Supreme Court of South Australia

SHERRY & ORS v FAI GENERAL INSURANCE COMPANY LIMITED (IN LIQ) No. SCCIV-99-494 [2002] SASC 3 (18 January 2002)

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Court

SUPREME COURT OF SOUTH AUSTRALIA

Judgment of the Honourable Justice Debelle

Hearing

30/11/2000, 22/12/2000.

Catchwords and Materials Considered

CONTRACTS --- GENERAL CONTRACTUAL PRINCIPLES --- CONSTRUCTION AND INTERPRETATION OF CONTRACTS INSURANCE --- PROFESSIONAL INDEMNITY INSURANCE

> Insurance policy - application to determine preliminary questions - application allowed - application for leave to amend preliminary questions - leave granted - construction of policy - who was insured - whether policy covered claims arising out of fraudulent acts of insured - whether policy was avoided for want of proper disclosure - application of the Insurance Contracts Act 1984 - whether exclusion clauses apply - questions answered.

- Insurance Contracts Act 1984 (Cth) s14, s21, s24, s28, s33, referred to.
- Advance (NSW) Insurance Agencies Pty Ltd v Matthews (1989) 166 CLR 606, applied.
- AAMI v Wright (1998) 70 SASR 110;
- Bass v Permanent Trustee Co Ltd (1999) 198 CLR 334;
- Beresford v Royal Insurance Co Ltd [1938] AC 586;
- CBS Productions Pty Ltd v O'Neill [1985] 1 NSWLR 601;
- Darlington Futures Ltd v Delco Australia Pty Ltd (1986) 161 CLR 500;
- Fire and All Risks Insurance Co Ltd v Powell [1966] VR 513;
- Gilmore v AMP General Insurance Co Ltd (1996) 67 SASR 387;

- Gray v Barr [1970] 2 QB 626;
- Gray v Barr [1971] 2 QB 554; [1971] 2 All ER 949;
- Hardy v Motor Insurance Pty Ltd [1964] 2 QB 745;
- Maye v Colonial Mutual Life Assurance Society Ltd (1924) 35 CLR 14;
- Corporation, Berhad (1989) 167 CLR 219;
- Rogers v Baillieu Bullock Wilkinson Pty Ltd (1981) 28 SASR 594;
- Rouleston Clarke Pty Ltd (in liq) v FAI General Insurance Co Ltd (2000) 11 ANZ Insurance Cases 75,412; [2000] TASSC 63;
- Rouse v IOOF Australia Trustees Ltd (1999) 73 SASR 484;
- Yorkville Nominees Pty Ltd v Lissenden (1986) 160 CLR 475, considered.

Representation

First Plaintiff: DEAN RAYMOND PATRICK SHERRY
Counsel: MR R WHITINGTON QC WITH MR M EVANS - Solicitors: PIPER ALDERMAN LAWYERS

Second Plaintiff: PENELOPE ANN ELDRIDGE
Counsel: MR R WHITINGTON QC WITH MR M EVANS - Solicitors: PIPER ALDERMAN LAWYERS

Third Plaintiff: EULALIE MARIE ANGELA LAUBMAN
Counsel: MR R WHITINGTON QC WITH MR M EVANS - Solicitors: PIPER ALDERMAN LAWYERS

Fourth Plaintiff: CHARLOTTE JOYCE SCHULTZ
Counsel: MR R WHITINGTON QC WITH MR M EVANS - Solicitors: PIPER ALDERMAN LAWYERS

Defendant: FAI GENERAL INSURANCE COMPANY LIMITED (IN LIQ)
Counsel: MR J WELLS QC - Solicitors: DAVID DEAKIN DAVIES & CO

SCCIV-99-494

Judgment No. [2002] SASC 3

18 January 2002

(Civil)

SHERRY & ORS v FAI GENERAL INSURANCE

COMPANY LIMITED (IN LIQ)

[2002] SASC 3

Civil

1. DEBELLE J. This is an application for an order that a number of questions concerning the construction of an insurance contract be determined before proceeding to a trial on the facts. The initial application was made on 17 April 2000. For a number of reasons, and despite a number of attempts to do so, it was not possible to list the application for a prompt hearing. On 17 October 2000 the plaintiffs amended their application. The amendments reflect amendments to the pleadings. However, the substance of the application remains the same.

2. Pursuant to a direction of a Master made on 7 April 2000, the plaintiffs filed an affidavit exhibiting a proposed statement of agreed facts which were to be the facts on which the application was to proceed. On 20 April 2000 that affidavit was served on the solicitors for the defendant, FAI General Insurance Company Ltd ("FAI"). The solicitors for FAI did not directly challenge those facts, although some rather vague suggestions were made that some facts might be questioned. As FAI had had notice of those facts for more than six months before the hearing and has not directly challenged them, I propose to proceed on the basis of those facts. A party cannot simply sit on its rights with impunity. Furthermore, in the event, I do not think that there is any disputed fact which relates to the questions of construction. This application is made pursuant to Rule 75.02(c) of the Supreme Court Rules for determination of points of law arising on the pleadings. The questions of construction of the insurance contract are questions of law and Rule 75.02(c) requires that those questions must be determined on the pleadings. The pleadings contain admissions of most of the relevant facts. Other relevant facts are not seriously in dispute.

3. I first heard argument on the question whether there should be a preliminary hearing. Having ruled that there should be such a hearing, I then heard argument on the questions of construction. I now set out my reasons for my ruling as well as on the substantial issues. However, before doing so, I set out the relevant facts.

Davies Appointed Attorney

4. The plaintiffs are the executors and trustees respectively of the estates of Miss Eulalie Laubman and Mrs Joyce Schultz. Miss Laubman died on 15 September 1989 and Mrs Schultz died on 7 December 1999. Mr Brian Davies ("Davies") held powers of attorney from both Miss Laubman and Mrs Schultz. The plaintiffs allege that at all relevant times Miss Laubman and Mrs Schultz were elderly and infirm, were not capable of managing their commercial affairs, and were dependent on Davies. Davies was a chartered accountant and a member of the firm of Mann Judd, Chartered Accountants ("Mann Judd"). He was also a director of Mann Judd Associates Pty Ltd, a company which provided accounting services. The company later changed its name to Amjex Pty Ltd. I will call it "Amjex". The plaintiffs allege that Davies dealt fraudulently with the estates of Miss Laubman and Mrs Schultz while a member of the firm or as a director of Amjex.

