FEDERAL COURT OF AUSTRALIA

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

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| File numbers: | NSD 63 of 2018  NSD 448 of 2018 |
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| Judges: | **ALLSOP CJ, LEE AND DERRINGTON JJ** |
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| Date of judgment: | 3 August 2018 |
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| Catchwords: | **INSURANCE** – Defence Costs extension – payable until wrongful act determined by judgment, adjudication or admission – whether implication that insurer prevented from relying on rights consequent upon insured’s fraudulent non-disclosure pending judgment, adjudication or admission of wrongful act  **CONTRACT** – Insurance policy – agreement to pay defence costs until alleged wrongful acts not covered by policy are determined by judgment adjudication or admission – whether insurer prevented from avoiding policy for fraudulent non-disclosure – whether party able to contract out of the consequences of their own fraud |
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| Legislation: | *Criminal Code Act 1995* (Cth)  *Federal Court Rules 2011* (Cth)  *Insurance Contracts Act 1984* (Cth)  *Proceeds of Crimes Act 2002* (Cth)  *Evidence Act 1995* (NSW) |
|  |  |
| Cases cited: | *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606  *Alexander Stenhouse Ltd v Austcam Investments Pty Ltd* (1993) 67 ALJR 421  *Carter v Boehm* (1776) 3 Burr 1905; 97 ER 1162  *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1  *Chardon v Bradley* [2017] QCA 314  *Duncombe v Porter* (1953) 90 CLR 295  *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 343 ALR 58  *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* (2014) 251 CLR 640  *Environment Protection Authority v Caltex Refining Co Pty Ltd* (1993) 178 CLR 477  *Franklins Pty Ltd v Metcash Ltd* [2009] 76 NSWLR 603  *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61  *Jones v Provincial Insurance Co* (1857) 3 CBNS 65; 140 ER 662  *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579  *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104  *National General Insurance Co Ltd v Chick* (1984) 3 ANZ Ins Cas 60-579  *Permanent Trustee Australia Limited v FAI General Insurance Company Limited (in liq)* (2003) 214 CLR 514  *Simic v New South Wales Land and Housing Corp* (2016) 260 CLR 85  *Southern Cross Assurance Co Ltd v Australian Provincial Assurance Assn Ltd* (1939) 39 SR (NSW) 174; 56 WN (NSW) 77  *Todd v Alterra at Lloyd’s Ltd* (2016) 239 FCR 12  *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165  *Weir Services Australia Pty Ltd v AXA Corporate Solutions Assurance* [2018] NSWCA 100  *Wilkie v Gordian Runoff Limited* (2005) 221 CLR 522  Derrington D and Ashton R, *The Law of Liability Insurance* (3rd ed, LexisNexis, 2013) |
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| Date of hearing: | 20 June 2018 |
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| Registry: | New South Wales |
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| Division: | General Division |
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| National Practice Area: | Commercial and Corporations |
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| Sub-area: | Commercial Contracts, Banking, Finance and Insurance  Insurance List |
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| Category: | Catchwords |
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ORDERS

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|  | | NSD 63 of 2018 |
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| BETWEEN: | JASON ONLEY  Applicant | |
| AND: | CATLIN SYNDICATE LTD AS THE UNDERWRITING MEMBER OF LLOYD'S SYNDICATE 2003  Respondent | |

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|  | | NSD 448 of 2018 |
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| BETWEEN: | ADAM CRANSTON  Applicant | |
| AND: | CATLIN SYNDICATE LTD AS THE UNDERWRITING MEMBER OF LLOYD'S SYNDICATE 2003  Respondent | |

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| JUDGES: | ALLSOP CJ, LEE AND DERRINGTON JJ |
| DATE OF ORDER: | 3 AUGUST 2018 |

THE COURT ORDERS THAT:

1. Rush Corporation Pty Ltd have leave to intervene in these proceedings.
2. The separate question posed to the Court which is:

whether, either:

(i) On the true construction of the Labour Force Liability Insurance Policy number LCB171202453 (“Policy”); or

(ii) On application of the principles of waiver or estoppel, under the *Insurance Contracts Act 1984* (Cth) (“the Act”) or otherwise; or

(iii) Upon application of the duty of utmost good faith under s 13 of the Act,

the Respondent has agreed not to exercise or is otherwise prevented from exercising rights or from relying on remedies under Part IV of the Act under circumstances where:

(a) Claims (as defined in the Policy) have been made against the Applicant alleging conduct of the Applicant of the kind stipulated in the Dishonest or Criminal Intent / Improper Conduct exclusion of the Policy ("Conduct"); and

(b) the Conduct has not been established by admission of the Applicant, judgment or adjudication (“Determination”); and

(c) the Respondent's exercise of rights or entitlement to remedies under Part IV of the Act is or would be based upon its conclusion, ahead of a Determination, that there has been a failure on the part of an insured to disclose that the Conduct had occurred or that it was intended or planned to occur.

be answered “No”.

1. The Applicants pay the Respondent’s costs of the application.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

THE COURT:

## Introduction

1. The Applicants, Mr Michael Onley and Mr Adam Cranston, seek orders that they are entitled to insurance cover in respect of the legal costs which they have incurred and are currently incurring in relation to two legal proceedings presently being pursued against them. In one, they have been charged under the *Criminal Code Act 1995* (Cth) with conspiring together with the intention of dishonestly causing loss to the Australian Taxation Office. In the second the Commissioner of the Australian Federal Police seeks recovery from them under the *Proceeds of Crimes Act 2002* (Cth). Each proceeding arises out of their previous business activities which they partially conducted through a number of corporate entities.
2. The Respondent underwriters, being certain Lloyd’s underwriters subscribing to Agreement Number B123016LAW1194 (“the insurer”), had issued a broadform Liability policy to various companies which included a number of which the Applicants were directors. Pursuant to that policy Liability cover, including the provision of defence costs, was extended to each director. When the relevant proceedings were commenced against them, the Applicants sought indemnity in relation to the costs which they had incurred and would incur in relation to them.
3. The insurer claimed that the conduct which is the foundation of both proceedings was dishonest conduct which had occurred, at least in part, prior to the policy’s inception, that the Applicants were aware of it and of its materiality, and that they failed to disclose its existence. That being so, it has purported to avoid the policy on the ground of fraudulent non-disclosure or, alternatively, claims that it is entitled to reduce its liability to nil if the non-disclosure not be fraudulent.
4. For their part, the Applicants claim that the language of the Extension providing for the payment of Defence Costs requires the insurer to meet the cost of the proceedings unless and until the criminal or dishonest conduct is established by judgment, adjudication or is otherwise admitted by them, regardless of whether they had breached their obligation to disclose their criminal or dishonest conduct or the facts underpinning it. They commenced the present action seeking declaratory relief that they are entitled to indemnity under the policy pending the determination of the various proceedings against them.
5. On 12 April 2018, the Chief Justice ordered that this question be heard by a Full Court separately from other questions in the proceeding. On 10 May 2018, his Honour made further orders permitting Rush Corporation Pty Ltd (“Rush”) to make an application at the hearing of the separate question to intervene in it. Rush claims to have an interest in the construction of the policy as it also falls within the description of an “insured”. It has proceedings on foot in the Victorian Supreme Court in which it challenges the insurer’s purported avoidance of the policy in reliance upon the non-disclosure which is at issue in this Court. There is no doubt that it has a real commercial interest in the outcome of these proceedings and it should be permitted to intervene.
6. The arguments advanced by the Applicants and by Rush cannot succeed. First, as a matter of construction the Defence Costs Extension does not diminish or contractually qualify the insurer’s right to rely upon its remedies in Part IV of the *Insurance Contracts Act 1984* (Cth) (the “ICA”) consequent upon the Applicants’ non-disclosure. In this respect this case is notable as the Applicants’ contention relies upon the very provision which their non-disclosure prevented the insurer from excluding. Secondly, as a matter of public policy, Courts will not allow a party to contract out of the consequences of their own fraudulent conduct. Here, the insurer relies on the Applicants’ alleged fraudulent non-disclosure and if that allegation proves to be correct, it will have validly avoided the policy. The result would be the same even if there existed an express term purporting to relieve the insureds of the consequences of their own fraud.
7. Despite the outcome in this particular case, it ought to be observed that an insurer may not escape its obligation to advance defence costs until relevant facts are established by a simple allegation of non-disclosure. Consistent with its obligation of utmost good faith under s 13(1) of the ICA, an insurer must have a real or substantial ground for alleging non-disclosure. That does not mean the insurer must then have all necessary proof of the insured’s conduct to establish the ground for the exclusion. However, sufficient grounds must then exist which can be relied upon consistently with the obligation of utmost good faith. This is not an issue in this case, where there is no suggestion of disclosure, and the relevant facts of the charges, if true, must have been known to the Applicants, and the merits of the charges are sufficient to support the commencement of a prosecution.

