HIGH COURT OF AUSTRALIA

GLEESON CJ,
GAUDRON, KIRBY, HAYNE AND CALLINAN JJ

HARRY KEVIN McCANN (for himself and representing each of the persons identified in Schedule 1 to the notice of appeal) APPELLANT

AND

SWITZERLAND INSURANCE AUSTRALIA LIMITED & ORS RESPONDENTS

McCann v Switzerland Insurance Australia Limited
[2000] HCA 65
14 December 2000
S229/1999

ORDER

Appeal dismissed with costs

On appeal from the Supreme Court of New South Wales

Representation:

A J Meagher SC with I McN Jackman for the appellant (instructed by Allen Allen & Hemsley)

N J Young QC with J T Gleeson for the respondents (instructed by Phillips Fox)

CATCHWORDS

McCann v Switzerland Insurance Australia Limited

Insurance – Professional indemnity insurance – Exclusion for liability brought about by dishonest or fraudulent act or omission of the assured – Loss to client of the appellant – Claim against professional indemnity policy – Whether respondents entitled to rely on the exclusion.

Words and phrases – "brought about by", "dishonest or fraudulent act or omission".

1 GLEESON CJ. The issue in this appeal concerns the meaning and effect of an exclusion clause in each of three policies of professional indemnity insurance.

2 The appellants, partners in the legal firm of Allen Allen & Hemsley ("Allens"), incurred civil liability to a client, Nauru Phosphate Royalties Trust, ("the Nauru Trust" or "the Trust"), in an amount which included the sum of $US8.7 million. The dispute concerns part of that sum, $US8.55 million. For reasons that will appear, there is no dispute as to the balance of $US150,000. The respondents, the insurers under the policies, are liable to indemnify the appellants against loss arising from any claims made against them during the relevant period in respect of any description of civil liability incurred in connection with their practice. The Nauru Trust made such a claim. It was settled on terms which gave Allens an entitlement to indemnity, subject to what follows.

3 Each policy contained an exclusion clause in the following terms:

> "5(f) This Insurance shall not indemnify the Assured in respect of any liability:-
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> …
>
> (v) brought about by the dishonest or fraudulent act or omission of the Assured including any Partner or former Partner of the Assured. Save that this exclusion shall not apply to liability arising out of any claim brought about by the dishonest or fraudulent act or omission of any person employed in connection with the Practice [including any articled clerk and any solicitor who is a Consultant or Associate with the Firm];
>
> …"

4 Allens had a London office. At the relevant time, a partner (now a former partner) of the firm, Mr Powles, was in charge of that office. The sum of $US8.7 million was paid by the Nauru Trust into a bank account in London in the name of Allens which Mr Powles maintained and controlled without the knowledge of his partners. The Trust erroneously believed it was an Allens trust account. Mr Powles and two other persons arranged between themselves to take secret commissions in respect of the transaction in a total of $US150,000. Mr Powles later applied the sum of $US150,000 for that fraudulent purpose. To that extent, Allens' entitlement to indemnity is excluded by cl 5(f). The issue is as to the balance of $US8.55 million; but the fraudulent misapplication of $US150,000 is not irrelevant to that issue.

5 The detailed facts of the case are set out in the reasons for judgment of Hayne J.

6 The liability which Allens incurred to the Nauru Trust in respect of the amount of $US8.55 million is not in dispute. However, in order to consider the operation of the insurance policies it is necessary to identify the basis of that liability.

7 As appears from the facts recounted by Hayne J, the Trust had been induced to invest $US8.7 million to purchase an "instrument" (a letter of credit) with a face value of $US10 million. The "market" in which this transaction was to be entered into was fictitious; but the trial judge, Hunter J, found that Mr Powles believed in it. He sought to take advantage of it, not only to make profits for his clients, but also to obtain secret commissions for himself. His need for money arose from a series of previous defalcations.

8 The Nauru Trust was introduced to the transaction by Linpar Ltd. That company, in turn, had the support of a reference and commendation from Mr Powles on Allens' letterhead. It is plain that the Trust relied, and was entitled to rely, upon the standing and reputation of Allens, and believed that the fact that its investment would be made through the medium of an Allens trust account gave it protection. The Court of Appeal found, correctly, that the duty of Mr Powles, as solicitor for the Nauru Trust, "was to ensure that the funds [US$8.7 million] were used only for the purpose of acquiring the letter of credit and to safeguard the funds pending delivery of the instrument or security."

9 In breach of that duty, Mr Powles instructed his bank to transfer $US8.55 million to an account in the name of one Glasby with Barclays Bank. He received no letter of credit or other security in return. He lost control of the funds at that time. Thereafter the $US8.55 million passed through other accounts, over which Mr Powles had no control, into and through the Swiss banking system. They were never recovered. The Nauru Trust never received any letter of credit. As was noted above, the balance of $US150,000 was misappropriated by Mr Powles for himself and others.

10 The Court of Appeal made the following findings, which were not challenged on appeal to this Court (although the characterisation of Mr Powles' conduct based on the findings was disputed).

> "There is no room for any doubt that Powles received the US$8.7 million from the Nauruan Trust and paid away US$8.55 million of it in serious conflict of interest and in breach of trust. His duty was to ensure that the funds were used only for the purpose of acquiring the letter of credit and to safeguard the funds pending delivery of the instrument or security. However, Powles' self-interest was to obtain a transaction so he could earn commissions in fraud of his partners on this and, he hoped, subsequent transactions. The trial judge was correct to characterise Powles' conflict as exacerbated by his great need for substantial funds to cover his fraud of

> clients' trust moneys and to say that his propensity was to prefer his own interest to that of the Trust if they clashed. …
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> As Hunter J found, the moneys were paid away by Powles with undue haste and with no attempt whatsoever to check the credentials of [the recipient]. …
>
> On consideration of all the relevant evidence, the irresistible conclusion to which we are driven is that Powles must have appreciated the real risk of loss of the moneys."

11 Both Hunter J and the Court of Appeal found that Mr Powles was dishonest. To that finding it will be necessary to return.

12 The Court of Appeal went on:

> "Further, Powles was in breach of his fiduciary duty to the Trust in the manner in which he paid away the funds. He failed to ensure that he retained control over the funds without obtaining the required bank instrument. In this regard, he failed to safeguard the funds pending delivery of the instrument. Powles parted with control of the funds in circumstances where he knew (or must have known) that he was placing them at a real and considerable risk of loss. He must have known that parting with the funds, without having acquired the instrument, would seriously endanger any successful recovery of the moneys."

13 The arguments for the appellants commenced by seeking to draw a sharp distinction between the liability of Allens to the Nauru Trust in respect of $US8.55 million and the liability in respect of $US150,000. The respondents described this distinction as artificial. It is understandable that Allens should resist the notion that the attempt by Mr Powles and his associates to misappropriate $US150,000 should deny them insurance cover in respect of the loss of $US8.55 million. However, as the findings of the Court of Appeal show, there is a relationship between the amounts, and the various aspects of Mr Powles' behaviour, that cannot be disregarded.