5. Miss Laubman granted Davies a power of attorney on 1 September 1981 and a further power on 7 May 1987. It is alleged on her behalf that, among other things, Davies fraudulently misappropriated her estate and acted in breach of his fiduciary duties to her. On 15 September 1989 Miss Laubman died and, on 10

December 1990, Davies and a Mr B J Bowler were appointed executors and trustees of her estate. On 15 September 1993 Davies resigned as executor and trustee of the estate. Later, the plaintiffs, Mr Dean Sherry and Ms P Aldridge were appointed trustees and executors of the estate, and Mr Bowler resigned as trustee and executor. Mr Sherry and Ms Aldridge are still the trustees and executors of the estate of Miss Laubman.

6. Mrs Schultz granted Davies a power of attorney on 7 March 1983. That power of attorney gave Davies an absolute discretion to invest monies on her behalf. It is alleged on behalf of Mrs Schultz, among other things, that Davies fraudulently misappropriated her estate and acted in breach of his fiduciary duties to her.

The Insurance Contract

7. FAI is an insurance company. On 11 September 1992 its agent, Willis Corroon Professional Services Ltd issued a certificate of insurance which insured Mann Judd and others. The certificate of insurance is in fact and in law a contract of professional indemnity insurance between FAI and the insured named in the contract. The persons who are called "the Insured" in this contract are listed immediately below with a short note of the principal activity of each.

Mann Judd - Chartered Accountants.

Mann Judd Associates Pty Ltd - Accounting Services. Although this company has changed its name to Amjex Pty Ltd it was called Mann Judd Associates Pty Ltd in the contract.

Mann Judd Services Pty Ltd - A trustee company providing office services and administration.

Mann Judd Financial Services Pty Ltd - Investment adviser.

Mann Judd Nominees Pty Ltd - Trustee and investor.

The contract of insurance provided cover for claims made during the period 1 July 1992 to 1 July 1993 in respect of any act or omission whenever and wherever committed on the part of the insured. It will be necessary to note the precise terms of the cover in a moment. The indemnity was limited to $5 million. The contract was subject to an excess of $10,000. At all material times, Davies was a member of the firm Mann Judd and a director and shareholder of Amjex. Davies completed the proposal for the contract of insurance but did not disclose in that proposal any wrongdoing with the estates of Miss Laubman and Mrs Schultz.

Notice of Claim to FAI

8. By letter dated 30 May 1993, the solicitors for Amjex gave FAI notice of a claim under the policy. The claim arose out of the conduct of Davies in dealing, among other things, with the estates of Miss Laubman and Mrs Schultz. The letter

enclosed a statement from Davies concerning his conduct which included his dealings with the two estates. Relying on a number of grounds including non-disclosure, FAI refused to indemnify under the contract of insurance.

Plaintiffs Commence Legal Proceedings

9. On 6 September 1993 and on 30 August 1994, the then executors and trustees of the estate of Miss Laubman instituted proceedings in this Court against, among others, Davies and Amjex respectively. They were the actions numbered 1630 of 1993 and 1040 of 1994. In those actions claims were made arising out of the allegedly fraudulent conduct of Davies and the breach of his fiduciary duties to her. The two actions were consolidated and on 19 September 1998 judgment was entered against both Davies and Amjex in the sum of $2,093,982.14.

10. On 23 November 1995 Mrs Schultz commenced proceedings in this Court against, among others, Davies and Amjex. In that action, she alleged, among other things, that Davies had fraudulently misappropriated her estate and had acted in breach of his fiduciary duties to her and that he and Amjex were liable to her. On 3 March 1997 Mrs Schultz obtained judgment against Amjex and Davies in the sum of $3,386,244.16. Thus, by reason of these two judgments, Amjex and Davies are liable to pay the plaintiffs a total sum of $5,480,226.30. The plaintiffs allege that Amjex is entitled to be indemnified for that liability under the contract of insurance.

Davies and Amjex Assign Benefits

11. On 28 July 1997, in proceedings instituted by Mrs Schultz, the Federal Court of Australia made a sequestration order against Davies and appointed a trustee in bankruptcy of his estate. On 17 June 1997 Amjex was wound up by order of this Court and a liquidator appointed. By a deed dated 13 November 1998, the trustee in bankruptcy of the estate of Davies assigned, among other things, his benefits under the contract of insurance to Mrs Schultz and the executors of the estate of Miss Laubman. By a deed dated 23 December 1998, the liquidator of Amjex assigned, among other things, its benefits under the contract of insurance to Mrs Schultz and the executors of the estate of Miss Laubman. On 10 February 1999 the plaintiffs gave notice of the assignments to FAI.

Plaintiffs Commence this Action

12. On 3 May 1999 the plaintiffs issued this action seeking indemnity pursuant to the contract of insurance. The plaintiffs assert that, by reason of the assignments, Miss Laubman and Mrs Schultz are entitled to bring this action. When this action commenced, the plaintiffs were Mr Sherry and Ms Aldridge as executors and trustees of the estate of Miss Laubman. Mrs Schultz was then still alive and she was the other plaintiff. Mrs Schultz died on 7 December 1999 and by order of this Court made on 20 October 2000 her executors and trustees, Mr Sherry and Mr Keen, were substituted as plaintiffs and took over the conduct of the action on behalf of her estate.

FAI's Defence

13. FAI denies on a number of grounds that it is liable to indemnify the plaintiffs under the contract of insurance. It is unnecessary to list all of the grounds of its defence. It is sufficient to note that some of those grounds are founded on the terms of the contract of insurance, on an alleged failure of Davies and Amjex to make full disclosure, on misrepresentations alleged to have been made by Davies, and on the ground that neither Davies nor Amjex had any interest under the contract of insurance capable of assignment.