## The facts

### Background to the policy

1. The Applicants are directors of the company Synep Pty Ltd (Synep). On 1 June 2016, that company acquired 100% of the shares of Plutus Payroll Australia Pty Ltd (Plutus).
2. The insurer carries on the business of providing insurance, including Liability insurance, in Australia. It is uncontentious that its policy in this case is subject to the *Insurance Contracts Act 1984* (Cth) (the “ICA”).
3. On or about 1 July 2016, it granted to Synep a SURA Labour Force Liability Insurance policy, Number LCB171202453 (the policy), for the period from 1 July 2016 to 1 July 2017. The policy was effected by SURA Labour Hire Pty Ltd, and underwritten by the insurer. Five named companies including Synep and Plutus (although the latter’s name is misspelt) were identified as the named insured.
4. The policy is constituted by two documents being the SURA Labour Force Liability Insurance Policy Wording Edition SLHLFP V2 05-2016 and the Schedule of Insurance. The type of insurance provided is characterised as “labour industry and host employer insurance”, and the business identified in the Schedule of Insurance is “personal recruitment and/or labour hire”.
5. In general terms, the cover is divided into two main sections. Section one contains Broadform Liability cover and Section two provides cover in respect of “Management Liability and Professional Indemnity”. The Applicants have sought indemnity under the second section, and for present purposes it is accepted that under this section, an “insured person” means any natural person who was prior to the period of insurance or is during or after the period of insurance a director, officer or employee of an insured company. It is not in issue that the Applicants are each “an insured person” within the meaning of that definition.

### Policy terms and conditions

1. The Management Liability and Professional Indemnity section contains a number of general insuring clauses. In relation to Directors and Officers Liability, the general insuring clause provided:

We will pay, on Your behalf, Loss resulting from Claims first made against the Insured Persons and notified to Us during the Period of Insurance based on Management Wrongful Acts for which the Company has not agreed to provide indemnity.

1. To understand its operation it is necessary to refer to certain policy definitions which are, relevantly:

(a)  **We/Our/Us/Insurer** means SURA Labour Hire Pty Ltd ABN 67 604 373 088, and certain Underwriters at Lloyds. [In this matter it can be taken as referred to “the insurer”].

(b)  **You/Your/Insured** means:

a) the Company; and

b) the Insured Persons;

c) …

(c)  **Insured Person** means any natural person who was prior to the Period of Insurance, or is during or after the Period of Insurance a Director, officer or Employee of the Company.

(d) **Company** means:

a) the Insured; and

b) Subsidiaries of the Insured prior to or as at the commencement of the Period of Insurance, but cover only applies in respect of Wrongful Acts or any dishonest or fraudulent act committed or alleged to have been committed subsequent to the acquisition or creation of such Subsidiary.

(e) **Director** means any natural person who was prior to the Period of Insurance, or is during or after the Period of Insurance a validly appointed director (as defined in the Corporations Act 2001 or any equivalent provision in the jurisdiction in which the Company is incorporated) of the Company.

(f) **Loss** means:

a) the amount, whether determined by judgment, verdict or award for which You are legally liable to a third party for a Claim and includes damages, compensation orders, interest and claimant's costs and expenses; and

b) a settlement of a Claim by a third party against an Insured Person, which complies with Settlement Claims Condition; and

c) Defence Costs;

d) …

(g) **Defence Costs** means Your share, according to the Allocation of Loss Claims Condition, of necessary and reasonable costs, charges, fees and expenses (other than regular or overtime wages, salaries, fees or Benefits of the Insured Persons or Trustees) incurred by You with Our prior written consent, in defending, investigating or settling covered Claims.

(h) **Claim** means:

a) …

b) a civil proceeding commenced by the service of a written complaint, summons, statement of claim, writ or similar pleading or an arbitral process, cross-claim or counter claim against You alleging an act, error, omission, conduct, facts or circumstances that may constitute a Wrongful Act; or

c) any criminal proceeding commenced by a summons or charge of an Insured Person, Company arising from a Wrongful Act; or

d) …

(i) **Wrongful Act**means:

a) a Management Wrongful Act; or

b) …

(j) **Management Wrongful Act** means any act, error, omission, conduct, misstatement, misleading statement, neglect or breach of duty; trust; contract; warranty of authority; statute or confidentiality, actually or allegedly committed by:

a) …

b) any Insured Person in his or her capacity:

i) as an Insured Person; or

ii) …

or any matter claimed against any Insured Person solely by reason of his or her serving in such capacities.

1. The policy schedule contained a Retroactive Date of 1 July 2016 save in relation to Rush, in which case the date was 30 June 2014. The Retroactive Date clause provided:

The policy shall only provide cover with respect to Wrongful Acts committed after the retroactive date specified in the schedule.

1. The scope of the general insuring clauses of Section Two is expanded by extensions which includes the extension concerning Defence Costs and Representation Expenses. Given the submissions on its construction it is necessary to set it out in its entirety:

**Advancement of Defence Costs and Representation Expenses**

Insuring Clauses 1, 2, 3, 4, 5, and 9 and the Representation Expenses Extension, Occupational Health and Safety Expenses Extension and Pollution Expenses Extension are extended as follows:

We will advance Defence Costs and, under the Representation Expenses Extension Occupational Health and Safety Expenses Extension and Pollution Expenses Extension, Representation Expenses. However, if and to the extent that You are not entitled to cover for Loss under the terms of this Policy, then we will cease to advance Defence Costs and Representation Expenses and any amounts previously advanced shall be repaid to Us by You within thirty (30) days following a request by Us for such payment.

If a Claim alleges a Wrongful Act or illegal or improper conduct as described in the Dishonest or Criminal Intent / Improper Conduct Exclusion, then We will advance Defence Costs and Representation Expenses in respect of such Claim until it is found by way of an admission by You, judgment or adjudication that such Insured did in fact commit such Wrongful Act or engage in such illegal or improper conduct and any amounts previously advanced shall be repaid to Us by You within thirty (30) days following a request by Us for such repayment.

In these reasons this extension will be referred to as “the Advancement Extension”.

1. But for the issue of non-disclosure, in the present case this extension would apply to the defence costs in the extant proceedings, subject to reimbursement if it were to be ultimately found that the insureds had engaged in the alleged Wrongful Conduct.
2. The operation of the Extensions is explained by the following clause:

**EXTENSIONS APPLICABLE TO SECTION TWO**

Unless otherwise stated, any payment made under each of these Extensions will be part of and not in addition to the Professional Indemnity Limit of Liability or the Management Liability Limit of Liability as applicable to the stated Insuring Clause in relation to which the payment is made pursuant to the Extension. These Extensions only extend the stated Insuring Clauses.

1. Section Two contains the following relevant exclusions:

**EXCLUSIONS APPLICABLE TO SECTION TWO**

These Exclusions apply to all the terms of this Section of the Policy unless otherwise stated. Where an Exclusion applies to a particular Insuring Clause then it also applied [sic] to the Extensions applicable to that Insuring Clause.

…

We will not be liable for:

…

**Dishonest or Criminal Intent / Improper Conduct**

Loss resulting from Claims against any Insured arising directly or indirectly from or in respect of:

a) any Wrongful Act committed by that Insured with wilful, reckless, dishonest, fraudulent, malicious or criminal intent; or

b) that Insured improperly using their position to gain an advantage for that Insured or someone else or to cause a detriment to the Company; or

c) that Insured improperly using information obtained as a result of their position to gain an advantage for that Insured or someone else or to cause a detriment to the Company,

in each case only if established by any admission by the Insured, judgment, or other adjudication.

For the purpose of this Exclusion, the fact that one Insured has committed or is alleged to have committed the conduct described in a), b) or c) above will not be imputed to any other Insured.

(In these reasons this is referred to as the “Wrongful Conduct Exclusion” and the conduct identified therein is referred to as “Wrongful Conduct”.)