14 As to the liability in respect of the $US8.55 million, it is denied that the acts and omissions which brought about the liability were dishonest or fraudulent. This was treated as giving rise to two questions. Was the conduct of Mr Powles in relation to the $US8.55 million dishonest or fraudulent? If so, was there a sufficient connection between the dishonesty or fraud and the liability of Allens to the Nauru Trust to lead to the conclusion that the liability was brought about by the dishonest or fraudulent act or omission?

15 The first question is to be considered in the light of the findings of fact set out above. It is also to be considered in the light of an understanding of Mr Powles' fiduciary responsibilities. What was involved was not merely a

negligent payment away of moneys entrusted to him by a client. What was involved was a misapplication of such moneys, in disregard of the client's interests, and in pursuit of his own, conflicting, interests.

16 The principle that a solicitor "shall not be permitted to make a gain for himself at the expense of his client" was said by the Lord Chancellor, Lord Westbury, in *Tyrrell v Bank of London*[1], to be one strictly requiring a faithful and honourable observance. In *Law Society of NSW v Harvey*[2] the Court of Appeal of New South Wales observed that an appreciation of a solicitor's duty not to prefer his or her interest to that of the client rests, not upon some technical instruction, but upon understanding and applying the ordinary concepts of fair dealing. It was said of the solicitor's conduct in that case[3]:

> "He recklessly disregarded the need to protect his clients' property, by failing to provide adequate securities. Moneys were invested in ventures, upon securities, or with the lack of them, and upon terms that no reputable solicitor acting independently could have contemplated. So investing clients' moneys and advising and permitting clients to so invest was not due to any lack of commercial or legal experience, but to the pressure of his own self interest. …
>
> Although the moneys of clients were, for the most part, applied in the form of loans and fell within the general or particular discretion which the defendant extracted from his clients, there is little to distinguish much of the defendant's conduct in point of moral culpability from that found in a misappropriation of clients' moneys for use in a solicitor's private speculative ventures, with the intent of restoring the same upon the expected success of the ventures".

17 The same can be said of the present case. Mr Powles did not intend that the Nauru Trust should lose the $US8.55 million. But he paid it away, in breach of his fiduciary responsibilities, without proper (or any) security, knowing there was a risk of its loss, and impelled by his own need for money. He preferred his personal interests to those of his client. He permitted his urgent need to make a secret commission to prevail over his duty to protect his client's funds. The Court of Appeal was right to find that his conduct in relation to the entire $US8.7 million was obviously dishonest and probably fraudulent.

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1 (1862) 10 HLC 26 at 39, 44 [11 ER 934 at 940, 941].

2 [1976] 2 NSWLR 154 at 170.

3 [1976] 2 NSWLR 154 at 172-173.

18 The next question is whether there was sufficient causal connection between the liability of Allens to the Nauru Trust in relation to the amount of $US8.55 million and the dishonest or fraudulent act or omission by Mr Powles to lead to the conclusion that the liability was brought about by the dishonest or fraudulent act or omission.

19 A negative answer to that question does not follow from the circumstance that there were also dishonest or fraudulent acts of third parties which resulted in the disappearance of the funds after they left Mr Powles' bank account[4]. The money was not lost to the Trust because it was embezzled by some fraudulent employee of Mr Powles' bank. The misapplication of the money by Mr Powles placed it at risk. His fiduciary obligation was to deal with the money in the interests of his client, disregarding his own conflicting interests. Execution of that duty required keeping the money under his control until his client obtained the security in which it was investing. There was a direct causal connection between his dishonest and fraudulent breach of that obligation and the liability of Allens to the Nauru Trust. The liability resulted from the breach of duty. The breach of duty was not merely negligent. The acts and omissions constituting the breach were dishonest and fraudulent.

20 It was submitted for the appellants that, in a case where a dishonest act was not of itself sufficient to bring about the loss resulting in liability to the client, then the exclusion clause will only apply if the act was intended to result in such loss. On this argument, liability is only brought about by a dishonest or fraudulent act or omission if it results, without any intervening or additional cause, from the act or omission, or if there is such an intervening or additional cause, the loss was intended by the partner whose act or omission is in question.

21 Solicitors and other fiduciary agents who fraudulently misapply moneys of their clients often expect, or hope, that no loss will ultimately result to the client. If loss results, that places them at risk of exposure. As was indicated in *Law Society of NSW v Harvey*[5], a common case of fraudulent misappropriation is one involving use of a client's money in a solicitor's private speculative venture, with the intent of restoring the money upon the success of the venture. Liability resulting from such conduct might be expected to be in the contemplation of the parties to policies of the kind presently in question. The loss giving rise to such liability would usually require some intervening or additional cause, such as the failure of the solicitor's venture. And the solicitor would rarely intend that loss should result.

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4 *Maguire v Makaronis* (1997) 188 CLR 449 at 470 per Brennan CJ, Gaudron, McHugh and Gummow JJ.

5 [1976] 2 NSWLR 154 at 173.

22 A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation[6]. Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure[7].

23 The language of the exclusion clause does not require the interpretation for which the appellants contend. They seek to read into it words that are not there. Furthermore, for the reasons given above, the liability of a solicitor to a client brought about by a dishonest or fraudulent act will frequently arise in circumstances where the solicitor did not intend that there should be loss to the client, and where there were additional causes of the loss. If the clause had the meaning for which the appellants contend, it would not apply to common cases of liability involving fraudulent misapplication of a client's funds. Such cases form part of the ordinary circumstances which a clause such as this is likely to have been intended to address. To give it the appellants' construction does not make business sense.

24 The exclusion clause applies. The appeal must be dismissed with costs.

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6 *Hydarnes Steamship Co v Indemnity Mutual Marine Assurance Co* [1895] 1 QB 500 at 504 per Lord Esher MR.

7 *Lake v Simmons* [1927] AC 487 at 509 per Viscount Sumner.

25 GAUDRON J. The question in this appeal is whether the respondents, which companies were, at the relevant time, the excess professional indemnity insurers of the appellants, the partners of Allen Allen & Hemsley ("Allens"), are entitled to rely on exclusion clauses contained in the insurance policies issued by them. As the policies are in identical form, it is convenient to proceed as if there were but one insurer, one policy and one exclusion clause.

The policy and the exclusion clause

26 Under the policy, the insurer agreed, subject to terms and conditions, to indemnify Allens "against all loss ... in respect of any description of civil liability whatsoever incurred in connection with the Practice". The exclusion clause in issue in this appeal relevantly provides:

> "This Insurance shall not indemnify the Assured in respect of any liability:-
>
> ...
>
> (v) brought about by the dishonest or fraudulent act or omission of the Assured including any Partner or former Partner of the Assured".