An Application to Determine Preliminary Directions

14. Given the matters which FAI has put in issue in its defence, it is readily apparent that the hearing of this action will be long. The issues are complex. It will be necessary to prove Davies' conduct in relation to his dealings with the estates of Miss Laubman and Mrs Schultz, the capacity in which he made those dealings, the circumstances in which the policy was issued and the issues relating to the alleged non-disclosure. The dealings in the two estates were detailed and complex. The plaintiffs will clearly have to incur very substantial costs and expense in preparing the action for trial and in the conduct of the trial.

15. The plaintiffs have identified a number of questions concerning the proper meaning of certain clauses of the contract and as to the operation of certain provisions of the Insurance Contracts Act 1984. The terms of the contract are not in issue. Depending on what they are found to mean, the terms of the contract of insurance have the potential to defeat the plaintiffs' claim. The facts necessary for the determination of the various questions are admitted or are not seriously in dispute. Essentially, all that is involved is determining the meaning of some clauses in the contract and of some provisions in the Insurance Contracts Act. The issues can be determined as questions of law. The determination of the issues will resolve some important issues in this action. More specifically, some questions will decide whether the plaintiffs have any entitlement at all to the relief they seek. If the plaintiffs cannot succeed, it is desirable that they should learn that at the earliest possible stage. All of the issues arise upon the pleadings. I therefore decided that it was appropriate to determine as preliminary questions of law all of the questions of construction save two. In reaching that conclusion, I had regard to the principles expressed in Rogers v Baillieu Bullock Wilkinson Pty Ltd (1981) 28 SASR 594; Rouse v IOOF Australia Trustees Ltd (1999) 73 SASR 484 and Bass v Permanent Trustee Co Ltd (1999) 198 CLR 334.

The Amended Questions

16. In the course of the argument whether it was appropriate to determine the questions as preliminary issues, it became apparent that some questions required amendment. It was common ground that the court has the power to amend the questions proposed by the plaintiff. The power to amend exists by virtue of Rule 53 and see also CBS Productions Pty Ltd v O'Neill [1985] 1 NSWLR 601. I informed the parties that I was prepared to consider an application for leave to amend. The substantive hearing concerning the preliminary questions was adjourned before counsel for the plaintiffs had completed his submissions. Over

the adjournment, a period of several weeks, the plaintiffs applied for leave to amend. FAI had almost two weeks' notice of the application to amend and was able to argue the substantive application with notice of the terms of the proposed amendments. Given that the substance of the questions remained the same, that the amendments were essentially a matter of form, and that the terms of the amendments had been canvassed during the argument of counsel for the plaintiffs, it is appropriate to grant leave to amend. I acknowledge that, as a general rule, it is desirable that the terms of the questions be determined before argument on those questions. However, the substance of the questions was known and FAI was not, in my view, prejudiced in any respect. As amended, the questions are:

> "1.1 The Basis of Contract Argument
>
> Was the effect of Section 24 of the Insurance Contracts Act such that the particulars and statements contained in the proposal for the Contract of Insurance operated:
>
> (a) merely as precontractual representations; or
>
> (b) did they have any other, and if so what effect?
>
> (Paragraph 39.1 of the Second Amended Defence and paragraph 15.1 of the Reply).
>
> 1.2 The Extent, and Subsequent Waiver, of Rights of the Defendant where there has been a Non-Disclosure or Misrepresentation
>
> 1.2.1 Was Section 21 of the Insurance Contracts Act the only precontractual duty imposed on the insured, in relation to the disclosure of a matter to the insurer? (Paragraph 43 of the Second Amended Defence and paragraph 16A of the Reply).
>
> 1.2.2 Subject to any contracting out by the defendant of the rights conferred thereunder, was Section 28 of the Insurance Contracts Act the only source of the defendant's rights to avoid the Contract of Insurance or have its liability in respect of any claim thereunder reduced for precontractual non-disclosure or misrepresentation? (Paragraphs 44, 48, 50, 52, 52A, 56A, 56B and 56C of Second Amended Defence and paragraphs 16B, 19, 21, 23, 23A, 23B, 23C and 23D of the Reply).
>
> 1.2.3 Was the effect of Clause 4 of Part II of the Policy such as to exclude, restrict or modify any rights that the defendant may have had pursuant to Section 28 of the Insurance Contracts Act? (Paragraphs 16B, 19, 21, 23, 23A, 23B, 23C and 23D of the Reply).
>
> 1.3 Other Points of Construction of the Policy

1.3.1 [Deleted].

1.3.2 Does Clause 4 of Part II of the Policy only operate in relation to a partnership? (Paragraph 39.2.3 of the Second Amended Defence).

1.3.3 Does the rule of law identified in paragraph 39B of the Defence (or any cognate rule of law) preclude the extension of indemnity to:

(a) Davies? and/or

(b) Amjex Pty Ltd?

in the circumstances pleaded in the Statement of Claim?

(Paragraph 39B of the Second Amended Defence).

1.3.4 Would it be contrary to public policy to extend indemnity under Clause 4 of Part II of the Policy to Davies and Amjex? (Paragraph 56A of the Second Amended Defence).

1.3.5 Is there an implied term of the Policy that illegal acts by the insured would not be rewarded? (Paragraph 56B of the Second Amended Defence).

1.4 Constraints imposed on the Plaintiffs in their Reliance on the Policy

1.4.1 In the circumstances pleaded in paragraph 39A of the defence, would it be a breach of their duty of utmost good faith for reliance to be placed on Clause 4 of Part II of the Policy by:

(a) Davies; and/or

(b) Amjex Pty Ltd?

(Paragraph 39A of the Second Amended Defence).

1.4.2 In the circumstances pleaded in paragraph 56C of the Defence, should equity intervene to estop Davies and Amjex Pty Ltd and those claiming through them, from enforcing any rights under the Policy, or require restitution from those persons? (Paragraph 56C of the Second Amended Defence).

1.4.3 Are the rights of action of Davies and Amjex Pty Ltd under the Policy assets which, by virtue of Clause 4 of Part II of the Policy either operate to reduce any liability of the defendant to the full extent of that asset or inure to the benefit

of the defendant? (Paragraph 57.1, 57.2 and 57A of the Second Amended Defence).

1.5 The Exclusion Clause

1.5.1 In the circumstances pleaded in paragraph 53 of the Defence, does the exclusion in Part III paragraph (e) of the Policy apply? (Paragraph 53 of Second Amended Defence).

