.

Finally, the Court of Appeal agreed with the argument put forward by Pacific Dunlop that the trial judge's conclusion rendered the date deeming clause nugatory and ignored the importance of the clause. That is, accepting the trial judge's view, the part of the clause deeming all Occurrences to have occurred on the day of the first Occurrence was not particularly useful. The trial judge had not been troubled by this conclusion and the Court of Appeal concurred. The latter held that the scope of the clause was vast, extending beyond personal injury to property damage and advertising injury. The fact that in this

[17] [1998] Lloyd's Rep IR 421 at 435.

[18] at [24].

particular context its utility was not evident did not render the clause nugatory and it may be very relevant for determining the quantum of damage to be assessed in other circumstances such as defamation or breach of copyright.

It is rather unusual to find an insurer supporting the arguments of an insured that the period of insurance provided by a policy is of secondary importance to the need to aggregate all claims of a particular class happening indefinitely into the future. In the circumstances of these proceedings, Zurich's position is explained by the reinsurance by the Lloyd's syndicate of its liability to Pacific Dunlop under the primary policy.

However, the Court of Appeal reaffirmed the importance of the temporal basis of insurance policies issued for a stated period of time. The fact that a particular clause of the policy may seem to have no use unless indemnity extends beyond the period of insurance will not persuade courts to broaden the cover beyond the point allowed by the business sense of the words used.

2.4 Nature of the Cover

The nature of the cover of the contract being considered is an important consideration in its construction. The courts will attempt to promote the commercial purpose of a contract and the nature of the cover provided provides an indication of the commercial purpose of the contract.

The perceived intention of the parties may not, however, overcome the plain meaning of the policy. The courts will not normally re-write the policy to attempt to give it its commercial purpose if the words used simply do not permit that outcome. The balancing of these interests was expressed by Pincus J in *EJ Hampson & Ors Syndicate 1204 v Mining Technologies Australia Pty Ltd* (1998) 10 ANZ Insurance Cases 61-389 at page 74-117, as follows:

> If one examines the policy looking for reference to a claim of this kind – one for expense incurred in recovering insured equipment which has been accidentally buried – no language will be found which appears at all clearly to cover such a claim. The express language of the contract is not at first sight of assistance to the respondent. But the policy is a commercial document and one which is in some respects poorly drawn; one should, no doubt, try to read it so as to reach a practically sensible outcome . . .
>
> On the other hand, ". . the policy must be understood, sympathetically no doubt, as meaning what it says" (*Smit Tak Offshore Services v Youell & General Accident Fire and Life Assurance Corporation PLC* (1991) 7 ANZ Insurance Cases para 61091). If the policy, fairly read, does not appear to cover a particular loss, then the fact that the omission to cover that loss may seem surprising or improvident is no ground for extending the risk the insurer has agreed to accept. It may seem odd that the insurance covers the value of equipment which has been "lost" by burial, but not the cost of attempts to uncover such equipment, the parties however, may make such bargain as they choose.

An example of where the type of cover influenced the court in construing its meaning is the case of *Fraser v Furman (Productions) Limited*[19]. In *Fraser v Furman*, an employer who had been sued by an employee for a work injury sued his insurance broker for failing to place an employer's liability policy. The broker defended the action on the basis that had a

[19] [1967] 1 WLR 898.

policy been placed, it would have contained a condition that required the employer to take reasonable precautions to prevent personal injury to employees. The broker argued that if it had been negligent in not placing the cover, no loss flowed as the insurance policy would not have responded as the employer had not taken reasonable precautions to prevent the injury. However, the only evidence led against the employer by the injured worker was that the employer had been negligent. There was no suggestion of any grievous wrongdoing against the employer. The court held against the broker on the basis that the policy would have responded to the employer's claim. The court considered it to be untenable to argue that the policy should have been construed in such a way as to require that the insured could not make a claim if he had been negligent. This would have effectively rendered the cover provided by the policy illusory. The court found that in the case of a liability policy, the "reasonable precautions" condition requires proof of more than mere negligence, rather, that proof of recklessness is required.

This approach might be contrasted with the approach of the Supreme Court of Queensland in *Kim & Anor v Cole & Ors*[20] (per McMurdo P, McPherson JA and Helman J). In *Kim* the Court considered the failure to comply with policy conditions excluding cover where there has been a breach of regulation or by-law.

This case considered whether a qualification may be read into a provision of a policy to "comply ... with all statutory obligations By-laws and Regulations imposed by any Public Authority" and what is "a simple breach of a regulation or by-law".

This was an appeal of a decision from the Magistrates' Court.

Mr Hurst was a plumber and gasfitter.

Mr Hurst was engaged by the owner of a pizza shop to fix the gas oven. Mr Hurst identified a fail-safe valve as the cause of the problem.

As no fail-safe valves were immediately available and the owners of the business wished to remain open, Mr Hurst fitted a valve without a fail-safe mechanism to the oven as an interim measure after satisfying himself that the owners of the business knew how to operate it.

Subsequently, the business owners failed to switch the valve off, gas leaked and a spark caused an explosion, destroying the building and damaging surrounding properties.

On the facts of the case, Mr Hurst was liable for a portion of damages.

Mr Hurst was insured under a policy (the ***policy***) with Wesfarmers Federation Insurance Limited (the ***insurer***), which contained provisions *inter alia* that Mr Hurst shall:

(a) take all reasonable measures to prevent ...damage to property ...;

(b) take all reasonable precautions for the safety of property insured;

(c) comply ... with all statutory obligations, By-laws and Regulations imposed by any Public Authority ...

[20] [2002] QCA 176 (24 May 2002).

The supply of gas is governed by the *Gas Act 1965,* under which the *Gas Regulations 1989* (the ***regulations***) have been made. The installation of the non-fail-safe valve was a breach of prohibition in the Act.

The trial judge construed the obligation of Mr Hurst to "comply...with all statutory obligations, etc" in the policy to incorporate the words to "take all reasonable precautions". On this basis, the magistrate held that Mr Hurst had not breached his obligations under the policy and, therefore, the insurer was liable to indemnify Mr Hurst.

Justice McPherson, with whom President McMurdo and Justice Helman agreed, held that it was impermissible to import the phrase "take all reasonable precautions" into sub-paragraph (c) and that it must be construed as it stands.