27 It is not in issue that, for the purposes of the policy, Allens suffered a loss by reason of their civil liability to the Nauru Phosphate Royalties Trust ("Nauru Trust"). Nor is it in issue that that liability arose directly out of the acts and omissions of one of their partners, Ronald Adrian Powles. The only question in this appeal is whether their liability was "brought about by [a] dishonest or fraudulent act or omission" on his part.

The facts

28 A detailed account of the facts is set out in other judgments and they are repeated only to the extent necessary to make clear my reasons for holding that this appeal should be dismissed.

29 In 1989, Mr Powles became Allens' resident partner in London. By that stage, he had already defrauded a number of his clients. His fraudulent behaviour continued in London in 1990 and 1991 and, as Hunter J found at first instance[8], "the extent of [his] defalcations as at the end of 1991 ... left him in need of several million dollars, if his frauds were to remain concealed."

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8 *McCann v Switzerland Insurance Australia Ltd* unreported, Supreme Court of New South Wales, 26 June 1998.

30 Allens maintained two bank accounts in London for the working needs of their London office. Neither was to be used as a trust account. Without authority from his partners, Mr Powles opened a third account in Allens' name in December 1990. That account has come to be known as "the US dollar account" and it is convenient to refer to it as such. The account was not a trust account and Mr Powles had no authority from his partners to open it or operate upon it.

31 Mr Powles used the US dollar account for a number of financial transactions, including attempts to purchase a prime bank instrument ("pbi"). Many, if not all, of those attempts were undertaken at the request of or on the instructions of a Mr Madden or companies with which Mr Madden was associated. One of those companies was Linpar Limited ("Linpar"). None of the attempts to purchase a pbi was successful and, in some cases, money was lost. Moreover, in the course of those attempts, Mr Powles became aware of the existence of fraudsters operating in the pbi market.

32 From August 1991, there was an arrangement between Mr Powles and Mr Madden that, in relation to any purchase of a pbi, Allens would be paid for legal services and Mr Powles would be paid $US100,000 for his "personal contribution". At first instance, Hunter J characterised that arrangement as one involving a "secret commission" payable to Mr Powles and, in that respect, a fraud on his partners.

33 Some time prior to December 1991, Mr Madden and Linpar put forward a proposal, or, perhaps, a series of proposals, to the Nauru Trust for it to invest in the pbi market. The proposal that ultimately evolved was one in which Linpar would purchase pbis with moneys paid by the Nauru Trust to Allens' London office. The Nauru Trust was given details of the number of the US dollar account for that purpose.

34 The Nauru Trust ultimately decided to proceed with Mr Madden's proposal. For that purpose, it caused $US8.7 million to be paid into the US dollar account on 23 December 1991. That money was to be used for the purchase by Linpar of a pbi in the form of a standby letter of credit with a face value of $US10 million. The letter of credit was to be sold within a short period and the proceeds "rolled over" in successive transactions in the pbi market. It was also envisaged that other payments would be made by the Nauru Trust to the US dollar account and would be utilised in the same manner.

35 As already pointed out, there was an agreement between Mr Powles and Mr Madden that Mr Powles would receive a secret commission of $US100,000 in connection with the purchase of each pbi. There is evidence to suggest that the agreed secret commission on each purchase for the Nauru Trust may have been $US150,000. There was no precise finding to this effect at first instance, but Hunter J held that that evidence "confirmed [Mr] Powles' financial interest in the dealing, over and above any legal fee entitlement".

36 The Nauru Trust later made other payments to the US dollar account for the purpose of other transactions. From those moneys, Mr Powles made a number of dishonest or fraudulent withdrawals. This appeal relates solely to the sum of $US8.7 million paid on 23 December 1991 and not to any other amount subsequently deposited by the Nauru Trust in the US dollar account.

37 The appeal is in fact concerned only with the sum of $US8.55 million. Mr Powles authorised the payment of that sum out of the US dollar account for the purpose of purchasing a standby letter of credit in the name of the Nauru Trust. However, no letter of credit was obtained. Rather, the money was stolen by third parties. The remaining $US150,000 was withdrawn from the US dollar account for the payment of secret commissions and is not the subject of this appeal.

38 It is important to note certain events between the payment of the $US8.7 million into the US dollar account on 23 December 1991 and 15 January 1992. During that period, there was an unsuccessful attempt by Linpar or those associated with that company to purchase a pbi in the name of the Nauru Trust. In the course of that attempt, Mr Powles authorised the payment out of $US8.525 million from the US dollar account. It was subsequently transferred back into that account on 13 January 1992. The detail of that attempt was not communicated to the Nauru Trust. On the contrary, on 16 January 1992, Mr Powles informed the Nauru Trust, by facsimile, that a pbi had, in fact, been purchased when that was not the case. Moreover, it was held at first instance that that statement did not represent "a truthful expression of [Mr Powles'] understanding of the state of the transaction".

39 It was on 15 January 1992, the day prior to the dishonest facsimile to the Nauru Trust, that, in a final unsuccessful attempt to purchase a standby letter of credit, Mr Powles authorised the transfer of $US8.55 million to Barclays Bank for ultimate transmission to the Commonwealth National Bank in Antigua. As a result of incorrect information as to the number of the Barclays Bank account to which that money was to be paid, the money was not transferred until 17 January. It did not arrive in Antigua. It was stolen by third parties on or after 28 January 1992 when it left the English banking system and entered the Swiss banking system.

The decision at first instance

40 It seems likely that no pbi market ever existed. However, it was found by Hunter J at first instance that, notwithstanding Mr Powles' earlier unsuccessful attempts to enter that market, he believed in its existence at all relevant times and believed, also, that substantial profits were to be made by investing in it. His Honour also found that Mr Powles did not intend to cheat or defraud the Nauru Trust of the $US8.55 million transferred out of the US dollar account on

17 January 1992. However, his Honour found that he was in breach of his duty "to ensure that proper safeguards were in place to protect those funds from loss and to ensure the[ir] application ... for the purpose only of the acquisition of the required financial instrument."

41 Mr Powles' failure to protect the funds from loss was, in the view of Hunter J, dishonest but not fraudulent. It was dishonest, in his Honour's view, because the manner in which and the terms on which Mr Powles authorised their payment out of the US dollar account "were the product of [his] overriding self interest in seeing the transaction proceed". And that was so notwithstanding that, in his Honour's view, Mr Powles "believed that the payment away of the funds was conditional upon the acquisition of the required letter of credit" and did not know "that he was 'imperilling or gambling' with the Nauruan Trust's money."

42 Although Hunter J held that Mr Powles was dishonest in authorising the payment of $US8.55 million out of the US dollar account, in the sense explained, he concluded that that conduct did not bring about Allens' liability. Rather, in his Honour's view, "that liability ... was brought about by the calculated fraud" of those who stole the money. In so concluding, his Honour distinguished between "proximate cause and other causative factors" and construed the exclusion clause as operating only where the dishonest or fraudulent act or omission of a solicitor is the proximate cause of liability. In the result, his Honour held the insurer liable to indemnify Allens in the sum of $US8.55 million.