1.5.2 In the circumstances pleaded in paragraph 53 of the Defence, does the exclusion in Part III paragraph (c) of the Policy apply? (Paragraph 53 of Second Amended Defence)."

(The passages in brackets refer to the relevant pleadings.)

The Cover Provided

17. Central to the determination of a number of the questions and, indeed, central to the question whether the plaintiffs will be able to succeed in this action, is the nature of the cover provided by the contract. For present purposes, it is sufficient to note Part I and clause 4 of Part II of the contract. Part I of the contract describes the cover in these terms:

> "THIS CERTIFICATE is to indemnify the Insured against any claim or claims first made against them during the period set forth in the said schedule and reported to the Company during such period by reason of any act error or omission whether of acts, facts, law or otherwise or breach of contract between the Insured and its clients whenever and wherever the same was or may have been committed or alleged to have been committed on the part of the Insured or their predecessors in business or any person now or heretofore employed by the Insured during the period of this Certificate in or about the conduct of any professional business conducted by or on behalf of the Insured or their predecessors in business.
>
> In addition to pay the costs and expenses incurred with the written consent of the company in the defence or settlement of any such claim, provided that if a payment in excess of the amount of indemnity available under this Certificate has to be made to dispose of a claim, the Company's liability for such costs and expenses incurred with its consent shall be such proportion thereof as the amount of indemnity available under this Certificate bears to the amount paid to dispose of the claim."

The meaning of the expression "the Insured" and other expressions are defined in Part I of the contract. For present purposes, it is sufficient to note the following:

> "The words 'professional business' are understood to apply to advice given or services performed of whatsoever nature undertaken by or on behalf of the Insured provided always that any fee accruing from such work shall inure to the benefit of the Insured.
>
> 'Professional business' includes work done without fee, providing that such work is undertaken in the name of or on behalf of the Insured.
>
> Wherever the words 'Insured' or 'partner' or 'partners' appear in the wording of this Certificate they are respectively understood to mean also where applicable 'incorporated company', 'director', 'directors', 'shareholder', 'shareholders', the words 'employee' and 'employees' are understood to mean also where applicable employee or employees other than shareholders of the Insured incorporated company."

Extensions to the contract are contained in clause 4 of Part II of the contract. It is in these terms:

> "The Insured shall be protected, within the terms of this Certificate for any claim upon which suit may be brought by reason of any alleged dishonesty, mis-statement or fraud on the part of the Insured or its partners or its employees, unless a judgement or other final adjudication thereof adverse to the Insured shall establish that acts of active and deliberate fraud or dishonesty committed by any partner or partners of the Insured with actual fraudulent or dishonest purpose and intent were material to the cause of action so adjudicated and notwithstanding that such acts were not disclosed within the Insured's proposal for insurance in which event this Certifcate (sic) shall only pay in excess of the full extent of such Partner's or Partners' assets in the firm. Any other personal assets of such Partner or Partners recovered by the Insured shall inure, to the extent of the amount paid by this Certificate, to the benefit of Company."

The plaintiffs contend

(1) that the true meaning of clause 4 is that the insured are covered when sued for fraudulent conduct which has occurred before the date of the proposal and which was not disclosed in the proposal; and

(2) that FAI has, by the terms of clause 4, waived its rights in respect of non-disclosure and misrepresentation under s 28 of the Insurance Contracts Act, 1984 in relation to that fraudulent conduct.

FAI pleads in effect that non-disclosure of fraudulent conduct before the

proposal was made avoids the contract and that it has not waived its rights under s 28.

18. Shortly stated, the contract provides indemnity in respect of claims first made against the insured during the period of the policy. Indemnity will be provided no matter when or where the fraud or the act, error or omission in or about the conduct of any professional business giving rise to the claim occurred. As already noted, the expression "professional business" is widely defined. This claim was first made during the period of the policy.

The Meaning of Clause 4

19. The first few lines of clause 4 extend the indemnity to any claim for dishonesty, misstatement or fraud on the part of the insured or its partners or employees. Given the extended definition of both "Insured" and "partner", it also indemnifies directors of any of the insured companies. Thus, the partners of the firm Mann Judd and the directors of Amjex and the other companies listed as insured are indemnified in respect of any claim for dishonesty, misstatement or fraud on their part or on the part of any employees of the firm or any director or employee of the four companies.

20. The rest of clause 4 specifies events which create what is effectively an increased excess. It limits the exposure of FAI as insurer by increasing the excess above the nominated sum of $10,000. In other words, cover is extended but not if the nominated events occur, in which case the excess is increased. It is convenient to put to one side for the moment the clause "notwithstanding that such acts were not disclosed within the Insured's proposal for insurance", which I shall call "the notwithstanding clause". The meaning of the remaining words is quite clear. In those instances where a judgment or other final adjudication adverse to the insured establishes that acts of active and deliberate fraud were committed by any partner or partners of any of the insured with actual fraudulent or dishonest purpose and intent were material to the cause of action, the liability of FAI is limited to indemnifying the insured only for an amount in excess of the assets in the firm of the fraudulent partner or partners. In this way, FAI penalises the fraudulent partner or partners without denying indemnity. The provision is a disincentive to fraudulent conduct. In the last sentence in clause 4, the phrase "to the benefit of Company" is intended to mean "to the benefit of FAI". That is a consequence of the fact that FAI is defined as "the Company" in the opening words of the certificate.

21. I turn to examine the meaning and operation of the words of the notwithstanding clause which reads "and notwithstanding that such acts were not disclosed within the Insured's proposal for insurance". In my view, those words mean that the indemnity extended by clause 4 is further extended so that FAI will provide indemnity even in those instances when the insured has, when completing the proposal, failed to disclose acts of active and deliberate fraud or dishonesty of the kind described in clause 4 which existed when the proposal for insurance was made. In other words, FAI has by those words modified the duty of disclosure imposed on an insured by s 21 of the Insurance Contracts Act. FAI's power to do so is provided by s 21(2) of that Act. FAI has not waived every aspect of the

obligation to make full disclosure. It has modified that obligation only to the extent that there has been a failure to disclose acts of dishonesty, misstatement or fraud which the judgment or other final adjudication has identified as having been committed by the fraudulent partner or partners.