In installing a valve without a fail-safe mechanism, Justice McPherson found that Mr Hurst had contravened Clause 5.2.6 of the Gas Installation Code and, therefore, the statutory duty imposed under the *Gas Regulations 1989* to comply with the Code. Consequently, Justice McPherson, with whom President McMurdo and Justice Helman agreed, held that Mr Hurst lost the benefit of his cover.

Justice McPherson made reference to the decision of the Full Court in *Gold Coast Bakeries (Qld) Pty Ltd v Heat & Control Pty Ltd*[21], which is authority for the proposition that a "simple breach of a regulation or by-law" is not enough to constitute a breach of a policy provision requiring reasonable care to be taken to comply with all regulations and by-laws. Justice McPherson observed that, even if it is permissible to import such a qualification into sub-paragraph (c), the statutory provision that was contravened was intended to protect people and property that would be placed at serious risk if it were omitted and, therefore, "it would scarcely be correct to regard what happened as a simple breach of a regulation or by-law".

This case will provide some comfort to insurers seeking to rely on obligations or exclusions in the policy aimed at conduct that increases the risk. It demonstrates the limits to which courts will go to import qualifications into contractual conditions. Further, a "simple breach of a regulation or by-law" does not include a breach of a regulation that places people or property at serious risk.

2.5 Duty of Good Faith

Contracts of insurance are subject to a duty of utmost good faith. In Australia the *Insurance Contracts Act 1984* enshrines this principle by implying into each contract governed by the Act a condition requiring each party to act towards the other, in respect of any matter arising under or in relation to the contract, with the utmost good faith.

The construction of a policy is clearly a matter arising under or in relation to the contract. Consequently, at least in Australia, the construction of a contract of insurance is subject to the duty of good faith. Fanciful or absurd constructions of policies (by either party) may be in breach of the duty of utmost good faith not only under the Insurance Contracts Act 1984 but also potentially at common law. The circumstances in which such a breach might be found though are likely to be fairly extreme, eg an insurer taking an interpretation which it

[21] [1992] 1 QdR 162, 173.

knew was unsustainable because it knew the insured had insufficient resources to litigate it.

This is an area which may see more attention but at this stage it is probably fair to say that a legitimate construction of a wording taken in good faith (without fraud or bad faith/improper motive) is not likely to ever be enough.

2.6 Indemnity Principle

Contracts of insurance which are true indemnity policies must be construed against the background of the fundamental principle that the insured is only entitled to an indemnity for actual loss sustained. A loss which is only a "loss" as formulated under the policy will not give rise to a claim if no actual loss has been suffered: *Coalex Pty Ltd v Commercial Union Assurance Co of Australia Limited*[22].

The facts in *Coalex* were that at the material time Coalex Pty Ltd (***Coalex***) operated a coal mine in New South Wales together with other joint venturers. The main drift conveyor at the mine was damaged in November 1982 which caused an interruption to their business over a 5 month period. Whilst the mine suffered a loss of production, it was able to maintain its turnover when compared to the equivalent period in the previous 12 months of operations.

Coalex was insured by Commercial Union Insurance Co of Australia Limited (***Commercial Union***) under an Industrial Special Risks Insurance Policy. The policy was largely in an industry standard form and provided material loss coverage under section 1 of the Policy and consequential loss coverage under section 2.

The consequential loss coverage provided by the policy was contained in the following clauses:

> In the event of damage, Insurers shall be liable for the actual Loss sustained by the Insured resulting directly from such interruption or interference of business but not exceeding the loss of Gross Profit due to:
>
> (a) REDUCTION IN TURNOVER – the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period shall, in consequence of the damage, fall short of the Standard Turnover;
>
> (b) INCREASE IN COST OF WORKING – the additional expenditure necessarily incurred during the Indemnity Period and in consequence of the damage for the purpose of avoiding or diminishing the reduction in Turnover or for the purpose of resuming or maintaining normal business operations.

Coalex contended that these provisions (and other relevant definitions) provided an exclusive formula for calculating the value of the insured's "loss". It argued that the loss did not depend upon external elements other than the "ingredients as defined in the policy itself". When the policy provisions were applied to the facts in Coalex, a "paper loss" was produced even though the reality was that Coalex had not sustained any actual financial loss due to its use of stockpile reserves.

[22] (1988) 5 ANZ Insurance Cases, paragraph 60558.

Commercial Union argued that the formula within the policy represented nothing other than a ceiling fixing the maximum amount which Coalex could recover under the policy upon proof of actual financial loss sustained as a direct result of the interruption of the business.

Wood J at first instance rejected Coalex's construction and entered judgment for Commercial Union. Coalex appealed the decision to the New South Wales Court of Appeal. The Court of Appeal unanimously dismissed Coalex's appeal. Samuels JA (with whom Hope and Priestly JJA) agreed, considered that the policy was intended to provide an indemnity to Coalex for its actual loss. The contractual specifications provided a formula which set a maximum ceiling on the amount of loss that could be sustained under the policy. He stated at pages 75381 and 75382 that:

> The present policy is a hybrid which grafts the formula commonly used in the United Kingdom consequential loss policies to the "actual loss sustained" specification generally adopted in business interruption policies in the United States of America. A typical American policy expresses the indemnity thus: "Actual loss sustained – in the event of such damage… this Company shall be liable for the actual loss sustained by the Insured resulting directly… but not exceeding the reduction in Gross Earnings…" (Riley on Business Interruption & Consequential Loss Insurances & Claims 6th ed. (1985), Appendix Q at p. 447). Policies in this form are regarded as an indemnity against actual loss of business earnings up to the maximum imposed by the proviso: see *National Union fire Insurance Co. of Pittsburgh v Anderson-Prichard Oil Corp*. et al. 141 F. 2d 443 (1944) and *Northwestern States Portland Cement Co. v. Hartford Fire Insurance Co. et al.* 360 F. 2d 531 (1966).
>
> On the other hand a United Kingdom consequential loss policy typically stipulates, so far as material, that the insurance "is limited to loss of gross profit due to reduction in turnover and the amount payable as indemnity thereunder shall be (a) In respect of reduction in turnover: the sum produced by applying the rate of gross profit…" and the formula that follows is identical to that adopted in the present case. It will be seen therefore that the subject policy predicates indemnity upon actual loss and formulates the ceiling ordinarily attached to such an indemnity by borrowing the terms which in English policies define and limit the amount payable.
>
> The only relevance of these matters is to supply some explanation of how this policy appears to have been put together. But they are not an aid to construction, and it was not suggested that the court should use them for that purpose. Even less do they reveal why the insurers chose to amalgamate two fundamentally different forms of indemnity. But, as it turns out, the language used is plain, involves no ambiguities and must be given, in my view, the construction for which the respondents contend.