### The circumstances giving rise to the claim for indemnity under the Policy

1. On 16 May 2017, the Commissioner of the Australian Federal Police commenced proceedings in the Supreme Court of New South Wales seeking a variety of orders under the *Proceeds of Crimes Act 2002* (Cth) against the Applicants and numerous companies associated with them. The relief sought includes orders restraining the Applicants and others who held the property of the Applicants, from disposing of that property, an order vesting control of their property in the Official Trustee in Bankruptcy, examination orders, and a number of ancillary orders. It appears that on that same day the Commissioner also secured a number of *ex parte* orders pursuant to s 18 of that Act which restrained any person from disposing or otherwise dealing with certain specified property of the Applicants except as was provided for, and more general orders in relation to other properties.
2. On 17 May 2017, the Applicants were charged pursuant to s 135.4(3) of the Schedule 1 to the *Criminal Code Act 1995* (Cth)that between 1 June 2016 and 17 May 2017 at Bondi Beach in the State of New South Wales they conspired with other persons, being each other, with the intention of dishonestly causing loss to the Australian Taxation Office. Attendance Notices commencing the criminal proceedings against them were issued on the date on which they were charged.
3. It is not in dispute that both proceedings are “proceedings” within the scope of the coverage of the policy or that the alleged conduct giving rise to both is conduct which falls within the definition of “Management Wrongful Act”.
4. The parties agree that in both proceedings, neither Applicant has admitted to the conduct alleged against him, nor have they entered pleas in the criminal proceedings. As at the date of the hearing of the instant matter neither of the proceedings has proceeded to a final hearing.

### The Applicants’ claim for indemnity and the insurer’s purported avoidance of the policy

1. On 16 June 2017, Mr Onley’s legal representatives wrote to the insurer’s representatives, making reference to the civil and criminal proceedings and requesting indemnity for him under the policy. By a letter of 28 July 2017, Mr Cranston’s legal representatives sought similar indemnity for him.
2. Some two months later, on 25 September 2017, Norton Rose Fulbright for the insurer responded to the requests, and advised that the insurer declined to extend cover because, it was alleged, the Applicants had breached their obligations under s 21 of the ICAto disclose matters known to them to be relevant to the decision of the insurer whether to accept the risk proposed. Specifically, it was alleged that the matters known to the Applicants included the facts that Synep and Plutus were engaged in a dishonest enterprise involving the misappropriation of funds which had been paid to Plutus by its clients for the purposes of making pay as you go withholding (“PAYGW”) payments to the ATO, or that it was proposed that they be so engaged. It was also alleged that the Applicants and Synep failed to disclose that Mr Onley had been knowingly receiving, from entities associated with a Mr Simon Anquetil, funds dishonestly misappropriated from clients of Plutus for some time prior to the inception of the policy. It was further alleged that the non-disclosure of these facts was fraudulent in that the information was deliberately withheld knowing that it would be relevant to the insurer’s assessment of risk. The insurer also asserted that, as Synep provided the proposal and entered into the policy as agent for all the insureds, the policy was avoided against all of them. Alternatively, the insurer claimed that if the non-disclosure had not been fraudulent, it was entitled to reduce its liability to nil. Norton Rose Fulbright’s letter various facts relating to the acquisition of the Plutus business and what appears to be the allegations of knowledge of the Applicants are detailed.
3. Subsequent correspondence between the parties ensued. In it, the Applicants’ legal representatives asserted that the insurer’s refusal to indemnify and purported termination of the policy were wrongful. It was alleged that the insurer had relied upon an affidavit used by the Australian Federal Police to obtain the *ex parte* orders under the *Proceeds of Crimes Act* in which the deponent had indicated that he held a “suspicion” of the commission of offences by, inter alia, Messrs Onley and Cranston and, further that there were reasonable grounds for that suspicion. It was then said that where the subject matter of the alleged non-disclosure was the same as that which underpinned the wrongful acts suspected or alleged in the various proceedings, the underwriters could not, in the absence of an admission in judgment or adjudication, avoid the policy on that basis.
4. The evidence before the Court is that the Applicants have expended sums in excess of $300,000 on their defence of the proceedings and continue to incur substantial costs.
5. In subsequent correspondence the insurer formally purported to avoid the policy.

## Question for determination

1. Pursuant to the orders made on 26 March 2018 by the Chief Justice, the following question is to be determined pursuant to r 30.01 of the *Federal Court Rules 2011* (Cth) in respect of each Applicant:

**The questions for determination**

Whether, either:

(i) On the true construction of the Labour Force Liability Insurance Policy number LCB171202453 (“Policy”); or

(ii) On application of the principles of waiver or estoppel, under the *Insurance Contracts Act 1984* (Cth) (“the Act”) or otherwise; or

(iii) Upon application of the duty of utmost good faith under s 13 of the Act,

the Respondent has agreed not to exercise or is otherwise prevented from exercising rights or from relying on remedies under Part IV of the Act under circumstances where:

(a) Claims (as defined in the Policy) have been made against the Applicant alleging conduct of the Applicant of the kind stipulated in the Dishonest or Criminal Intent / Improper Conduct exclusion of the Policy ("Conduct"); and

(b) the Conduct has not been established by admission of the Applicant, judgment or adjudication (“Determination”); and

(c) the Respondent's exercise of rights or entitlement to remedies under Part IV of the Act is or would be based upon its conclusion, ahead of a Determination, that there has been a failure on the part of an insured to disclose that the Conduct had occurred or that it was intended or planned to occur.

## The insurer’s identification of matters not disclosed and claimed avoidance

1. In compliance with an order of this Court made on 16 February 2018, the insurer has set out with particularity its allegations of the undisclosed matters upon which its purported avoidance of the policy is founded. There is no need to set them out in full. It is sufficient to identify the general nature and extent. At its highest level of generality the insurer claims that the insureds had failed to disclose that in the 14 months prior to June 2016, Plutus had conducted a dishonest enterprise in misappropriating funds which it had received from entities for which it provided payroll services. The further details provided by the insurer allege that Plutus had received the funds from clients for the purpose of remitting them or some of them to the Australian Taxation Office. The misappropriation had been orchestrated by Mr Onley and Mr Anquetil pursuant to an organised scheme by which companies controlled by them “intercepted” PAYGW payments from client companies and diverted them to their own associated companies. Part of it is said to have included an under-reporting of liability for PAYGW amounts to the Australian Taxation Office. It is said that the scheme was expanded by the incorporation of Synep on or about 1 June 2016 from which point Mr Cranston was involved. Part of the scheme also included the creation of various straw companies which would become liable to meet the PAYGW tax obligations to the ATO, but it was intended that those obligations would remain unfulfilled. These companies were controlled by the Applicants though they were not formally appointed as directors of them. It appears that those appointed as directors were without means. It is alleged that the scheme involved substantial amounts of money.
2. The insurer alleges that the Applicants’ failure to disclose the substance of the scheme and its unlawful characteristics, in breach of their obligation s 21 of the ICA, and its fraudulent quality is what affords it the right to terminate the policy or, in the alternative, if the non-disclosure was not fraudulent, the right to reduce its liability to nil.
3. It founds its entitlement to decline indemnity upon either of the entitlements granted by s 28 of the ICAwhich provides:

**28 General insurance**

(1) This section applies where the person who became the insured under a contract of general insurance upon the contract being entered into:

(a) failed to comply with the duty of disclosure; or

(b) made a misrepresentation to the insurer before the contract was entered into;

but does not apply where the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation before the contract was entered into.

(2) If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.

(3) If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection (2) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made.