22. The purpose of the notwithstanding clause is apparent. Partners in a firm will not necessarily be aware of all of the acts or omissions of their fellow partners in the course of engaging in the partnership business. They will seek indemnity should those acts or omissions give rise to a claim against the firm. Clause 4 provides such a cover. But clause 4 goes a step further and deals with the situation where a partner has been guilty of fraud or dishonesty before the proposal for insurance is completed and there is a failure to disclose it. Fellow partners will seek to be covered against the risk of a failure to make proper disclosure. All partners will seek to be covered against the risk that, unbeknown to the person completing the proposal, one of them has already acted dishonestly or fraudulently. The facts in Yorkville Nominees Pty Ltd v Lissenden (1986) 160 CLR 475 and in Gilmore v AMP General Insurance Co Ltd (1996) 67 SASR 387 provide two instances from reported cases. In the former, an innocent partner sought such an indemnity in circumstances where his co-partner had falsely failed to disclose circumstances likely to give rise to a claim against the firm. In addition, all partners will seek to be covered against the risk that the partner making the proposal for insurance has himself acted dishonestly or fraudulently and has failed to disclose it in the proposal. This contract of insurance issued by FAI provides indemnity notwithstanding a failure to make disclosure.

23. The decision in Yorkville concerned a clause which was to all intent and purposes in terms identical to those in clause 4 but which excluded the phrase "notwithstanding that such acts were not disclosed within the Insured's proposal for insurance". In that case, the failure by an innocent partner who also completed the proposal for insurance to disclose prior fraudulent conduct avoided the contract of insurance. It is reasonable to infer that the notwithstanding clause was inserted into clause 4 so that innocent partners would continue to be indemnified notwithstanding a failure to make full disclosure either by an innocent partner or by a partner who had himself been guilty of fraudulent conduct. It is open to an insurer to waive its right to rely on the failure to make disclosure. While there is clearly an added risk, some protection against that risk can be achieved by increased premiums for that kind of policy. In my view, this is the only sensible construction of this unfortunately drawn clause. It means that non-disclosure of acts of dishonesty or fraud will not mean that innocent partners are disqualified from indemnity under the contract. Instead, there will be an increase in the excess by an amount equal to the assets in the firm of the fraudulent partner or partners.

24. That conclusion follows from the plain reading of the words which have been employed in clause 4. As the decision in Yorkville demonstrates, it is also the logical consequence of the law relating to disclosure in insurance contracts. If this clause had not been included, the extension to provide indemnity for fraud would be defeated or, depending on how s 28 of the Insurance Contracts Act might operate in the particular circumstances of each case, at least significantly limited.

The Arguments of FAI

25. I do not propose to deal separately with all of the arguments advanced by Mr Wells QC on behalf of FAI. The greater part of those arguments failed to have regard to the plain words of clause 4 or to its purpose in this contract which is intended to provide professional indemnity insurance to partners in a firm as well as directors of companies carrying on the business of a profession. It is, however, necessary to deal with two of those arguments.

The Extended Definitions

26. The first was founded on the extended definition of the words "Insured" and "partner" or "partners". As already noticed, the meaning of those words is extended by a definition clause in the contract. It is convenient to repeat the clause.

> "Wherever the words 'Insured' or 'partner' or 'partners' appear in the wording of this Certificate they are respectively understood to mean also where applicable 'incorporated company', 'director', 'directors', 'shareholder', 'shareholders', the words 'employee' and 'employees' are understood to mean also where applicable employee or employees other than shareholders of the Insured incorporated company."

Mr Wells QC fastened on the words "where applicable" and said that the extended definition did not apply in respect of clause 4. He sought to reinforce that submission by stating that the collection of rights, which represents a partner's interest in a firm, had no equivalent in the law relating to corporations or in the relationship between a corporation and its directors or shareholders. The argument failed to have regard to the fact that one of the purposes of this contract of insurance was to provide indemnity to partners of a firm who might also be fellow directors of companies providing professional services. A consequence of his argument would be that the extension of the indemnity to include fraudulent or dishonest conduct would apply to the partnership but not to any of the companies. That could never have been the intention of the parties. In clause 4, the expression "the Insured" is intended to mean the partnership, each partner and each of the four companies listed in the schedule to the contract.

27. Another consequence of the argument of Mr Wells is that the expression the "Insured" would have a different meaning in different parts of the contract and in the extension provided by clause 4. This is, of course, possible but is not a conclusion which is realistically open when considering the nature of the cover provided under the contract and the extensions of that cover. Such a conclusion would defeat the commercial purpose of the contract.

28. This clause, like others in this contract, is not well drawn. The words "director" and "directors" can only sensibly refer to directors of the companies listed as being insured. Having regard to the entities listed as insured in the schedule, the words "partner" and "partners" can only sensibly apply to the firm Mann Judd. Thus, when regard is had to the combined effect of the list of persons identified as the "Insured" and the definitions in Part I of the contract, indemnity is provided

not only to the persons listed in the schedules but also to any partner of the partnership trading as Mann Judd, to the four companies listed in the schedule and any director of any of those four companies. Although the expression "partners' assets in the firm" is not capable of application to corporations, the use of the expression is an instance of the drafter of this contract not thinking through the consequences of the extended meanings of "Insured" and "partner" and "partners". In a business of this kind, it is likely that the directors of the insured companies will also be shareholders. Where the insured is a company, it is plainly intended that FAI will indemnify only to an amount in excess of the full extent of the interests of the fraudulent director or directors in the company. If the fraudulent director has an interest in the company, the clause will operate. If the fraudulent director has no interest in the company, FAI will be obliged to provide a full indemnity.