2.7 Implied Terms

Terms may be implied into a contract if:-

- the contract has an obvious gap and therefore the term is required to be implied for the sake of giving the contract business efficacy;
- the term to be implied can be articulated with certainty;
- the term to be implied is so obvious that it goes without saying;
- the term to be implied is not inconsistent with an express term of the policy[23].

In *EJ Hampson and Others Syndicate 1204 v Mining Technologies Australia Pty Ltd*[24], the insured was successful in having a term implied that mitigation costs should be paid by the

[23] *BP Refinery (Western Port) v Shire of Hastings* 1977 16 ALR 363 at 265.

insurer in a mobile plant and machinery policy. The case involved an insurance claim made by Mining Technologies Australia Pty Ltd (***MTA***) under its Mobile Plant and Machinery Policy issued by E J Hampson's Syndicate 204 (***EJ Hampson***) syndicate and plant.

The claim arose in the following circumstances. MTA carries on the business of providing mining services to owners of open-cut coal mines and, in doing so, engages in what is called "highwall mining". Highwall mining involves the use of specialised equipment to tunnel into the face of existing open cut mines. The equipment burrows into and beyond the coal face for distances of up to 350 m, recovering quantities of coal which are automatically conveyed back to a launch vehicle, which is located at right angles to the coal face. The launch vehicle is a vehicle that launches a continuous miner into the coal, towing a lead car and a series of other "add cars" attached to the lead car, to form a progressively increasing train of cars following the miner into the tunnel being excavated in the coal.

On 27 December 1995, MTA was carrying out highwall mining operations for BHP AC at its Moura mine. MTA's continuous miner was working in a tunnel in the coal seam at a distance of 250 m from the face, when there was a collapse of the roof of the tunnel. The equipment which was trapped consisted of the continuous miner, the lead car and 19 add cars. MTA successfully recovered 16 add cars. This left the continuous miner, the lead car and 3 add cars still trapped in the area of the cave-in. Attempts to retrieve these remaining items of property were abandoned on 1 March 1996 because of the danger and expense involved and limited prospects of further success.

The equipment that remained in the tunnel was valued at $1.7 million. The value of equipment recovered was $1.82 million. An amount of $725,000 was expended in the rescue attempts. A deductible of $100,000 was applicable.

E J Hampson indemnified MTA in respect of the continuous miner, lead car and 3 add cars which were abandoned underground on the basis they were "lost", but refused to pay MTA's costs of recovery of the 16 add cars except for an amount of $3,000 which was the sub-limit of indemnity for removal costs.

The relevant provisions of the policy were as follows:

> Section 1: Loss or damage to your Machinery/Equipment
>
> The company will indemnify the insured against:
>
> 1. Loss, damage or liability to the items described in the schedule, accessories, and spare parts (limited to $1,000) unless otherwise specified in the Schedule …
>
> PARTIAL LOSS
>
> In the event of partial loss or damage under this insurance, the Underwriters shall be liable only for the actual cost of (and shall have the option of) repairing, re-building, or, if necessary, replacing the parts damaged or destroyed, to restore the machinery to a condition equal to that immediately prior to the loss.

[24] (1998) 10 ANZ Insurance Cases 61389.

EJ Hampson contended that the property that had been recovered by MTA was not lost. It said this was self-evident by the fact that it had ultimately been recovered.

MTA contended that if it was not lost, then it had at least been partially lost as the concept of a partial loss permitted a temporary loss. The court noted that the difficulty with this concept was that the relevant insuring clause, as it applied to a partial loss, only permitted repair, rebuilding or replacing of the relevant property. None of these basis of settlement were apt to deal with a situation where money was spent to recover buried (though not damaged) equipment.

The court was therefore faced with the possibility of an anomalous outcome in which had the insured not made the effort (or incurred the expense of) retrieving the equipment, it would have had a good claim under the policy. But because it had retrieved the property there was no claim.

It seems the court then grappled with ways to overcome this apparent result.

At first instance, White J implied a term in the contract to the effect that where a policy requires or apprehends an insured to take steps to mitigate a loss, the insurer shall be obliged to reimburse it for the costs of the mitigation. She stated (at page 10 of her judgement), that:

> If the peril insured against is sufficiently imminent or has eventuated, it would, in my view, be unjust in the absence of a term to the contrary in the policy of insurance if an insured expended money to avert or reduce the risk of the insurer becoming liable under the policy without a correlated obligation on the part of the insurer to pay for that expenditure …

EJ Hampson appealed this decision to the Queensland Court of Appeal. The decision of White J was upheld by a 2:1 majority. However, the judges in the majority (Davies and McPherson JA) based their decisions on different reasons. Davies JA agreed with White J that in order to give business efficacy to the policy, there should be implied in the policy a term to the effect that where loss, damage or liability which would otherwise have occurred, was avoided by the exercise of reasonable care, including the reasonable expenditure of money or performance of work on the part of the insured or any person acting on the insured's behalf, the insurer should indemnify the insured against that expenditure or the value of that work. Davies JA, considered that the implication of this term was reasonable because:

> It could not possibly have been within the contemplation of the parties that where, as occurred here, the insured by the exercise of reasonable care and the expenditure of $725,000, avoided loss, the insurer should not be liable to indemnify it to the same extent.

Without expressing a concluded view on the matter, McPherson JA also indicated that, if necessary, a term could have been implied into the policy along the lines of that suggested by White J and Davies JA. However, he did not ultimately consider it necessary to imply such a term as he found that the express words of the policy were sufficient to cover the costs. He construed the meaning of the word "repair" in the "Partial Loss" basis of settlement to include recovery costs. Both Davies JA and Pincus JA (who dissented) rejected this construction. McPherson JA stated at page 74130 that:

> It seems both legitimate and correct to regard the process of retrieving the add cars from the collapsed tunnel as one of "repair". It involved the restoration of those items to their former condition without changing their character; or, to use the expression in the Partial Loss Provision of the policy, a restoration of those items to a condition equal to that immediately prior to the loss.

Pincus JA found that there was no express provision within the policy to cover the loss and that no terms should be implied.