## General principles of construction

1. The Applicants’ arguments before this Court concern the interpretation of the Advancement Extension in the context of the policy and, to some degree, the existence of an implication preventing the insurer from exercising its entitlements under s 28. Such arguments call for the application of the well-established principles concerning the construction of policies of insurance as commercial contracts. Those principles were not in dispute between the parties. Necessarily, a policy of insurance is assumed to be an agreement which the parties intend to produce a commercial result: *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* (2014) 251 CLR 640 at [35]: as such, it ought to be given a businesslike interpretation being the construction which a reasonable business person would give to it: *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 343 ALR 58 at [17]; *Simic v New South Wales Land and Housing Corp* (2016) 260 CLR 85 at [78]; *Todd v Alterra at Lloyd’s Ltd* (2016) 239 FCR 12 at 22–23 [42]; *Weir Services Australia Pty Ltd v AXA Corporate Solutions Assurance* [2018] NSWCA 100, [52]. The contract is naturally enough interpreted, in a temporal sense, as at the date on which it was entered into: *Ecosse Property Holdings* at [16] per Kiefel, Bell and Gordon JJ; *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 at 116 [47]; *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at [40]. The Courts frequently have regard to the contextual framework in which a contract is formed, to the extent to which it is known by both parties, to assist in identifying its purpose and commercial objective: *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 per Gleeson CJ at 589 [22]; *Mount Bruce Mining* at117; *Franklins Pty Ltd v Metcash Ltd* [2009] 76 NSWLR 603 per Allsop P at 618 [19]. It goes without saying that a construction that avoids capricious, unreasonable, inconvenient or unjust consequences, is to be preferred where the words of the agreement permit.
2. The Applicants contend that on the above principles, the Advancement Extension should be construed as excluding the right of the insurer to rely upon their non-disclosure of the Wrongful Conduct as a ground for refusing indemnity because the Extension requires it to pay the Defence Costs until the alleged Wrongful Conduct is adjudicated upon or admitted. More particularly, they argue, as the words of the Extension expressly and unequivocally promise to provide Defence Costs until the underlying allegations are adjudicated upon or admitted, the insurer cannot, contrary to the intent of the Extension, rely upon its statutory rights to avoid the policy or limit its liability unless and until the adjudication occurs.
3. In answer, the insurer submits that the Extension operates only if there is an obligation under the policy and that obligation does not exist if the effect of the non-disclosure, which is a primary issue and fundamental, defeats the foundation of the Extension’s efficacy. Simply, a suggested implication from a provision cannot affect its rights under s 28 of the ICA of avoiding the contract and its provisions including the Extension when the insured has failed to disclose material facts.

## The issues

### The uncontroversial operation of the Advancement Extension

1. It is best to commence with an understanding of the uncontroversial operation of the Advancement Extension. In doing so it is apt to keep in mind that the policy does not provide cover for Wrongful Conduct. However, if a claim is founded upon it, the Extension in issue ensures that the insured’s costs for the time being are met by the insurer. There is substantial value in this as it provides the insured with the cost of defending claims alleging Wrongful Conduct which do not succeed. And even when the insured is, in fact, guilty of it, the Extension will fund a defence to the claim which provides the insured with the benefit of a chance of success, though the insured is required to repay the defence costs where guilt is established.
2. In this respect, the Extension is coherent with the Wrongful Conduct Exclusion, which operates only if the conduct is “established” in one of the prescribed methods. The effect of this limit is that the insurer cannot deny liability simply on the basis that a claim is founded upon Wrongful Conduct. It is only after the insured’s liability is established to be a result of the Wrongful Conduct that the insurer is entitled to deny indemnity on the basis that the claim falls outside of the scope of coverage and to recover reimbursement for any costs advanced.
3. These clauses will operate without much difficulty in relation to a claim which is founded on conduct which has occurred during the policy period so that there is no question of non-disclosure. However, a more difficult question concerns the operation of the exclusion when, as here, the Wrongful Conduct of a material quality, or some of it, is alleged to have occurred prior to the formation of the contract of insurance and has not been disclosed in accordance with the usual obligations of utmost good faith. In ordinary circumstances that would entitle the insurer to terminate the policy or reduce its liability. What, then, if any, is the effect of the Extension, with its qualification, on this? The Applicants argue that it amounts to an implied agreement not to rely upon any such rights based on circumstances touched by the Extension. The insurer responds that its rights operate outside the context of the terms of the policy and no manner of construction can deny them.

### The Construction arguments

1. The Applicants’ primary submission, and one which underlies most of the arguments advanced, is that, when a claim of Wrongful Conduct is made against an insured in any proceedings, the effect of the Advancement Extension (either by itself or together with the Wrongful Conduct Exclusion) is that the insurer is prevented *for any purpose* from relying on the nature of the allegations and, particularly whether or not they amount to Wrongful Conduct, until that question is answered by admission, judgment or adjudication. The words, “for any purpose”, are important to the submission as the Applicants must argue that the insurer is prevented from relying upon the alleged existence of Wrongful Conduct, not only for the purpose of refusing to pay pursuant to the obligations contained in the policy, but also for the purposes of relying on an alleged breach of the disclosure obligations. This construction is said to follow from its unqualified agreement in the Extension that its obligation to advance Defence Costs was to continue until the existence of the Wrongful Conduct has been established in the ways identified and that the Wrongful Conduct Exclusion is operative only then. It was emphasised that there is no equivocation in the terms of the Extension or the Wrongful Conduct Exclusion that would limit the insurer’s identified obligations. It was submitted that the requirement in each clause that the Wrongful Conduct has to be admitted or adjudicated upon before the insurer can refuse to indemnify has the consequence that until then the insurer is not entitled to rely upon the pre-contractual non-disclosure of that Wrongful Conduct to avoid the policy or to reduce its liability.
2. At least in the first instance, Ms Seiden SC, for Mr Onley, eschewed the suggestion that the combined effect of the clauses had the consequence that the insurer had waived its right to rely upon non-disclosure. She submitted, in effect, once proceedings had been commenced against an insured in respect of any alleged Wrongful Conduct, until it was established by judgment, adjudication or admission, the clauses postponed the insurer’s entitlement to invoke its claim that the insured had engaged in that conduct and that it had not been disclosed as required by s 21. It could neither refuse to advance Defence Costs under the Extension, nor terminate the policy for any non-disclosure of the Wrongful Conduct.
3. A recurring theme in the Applicants’ submissions supporting this construction was that it had the commercial benefit of protecting the insureds’ common law privilege against self-incrimination. They submitted that where proceedings had been begun against them, the insurer’s unqualified obligation to provide Defence Costs would save them from having to litigate on two fronts, that is, with the insurer about the matters which were also the subject of the proceedings against them. If litigation against the insurer were required, they claimed they would necessarily have to forego their privilege in the proceedings against it in order to effectively answer any claim of non-disclosure. This is correct in relation to claims wherein the alleged Wrongful Conduct which would otherwise attract the exclusion, occurs after the inception of the contract; and partially it explains the reason for the requirement that the Wrongful Conduct be established before loss of entitlement to advancement of defence costs. But because the reasoning is valid for those cases, it plainly does not follow that it is valid on the issue of the consequences of non-disclosure of pre-contractual Wrongful Conduct.
4. Ms Seiden SC accepted that her suggested construction did not restrain the insurer’s right to terminate the contract for fraudulent non-disclosure or perhaps to reduce its liability under s 28(3) of the *ICA* if no proceedings were on foot against the insured in respect of the alleged Wrongful Conduct, since the insureds would not then be obliged to forego any relevant privilege in an attempt to enforce the cover. She accepted, however, that difficult questions arise where, short of proceedings having been commenced, the process of the criminal justice system had been put in place. Ultimately, she conceded that the limitation on refusal in the Extension would not operate merely because criminal investigations were on foot and that there would then be no limitation on the insurer’s reliance on the non-disclosure of the alleged Wrongful Conduct to terminate the policy.
5. A further interesting issue which arose in the course of argument was whether the Applicants’ submission went so far as to prevent the insurer from relying upon the non-disclosure of the facts underlying any allegation of Wrongful Conduct to avoid the contract or reduce its liability by reason of it. That is, on the Applicants’ construction, could the insurer, without reaching any conclusion as to whether non-disclosed facts amounted to Wrongful Conduct, rely on the non-disclosure of the bare facts of the Applicants’ business activities to avoid the policy? No clear answer to that question emerged, but it was submitted that in the present case the insurer has alleged that the non-disclosure concerned the concealment of the existence of the dishonest scheme involving the misappropriation of money by various companies rather than the concealment of the underlying facts. In that sense, there is an indication that the non-disclosure relied upon was the failure to disclose the Wrongful Conduct as opposed to the substratum of matters on which the allegations were made.
6. The insurer submitted that all that it did was rely on the fact that the insureds or some of them had engaged in certain conduct which had occurred or was intended to occur, that the conduct or the planning for it happened prior to the entry into the contract, that there had been a failure to disclose those matters, and that it avoided the policy accordingly. It submitted that the Extension contains no express covenant to forego reliance on its statutory rights in s 28 of the ICA in the event of the insured’s non-disclosure. It also submitted that the operation of the Extension is not concerned with the exercise or non-exercise of rights under Pt IV of the ICA and that the limitation is concerned only with the insurer’s obligation under the clause to advance Defence Costs. It further submitted that there is no implied negative stipulation restricting it from relying upon non-disclosure merely by reason of its express promise to pay Defence Costs where the claim may be beyond the scope of the policy. It submitted that clear words would be necessary before the Courts would restrict its entitlement to rely upon non-disclosure.