Public Policy Issues

29. Mr Wells QC also submitted that public policy defeated the meaning of the notwithstanding clause for which the plaintiffs contended. To support his argument, he referred to the well established principles first, that an insured does not as a general rule intend to cover loss deliberately created by an insured particularly where it amounts to the commission of a crime or fraud: Fire and All Risks Insurance Co Ltd v Powell [1966] VR 513 at 517, 519 - 523, 527; AAMI v Wright (1998) 70 SASR 110; and see generally Sutton, Insurance Law in Australia (3rd edition) at paras 14.1, 14.11 - 14.14; and secondly, that public policy will prevent recovery of an indemnity in such circumstances: see cases such as Hardy v Motor Insurance Pty Ltd [1964] 2 QB 745; Gray v Barr [1970] 2 QB 626, 639 - 641 affirmed in Gray v Barr [1971] 2 QB 554; [1971] 2 All ER 949; Beresford v Royal Insurance Co Ltd [1938] AC 586; and Sutton, Insurance Law in Australia (supra) at paras 14.7 - 14.10. But as was noted by O'Bryan and Pape JJ in Fire and Risks Insurance Co Ltd v Powell (supra) at 517, these principles do not have universal application. It is necessary to examine the nature of the contract and the type of indemnity provided. Effect must be given to the terms of the contract. This argument, like others advanced on behalf of FAI, fails to have regard to the nature of the contract. The contract is, among other things, designed to indemnify innocent partners in a firm against the fraud or dishonesty of one or more other partners in the firm or of an employee in the firm. In the case of the insured companies, indemnity is provided to the company and to innocent directors against the fraud or dishonesty of one or more other directors or one or more employees of each of the companies which is insured under the contract. The contract is essentially for the protection of the innocent members of the partnership or the innocent directors of the relevant company. The reasons for such indemnity and for including a provision such as the notwithstanding clause have already been mentioned. This kind of contract is well established and does not offend either of the two principles on which Mr Wells relied.

30. The fact that the contract is designed to protect innocent partners in the firm or the companies and innocent directors of the companies has the necessary consequence that Davies is also one of the insured and, notwithstanding his guilty acts, is entitled to be indemnified. In this way, the innocent parties gain a measure of protection. This conclusion is reinforced by the fact that the excess is increased

where a judgment or other final adjudication finds fault or dishonesty on the part of Davies. If FAI had wished to limit the cover to exclude the guilty partner or partners or a guilty director, it could so easily have done so. Any doubts as to the meaning of this provision must, I think, be resolved against FAI as the drafter of the document.

The Questions

31. I turn to deal with each of the separate questions. It is convenient to restate each question.

32. Question 1.1

> Was the effect of Section 24 of the Insurance Contracts Act such that the particulars and statements contained in the proposal for the Contract of Insurance operated
>
> (a) merely as precontractual representations; or
>
> (b) did they have any other, and if so what effect?
>
> (Paragraph 39.1 of the Second Amended Defence and paragraph 15.1 of the Reply).

In paragraph 39.1 of its defence, FAI pleads:

> "The certificate wording incorporates as part of the contract of insurance the particulars and statements contained in the proposal forms and makes the contents of the proposal form the basis of the contract of insurance."

In their reply the plaintiffs join issue on this plea. The effect of the plea in para 39.1 is that the particulars and statements contained in the proposal have the status of a warranty. The plea fails to have regard to the clear terms of s 24 of the Insurance Contracts Act. Given the terms of s 24, the plea in para 39.1 cannot stand. By reason of s 24, the particulars of the statements made in the proposal have the status of pre-contractual representations: Advance (NSW) Insurance Agencies Pty Ltd v Matthews (1989) 166 CLR 606, 614. In the course of his submissions, Mr Wells QC said that the meaning of s 24 was not in issue and s 24 simply means what it says. The plaintiffs, he said, had raised a false issue and the court should not determine this question. It is, however, necessary to deal with the question as FAI has pleaded it and does not resile from that plea. It is a proper question for preliminary determination. For these reasons, the answer to question 1.1 is, No.

33. Question 1.2.1

> Was Section 21 of the Insurance Contracts Act the only

precontractual duty imposed on the insured, in relation to the disclosure of a matter to the insurer? (Paragraph 43 of the Second Amended Defence and paragraph 16A of the Reply).

In para 43 of its defence, FAI pleads, among other things, that, if Davies engaged in the conduct pleaded in the statement of claim, he breached his duty of disclosure, that he breached his duty of utmost good faith, that the nature of the non-disclosure was fraudulent, that he made false answers, and that the false answers were fraudulent misrepresentations. Section 33 of the Insurance Contracts Act provides:

> "The provisions of this Division are exclusive of any right that the insurer has otherwise than under this Act in respect of a failure by the insured to disclose a matter to the insurer before the contract was entered into and in respect of a misrepresentation or incorrect statement."

It is clear from the terms of s 33 that an insurer cannot have any remedies outside the terms of the Act. The remedies provided by s 28 (which form part of Division 3 of Part IV of the Act) enable the insurer to avoid a policy on the grounds of misrepresentation as well as non-disclosure. Thus, an insurer cannot by contract acquire rights beyond those prescribed in Division 3 of Part IV of the Act. The common law remedies for non-disclosure are excluded and the common law remedies for misrepresentation modified: Advance (NSW) Insurance Agencies Pty Ltd v Mathews (supra) at 615. Thus, when completing a proposal form, the insured has the duty not to make any misrepresentation as well as the duty of disclosure contained in s 21 of the Act.

34. The plea that Davies breached the duty of utmost good faith has a limited effect. Although that duty existed by reason of s 13 of the Act, it does not have the effect of imposing on an insured, in relation to the duty of disclosure of a matter to the insurer, a duty other than the duty of disclosure imposed by s 21: see s 12 of the Insurance Contracts Act.

35. I would therefore answer question 1.2.1 by saying that, when completing the proposal, the insured had to comply with the duty of disclosure in s 21 of the Insurance Contracts Act and with the common law duty not to make any misrepresentations as that duty is qualified by the Insurance Contracts Act.

36. Question 1.2.2

> Subject to any contracting out by the defendant of the rights conferred thereunder, was Section 28 of the Insurance Contracts Act the only source of the defendant's rights to avoid the Contract of Insurance or have its liability in respect of any claim thereunder reduced for precontractual non-disclosure or misrepresentation? (Paragraphs 44, 48, 50, 52, 52A, 56A, 56B and 56C of Second Amended Defence and paragraphs 16B, 19, 21, 23, 23A, 23B, 23C and 23D of the Reply).