The case illustrates the many different ways that a court may approach the construction of an insurance policy and the efforts they will make to seek to achieve a just outcome by reference to the intentions of the parties.

Another example of a case dealing with issues of implied terms is *Royal Sun Alliance Insurance Australia Ltd v Mihailoff & Anor*[25] the Supreme Court of South Australia considered a statutory building works insurance policy.

The case examines the circumstances in which the courts will find an implied obligation under a policy for an insurer to indemnify the insured for legal costs incurred.

In relation to building work to be carried out on their house, Mr and Mrs Mihailoff obtained an insurance policy from Royal Sun Alliance Insurance Australia Ltd (***RSAI***) covering loss resulting from an inability to enforce or recover under a statutory warranty brought about by the builder's insolvency, death or disappearance.

A dispute arose as to whether the builder's work breached statutory warranties imposed by the *Building Work Contractors Act 1995* (SA) (the ***Act***), and the Mihailoffs referred the matter to arbitration. The arbitrator found in favour of the Mihailoffs, and made awards against the builder in relation to the breach of the statutory warranties and the Mihailoffs' legal costs. The builder became insolvent and a claim was made against RSAI under the policy. RSAI accepted the claim for the award for breach of statutory warranties but rejected the claim for the award for costs.

At first instance, the magistrate held that the Mihailoffs were entitled, under the policy, to recover costs incurred in establishing the breach of the statutory warranties. A single judge of the SA Supreme Court upheld this decision, but for different reasons. RSAI appealed.

By majority, the SA Court of Appeal found that the policy did not cover the Mihailoffs' legal fees.

Justice Gray (with whom Justice Nyland agreed) found that neither the policy nor the Act (under which the policy was purportedly issued) specifically addressed whether legal costs incurred in pursuing the builder for breach of statutory warranties were covered. However, Justice Gray considered that the penal nature of the relevant sections of the Act supported a narrow construction that would exclude legal costs.

Further, Justice Gray held that there was no implied term providing cover for the insured's legal costs of pursuing the builder. He considered in detail the provisions of the Act that required the building insurance to be taken out. He said one of the aims of the Act was to minimise the number of building disputes that proceeded to court. Another purpose was to

[25] [2002] SASC (per Prior (dissenting), Gray and Nyland JJ).

provide a measure of consumer protection. However, it was not intended to provide litigation insurance. In this case, Justice Gray found that the Mihailoffs were not obliged to submit their dispute to arbitration and the decision to do so was undertaken for their own benefit. The fact that the policy did not require the insured to give notice of any arbitration or legal proceedings to RSAI and, therefore, RSAI could do nothing to protect its position with respect to such proceedings or any costs that might be incurred, was considered by Justice Gray as an additional reason to conclude that the policy did not contemplate indemnifying the Mihailoffs against legal costs.

The Mihailoffs argued that the subrogation provisions in the policy implied that legal costs incurred in pursuing the builder were covered. This was rejected by Justice Gray.

This case demonstrates that, in the absence of an express term in the policy, a court may be reluctant to imply a term that the insurer must indemnify the insured for costs incurred in connection with an insured loss, particularly where the costs were incurred for the benefit of the insured.

2.8 Rectification

Where the contract does not contain the agreement between the parties the Court will, in some circumstances, rectify the contract.

To obtain an order that an agreement be rectified:

(a) there must be an intention common to both parties at the time of contract to include in their bargain a term which by mutual mistake is omitted from it: *Maralinga Pty Ltd v Major Enterprises Pty Ltd*[26];

(b) the plaintiff must advance "convincing proof" that the written contract does not embody the final intention of the parties. The omitted ingredient must be capable of such proof in clear and precise terms. The Court must not assume for itself the task of making the contract for the parties.

In other words, it is necessary to show a concurrent intention of the parties, existing at the time when the written contract is executed, as to a term which would have been embodied in the contract if the parties had not made a mistake in expressing their intention. Proof of such an intention is necessary to "displace the hypothesis arising from execution of written instrument, namely, that it is the true agreement of the parties".

As Mason J in *Maralinga*[27]:

> What is of importance is that the purpose of the remedy is to make the instrument conform to the true agreement of the parties where the writing by common mistake fails to express that agreement accurately. And there has been a firm insistence on the requirement that the mistake as to the writing must be common to the parties and not merely unilateral, except in cases of a special class to which I shall later refer.

[26] (1973) 128 CLR 336 at p350.

[27] at p350.

2.9 Contra Proferentem Rule

The contra proferentem rule permits a court to resolve a (genuine) ambiguity against an insurer which is the author of the contract in dispute. In the insurance context, the rule is based upon two principles, namely, that a party should be responsible for the ambiguities in their expression and secondly that in general there is unequal knowledge between an insurer and an insured and therefore the insurer, which has greater knowledge, should take greater care in the formulation of the contract.

The contra proferentem rule is only applicable when there is a genuine ambiguity in a policy. It is not intended to apply in a circumstance where two or more alternative meanings are open. The rule is therefore reserved for those cases where the meaning of a word or phrase is entirely unclear.

Strictly speaking, the contra proferentem rule does not apply against an insured who has drafted an insurance policy either on its own or in consultation with an insurance advisor, such as a lawyer or broker. Whether this strict application will continue to apply in an age where major international broking houses draft manuscript wordings is unclear although it is not difficult to foresee the doctrine (or a hybrid form of it) applying both ways where major international brokers are involved.

In *Independent Timber Importers (Aust) Pty Ltd v Mercantile Mutual Insurance (Australia) Limited*[28] considered whether an individual could own subsidiary companies and the application of the contra proferentem rule.

The court held that an individual cannot own a "subsidiary company".

Independent Timber Importers (Aust) Pty Limited (***ITI***) sought indemnity under a public liability policy that named Paul Shadbolt as the insured.

The policy provided cover to subsidiary companies of the named insured. ITI argued that it was a subsidiary company of Mr Shadbolt. The insurer argued that a company cannot be a subsidiary of an individual.

The court held that a "subsidiary company" must be a subsidiary of another company.