43 Before leaving the decision at first instance, it is important to note one other finding made by Hunter J. The finding was in these terms:

> "I accept that, had [Mr] Powles informed the Nauruan Trust that (a) doubt hung over the ability of Linpar to effect the transaction, or (b) he was not aware of any transaction of a like nature in which Linpar had successfully obtained a prime bank instrument, or (c) he had been associated with numerous attempts to obtain such an instrument, all without success, and in some cases with the loss of fees, the Nauruan Trust would not have been interested in parting with its funds in the first place."

However, his Honour seemed to think that that was of no relevance to the issue to be decided because "that was true of [Mr] Powles' conduct long before 17 January 1992." Seemingly, his Honour was of the view that the act giving rise to Allens' liability to the Nauru Trust occurred on that day when the sum of $US8.55 million was transferred out of the US dollar account.

The decision of the Court of Appeal

44 The Court of Appeal held that Hunter J was correct to find that Mr Powles' conduct in authorising payment of the $US8.55 million out of the US dollar account was dishonest[9]. However, the Court of Appeal went further. It was of the view that Mr Powles knew that, in so doing, "he was placing the Trust's moneys at considerable risk."[10] Additionally, the Court of Appeal held:

> "He treated the Trust in what can only be seen as a blatantly dishonest fashion, deliberately concealing information from it and intentionally concealing the truth in his reports to it. He made no disclosure to the Trust about the commissions he stood to make. [Mr] Powles also participated in arrangements for others to receive secret commissions out of his bank account. This was also kept from the Trust."[11]

This conduct was characterised by the Court of Appeal as a breach of trust and a breach of fiduciary duty, which breaches were held to be "dishonest and probably fraudulent."[12]

45 The Court of Appeal further held that Allens' liability was brought about by Mr Powles' dishonest breaches of his trust and fiduciary duties "[i]n allowing the funds to leave the English banking system on or about 15 January 1992, in the circumstances that [he] did"[13]. In so holding, the Court of Appeal emphasised that the exclusion clause is relevantly concerned with liability brought about by dishonest conduct, not loss caused by that conduct[14]. And that being so, there was no basis for treating that clause as concerned simply with dishonest conduct which is the real or proximate cause of the loss covered by the policy.

46 In the result the Court of Appeal allowed the appeal of the respondent companies and entered judgment in their favour[15].

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9 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446.

10 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,117 [65].

11 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,118 [69].

12 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,118 [70].

13 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,121 [92].

14 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,121 [91].

15 (1999) 10 ANZ Insurance Cases ¶61-446 at 75,121 [97].

Causation: "brought about by"

47 In this Court, counsel for the appellants noted that, in various sub-clauses, the causal connections which activate the exclusion clause are expressed in significantly different terms. Thus, those sub-clauses relevantly refer to "liability ... for damages arising from death, bodily injury, physical loss or physical damage to property"[16], "liability ... arising from a contract other than a contract to provide services"[17], "liability ... directly or indirectly caused by or contributed to by, or arising from [radioactivity]"[18], "liability ... incurred in connection with a practice conducted wholly outside" certain named States and Territories[19] and, "liability ... incurred by the Assured in his capacity as an insurance agent."[20]

48 By reference to the different causal connections specified in the exclusion clause, it was argued for the appellants that the expression "brought about by" signifies something more than conduct "which merely initiates or contributes to the relevant sequence of events without intentionally achieving the ultimate consequence".

49 Certainly, the different expressions used in the various sub-clauses of the exclusion clause convey different shades of meaning or different degrees of causal connection. This notwithstanding, each sub-clause must be read as a whole and read in its own particular context. One thing, however, is common to each of those sub-clauses: as the Court of Appeal pointed out, the sub-clauses are concerned to specify a causal connection between particular acts or events and the liability of the insured, not with the loss sustained.

50 It may well be that Allens' loss was sustained only when they could no longer recover the money paid out of the US dollar account (ie when the money was stolen by third parties) and, in that sense, their loss was caused by the actions of somebody other than Mr Powles. But that is not the issue posed by the sub-clause in issue in these proceedings. What that sub-clause postulates is "liability ... brought about by [an] ... act or omission". And there can be no doubt that Allens' liability to the Nauru Trust was brought about by the acts and/or omissions of Mr Powles. Once that is accepted, as it must be, the only question

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16 Clause 5(f)(i).

17 Clause 5(f)(ii).

18 Clause 5(f)(vi).

19 Clause 5(f)(vii).

20 Clause 5(f)(viii).

is whether it can be said that that liability was brought about by his "dishonest or fraudulent act or omission". And that requires an analysis of the basis of Allens' liability to the Nauru Trust.

51 Before turning to consider the basis of Allens' liability to the Nauru Trust, it is convenient to note one other argument advanced on behalf of the appellants. It was put that the exclusion clause does not apply where "what was 'brought about' by a partner of the insured was only a risk of loss [and] the actual loss was brought about by ... unintended theft ... by another person". Again, that argument fails to recognise that the exclusion clause is concerned with defining the circumstances in which liability arises, not the circumstances in which loss occurs. However, there is another and more fundamental reason why that argument must be rejected.

52 If a person breaches a legal duty to protect or warn another against a foreseeable risk of harm at the hands of a third party or, even, from a random occurrence, and, if that risk eventuates, it is contrary to common sense to treat that eventuality as having been "brought about" by that third party or, even, by happenstance. That is because, when questions of causation arise in a legal context, they are answered "in the legal framework in which they arise"[21] and not by reference to philosophical or scientific notions of causation[22]. To put the matter another way, it would be absurd for the law to impose a duty to protect or warn against a risk from a third party or an external force and, at the same time, allow that, in the event of breach, no liability attaches because the event in question was brought about by external force or by the third party.

53 It may be that the law does not often impose a duty to protect or warn another against a risk of harm at the hands of third parties or the risk of random occurrences. *Chappel v Hart* was such a case, the duty imposed in that case being a duty on the part of a medical practitioner to warn against the random risk of infection and its possible consequences[23].

54 The present is a case in which there was a duty to protect or warn against the risk of harm at the hands of third parties. In this respect, it is sufficient to

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21 *Chappel v Hart* (1998) 195 CLR 232 at 238.

22 See *March v Stramare (E & M H) Pty Ltd* (1991) 171 CLR 506 at 509, 515 per Mason CJ, 522-523 per Deane J. See also *Fitzgerald v Penn* (1954) 91 CLR 268 at 277 per Dixon CJ, Fullagar and Kitto JJ; *The National Insurance Co of New Zealand Ltd v Espagne* (1961) 105 CLR 569 at 591 per Windeyer J; *Bennett v Minister for Community Welfare* (1992) 176 CLR 408 at 428 per McHugh J.