This question reflects the issues raised in the previous question and, for the reasons just given, it must be answered by saying that FAI's rights to avoid the contract of insurance are contained in s 28 of the Insurance Contracts Act.

37. Question 1.2.3

> Was the effect of Clause 4 of Part II of the Policy such as to exclude, restrict or modify any rights that the defendant may have had pursuant to Section 28 of the Insurance Contracts Act? (Paragraphs 16B, 19, 21, 23, 23A, 23B, 23C and 23D of the Reply).

The meaning of the terms of clause 4 has already been examined. For the reasons already expressed, FAI has by the notwithstanding clause in clause 4 modified its rights under s 28 of the Insurance Contracts Act in the case of non-disclosure or misrepresentation, even if fraudulent. FAI is entitled to waive, either in part or in whole, its rights under s 28 in the case of non-disclosure pursuant to s 21(2) of the Act and, in the case of misrepresentation, has a common law right to do so. As noted above, FAI has not waived the whole of the obligation to make full disclosure. It has waived that obligation only to the extent that it will not avoid the contract where there has been a failure to disclose acts of dishonesty, misstatement or fraud which a judgment or other final adjudication has identified as having been committed by the fraudulent partner or partners. Mr Wells QC contended for FAI that neither Davies nor Amjex could rely on the partial waiver because to do so would be to act contrary to their respective obligations to act with the utmost good faith in accordance with s 14 of the Insurance Contracts Act. However, the submission fails to have regard to the fact that this policy is intended to provide indemnity for, among other things, the very kind of conduct in which Davies engaged. The answer to question 1.2.3 is that clause 4 modified the rights of FAI to the extent just noted.

38. Question 1.3.1.

> [Deleted].

39. Question 1.3.2

> Does Clause 4 of Part II of the Policy only operate in relation to a partnership? (Paragraph 39.2.3 of the Second Amended Defence).

Reference has already been made in these reasons to the extended meaning of "Insured", "partner" or "partners" in this contract of insurance. For the reasons already expressed, clause 4 applies to the four companies listed as insured and the directors of those companies as well as to the partnership called Mann Judd and the members of that partnership. That conclusion is

subject only to exclusions in Part III of the policy. The answer to this question is, No.

40. Question 1.3.3

> Does the rule of law identified in paragraph 39B of the Defence (or any cognate rule of law) preclude the extension of indemnity to
>
> (a) Davies, and/or
>
> (b) Amjex Pty Ltd?
>
> in the circumstances pleaded in the Statement of Claim?
>
> (Paragraph 39B of the Second Amended Defence).

Paragraph 39B is in these terms:

> "39.B The defendant says that the certificate wording and, more specifically, clause 4, cannot be construed so as to extend indemnity to Davies and Amjex in the circumstances pleaded in the Statement of Claim in that:
>
> 39.B.1 It is a rule of law that loss or damage which is inflicted deliberately by the insured or those for whom the insured is responsible is not insurable.
>
> 39.B.2 To do so would be contrary to the following rules of construction:
>
> 39.B.2.1 that it is to be presumed that an insurer does not intend to cover loss intended by the insured;
>
> 39.B.2.2 that, by its very nature, insurance covers risks and not certainties and not, therefore, intended loss;
>
> 39.B.2.3 on ordinary principles of insurance law, an insured cannot, by his own deliberate act, cause the event upon which the insurance money is payable;
>
> 39.B.2.4 that it is to be presumed that it was not the intention of the parties that either party should be entitled to rely upon his own wrongs and defaults to give rise to rights as against the other party."

The rule of law is identified in para 39.B.1 and the following paragraphs assert an implied term in the contract reflecting that rule. This issue has already been considered when examining the meaning of clause 4 and the

public policy issues associated with that meaning. For the reasons there expressed, the answer to this question is, No.

41. Question 1.3.4

> Would it be contrary to public policy to extend indemnity under Clause 4 of Part II of the Policy to Davies and Amjex? (Paragraph 56A of the Second Amended Defence).

42. Question 1.3.5

> Is there an implied term of the Policy that illegal acts by the insured would not be rewarded? (Paragraph 56B of the Second Amended Defence).

These questions may be answered together. The issues were addressed when examining the meaning of clause 4. For the reasons there expressed, clause 4 is not contrary to public policy and the policy is not of the kind that is avoided on the ground that it compensates illegal activity. The answer to each question is, No.

43. Question 1.4.1

> In the circumstances pleaded in paragraph 39A of the defence, would it be a breach of their duty of utmost good faith for reliance to be placed on Clause 4 of Part II of the Policy by
>
> (a) Davies; and/or
>
> (b) Amjex Pty Ltd?
>
> (Paragraph 39A of the Second Amended Defence).

This question addresses another aspect of clause 4. In para 39A of its defence, FAI plead:

> "The defendant says that if Davies and Amjex would otherwise have been entitled to indemnity under the certificate wording and, more specifically, clause 4, (which the defendant denies) then they, and those claiming through them (namely the plaintiffs), are not entitled to rely on that clause because for them to do so would necessarily mean that Davies and Amjex had committed and were relying on their own acts of deliberate fraud and dishonesty and therefore had failed to act with the utmost good faith. The defendant refers to and relies upon Section 14(1) of the ICA."

The reliance on s 14(1) of the Insurance Contracts Act is misplaced. Although Davies may have deliberately acted fraudulently and dishonestly,

and although Amjex may be vicariously liable for his actions as a director, that conduct is the very kind of conduct for which FAI has contracted to indemnify all of the insured. Section 14(1) can therefore have no operation in this context. The answer to this question is, No.

44. Question 1.4.2

> In the circumstances pleaded in paragraph 56C of the Defence, should equity intervene to estop Davies and Amjex Pty Ltd and those claiming through them, from enforcing any rights under the Policy, or require restitution from those persons? (Paragraph 56C of the Second Amended Defence).