ITI argued that, in construing the policy, the court should have regard to the commercial purpose of the policy, the contra proferentem rule and/or to various events subsequent to the policy, which allegedly supported its interpretation (that a company could be a subsidiary of an individual). The court rejected these arguments as

- there was no ambiguity about the meaning of "subsidiary company" and therefore no room for the operation of the contra proferentem rule;
- later conduct and statements of parties to a contract are not admissible to resolve an ambiguity in the meaning of the contract (although they are admissible to identify the matters with which the contract deals); and
- the evidence did not in any case justify drawing an inference that the policy was intended to apply to ITI (or that there was a separate contract to insure ITI).

[28] [2002] NSWCA 304 the New South Wales Court of Appeal (per Sheller JA, Giles JA and Gzell J).

This case emphasises the care that is required, before entering into an insurance policy, in stating which individuals and companies are to be insured under the policy.

2.10 Other Rules

There are a number of other rules that relate to the construction of a contract. It is beyond the scope of this paper to discuss them in any detail but the following are simply noted for the sake of completeness:-

- *noscitur a sociis* – meaning that the meaning of a doubtful word can be based on an inference drawn from the meaning of words that surround it;
- *ieusdem generis* – meaning that the meaning of a word of general import can be flavoured and take on a meaning that is consistent with a class or species of more specific words which appear immediately before it;
- *ut res magis valeat quam pereat* – meaning that words should be construed in a way which tends to render them effective rather than ineffective;
- the "*generalia*" rules – meaning that specific words derogate from general words and general words do not derogate from specific words.
- parole evidence rule – meaning that a written contract is assumed to incorporate the entirety of the parties' agreement. This precludes external evidence from being taken into account when construing the contract with some exceptions.

3. Exclusion Clauses

Where two or more events can be described as being the proximate or efficient cause of an insured's loss it is sufficient to trigger cover if at least one of those causes is an insured peril under the policy. However, if the contract contains a clause in pursuance of which a loss caused by one of those events is excluded, the whole loss is excluded even if the loss can be shown to also have been caused by another event which is not excluded.

Exclusion clauses will be construed narrowly and must be drafted with clear and unambiguous language.

Rouleston Clarke Pty Ltd v FAI General Insurance Company Limited[29] involved the construction of a policy of professional indemnity insurance and an alleged tension between the insuring clause and the exclusion clause. It is a good example of a Court applying the various rules of construction.

By insuring clause 1(a), FAI agreed to indemnify the insured against any claims for compensation for breach of professional duty in the conduct of its business, by reason of any negligence committed by it or its employees.

Exclusion clause (b) expressly excluded from the indemnity any claim against the insured for dishonest, fraudulent, criminal or malicious acts or omissions of the insured or its employees, except to the extent provided in those extensions to the policy for which the

[29] (2000) 11 ANZ Insurance Cases 61-465.

policy schedule stated limits of indemnity. Relevantly, the schedule provided a "dishonesty limit" of $1 million and a "fidelity limit" of $250,000.

The relevant extension clauses were 4 and 5. Extension clause 4, a dishonesty extension, deleted exclusion clause (b) and extended the terms and conditions of the policy to indemnify the insured in respect of claims for damages for breach of conduct of employees, excluding however "claims for loss of money, negotiable instruments, bearer bonds or coupons, stamps, bank or currency notes".

Exclusion clause 5, a fidelity extension, indemnified the insured against any "loss of money, negotiable instruments, bearer bonds or coupons, stamps, bank or currency notes" belonging to the appellant or for which the appellant was legally liable.

An employee of the insured converted to his own use negotiable instruments of the insured's clients. The insured sought indemnity from FAI under the policy in respect of the claims brought against it by its clients.

At first instance, Evans J in the Supreme Court of Tasmania held that the insured was entitled to be indemnified only under the fidelity extension (clause 5) and FAI's liability for all of the claims was, therefore, capped at $250,000 and not $1 million, as would have been the case if FAI had been liable to indemnify the insured under insuring clause 1(a) or the dishonesty extension (clause 4). The insured appealed to the Full Court of Supreme Court of Tasmania.

The Full Court of the Supreme Court of Tasmania upheld the decision of Evans J at first instance. The main issue on appeal was whether, on a proper construction of the policy, the insured was entitled to be indemnified for the claims pursuant to either insuring clause 1(a) or the dishonesty extension.

The Full Court held that exclusion clause (b) made it clear that without the dishonesty and fidelity extension the policy did not indemnify the insured in respect of claims directly arising out of the fraudulent acts of employees.

The insured argued that the opening words of the dishonesty extension should be given their literal meaning. The opening words of the dishonesty extension clause provided that if the extension was triggered "exclusion (b) is deleted" and the policy is extended to indemnify the insured in respect of claims for damages for breach of professional duty arising out of or contributed by the dishonest conduct of employees. It was submitted, therefore, that exclusion clause (b) must not be read or taken into account in ascertaining the extent of the indemnity under the policy. On that basis, it was argued that there was nothing to exclude the operation of insuring clause 1(a) in this case.

Justice Crawford applied the principle that the policy must be read as a whole and rejected the insured's submission. According the Crawford J, the words "exclusion (b) is deleted" were only inserted to make it abundantly clear that the exclusion of an indemnity for dishonesty was not to apply and that *instead* the indemnity described by the extension clause would apply.

In coming to this decision, Crawford J noted the opening words of exclusion (b), which provided that "except as provided for in those extensions for which limits are stated in the schedule" there shall be no indemnity for fraudulent acts of employees. If the insured's

argument is correct, reasoned Crawford J, the opening words of this exclusion "do not mean what they say, for they do not in fact mean that except as provided in dishonesty extension clause 4 the policy shall not indemnify the insured in respect of any claim for fraudulent, etc, acts of employees." Instead, if the insured's argument is correct, insuring clause 1(a) will also operate to the benefit of the insured in respect of any claim. Justice Crawford held that such an interpretation was not intended by the parties.

Justice Crawford also held that the insured's interpretation of the policy created an internal conflict with regard to the limits of the indemnity provided. In order to trigger extensions 4 and 5, the insured had to pay an additional premium. If the insured's interpretation was accepted, in the case of a claim relating to fidelity the insured would, by paying a small additional premium, be entitled to the $1 million limit rather than the $250,000 limit provided for in the fidelity extension.