23 (1998) 195 CLR 232.

note that if there was no duty on the part of Mr Powles to protect or warn the Nauru Trust against the risk of its funds being stolen, no liability attached to Allens. And if there was such a duty, it necessarily follows, in a legal context, that Allens' liability was brought about by breach of that duty. As it is not in issue that Mr Powles was under a duty to protect the funds of the Nauru Trust from the risk of being stolen and that he breached that duty, the only question is whether the act or omission constituting that breach was dishonest.

Dishonesty: dishonest omission

55 Dishonesty is an ordinary concept, not a term of art. It is, on that account, difficult to define in any comprehensive manner. However, dishonesty is a matter to be determined by reference to the mental state of the person whose conduct is in issue. It was pointed out in *Peters v The Queen* that "in most cases where honesty is in issue, the real question is whether an act was done with knowledge or belief of some specific thing or with some specific intent"[24]. That statement was concerned with positive acts, not with omissions.

56 Leaving aside the situation in which there is an honest claim of right[25], the question whether a failure to act is dishonest is usually answered by considering whether that failure was motivated by a desire to conceal the truth or to obtain an advantage to which the person concerned knew he or she was not entitled.

57 There are, in my view, some difficulties with the notion that Mr Powles was dishonest in undertaking the positive act of authorising the payment out of the US dollar account of $US8.55 million on the basis found by Hunter J. And the difficulty remains whether his actions in that regard are viewed as a positive act, namely, the payment out of that money, or as an omission, namely, the failure to ensure that the money would only be paid away in exchange for a standby letter of credit.

58 So far as the positive act of payment out is concerned, it was done to effect the very purpose authorised by the Nauru Trust. That being so, it cannot be said to be an act which Mr Powles should not have undertaken, much less one that he knew he should not have undertaken. Nor can it be said that it was done with intent to deprive the Nauru Trust of the money involved. And even if Mr Powles was in part motivated by his desire to earn a secret commission, it is difficult to see that that, in itself, made the payment out dishonest when it was undertaken for the very purpose which the Nauru Trust intended.

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24 (1998) 192 CLR 493 at 503 [16].

25 See *Walden v Hensler* (1987) 163 CLR 561.

59 So far as there was an omission by failure to ensure that the moneys would only be paid away in exchange for a standby letter of credit, the difficulties lie in the findings of Hunter J that Mr Powles believed that his authorisation of the payment out was conditional upon obtaining a standby letter of credit and, also, did not believe that he was imperilling the funds of the Nauru Trust. And in those circumstances, it is also difficult to see that the underlying motive to earn a secret commission could warrant that omission being characterised as dishonest.

60 There is a further difficulty with a finding of dishonesty based on Mr Powles' failure to take some step to ensure that the moneys would only be paid away in exchange for a standby letter of credit. The precise step that should have been taken was not identified in the judgments below. It is, thus, impossible to determine the state of mind that accompanied that failure to act. More to the point, however, if there was, in fact, no pbi market, as would seem to have been the case, there was no step that could have been taken which would have achieved that end.

61 It does not follow that, because Mr Powles was not dishonest in the precise manner identified by Hunter J, the conduct which brought about Allens' liability to the Nauru Trust was honest. There can be no doubt that, as the solicitor engaged for the purpose of effecting the purchase of a pbi through the agency of Linpar, it was Mr Powles' duty to inform the Nauru Trust of his knowledge of the pbi market and, also, of Linpar's capacity to effect the purchase of a pbi. At the very least, he was under a duty to inform the Trust that he had not been associated with any transaction in which Linpar had been successful, that he had been associated with unsuccessful attempts which, in some cases, had resulted in the loss of moneys, and that he was aware that there were fraudsters operating in the market. Moreover, he should have informed the Trust of the unsuccessful efforts to purchase a pbi on its behalf between 28 December 1991 and 15 January 1992. He breached his duty to the Nauru Trust by paying away the moneys without informing it of those matters. That was an omission.

62 Moreover, the failure of Mr Powles to inform the Nauru Trust as to his knowledge of Linpar and of the pbi market and, also, of the unsuccessful attempt to purchase a pbi for it in the period prior to 15 January 1992 was a dishonest omission. That is because, as a solicitor, Mr Powles must have known that it was his duty to disclose those matters. And, on the facts found at first instance, it can only be concluded that he deliberately concealed those matters so that he could earn secret commissions from the involvement of the Nauru Trust in the pbi market.

Conclusion

63 The appeal should be dismissed with costs.

64 KIRBY J. The outcome of this appeal depends on the meaning of a phrase in an exclusion clause contained in policies of professional indemnity insurance. The key words of the clause are "brought about by". Consideration of this phrase has directed the attention of this Court, once again, to the "difficult topic of causation"[26]. Problems of causation have recently been considered by this Court in the context of the law of tort[27] and fiduciary duties owed by a professional person to a client[28]. It is necessary, in this matter, to address the issue as it is presented by contracts of insurance upon which the parties had agreed but about which they are now in dispute.

The facts, insurance policies and proceedings

65 The facts are sufficiently stated in the reasons of the other members of the Court[29]. So are the applicable provisions of the exclusion clause, the insuring clause[30] and other exclusion clauses with which the subject exclusion clause must be compared[31]. The issues are also stated in those reasons[32]. So is the history of the litigation[33]. In essence, the partners of a large legal firm, Allen Allen & Hemsley ("Allens"), who were indemnified by Switzerland Insurance Australia Ltd and other insurers ("the insurers") succeeded in their claim for indemnity before the primary judge, Hunter J, in the Supreme Court of New South Wales[34]. However, by a unanimous decision of the New South Wales Court of Appeal[35],

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26 *Chappel v Hart* (1998) 195 CLR 232 at 263 [86].

27 *Chappel v Hart* (1998) 195 CLR 232. See also *March v Stramare (E & M H) Pty Ltd* (1991) 171 CLR 506 at 509-510.

28 *Maguire v Makaronis* (1997) 188 CLR 449 at 468.

29 Reasons of Gleeson CJ at [2]-[9]; reasons of Gaudron J at [28]-[39]; reasons of Hayne J at [96]-[117]; reasons of Callinan J at [144]-[167].

30 Reasons of Hayne J at [94]; reasons of Callinan J at [143]. See below at [82].

31 Reasons of Callinan J at [200].

32 Reasons of Hayne J at [95]; reasons of Callinan J at [143].

33 Reasons of Gaudron J at [40]-[46]; reasons of Callinan J at [168]-[182].

34 *McCann v Switzerland Insurance Australia Ltd* unreported, Supreme Court of New South Wales, 26 June 1998 ("reasons of Hunter J").

35 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446. See reasons of Gleeson CJ at [10]-[12]; reasons of Gaudron J at [44]-[46]; reasons of Callinan J at [173]-[182].

they lost on appeal. Allens, by special leave, are now before this Court appealing against that Court's decision. They dispute the application of the exclusion clause and the basis upon which the Court of Appeal held that the insurers were entitled to deny them indemnity under the policies. I will not repeat any of the foregoing materials. I incorporate them all by reference.