## Consideration of the construction arguments

1. There is authority that the obligation of disclosure may be altered by an insurer limiting its right to be informed of the insured’s knowledge, not only as to the existence of facts but also as to their materiality: *Jones v Provincial Insurance Co* (1857) 3 CBNS 65 at 86; 140 ER 662 at 671; *Southern Cross Assurance Co Ltd v Australian Provincial Assurance Assn Ltd* (1939) 39 SR (NSW) 174 at 187-188; 56 WN (NSW) 77 per Jordan CJ and Nicholas J; *National General Insurance Co Ltd v Chick* (1984) 3 ANZ Ins Cas 60-579. That said, each of those cases tends to turn on the insurer’s pre-contractual actions in posing questions, the answers to which will form the basis of the policy. It is one thing for an insurer to accept the risk of being uninformed by the manner in which pre-contractual questions are posed to a prospective insured, but there are entirely different considerations when the insurer has been prepared to enter into the policy on the assumption that the statutory disclosure obligations have been fulfilled. Here, there is no suggestion that prior to entering into the contract there was any agreed alteration to the insured’s obligation of disclosure and nothing to suggest that the insurer offered the policy terms to the Applicants otherwise than on the basis that they had complied with their disclosure obligations.
2. The difficulty with the Applicants’ principal submission is that it relies upon an implication which negatives a fundamental element of the agreement between the parties. As against the serious duty of full material disclosure what is relied on is an oblique implication made by part of a single term which is primarily directed at other matters. The argument is not that one term of the policy should be read down so as to give the Advancement Extension its full and complete operation. It is that the Extension should be read as an agreement by the insurer to forgo, or to temporarily forbear from, exercising its statutory rights concerning the contract, some of the rights being concerned with fraud. In this light the argument encounters significant difficulties.
3. The terms of a policy of insurance are usually agreed to by the insurer on the common understanding of the insured’s having performed an obligation to disclose to it all relevant facts which are or ought to be reasonably known to it which are relevant to the risk insured. In *Permanent Trustee Australia Limited v FAI General Insurance Company Limited (in liq)* (2003) 214 CLR 514 at 542 [67], Gummow and Hayne JJ recognised that prior to the ICA it had been accepted that insurance was a contract on a speculation and that the special facts on which the contingent chance is to be computed are most commonly within the knowledge of the insured only. That required the underwriter to trust representations made by the insured and the insured not to keep “back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risque, as if it did not exist”: *Carter v Boehm* (1776) 3 Burr 1905 at 1909; 97 ER 1162 at 1164. The duty was one at common law, upon compliance of which the contract was founded; it was not a term or obligation of the contract.
4. Whilst s 21 of the ICA replaced the common law duty of disclosure in terms of the extent of the insured’s obligations: *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606, 615: the underlying rationale for pre-contractual disclosure remains. Also, it remains properly conceptualised as separate from (though obviously related to) the contract of insurance. The importance of the duty under the ICA is emphasised by the remedies available to the insurer under s 28 for failure by an insured to comply with it. In particular, an insurer’s entitlement to reduce its liability to the extent to which it has been prejudiced by the non-disclosure manifests the direct link between the obligation and the terms and conditions on which the insurer is prepared to underwrite the risk or, indeed whether it is prepared to do so at all. If it can show that, had it been informed of the facts relevant to the risk which has crystallised, it would not have entered into the policy or would have included an exclusion in relation to such circumstances, it is entitled to reduce its liability to nil: *Alexander Stenhouse Ltd v Austcam Investments Pty Ltd* (1993) 67 ALJR 421; *Advance (NSW) Insurance Agencies Pty Ltd v Matthews*. The duty of disclosure has always been and remains the essence of the insured’s obligation of utmost good faith: Derrington D and Ashton R, *The Law of Liability Insurance* (3rd ed, LexisNexis, 2013) at [4-48] [4-49]: and the argument that this essential obligation ought not be displaced by an implication from words of general import or that its displacement required a degree of clarity has more than substantial respectability.
5. The significance of the insured’s obligation of disclosure to the formation of the contract of insurance and the terms on which the underwriter might assume the risk, inform the manner in which the Advancement Extension might be construed in the present case. We see no basis to conclude that the cover provided by the Advancement Extension was granted to the insured on the basis other than that the insured had complied with the duty of disclosure.
6. As has been indicated, the Applicants argue that, regardless of any breach of their obligation of disclosure, they remain entitled to rely upon the insurer’s obligation to provide cover which it agreed to on the faith of the fulfilment of that obligation. That proposition is unusual as it inverts the ordinary process of the formation of contracts of insurance, and would result in an insurer being required to cover a claim which the insured ought to have disclosed prior to the entry into the contract and which, had it been disclosed in the ordinary course, would likely have been specifically excluded. The purpose of disclosure is to permit the insurer to be as fully informed of the risk as the would-be insured’s special knowledge would provide so that it may introduce suitable limitations on the cover which it is willing to provide. It is not uncommon for a disclosed risk to be specifically excluded. In the present case, there is no basis to believe that the insurer would have agreed to cover the disputed risk if it had been fully informed of its details, and it is stretching the principles of implication to imply, from the indirect terms of the limitation on refusal to advance costs, a promise that the insurer would cover a risk which had been wrongly undisclosed.
7. The manner in which limitations on an insurer’s entitlement to refuse to advance defence costs operate is discussed with some particularity in Derrington and Ashton at [8-583], which contains the following:

There are other variations of the terms on which the obligation to advance these funds may be engaged and the insurer’s liability in this respect is sometimes affected by the policy’s language. For example, it may be that it may not refuse to do so by reason only that it considers that the insured’s conduct referred to in a particular exclusion has occurred, until such time as there is an admission by the insured, or, a judgment, award or other finding by a court, tribunal or arbitrator with jurisdiction to finally determine the matter (including the outcome of any appeal in relation to such judgment, award or other finding) which establishes the foregoing. At the same time, it may provide that the obligation does not engage if the insurer denies liability to provide indemnity. This complication is resolved by a construction which permits the insurer to refuse to advance costs if it is entitled to deny liability on any ground other than the exclusion which requires admission or adjudication. The inapplicability of one exclusion as a valid ground for the insurer’s denial would not defeat the application of another ground which is available. There has been some difference of opinion as to whether it would be incongruous for an insurer to be liable to indemnify for defence costs of a claim in respect of which liability for the loss claimed was excluded: *McCarthy & Ors v St Paul International Insurance Co Ltd* [2007] FCAFC 28; *Major Engineering Pty Ltd v CGU Insurance Ltd* (2002) 238 ALR 363 at [41]–[42]. *Contra*: *Silbermann v CGU Insurance Ltd* [2003] NSWCA 203; (2003) 57 NSWLR 469 at [70]–[77] and on appeal to the High Court of Australia in that case in *Rich v CGU Insurance Ltd* [2005] HCA 16; (2005) 214 ALR 370 at [11]. But this factor, while having an influence on the construction of the Advance of Costs provision, cannot prevail over its clear terms. It is true that a denial of indemnity under the provision may be based on matters which have nothing to do with any exclusion under the list of Exclusions. Also, it may not be said that the insurer’s power to deny indemnity for the purposes of the provision necessarily extends to all of the bases of exclusion under that list. But it may be clear that although its extension to the specified Exclusion is subject to the requirement that the application of that exclusion is established, there may be nothing in the text of the provision which suggests that the relevant right to deny is not intended to extend to other exclusions. Any absence of any reference to Defence Costs in the opening words of the list of exclusions is not to the point: *BOQ Ltd v Chartis Aust Insurance Ltd* [2012] QSC 319.

On the other hand, if an exclusion which is invoked by the insurer requires proof for its engagement, it cannot rely on it to refuse to make the advance, but it can do so if the exclusion is engaged, or if there is another operative ground for refusal, such as avoidance: *Intergraph* (supra); *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; *Rich v CGU Insce Ltd; Silbermann v CGU Ltd* [2005] HCA 16. If it relies on a qualification as to its obligation to advance costs, and the qualification depends on the existence of circumstances which are described in the provision as ‘determined’, ‘in fact’ or ‘finally adjudicated’, there is considerable disagreement as to when and how this is fulfilled, but it is clear that much depends on the language used, including comparison with other terminology of the same genus in the policy that will suggest exclusion of a construction by reason of the variation of usage. The parties may agree as they wish, as manifested by the words of their agreement, so that no rule can be stated that may not be overridden by the terms. Still, some general forms of reasoning may be observed. If a provision’s operation is qualified by the preface, ‘If the court finds …’, it is an issue of fact as to whether the insured was a party to the conduct: *Coral Reef Prods v Axis Supply Insce Co* 2012 Mich App LEXIS 1149. If an exclusion refers to the conduct or state of affairs ‘in fact’, whether the insurer may rely upon the nature of the claim that is made before judgment is given against the insured may depend on the nature of the claim and his intended action: *Brown & Laconte LLP v Westport Insce Corpn* (supra). The expression does not necessarily require final adjudication by the underlying fact-finder, but does require evidence upon which the fact may be determined in the relevant proceedings: *Westport Insce Corpn v Hanft & Knight PC* 2007 US Dist LEXIS 90599.