In coming to his decision, Justice Crawford cited the following general principles of construction of insurance policies:

- The task in construing the policy is to ascertain the objective intention of the parties from a consideration of its wording. Regard must be had to the fact that it is a policy of insurance. It must be read in its commercial setting in such a way as to fulfil and not restrain its commercial purpose (*MGICA Limited v United City Merchants (Australia) Limited)*[30];
- Each clause in dispute is to be interpreted according to its natural and ordinary meaning, read in the light of the policy as a whole, thereby giving direct weight to the context in which the clause appears, including the nature and object of the policy (*Darlington Futures Limited v Delco Australia Pty Ltd)*[31];
- It is appropriate to resolve any ambiguity in the policy by reading it as a whole (*Zurich Australian Insurance Limited v Fruehauf Finance Corporation Pty Limited)*[32];
- In resolving ambiguities, a reasonable construction is to be preferred as representing the presumed intention of the parties (*Alex Kay Pty Ltd v General Motors Acceptance Corporation)*[33];
- As a rule of last resort and a principle for construction to remove ambiguities only when other more rational approaches fail, the policy is subject to the *contra proferentem* rule of construction.

In *Transfield Pty Limited v National Vulcan Engineering Insurance Group Limited & Ors; Connell Wagner Pty Ltd v National Vulcan Engineering Insurance Group Ltd & Ors*[34],

[30] (1986) 4 ANZ Ins Cas 74,340 at 74,349 and 74, 350.

[31] (1986) 161 CLR 500 at 510.

[32] (1993) 7 ANZ Ins Cas 78,007 at 78,011.

[33] [1963] VR 458 at 463.

[34] [2002] MSWSC 830.

McClellan J considered the effect of exclusions clause and cross-liability clause in a Contract Works policy.

This case considers: (i) the effect of an exclusion and a cross-liability clause where multiple entities are insured under a single policy; and (ii) whether acceptance by an insurer of a claim by an insured amounts to an election, and thereby subsequently disentitles the insurer from subsequently denying liability.

Transfield Pty Limited (***Transfield***) was the head contractor for a railway construction project. Transfield engaged four subcontractors and consultants (the ***subcontractors***). Two incidents occurred at the construction site, causing damage to the property of Transfield and two of the subcontractors.

Various claims were brought by and against Transfield and the other two subcontractors (together the ***plaintiffs***) for compensation for loss and damage.

The plaintiffs each sought indemnity under a policy of insurance held by Transfield Holdings Pty Limited (***THPL***), the parent company of Transfield. The policy covered THPL, all of its subsidiaries and their subcontractors for any liability for (among other things) loss of, damage to or destruction of property.

The insurers denied indemnity, relying on an exclusion (the ***exclusion***) for liability for damage to property owned by "the insured".

The insurers argued that the expression "the insured" means *all* parties insured under the policy. Accordingly, property owned by "the insured" means property owned by any one or more of the insured entities, including property owned by any of the subcontractors.

The plaintiffs argued that:

1. the exclusion did not apply, as the expression "the insured" refers not to any insured entity but to the particular entity bringing the claim. This is because the exclusion must be interpreted in light of a cross-liability clause in the policy, which stated that:

   > Each of the persons comprising the Insured shall...be considered as a separate and distinct unit and the words "the Insured" shall be considered as applying to each...in the same manner as if a separate policy had been issued to each...

2. even if the exclusion applied, the insurers had conducted Transfield's defence on its behalf, required Transfield's cooperation and told Transfield that indemnity had been granted. The plaintiffs claimed that the insurers had thereby elected not to exercise their right to deny liability under the policy, and could not at a later time rely on the exclusion.

The insurer argued that the exclusion had no work to do if the insured's contentions were accepted, since there could be no question of legal liability arising from damage to one's own property. It also argued that its construction was in accordance with good business sense and the weight of authority.

In relation to the first issue, Justice McClellan considered case law relating to the interpretation of exclusion clauses in policies containing cross-liability clauses. His Honour concluded that, informed by the cross-liability clause, the phrase "the insured" in the

exclusion is a reference to the particular party that makes a claim under the policy. This was on the basis that:

- the contract must be construed with regard to the language used by the parties;
- any doubt must be resolved in favour of the insured;
- the purpose of the policy was plainly to provide insurance to all parties. Although separate policies could have been issued, this had obvious practical difficulties; and
- for the exclusion to have the operation suggested by the insurer, it would have had to read "any insured" or "an insured" rather than "the insured".

In rejecting the insurer's submission that the exclusion would have no work to do, Justice McClellan considered obligations to others may arise where one damages one's own property; for example, the property may be leased or mortgaged or others may have rights to use it.

In relation to the second issue, Justice McClellan considered the law relating to election. His Honour concluded that acceptance by an insurer of a claim by an insured to which the policy does not extend cover does not amount to an election, so as to disentitle the insurer from subsequently denying liability under the policy. In such circumstances, the insured would need to demonstrate some detriment entitling it to raise an estoppel.

This case illustrates the importance of careful policy drafting to avoid coverage in circumstances that may not have been intended by the insurer, particularly where the policy contains a cross-liability clause.

The case also provides some comfort to insurers on the issue of election. However, insurers need to be wary that once indemnity is confirmed, even if the policy does not cover the claim, it may not be able to be subsequently denied if the insured can establish detriment.

Terrorism and insurrection exclusions

Particularly following September 11 the world is more susceptible to, or at least there is an increased perception of risk of, terrorism and the Bali bombings among other regional events showed that the Asian, Australasian and Pacific regions are not exempt from global risks or from internal dislocation. In those circumstances I thought that there may be some interest in some decided cases which have considered exclusion clauses in relation to mutiny, rebellion, revolution, insurrection or terrorism.

Oscar Shub and John Edmond of my office and Graham Leung and Shayne Sorby from Howards in Suva have recently been involved in a matter heard by Pathik J of the High Court of Fiji in Suva between 3 March and 10 March 2003: *Tappoo Holdings Limited & Tappoo Limited v Robert Arthur Stuchbery & Ors*. Judgment in this matter has been reserved. The case concerned damage suffered by the Tappoo department store in Suva on 19 May 2000 and whether or not an exclusion in the relevant policy applies or not. The relevant exclusion was as follows:

> (1) This Policy does not insure any loss or damage directly or indirectly caused by or resulting from:

> (a) war, invasion, act of foreign enemy, war-like operations (whether war is declared or not), civil war, mutiny, rebellion, revolution, insurrection, military or usurped power. This exclusion does not apply to loss or damage caused by acts of terrorism or sabotage, providing the acts are not committed in time of war by any agent acting in connection with any operation of armed forces of a government or sovereign power.