66 In this Court, there is a division of opinion. Callinan J would allow the appeal and restore the judgment of the primary judge. The other members of the Court would dismiss it. I agree in the conclusion of the majority. For my own part, I am not inclined to explain the meaning of the exclusion clause in terms of how the Nauru Phosphate Royalties Trust ("the Trust") could frame the claim against Allens and how such claim might be pleaded[36]. The exclusion clause is intended to operate as part of a commercial agreement between the parties without the necessity for litigation giving rise to pleading. But this is a minor point. Putting it to one side, I will explain why I agree in the conclusion that the appeal should be dismissed.

Common ground

67 The ultimate question for decision is quite a narrow one, but not without difficulty. It is narrow because of the high measure of agreement concerning the facts and the issues which those facts presented.

68 Thus, it was agreed that the miscreant London partner of Allens, Mr Adrian Powles, whose initiatives preceded (to use a neutral word) the losses suffered by Allens, committed many acts of dishonesty. He repeatedly stole money from clients of the firm. Moreover, because of his dishonesty, Mr Powles was constantly in need of new funds from other clients in order to cover his tracks. The bank account, opened and operated by Mr Powles with the Westpac Banking Corporation in London ("the US dollar account"), although bearing the name of Allens and appearing to clients to be a trust account of Allens, was nothing of the sort. It was a private account controlled by Mr Powles, basically for his own ends. Its creation would not have been possible but for his position as a partner of Allens. His creation and operation of the account was done dishonestly.

69 There was no contest about the finding of the primary judge that Mr Powles did not intend that the sum of $US8.55 million would be lost to the Trust. The primary judge considered that Mr Powles had accepted the transaction, into which he led the Trust, as unconventional but one that (despite already substantial evidence to the contrary) afforded the Trust the opportunity to

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36 Reasons of Hayne J at [127].

gain "unusually high profits"[37]. The Trust was itself prepared to make those profits. The actions both of the Trust and of Mr Powles were contaminated by the unlawful and undisclosed purposes of an officer of the Trust, on the one hand, and of Mr Powles, on the other, to make substantial secret commissions. They aimed to do so by investing in prime bank instruments, a course which Mr Powles followed and in which he persisted to its predictable, and discreditable, loss to the Trust.

70 In the action brought by the Trust against Allens, it was not pleaded by the Trust that the loss suffered by the Trust was "brought about by" the dishonest or fraudulent act or omission of Mr Powles as a partner or former partner of Allens. There was no reason for the Trust to plead the claim in such a way. Nor was the Trust obliged to assume the additional burden of proving such an allegation. Unsurprisingly, perhaps, the claim was pleaded in terms of a breach of mandate, breach of fiduciary duty and negligence on the part of Allens. The Trust, whilst asserting (not unreasonably) that it was induced into the transaction by the high reputation of Allens, the deposit of the funds in Allens' "trust account" in London and "the professional indemnity cover that [Allens] undoubtedly provides"[38], was not concerned, as such, with Allens' entitlement to insurance indemnity. The liability of the insurers to partners of a legal practice indemnified by such insurance could not depend on the way in which the client formulated its claim against the legal practitioners[39].

71 In the event, Allens compromised the claim brought by the Trust against them. No question arises in these proceedings as to the reasonableness of that compromise or as to its amount. Nor was it suggested that the insurers had any defence on the footing that they were not appropriately made aware of negotiation of the compromise[40]. This Court has not been concerned with possible questions of double insurance, having regard to the existence of other forms of indemnity relevant to the case. Nor has the Court been addressed on the liability inter se of the several insurers.

72 The precise identity of the ultimate recipients of the Trust's deposit in the US dollar account, when that fund finally moved from that account through the United Kingdom banks into the Swiss banking system, is not known. It was not claimed that Mr Powles himself was the ultimate recipient of the fund. But this

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37 Reasons of Hunter J at 126.

38 Letter from the Trust to Allens, 27 October 1992, set out in the reasons of Callinan J at [165].

39 cf reasons of Hayne J at [127].

40 cf *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603.

much is clear. The fund was lost when it left the US dollar account. Allens were liable to the Trust in respect of that loss. Allens properly paid the Trust the amount now claimed against the insurers. The loss of the fund proved to be Mr Powles' ultimate undoing. This is usually the case for those who embark on such a course of deception and breach of trust.

General principles of construing the policies

73 The disputed phrase, "brought about by", is ambiguous. It imports notions of causation which are inherently disputable. The ambiguity is evidenced in the differences between the courts below and now in this Court. It is useful, therefore, to return to the basic principles which govern the resolution of such ambiguities.

74 In *Johnson v American Home Assurance Co*[41], I collected some of those principles. That was a case involving an injury and sickness insurance policy, with maximum liabilities of comparatively modest sums. The present case concerns substantial policies in respect of the professional liability of one of the largest firms of legal practitioners in Australia. But the principles are relevantly the same. They include the following:

1. As a species of commercial contract, an insurance policy must be interpreted to give to the words used their ordinary and fair meaning[42]. Although the basic cover in the applicable policies was of a kind required by Pt 3 of the *Legal Profession Act* 1987 (NSW), as extended by excess provisions agreed on between the parties, it was not suggested that any special statutory rules governed the approach to the interpretation of the policies[43].

2. The meaning to be given to an insurance policy must take into account the commercial and social purposes for which it was written[44]. Under the guise of giving the language of a policy its ordinary and fair meaning, a court is not entitled to make a new contract for the parties at odds with that upon which they have agreed[45]. Maxims and rules of construction,

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41 (1998) 192 CLR 266 at 272-276 [19].

42 *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513 at 520-521, 525.

43 Such as *Marine Insurance Act* 1909 (Cth), Sched 2.

44 *Legal & General Insurance Australia Ltd v Eather* (1986) 6 NSWLR 390 at 394, 405.

45 *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 272 [19].

developed as tools to aid the task of interpretation, are subordinate to the primary duty, which is to uphold the contract between the parties. Without the authority of statute[46], no court is authorised to attribute a different meaning to the words of a policy simply because the court regards the meaning as otherwise working a hardship on one of the parties.

3. Where, especially in an insurance contract written for application in different jurisdictions, language has been used which enjoys a settled meaning, courts will ordinarily endeavour to adhere to such a meaning, particularly in a policy of a commercial character upon which the parties might have been expected to obtain expert advice from lawyers or insurance brokers[47]. In the present case, there is no decision of this Court, or of any other final court, on the meaning of the phrase "brought about by" in the context of the exclusion clause invoked by the insurers. However, a number of earlier decisions of State courts in Australia[48] were referred to in argument. Only one of those cases was specifically addressed to the particular phrase in an identical policy[49]. The most that this earlier case established was that the phrase connoted ideas of causation which extended beyond the "but for" test as expressed in tort[50]. The insurers accepted that this conclusion was correct, and that the words "brought about by" required a causal connection between the dishonest or fraudulent conduct of Mr Powles and the liability of Allens to the Trust which involved more than proving that the dishonesty or fraud was a sine qua non[51] for the liability. Past authority could not therefore be called in aid of having "settled" the meaning of the terms of the exclusion clause in a way to which the parties should be held in this case.