1. As can be seen from that passage, the extent of any limitation on an insurer arising from an agreement to advance defence costs, will be limited to the obligations contained in the extension and by its terms. Consistently with established principle, a limitation on the ability to refuse to advance defence costs contained in an Extension will not usually be taken to limit the insurer’s entitlement to decline indemnity on other grounds save where that is expressly agreed.
2. None of the above should be taken as denying that there may be circumstances in which an insurer may be found to have agreed to provide cover for risks which in breach of the obligation have not been disclosed. However, that unusual construction would need support by clear words rather than words of dubious effect: *Duncombe v Porter* (1953) 90 CLR 295, 311. Here, there are no such clear words in the Extension limiting the insurer’s rights consequent upon the insured’s non-disclosure.
3. Further, the process of construction advanced by the Applicants fails to construe the policy as a whole. Their construction would make it necessary to conclude that the insurer has agreed to temporary non-reliance on its rights under s 28 consequent upon the insured’s non-disclosure. This is not consistent with the actual terms of the policy. Both by the policy’s schedule and general terms/conditions section, the Management Liability and Professional Indemnity cover is issued in a “claims made and notified” form. It is explained that the cover applies to claims, as defined, provided that the insured was not aware at any time prior to the policy inception of circumstances which would have put a reasonable person in their position on notice that a claim might be made. Additionally, the exclusion for “Known Claims and Circumstances” is a strong indication that the insurer would not provide cover in respect of claims where the underlying circumstances were known to the insured prior to the policy’s inception. The Retroactive Date applicable to Messrs Onley and Cranston of 1 June 2016, fortifies the above conclusion.

#### “Matters” not disclosed

1. As mentioned, another difficulty with the Applicants’ construction is that it does not answer the question of whether, in the exercise of its rights under s 28 of the ICA, the insurer is entitled to rely upon their failure to disclose the facts underlying the alleged Wrongful Conduct. The Applicants’ argument is that the insurer is not entitled to rely on the conclusion that the conduct amounted to Wrongful Conduct because that conclusion has to be determined by judgment, adjudication or admission. However, the “neutral” matters of the manner in which the Applicants had carried on or intended to carry on business would also have been of importance to the insurer. Any asserted prohibition on the insurer relying on a conclusion that certain conduct amounted to Wrongful Conduct would not seem to prevent it from relying on the Applicants’ omission to disclose the nature of the business activities which they pursued.
2. In its identification of the matters which were not disclosed, the insurer identifies the fact that the scheme being engaged in to 1 June 2016 and the new arrangements from 1 June 2016 were “dishonest”. If that were subsequently found to be so by judgment, adjudication or admission, it would be Wrongful Conduct and beyond the scope of the policy. However, in relying on its entitlement to avoid, the insurer need not rely on the undisclosed conduct as being “dishonest” or falling within the definition of Wrongful Conduct. It might rely on the non-disclosure of the business transactions and business model as being relevant matters which were fraudulently not disclosed. There can be little doubt that such matters were relevant. The business model involved a scheme or arrangement in which Plutus undertook to provide payroll services for its clients and received from those clients PAYGW amounts which it then transferred to related companies. Rather than forwarding the PAYGW amounts to the ATO, the related companies transferred the amounts, inter alia, for the benefit of Mr Cranston and Mr Onley with the consequence that the ATO could only enforce the taxation obligations against straw companies. One need only set out the business model in these basic terms to appreciate that it is fraught with the risk that the ATO may seek to recover its lost tax revenue from those involved in the scheme.
3. The Applicants’ response to the question of whether, on their propounded construction, the insurer would be prevented from relying on non-disclosure of the underlying facts, was unsatisfactory. They merely relied on the insurer’s inclusion in the matters not disclosed, the fact that the conduct was dishonest. However, it is the thrust of the Applicants’ argument that the effect of the Extension is that the insurer has undertaken to not to rely upon the existence of Wrongful Conduct for refusing to pay Defence Costs. That is because the extension requires the insurer to meet the defence costs until the quality of the conduct has been adjudicated upon. However, such an argument has nothing to say about the insured’s obligation to disclose to the insurer the nature of the business activities in which it is engaged. Nor does it have any bearing on whether the insurer would, if it had knowledge of the business activities of the insureds, accept the risk even if it made no assessment that such activities were illegal or improper or within the meaning of a Wrongful Act as defined in the policy.
4. At the time of entering into the policy, the facts surrounding the manner in which the payroll business was operating, by the payment of PAYGW amounts to related companies for distribution to, inter alia, the Applicants were relevant to the insurer’s decision whether to accept the risk and if so on what terms. That would, one would have thought, have been apparent to a reasonable person. The dealing with PAYGW amounts in this way must have given rise to a risk of a potential civil claim by the Commissioner of Taxation for recovery of those amounts. That being so, it is difficult to see why the insurer ought not rely upon the non-disclosure of those facts to avoid the policy. In doing so, it need not reach any conclusion as to whether the conduct could be characterised as a Wrongful Act or illegal or improper conduct. In that way, and on this hypothesis, insurer’s avoidance of the policy in no way offends the construction which the Applicants would give to the Extension.
5. That conclusion significantly weakens the Applicants’ arguments as it means that any benefits which might be obtained by them from their proposed construction would be illusory and the Court is not likely to give a policy a construction the effect of which might be easily circumvented by the operation of the other party’s undoubted rights.

#### A businesslike interpretation

1. The Applicants submitted that if the policy was not construed in the manner asserted by them it would be denied a businesslike interpretation of the policy. They submitted that if the insurer is entitled to decline indemnity for Defence Costs on the grounds of non-disclosure, the protection of the Extension when Wrongful Conduct is alleged against an insured would be lost. Whilst there can be no doubt that where such conduct as alleged has occurred prior to the inception of the policy and it has not been disclosed to the insurer, any benefit flowing from the Extension will be diminished by the insurer’s right of avoidance. That is consistent with the policy terms which indicate clearly enough that it was not intended to cover Known Claims and Circumstances which were not disclosed, save where cover was extended by the operation of the Continuity clause. But there is nothing surprising in that and the clause will operate in an unlimited manner where the alleged Wrongful Conduct occurred in the policy period. To that extent it provides substantial protection for the insured against whom such conduct is alleged.
2. Conversely, a construction of the Extension which gave it the effect of affording cover by the provision of Defence Costs in relation to claims of Wrongful Conduct in circumstances where the insureds, who were aware of such conduct, fraudulently failed to disclose it would be most unusual and most unbusinesslike. Honest common-sense is and should be taken by the courts to be a foundation of commercial and business activity. Insurers are not readily to be taken to agree to cover claims which have been fraudulently concealed from them. Even in the absence of the disclosure regime which is attached to the formation of contracts of insurance, the Court is not likely to construe a contract in a way which allows one party to obtain the benefit of a fraud committed on the other. It is even less so in relation to contracts of insurance where the insurer relies on the insured to provide information so it can determine whether to accept the risk and, if so, on what terms.
3. The Intervener, Rush, made a submission similar to that advanced by the Applicants in relation to the construction and operation of the Extension. It argued that such a construction would effectively denude the clause of operation for pre-inception conduct. It argued that if the insured disclosed the relevant conduct to the insurer prior to entering into the policy it would be taken as having admitted the alleged Wrongful Conduct and, as such, the Defence Costs would not be available. So far, this argument is correct, but it commences from an erroneous starting point. The cover is not intended for, and the non-disclosure effectively excludes application to, pre-inception conduct unless it falls within agreed exceptions which are irrelevant here. To that extent the argument is misguided.
4. Moreover, the qualitative nature of the conduct referred to in the Wrongful Conduct extension is significant. Not only must the conduct have occurred but it must also have been reckless, dishonest, fraudulent, malicious or undertaken with criminal intent or was otherwise improper. If, of course, the insured is aware of the criminal or dishonest nature of the pre-inception conduct and does not disclose it, it makes very little commercial sense to construe the Advancement Extension as intending to cover it. But, for the purpose of disclosure, the insured may know of the relevant conduct but be unaware of its qualitative nature which would have made it material. In such circumstances, the conduct may not have had to be disclosed and may have formed the foundation of cover for the advance of costs. This was an argument advanced by the insurer as affording the Extension some operation in relation to pre-contract conduct. If, on the other hand, the conduct had been properly disclosed, the cover for the advance of costs could still have been part of the insuring promise, but subject to an exception in respect of the disclosed risk. In those circumstances, the cover would still have had value in funding a defence of claims for post-contractual Wrongful Conduct, or pre-contractual Wrongful Conduct of which the Applicants were unaware, or claims where they were not guilty. Thus, it could not be said that without the disputed cover, the provision had no work to do and needed the suggested implication or construction to give it any meaning.
5. It follows that the construction advanced by the Applicants and Rush is not a businesslike interpretation, nor does the Extension want for business common sense without it. Although the remedy for non-disclosure claimed by the insurer diminishes its operation, it nevertheless provides the Applicants with substantial cover.