As judgment has been reserved in the matter I do not want to express any views about that case. I did want to mention it as those interested in the proper interpretation of such exclusion clauses might want to keep an eye out for the judgment.

In *Grell-Taurel v Caribbean Home Ins & Ors*[35] the Court of Appeal (Trinidad and Tobago) per Sharma JA, Hamel-Smith JA and Warner JA considered the extension of cover to riot, the exclusion of cover for insurrection and a reverse burden of proof clause.

The case considers the operation of an exclusion for loss or damage occasioned by insurrection where the policy requires that the burden of proving the loss is not caused by insurrection lies on the insured.

On 27 July 1990, members of the Muslimeen attempted to overthrow the government of Trinidad and Tobago, bombing the police headquarters in Port of Spain and storming the parliamentary chambers. In the aftermath, a great deal of looting took place. The Commissioner of Police took the decision not to employ men to deal with the looting, and the following day a state of emergency and a curfew was declared.

At the time of the attempted overthrow, Grell-Taurel Limited (***GTL***) was engaged in the business of selling and servicing industrial equipment and machinery at premises located about two-and-a-half miles from the city centre of Port of Spain. GTL was insured with the Caribbean Home Insurance Co Limited and others (the ***insurers***) under a collective fire and special risks and consequential loss insurance policy. Coverage under the policy extended to riot damage, subject to a special condition which provided that:

> this insurance does not cover any loss or damage occasioned by or through or inconsequence, directly or indirectly, of any of the following occurrences namely
>
> (b) ... insurrection ...
>
> (c) acts of terrorism

The special condition further provided that:

> For the purposes of this condition, "Terrorism" means the use of violence for political ends and includes any use of violence for the purpose of putting the public or any section of the public in fear.

In the judgment at first instance[36], Kangaloo J found, at 617:

> Sometime after the first television broadcast by Abu Bakr extensive looting and fires which resulted in the destruction of premises began in Port of Spain. By 8.00pm a great deal of looting was already taking place and there were a number of fires in Port of Spain. By the said 8.30pm men, women and children had been streaming past the Express newspaper's offices at the eastern end of Independence Square South with their hands full, shopping bags or garbage bags brimming with looted goods. Cars and trucks drove past with heavier items such as refrigerators and furniture. By 8.30pm the looting in Charlotte Street and

[35] [2002] Lloyds Rep IR 655.

[36] reported at [2000] Lloyds Rep IR 614.

> Queen Street was observed to be well underway. There was serious looting in downtown Port of Spain. People were stealing televisions, stereos, clothes and other goods, for example "Male Box" on Charlotte Street was already stripped clean and several shops were on fire. Looting continued throughout the night of July 27-28. … The plaintiff Grell-Taurel Limited engaged in business from premises known as Grell-Taurel Complex at Eastern Main Road Laventille. Its premises were looted from 11.00pm on 27 July 1990 to 5.00pm on 28 July 1990. … The plaintiff Joseph Nahous & Company Limited carried on business adjoining buildings at 6 Charlotte Street and 38 Independence Square. The looting there took place during the period from 27 July 1990 to 29 July 1990.

It was accepted by the parties that, for the purposes of the action, the immediate cause of GTL's loss was "riot" within the extension to the policy, and that the activities of the Muslimeen constituted "terrorism" and/or "insurrection" within the definition contained in the special condition.

The policy also provided that, in the event that the insurers alleged that by reason of the special condition that any loss or damage was not covered by the insurance, the burden of proving that the loss or damage was covered shifted to GTL.

At first instance, Justice Kangaloo dismissed GTL's application. He considered that GTL could not show from the evidence that their losses, on the balance of probabilities, had no real material connection with the insurrection, because it could not rebut the inference that the turbulence and collapse of public order caused by the insurrection led to and encouraged the acts of looting and vandalism, which were the immediate cause of the insured's losses.

The real issue to be resolved was whether, under the terms of the exclusion in that case, the loss which had occurred as a result of the riot was "occasioned by or through or in consequence, directly or indirectly, of" insurrection.

In dismissing the appeal, Justice Warner, with whom Justices Sharma and Hamel-Smith agreed, referred to the decision of Justice Mustill (as he was then) in *Spinneys (1948) v Royal Insurance Company*[37], which GTL sought to rely on. At 666-667, Warner JA analysed the question of the causal link between the insurrection and the looting by reference to the judgment of Mustill J in *Spinney*, and held, at 667:

> If therefore the reasoning in Spinney is applied to the instant case, I do not think it can be said that the insurrection was so far removed in time and place, to the extent that it had nothing to do with the looting. The issue is not whether the police had to be called to account for their failure to repress the internal disturbance or to preserve the peace, as they are required to do under the Police Service Act, but whether the looting was connected with the insurrection.
>
> The statement of agreed facts, standing on its own, provided cogent and unchallenged evidence that the Appellants' loss was occasioned indirectly, if not directly, by, through, or in consequence of the insurrection. (See Spinney at page 442.)

Justice Warner noted that it was held in *Spinney's* case that as regards causation:

> . . the plaintiffs had to face the assertion that the turbulence and collapse of public order (as in the present case), attendant on the civil commotion permitted and encouraged the acts of looting and vandalism, and unless rebutted would be sufficient to establish that the loss was occasioned indirectly (if not directly), by, through or in consequence.

[37] [1980] I Lloyds Rep 406.

At 659, Hamel-Smith JA, referred to the judgment of the Court of Appeal for Southern Ireland in *Motor Union Ins Co v Boggan*[38], in which O'Connor LJ referred to the true meaning and scope of a policy of this nature, and said:

> These words, in my view, aptly reflect what happened in Trinidad on the night of 27 July as a result of the insurrection. The looters were emboldened by the state of insurrection and took full advantage of the inability of the police to deal with the situation to plunder and steal. Whether the looting was done for private gain or to further the ends of the insurgents is immaterial in my view. The riot at the Appellant's premises took place against the background of insurrection. It fired the base instincts of some misguided persons whose only interest was to pillage and strip in full knowledge that the arm of the law was paralysed and this incapable of stopping them. It can hardly be said that the loss was not as a consequence, directly or indirectly, of the insurrection.

In reference to the drafting of the mode of proof required by the reverse burden clause, Justice Warner noted:

> The draftsman must have intended to stop somewhere and that place must be the point at which an event ceases to be a cause of the loss, and becomes merely an item of history.