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46 eg *Trade Practices Act* 1974 (Cth), *Contracts Review Act* 1980 (NSW), *Insurance Contracts Act* 1984 (Cth).

47 *Legal & General Insurance Australia Ltd v Eather* (1986) 6 NSWLR 390 at 394; *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 273 [19].

48 *Crowe v Wheeler & Reynolds (a firm)* [1988] 1 Qd R 40 at 44; *H G & R Nominees Pty Ltd v Fava* [1997] 2 VR 368 at 420-421; *Comino v Manettas* (1993) 7 ANZ Insurance Cases ¶61-162.

49 *Comino v Manettas* (1993) 7 ANZ Insurance Cases ¶61-162.

50 *Comino v Manettas* (1993) 7 ANZ Insurance Cases ¶61-162 at 77,869-77,870 per Mahoney JA.

51 An event without which liability would not have arisen: see *Comino v Manettas* (1993) 7 ANZ Insurance Cases ¶61-162 at 77,869; *Chittick v Maxwell* (1993) 118 ALR 728 at 748; *H G & R Nominees Pty Ltd v Fava* [1997] 2 VR 368 at 418-420.

4. Notwithstanding the primary duty of courts to give meaning to the words in an insurance policy, it has been recognised that, in cases of ambiguity, a "liberal approach"[52] will generally be adopted in the construction of insurance contracts[53]. There are several reasons for this approach. They go back to very old legal authority[54]. In the past, they were commonly summed up in the maxim *verba chartarum fortius accipiuntur contra proferentem*[55]. Courts now generally regard the *contra proferentem* rule (as it is called) as one of last resort because it is widely accepted that it is preferable that judges should struggle with the words actually used as applied to the unique circumstances of the case and reach their own conclusions by reference to the logic of the matter, rather than by using mechanical formulae[56]. Nevertheless, dictionaries, facts and logic alone will sometimes not provide an answer to the contest before the court[57]. In those cases:

> "it is not unreasonable for an insured to contend that, if the insurer proffers a document which is ambiguous, it and not the insured should bear the consequences of the ambiguity because the insurer is usually in the superior position to add a word or a clause clarifying the promise of insurance which it is offering"[58].

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52 *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 274 [19].

53 As this Court did in *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513 at 520.

54 *Co Lit* 36a: see *Western Australian Bank v Royal Insurance Co* (1908) 5 CLR 533 at 574.

55 The words of the document are to be construed against the party who has prepared it: see *Western Australian Bank v Royal Insurance Co* (1908) 5 CLR 533 at 559, 574.

56 An analogous development may be seen in *State Rail Authority of New South Wales v Earthline Constructions Pty Ltd (In Liq)* (1999) 73 ALJR 306 at 327-331 [88]-[92]; 160 ALR 588 at 615-620; cf Young, "Current Issues", (2000) 74 *Australian Law Journal* 795 at 797.

57 *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513 at 520; *Legal & General Insurance Australia Ltd v Eather* (1986) 6 NSWLR 390 at 394-395.

58 *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 275 [19].

5. Whilst the meaning of the words in an insurance policy is for the tribunal of fact to determine, if the judge misdirects a jury (or where sitting alone misdirects himself or herself) about the meaning to which the words in question are susceptible, an appellate court may intervene to correct the error[59]. These proceedings were conducted upon the basis that it was the duty of all of the judges concerned to construe the exclusion clause. Appropriate deference should be paid to such of the findings of fact of the primary judge as depended on advantages which that judge enjoyed. However, this consideration did not loom large in the present matter. The trial was substantially conducted on agreed statements of facts[60]. On this footing, the advantage of the primary judge to which appellate deference should be paid is the greater time which the primary judge had to absorb a vast amount of written material, to listen to detailed argument about it, to consider it in its totality and, against that background, to reach conclusions about the meaning of the clause in question[61].

The Court of Appeal and this Court may, in theory, be in as good a position to evaluate the facts and to construe the policies as the primary judge. However, the realities of selective appellate advocacy mean that there are still reasons for restraint in appellate disturbance of a reasoned conclusion reached at trial. Those constraints apply apart from traditional considerations of credibility. In an appeal such as this, error must be shown. However, in the end, the phrase in question in the policies remains to be construed. The general approach is that which I have outlined. It applies as much to this Court, in considering whether error is shown by the Court of Appeal, as it did to the Court of Appeal in deciding the appeal to it from the judgment of the primary judge.

Reasons for adopting the construction of Allens

75 In his reasons, Callinan J has persuasively (if I may respectfully say so) collected the reasons that lead him to the conclusion that the primary judge was correct and that his judgment should be restored. In order to ensure that my consideration is addressed accurately to the main factors which support that conclusion, let me state the considerations which seem to me to tell most strongly in favour of the construction of the policies urged by Allens.

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59 *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 275 [19].

60 See reasons of Callinan J at [168].

61 *State Rail Authority of New South Wales v Earthline Constructions Pty Ltd (In Liq)* (1999) 73 ALJR 306 at 330-331 [89]-[92]; 160 ALR 588 at 619-620; cf *Lend Lease Development Pty Ltd v Zemlicka* (1985) 3 NSWLR 207 at 209-210.

76 First, I regard it as important that the policies are ones required by legislation[62]. They are required for important social purposes. These are not confined to protecting particular legal practitioners, such as the partners in this case. They are intended to protect clients of legal practitioners where such practitioners would not be able otherwise to meet liability from their own resources. Such clients would then be dependent upon the existence and availability of insurance indemnity. Such clients may, in some circumstances, have direct entitlements against the insurers, where the legal practitioners concerned have died or disappeared, or are insolvent[63]. The relevant terms of the exclusion clause must be approached in light of these important social purposes. Whilst it is true that the exclusion clause appears in policies approved for a statutory purpose, an overly broad ambit should not be attributed to it, at least if doing so would undermine the objectives for which the insurance was required in the first place.

77 Secondly, an additional consideration favouring a restrained approach to the ambit of the exclusion for dishonest or fraudulent acts or omissions is that this Court must consider the application of the exclusion clause to the infinite variety of cases in which such indemnity might be claimed. Dishonest or fraudulent acts will include the sustained, premeditated conduct on a large scale over a long period that occurred in this case. But it will also include minor acts of dishonesty or fraud which may be no more than partly relevant to the liability incurred by the insured where the exclusion would appear inapplicable or its invocation disproportionate. It is to remedy the potentially serious consequences of denying indemnity to insured legal practitioners in such cases that the language of the exclusion clause may need to be confined. The only way to do so is by avoiding the attribution to the phrase "brought about by" of an overly inclusive meaning.