#### A purposive interpretation

1. The Applicants also contend that their construction advances the purpose of the Extension by being of assistance to them in “defending allegations of Wrongful Conduct by funding Defence Costs, without delay and without prejudice to [their] fundamental common law rights.” This is also correct as far as it goes, but it is not useful as a general proposition. The purpose is to enable Defence Costs to be advanced to the Applicants in circumstances where it may be that matters are proven that lead to a requirement for repayment of defence costs previously advanced. That, however, does not provide a justification for an extension of cover to which there is no entitlement for other reasons, being avoidance for non-disclosure. The former purpose is not an informing purposes for the latter circumstance. The characterisation of the purpose of a clause cannot be undertaken in a vacuum as the Applicants attempt to do. It must be undertaken in the context of the agreement as a whole and in the light of the surrounding circumstances. These surrounding circumstances include the limitation which excludes claims arising out of Known Claims and Circumstances; the essential nature of contracts of insurance as contracts on speculation entered into only after the proposed insured has made disclosure of all matters relevant to the insurer’s decision whether to accept the risk and, if so, on what terms; and the legal consequences of any failure of such duty of disclosure.

#### A construction to avoid the abrogation of common law rights

1. Although in different respects, both the Applicants and the respondent sought to rely upon the proposition that a contract ought to be construed in a manner which avoids the abrogation of the parties’ rights at law. The Applicants submitted that, if the Extension did not prevent the insurer from relying upon material non-disclosure to avoid the policy, it would have the consequence that their privilege against self-incrimination in relation to the alleged criminal conduct would be effectively abrogated. It is said that, unless their proffered construction is accepted, they could not oppose the insurer’s claim to avoid the policy without the risk of waiving their privilege in answering its allegations.
2. However, a construction that permits the insurer to rely upon the non-disclosure of a Wrongful Act or illegal or improper conduct does not involve any abrogation of the insured’s right of privilege against self-incrimination in respect of that conduct. On the true construction of the policy, which does not limit the insurer’s right to avoid it, if they contest it by action they would be entitled to be relieved of any obligation to plead in any way which would diminish their right against self-incrimination: cf *Chardon v Bradley* [2017] QCA 314: and on any trial they could not be required to respond to questions if there are reasonable grounds that the answer will tend to incriminate them: s 128 *Evidence Act 1995* (NSW). If they are dissatisfied with that approach, they may delay pursuit of their civil proceedings or seek a stay of any proceedings brought by the insurer until after the conclusion of the criminal proceedings and then recover the amount to which they were entitled under the policy, if any, from the insurer. This, of course, may deny them the benefit of having their defence costs paid in advance, which is the purpose of the Advancement Extension, but that is a different question and it is not substantially different from the position when an insurer incorrectly denies indemnity and an insured is required to defend third party proceedings themselves and pursue their entitlement to indemnity in the same proceeding or subsequently. It might also be observed that any disadvantage to the insured needs to be measured against the insurer’s possible loss of its right to avoid the policy for fraudulent non-disclosure and to escape having to advance costs it may never be able to recover.
3. The Applicants’ argument here also encounters the substantial hurdle that the policy would have a differential operation in relation to the several insureds. The primary insureds are incorporated companies and as such they have no entitlement to the privilege commonly known as the privilege against self-incrimination: *Environment Protection Authority v Caltex Refining Co Pty Ltd* (1993) 178 CLR 477. On the Applicants’ argument, in the case of these insureds, there is no necessity to limit the rights of the insurer in order to protect any common law privilege as there is with respect of the individuals. It follows that the underlying rationale for the Applicants’ construction leads to an inconsistent operation of the policy which is a result which ought not to be accepted.

#### Distinctions without meaning

1. The Intervener, Rush, made an argument that certain differences in the paragraphs of the Advancement Extension implicitly expanded the scope of its cover. Central to this was the submission that the Extension provided cover which was separate and distinct from the general insuring clauses. As will be seen, that starting point was necessary to make the argument that the insurer’s obligation to advance Defence Costs was not dependent upon the insured sustaining “Loss” as defined in the policy. However, the submission is not sustainable. As the first paragraph of the Extension shows, the additional cover provided is an extension of the cover provided by insuring clauses 1, 2, 3, 4, 5, and 9. The additional cover is limited to costs in respect of claims which are *prima facie* within the general indemnity cover of the policy. It would not apply to a claim for or criminal proceedings in respect of motor car bodily injury, which is excluded from the general cover. In relation to the present claim, it is insuring clause 1 which is the foundation of the cover, being for “Loss resulting from Claims first made against the Insured Persons and notified to Us during the Period of Insurance based on Management Wrongful Acts”. The Advancement Extension is an extension of Insuring Clause 1. To the extent Rush’s argument proceeded upon the foundation that the Extension was separate and distinct cover which did not involve a question of Loss, it must fail.
2. In both his written and oral submissions Mr Jones SC, for Rush, sought to identify a number of differences between the second and third paragraphs of the Extension. With respect, the distinctions made in Rush’s submissions are largely without meaning or are illusory. One difference relied upon was that the second paragraph terminated cover where it could be ascertained that the “Loss” was not covered by the policy. It was said that the exclusion of “Known Claims and Circumstances” from the concept of “Loss” in the policy meant the first paragraph of the Extension would not apply if the circumstances were previously known by the insured. So, the argument goes, the extension in the third paragraph does not refer to the insurer’s ceasing to provide cover when it is ascertained that no “Loss” has been sustained. On that basis, it is said, the third paragraph of the Extension implicitly does not exclude cover for “Known Claims and Circumstances”.
3. This argument cannot be accepted. First, the third paragraph of the Extension is concerned with the provision of “Defence Costs”, which are included in the definition of “Loss”. It necessarily follows that to the extent to which the exclusion of “Known Claims and Circumstances” limits the scope of “Loss” covered under the policy, the limitation applies to the provision of Defence Costs. Secondly, contrary to Rush’s submissions, the Extension does not exist as separate cover. It is an extension to part of the insuring clauses, in this case, Insuring Clause 1 which provides cover in respect of “Loss”, the boundaries of which are defined by, inter alia, the Known Claims and Circumstances exclusion. Thirdly, the chapeau to the Exclusions in the policy provides that the Exclusions “apply to all the terms of this Section of the Policy unless otherwise stated”. It is relevant that some of the Exclusion clauses expressly state that they do not apply to several of the Insuring Clauses, but there is no statement that the Known Claims and Circumstances exclusion does not apply to the Advancement Extension. It follows that there is no foundation to Rush’s argument that the absence of any reference to “Loss” in the third paragraph of the Extension indicates that the “Known Claims and Circumstances exclusion” does not apply to it.

#### Conclusion on the construction of the Advancement Extension

1. The Applicants’ submissions and Rush’s submissions must be rejected. There is nothing in the Advancement Extension which expressly or impliedly affects the insurer’s entitlement to rely upon its rights under s 28 consequent upon the Applicants’ failure to comply with their duty of disclosure.