In applying the reasoning in *Spinney,* Justice Warner concluded that she did not think that it could be said that the insurrection could be so far removed from time and place to the extent that it had nothing to do with looting, noting that the exclusion required only an indirect connection. Furthermore, it was not an issue whether the police had to be called to account for their failure to repress the internal disturbance or to preserve the peace, but the issue was whether the looting was connected with the insurrection.

Grell-Taurel also makes it clear that it makes no difference whether or not the insurgents took part in the looting – per Warner JA at 665-666, who noted that the trial judge had found there was no credible evidence to implicate the Muslimeem in the looting.

Citing *Spinney's Case* (supra), Warner JA also held, at 666, that motivations of personal gain on the part of the looters were irrelevant. It is interesting to note that Kangaloo J at first instance referred to "men, women, children … with their hands full, shopping bags brimming with looted goods".

This case demonstrates the application both of a reverse burden of proof clause and of a broadly worded exclusion clause (for losses indirectly occasioned by an insurrection).

In *Pillay v General Insurance Co*[39], the Supreme Court of the Seychelles had before it a case in which certain military personnel had attempted to take control of the Seychelles at about 2.00am on 17 August 1982. There then followed two days of fighting between the loyal and mutinous forces. From about 10.00pm on 17 August 1982, the plaintiff's store was ransacked. The plaintiff claimed under his insurance policy. The insurer declined indemnity on the basis of a similar exclusion to that in *Grell-Taurel*. At 169, the Chief Justice of the Seychelles held:

> It appears to me that the plaintiff's shop on the night of 17th August was a scene of tumult, of theft and forcible entry, of violence and disturbance of public peace, which to a layman as well as to a lawyer might well be said to have directly caused the loss and damage he

[38] 130 LT 588.

[39] [1985] LRC (Comm) 162.

> suffered; but if such loss was not directly caused, it was certainly indirectly caused by, contributed to, or arose from, a rebellion, civil commotion, or looting, which brings it within the exception in the insurance policy, and the plaintiff therefore cannot recover against the defendant.

As constitute "acts of terrorism", the following principles are relevant:

(a) In *T v Secretary of State for the Home Department*[40], at 886, the House of Lords adopted the definition of "terrorism" prescribed in the League of Nations Convention. Their Lordships defined "acts of terrorism" as "criminal acts directed against a State and intended or calculated to create a state of terror in the minds of particular persons, or a group of persons or the general public";

(b) The central element in terrorism appears to be an intention to create a state of fear in at least a section of the public. In *Lamey v the Queen*[41], the Privy Council stated, at 905, that "an act of terrorism presupposes an intention to create a state of fear in the public … an act of terrorism by its very nature involves an intention to strike others with terror". This intention can be demonstrated either by the circumstances in which the act has been committed or by some other conduct of which the act formed a part, such as blowing up of a building or a hijacked plane (*Lamey* at 905).

(c) For conduct to compromise an "act of terrorism" it must have an objective or purpose above and beyond personal or private gain. This is generally, but not necessarily, political, and involves an intention or aspiration to overthrow the established order. In *T v Secretary of State* (supra), the House of Lords said, at 885:

> The terrorist does not strike at his opponents; those whom he kills are not the tyrants whom he opposes, but people to whom he is indifferent. hey are the raw materials of a strategy, not the objectives of it. The terrorist is not even concerned to insure terror in the victims, for to him they are ciphers. They exist only as a means to inspire terror at large, to destroy opposition by moral enfeeblement, or to create a vacuum into which like-minded can stride.

4. Implications for Policy Drafting

An examination of the above principles reveals that when drafting insurance policies, the draftsperson must:-

- be clear and precise;
- define words and phrases which are intended to have a special meaning;
- be consistent in formatting, phrasing and terminology;
- be careful when cutting and pasting different wordings;
- not rely on standard wordings without first considering their applicability to a particular case;
- be alive to the commercial purpose of the contract.

[40] [1996] 2 All E R 865.

5. Conclusions

Whilst the various rules and principles governing the interpretation of insurance policies are relatively easy to state an analysis of just some of the cases in which those principles have been applied to various fact situations shows how difficult it can be to predict the outcome of proceedings involving such issues. It is difficult to reconcile a case like *E J Hampson v Mining Technologies* where the Court appears to have gone out of its way to ensure that an insured recovered the costs of rescuing the cars buried in the mining collapse with a case like *Manren Limited v RSA* where the Court refused coverage where although the Proposal described the business the Schedule did not do so.

Following September 11 and the collapse of HIH there has been an even more marked contraction of insurance availability in Australia than in other parts of the world. There has generally been a tightening of contract terms and increases in premium in most classes. In an effort to improve the position State and Federal governments in Australia have been introducing civil liability reforms with a view to limiting payouts particularly for high risk activities and, what might be perceived as less meritorious plaintiffs, such as alcohol or drug effected plaintiffs. At the same time there appears to be what some have identified as a growing trend particularly in the New South Wales Court of Appeal and the High Court to more critically examine plaintiff's claims.

Some examples are:

- *South Tweed Heads Rugby League Football Club Ltd v Cole* [2002] NSWCA 205 where the High Court found that a licensed club was not liable to an intoxicated patron subsequently runover.
- *Woods v Multi-Sport Holdings Pty Ltd* [2002] HCA 9 where the High Court found that an indoor cricket centre was not liable for an eye injury suffered by a patron.

General civil liability is of course a topic which is a very broad one and outside the scope of this paper. I mention these trends only because something similar may be happening with policy interpretation.

Manren and *Kim v Cole* may be examples of the Australian Courts starting to look more favourably at more strict interpretations of insurance policies and adopting a perhaps more neutral or even pro-insurer approach to policy construction. Having said that it is probably premature to identify or predict any general trend in this direction at this stage.

Insurance policies at times seem to be deliberately drafted to be difficult to interpret with insuring clauses, exclusions, extensions and schedules causing endless review of interlinking, sometimes inconsistent and interweaving provisions. That process is only made harder where the policy appears to give cover in one place and then to take it away elsewhere perhaps in an innocuous or less than obvious place.

[41] [1996] 1 WLR 902.

In such a situation the words from that chorus from The Monkees' "Words" come back to mind:

> Words that never were true
> Spoken to help no body but you
> Words with lies inside
> But small enough to hide 'til your playing was through.

Michael Quinlan

3 August 2003