Mr Wells QC contended that the question could only be determined after hearing evidence. I do not agree. In para 56.C FAI pleads:

> "56.C Further, or in the alternative, the defendant says that if the policy wording and, more specifically, clause 4 is construed to extend indemnity to Davies and Amjex in the circumstances pleaded in the Statement of Claim and herein (which is denied), then equity should intervene by either:
>
> 56.C.1 Holding that Davies and/or Amjex and those claiming through them (namely the plaintiffs) are estopped from enforcing any rights under the policy (including the certificate).
>
> 56.C.2 Requiring that Davies and/or Amjex and those claiming through them (namely the plaintiffs) make restitution in respect of any benefits acquired by them under the policy (including the certificate) through Davies' and Amjex's wrongful acts."

As noted, when answering the previous question, the circumstances pleaded in the statement of claim to which para 56C refers is the very conduct for which clause 4 provides indemnity. The circumstances pleaded in paras 56C of the defence could not, therefore, attract any principle of equity to deny Amjex and its directors the indemnity provided by clause 4. The answer to this question is, No.

45. Question 1.4.3

> Are the rights of action of Davies and Amjex Pty Ltd under the Policy assets which, by virtue of Clause 4 of Part II of the Policy either operate to reduce any liability of the defendant to the full extent of that asset or inure to the benefit of the defendant? (Paragraph 57.1, 57.2 and 57A of the Second Amended Defence).

In para 57A of its defence, FAI pleads:

> "Further, or in the alternative, the defendant says that to the extent that Davies and/or Amjex had any enforceable rights of action to claim indemnity under the certificate as at 24 May 1993 (which is denied) those rights of action were an asset of Davies and/or Amjex either in the Mann Judd practice in Adelaide or in their personal capacity which, respectively, by virtue of clause 4 of the policy wording either operated to reduce any liability by the defendant to the full extent of that asset or inured to the benefit of the defendant."

This question seeks the determination of a question which arises out of the terms of clause 4 relating to the increased excess which will obtain in those circumstances when a judgment or other final adjudication has established deliberate fraud or dishonesty. For the reasons already given, the "assets" to which the last part of clause 4 refers are, in the circumstances of this case, the assets of Davies. They cannot be the assets of Amjex. The assets of Davies cannot include any rights of action he might have under the contract of insurance. To contend that they do is to engage in circular reasoning. Further, such a contention would effectively extinguish any liability of FAI to pay the insured under clause 4. The clear intention of the reference to "assets in the firm" is to assets in the firm other than the right of action. The answer to this question is, No.

46. It is convenient to consider questions 1.5.1 and 1.5.2 together. They are in these terms.

Question 1.5.1

> In the circumstances pleaded in paragraph 53 of the Defence, does the exclusion in Part III paragraph (e) of the Policy apply? (Paragraph 53 of Second Amended Defence).

Question 1.5.2

> In the circumstances pleaded in paragraph 53 of the Defence, does the exclusion in Part III paragraph (c) of the Policy apply? (Paragraph 53 of Second Amended Defence).

FAI pleads in para 53 of its defence:

> "53. Further, or in the alternative, the defendant says:
>
> 53.1 That those claims brought against Amjex which relate to moneys advanced to Andmark, Henco and RMN are excluded by virtue of the operation of clause III(e) of the certificate wording; and
>
> 53.2 That the claim involving the personal loan to Davies is excluded by virtue of the operation of clause III(c) of the

> certificate wording."

The exclusion upon which FAI relies is in Part III of the contract and is in these terms:

> "This Certificate shall not indemnify the Insured against Claims made upon the Insured:
>
> ...
>
> (b) by or on behalf of any firm or corporation operated or controlled by the Insured or by any employees, nominees or trustees of the Insured and in which the Insured or any member of the Insured's family has a direct or indirect financial interest;
>
> (c) by any person advised or induced by the Insured or employees of the Insured to invest in or lend money to any person being a person referred to in the preceding sub-clause or to any person named as the Insured under this Certificate: or
>
> ...
>
> (e) arising out of the provision by the Insured of any advice, inducement, recommendation, endorsement or opinion regarding the investment of interest, capital or personal endeavour in an investment facility or service in which the Insured or any member of the Insured's family has a direct or indirect control or financial interest."

For two reasons I do not think it is either possible or desirable to answer these questions. First, the question whether any of the exclusion clauses apply, and if so which, depends on what facts are found in relation to each of the transactions mentioned in paras 53.1 and 53.2 of the defence. Those facts are not admitted. Until those facts are established, it is not possible to answer the question. Secondly, on their face, the terms of some of the exclusions seem to be entirely inconsistent with the kind of cover provided by the policy. There may be a question, therefore, whether the transactions fall within any of the exclusion clauses. This latter question may, depending on circumstances, attract the operation of the contra proferentem rule: Maye v Colonial Mutual Life Assurance Society Ltd (1924) 35 CLR 14; Darlington Futures Ltd v Delco Australia Pty Ltd (1986) 161 CLR 500 at 510; Nissho Iwai Australia Ltd v Malaysian International Shipping Corporation, Berhad (1989) 167 CLR 219 at 227; and Rouleston Clarke Pty Ltd (in liq) v FAI General Insurance Co Ltd (2000) 11 ANZ Insurance Cases 75,412; [2000] TASSC 63. The exclusion clauses are but another example of the very poor drafting in this contract.

47. For these reasons, there will be orders as follows.

1. Leave to the plaintiffs to amend the preliminary questions in terms of the application filed on 8 December 2000 (FDN 34).

2. That the meaning of all of the questions, save questions 1.5.1 and 1.5.2, be determined before proceeding to a trial of the facts.

3. That the questions be answered as follows:

1.1 No.

1.2.1 When completing the proposal, the insured to comply with a duty of disclosure in s 21 of the Insurance Contracts Act and with the common law duty not to make any misrepresentations as that duty is qualified by the Insurance Contracts Act.

1.2.2 The defendant's rights to avoid the contract of insurance are contained in s 28 of the Insurance Contracts Act.

1.2.3 Clause 4 modified the rights of FAI pursuant to s 28 of the Insurance Contracts Act to the extent that it will not avoid the contract where there has been a failure to disclose acts of dishonesty, misstatement or fraud which a judgment or a final adjudication adverse to the insured has established as having been committed by a partner or partners of the insured.

1.3.1 Deleted.

1.3.2 No.

1.3.3 No.

1.3.4 No.

1.3.5 No.

1.4.1 No.

1.4.2 No.

1.4.3 No.