## Fraudulent non-disclosure

1. The Applicants face a further difficulty. The primary ground relied upon by the insurer for its entitlement to avoid the contract is the Applicants’ alleged fraudulent non-disclosure of the Wrongful Conduct or the circumstances underpinning it. The above discussion does not involve any separate consideration of that entitlement. The insurer submits that, regardless of any construction argument, the Applicants are not entitled to escape the consequences of their fraudulent conduct, so that, even if it the terms of the policy were to be construed as restricting its right to rely upon a breach of the Applicants’ obligation of disclosure, the law regards fraudulent non-disclosure as “a thing apart”, the consequences of which cannot be defeated.
2. There is much force in this and it is supported by the speeches of the House of Lords in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61. That case concerned the construction and operation of a “truth of statement” clause in a policy. By that clause the insurer was prepared to enter into the policy in favour of Chase Manhattan Bank in reliance upon a statement by a third party to whom the insured was providing finance. The clause expressly provided that the insured had “no liability of any nature” to the insurers for any information provided by any other party. The policy was brokered by the second and third respondents, collectively referred to as “Heaths”, for Chase Manhattan. It was accepted that the truth of statement clause had the effect of precluding the insurer’s avoidance of the policy on the ground of innocent misrepresentation by the insured or its brokers. The question before the House of Lords was whether it also denied the insurer that right on the ground of negligent or fraudulent misrepresentation by Heaths. Lord Bingham, with whom Lord Steyn and Lord Hobhouse agreed, was of the opinion that whilst the wide words of the truth of statement clause precluded the Bank having any liability for any negligent misrepresentation by its broker, the preclusion of its liability for fraudulent misrepresentation by its broker was another matter. Read literally, the clause was unqualified and, on its face, would have excluded the usual consequences of fraudulent misrepresentation. However, even those clear words could not negate the consequences of fraudulent conduct. As Lord Bingham said (at [15] – [16]):

15. … For, as Rix LJ observed more than once in his judgment (paragraphs 160, 169), fraud is a thing apart. This is not a mere slogan. It reflects an old legal rule that fraud unravels all: *fraus omnia corrumpit*. It also reflects the practical basis of commercial intercourse. Once fraud is proved, “it vitiates judgments, contracts and all transactions whatsoever”: *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702 at 712, *per* Denning LJ. Parties entering into a commercial contract will no doubt recognise and accept the risk of errors and omissions in the preceding negotiations, even negligent errors and omissions. But each party will assume the honesty and good faith of the other; absent such an assumption they would not deal. What is true of the principal is true of the agent, not least in a situation where, as here, the agent, if not the sire of the transaction, plays the role of a very active midwife. As Bramwell LJ observed in *Weir v Bell* (1878) 3 Exch D 238 at 245,

‘I think that every person who authorizes another to act for him in the making of any contract, undertakes for the absence of fraud in that person in the execution of the authority given, as much as he undertakes for its absence in himself when he makes the contract’.

Of particular relevance to the present case is the observation of his Lordship that:

16. It is clear that the law, on public policy grounds, does not permit a contracting party to exclude liability for his own fraud in inducing the making of the contract.

After determining that the Court did not have to decide whether, as a matter of public policy, parties might exclude liability for the fraud of their agents, his Lordship (at [16]) continued:

For it is in my opinion plain beyond argument that if a party to a written contract seeks to exclude the ordinary consequences of fraudulent or dishonest misrepresentation or deceit by his agent, acting as such, inducing the making of the contract, such intention must be expressed in clear and unmistakable terms on the face of the contract. The decision of the House in *Pearson v Dublin Corporation* does at least make plain that general language will not be construed to relieve a principal of liability for the fraud of an agent: see in particular the speeches of Lord Loreburn LC at page 354, Lord Ashbourne at page 360 and Lord Atkinson at page 365. General words, however comprehensive the legal analyst might find them to be, will not serve: the language used must be such as will alert a commercial party to the extraordinary bargain he is invited to make.

1. Lord Hoffmann was of a similar view. At paragraph 68 his Lordship said:

The next question is whether the words relieve Chase from liability to avoidance of the contract or damages in cases in which the misrepresentation by its agent has been fraudulent or avoidance in cases in which the non-disclosure has been dishonest. Here again I agree with Rix LJ that fraud is quite different from negligence: ‘Parties contract with one another in the expectation of honest dealing’, particularly in an insurance context. I think that in the absence of words which expressly refer to dishonesty, it goes without saying that underlying the contractual arrangements of the parties there will be a common assumption that the persons involved will behave honestly. As Lord Loreburn LC said of the exempting clauses in *S Pearson & Son Ltd v Dublin Corpn* [1907] AC 351, 354, ‘They contemplate honesty on both sides and protect only against honest mistakes.’

1. The two principles which emerge from the above case are, first, public policy prevents contracting parties excluding liability for their own fraud, and, secondly, clear and unmistakable language is required in order to exclude a principal’s liability for the fraud of its agent. The first is determinative of this matter insofar as the insurer claims an entitlement to avoid the policy in respect of those who engaged in the fraudulent non-disclosure. The construction advanced by the Applicants would mean that they would be relieved of the consequences of their own fraudulent non-disclosure even if the insurer can prove it, albeit on a temporary basis during their receipt of the advanced costs. The public policy referred to by Lord Bingham, means that such a construction cannot be accepted.
2. Where the relevant insured was not engaged in the fraudulent non-disclosure and the policy was entered into on its behalf by an agent who did engage in it, the same result follows in this case. Here, there are no clear or unmistakeable words used in the policy which might eschew the consequence of the agent’s fraud. There are no words which might alert the insurer that it was entering into an extraordinary bargain, being one it would be required to perform despite being fraudulently induced to enter into it. No exculpatory words expressly referring to “dishonesty” or “fraud” by the agent are used. At its highest the argument is that there exists an implied undertaking by the insurer to abstain from relying on the fraudulent conduct of the insured’s agent who brought the policy into effect on their behalf. That is simply insufficient to displace the common assumption that the parties to the agreement behaved honestly when entering into it.
3. That the Applicants’ construction does not excuse the consequences of the fraud, but merely defers them is not an answer. Even to require the insurer to defer acting upon its claim of fraudulent non-disclosure whilst the question of whether the Applicants committed Wrongful Conduct is adjudicated could give the Applicants the benefit of their own fraud. To accept such a proposition would be to undermine the common law’s historical abhorrence of such conduct. The diminution of standards of commercial morality in society is not a reason to lower the normative standards of behaviour upon which the law is constructed. On the contrary, it is a reason to maintain them. Courts should never be prepared to accord to a party any advantage which arises by reason of its own dishonest conduct.
4. It follows that even if the Applicants’ construction had been correct, its effect must be rejected as a matter of public policy as to the case of fraudulent non-disclosure. But in any case there is nothing in the terms of the Advancement Extension which inhibits the insurer’s entitlement to rely upon alleged fraudulent non-disclosure to avoid the policy under s 28 of the ICA.

## Other matters

### Waiver

1. The Applicants further submitted that by entering into the contract of insurance containing the Advancement Extension the insurer waived its right to rely upon its statutory entitlements to avoid it or to reduce its liability under it to nil. As Mr Donaldson SC for the insurer correctly submitted, that argument is dependent upon the Court’s acceptance of their construction argument. The waiver argument is not independent of it. It is only if the Extension operated to advance Defence Costs in respect of claims which were not disclosed to the insurer that it could be said to have waived its entitlements under s 28. As the Applicants failed to establish that construction, they cannot succeed on this ground and there is no need to consider it further.

### The duty of utmost good faith

1. The Applicants also argued that the insurer was bound by its duty of utmost good faith to act with due regard to their interests as its insured and to act consistently with commercial standards of decency and fairness: *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1. The foundation of this argument is also the acceptance of their construction and on that basis, it is said, the insurer must act in accordance with its unequivocal indication that it would support them by providing Defence Costs regardless of their non-disclosure. This argument must necessarily fall along with the construction argument.

### Wilkie v Gordian Runoff Limited

1. There is no need to consider in any detail the decision of the High Court in *Wilkie v Gordian Runoff Limited* (2005) 221 CLR 522. It concerned a similar policy, but its issues were substantially different from those which fall for consideration here. The issue there was the impact on the construction of a Defence Costs Extension by an exclusion of claims attributable to or in consequence of dishonest, fraudulent, criminal or malicious act or omission etc, where such act or omission had “in fact” occurred. The concept of such an event having “in fact” occurred required that it had been established by curial adjudication or admission. The question before the High Court concerned the manner in which the interpretation of the Extension was affected by the language of the exclusion. The entitlement of the insurer to rely upon its statutory entitlements under s 28 for the insured’s non-disclosure was not an issue and the majority expressly left it open and the judgments of the Court do not touch upon it.

## Answer to the separate question

1. It follows from the above that in the circumstances of this case there is nothing in the terms of the policy or any other reason which prevents the respondent from exercising its rights or from relying on the remedies under Part IV of the ICA. The necessary answer to the question for determination is “No”.

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| I certify that the preceding eighty-three (83) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Chief Justice Allsop and Justices Lee and Derrington. |

Associate:

Dated: 3 August 2018