78 Thirdly, insurers ordinarily have it within their power to ensure the broad ambit of an exclusion clause by adding words to the effect of "brought about directly or indirectly" or "substantially or in part". This argument has special significance in the present case because of the use, in the exclusion clause immediately following the one in question, of the adverbs "directly or indirectly"[64]. Where the insurers elsewhere chose to use such indications of

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62 *Legal Profession Act* 1987 (NSW), Pt 3.

63 *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW), s 6; *Bailey v New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399; cf *New South Wales Medical Defence Union Ltd v Crawford* (1993) 31 NSWLR 469 at 479-482.

64 General exclusion cl 5(f)(vi) set out in the reasons of Callinan J at [200].

indirect as well as direct connection, they must, so it was suggested, have meant something different in the exclusion clause invoked in the present case. Whilst the dangers of the rule of construction known as *expressio unius* have been acknowledged many times in this Court[65], the fact remains that the insurers had infinitely greater control over the language of the exclusion clause than did an ordinary legal practitioner. If they could make the broad ambit of the clause clear, it is open to argument that, having failed to do so, they must bear the consequences of a relatively strict construction, confining exclusion cl 5(f)(v) only to cases of direct causation of the liability in question by dishonest or fraudulent acts or omissions of a partner and nothing more.

79 Upon the insurers' concession that, "but for" Mr Powles' dishonesty, the liability of Allens would not have arisen, Allens submitted that it was critical to analyse the link between the dishonesty found and the loss actually giving rise to the liability. Their contention that Mr Powles' dishonesty could be severed from such loss rested, substantially, on the findings of the primary judge. The dishonesty preceded the loss in point of time. It was reprehensible. It constituted a breach of the contract of retainer, of the fiduciary duty owed to the client and of the duty of care. But all of this merely established the "liability" of Allens to the Trust and thus of the insurers to Allens under the insuring clause. In the submission of Allens, the true character of the loss of the funds of the Trust, in the facts found, was that it was brought about by dishonest acts *after* the fund finally left the bank in the United Kingdom. It was "brought about by" unknown third parties who moved the fund to the Swiss banking system. It was neither expected nor intended by the dishonest Mr Powles. The loss was thus not "brought about by" any dishonest or fraudulent act or omission on his part. At the most, to the extent that his acts and omissions had made it possible for others to bring about the liability of Allens, they were only a minor cause of the ultimate liability. They were no more than the causa sine qua non – without whose involvement the liability of Allens could not have arisen. Properly classified, Allens' liability was "brought about by" others. Mr Powles' dishonest acts and omissions could be severed from the loss of the funds. So went the argument for Allens.

The insurers' construction is preferred

80 I accept that the foregoing represents a supportable approach. However, in my view, the preferable construction of the exclusion clause is that

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65 *Houssein v Under Secretary of Industrial Relations and Technology (NSW)* (1982) 148 CLR 88 at 94; cf *State of Tasmania v The Commonwealth of Australia and State of Victoria* (1904) 1 CLR 329 at 343; *Rylands Brothers (Australia) Ltd v Morgan* (1927) 27 SR (NSW) 161 at 168-169.

propounded by the insurers. My main reasons for coming to this conclusion are as follows.

81 First, the polices must be given meaning according to their terms, notwithstanding their statutory provenance. They remain commercial agreements[66]. Nothing in the applicable statute modifies the approach which it is proper to take to the interpretation of the exclusion clause. If it had been the purpose of Parliament to protect legal practitioners and their clients in a way different from that expressed in the terms of the policies, it could have said so. Or it could have provided for the making of policies in terms more protective of legal practitioners and clients. The context is not a sufficient reason to distort the meaning of the exclusion clause as derived from its language. That language directs attention to the true cause of the liability of Allens. That question is to be answered in a practical and realistic way, not in a way which adopts an overly fine or theoretical approach that is alien to commercial agreements.

82 Secondly, by the terms of the policies[67], the exclusion clause applies not in respect to any "loss" suffered by the insured but "in respect of any liability". This takes the reader back to the insuring clause under the policies[68]. This is expressed in extremely wide language which, omitting parts that are immaterial, reads:

> "[T]he Insurers shall indemnify the Assured up to an amount not exceeding the Sum Insured and Related Costs against all loss to the Assured [including claimants costs] whensoever occurring arising from any claim or claims first made against the Assured during the Period of Insurance in respect of any description of civil liability whatsoever incurred in connection with the Practice".

83 In the modern approach to the construction of contested language[69], it is usual to look beyond the critical word ("by") or phrase ("brought about by") or sentence (the exclusion clause) to the whole policy[70]. Because the exclusion clause refers back to "liability", it incorporates, by reference, the insuring clause. It is that to which the exclusion is addressed. The insuring clause affixes the

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66 Reasons of Gleeson CJ at [22].

67 Reasons of Hayne J at [94]; reasons of Callinan J at [143].

68 cl 2.

69 *R v Brown* [1996] AC 543 at 561 per Lord Hoffmann; cf *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 at 397.

70 cf *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 at 396-397.

liability of the insurers, relevantly by reference to civil liability incurred "in connection with the Practice". Thus there are two large phrases of connection at work. The first, contained in the exclusion clause, is the phrase "in respect of". The second, contained in the insuring clause, is the phrase "in connection with". Given such broad expressions of connection, it seems unlikely that the notion of causation contained in the exclusion clause is to be construed narrowly.

84 Thirdly, and following this point, it is important to notice that it is Allens, rather than the insurers, who seek to read into the exclusion clause words which the drafter omitted. There is nothing in the words of the exclusion clause to require that liability of the kind posited must have been brought about *directly* by the dishonest or fraudulent acts or omissions of a partner. Yet Allens contend that a true interpretation of the exclusion clause includes this adverb. The exclusion clause makes no mention of "direct", "immediate", "proximate" or "effective" cause, but requires only that the liability should have been "brought about by" the act or omission hypothesised. There is no good reason to add any of the adverbs proposed. It was for Allens to persuade this Court that any such words should be added. Allens have not, in my view, done so. It was sufficient for the insurers to rely on the generality of the phrase of connection actually used.

85 Fourthly, I am unconvinced by the argument that relies on the fact that the succeeding exclusion clause in the policies included reference to "directly or indirectly". Those words appear in a wholly exceptional provision dealing with nuclear radiation, war and like hazards. That exclusion has the hallmarks of a draft into which has been cast every imaginable circumstance of extreme societal disruption. On the other hand, the exclusion clause in question in this appeal is one which, sadly, contemplates circumstances that are all too common in the kind of insurance provided. In effect, legal practitioners are warned by this exclusion clause that they will not be indemnified in respect of liability brought about by the dishonest or fraudulent acts or omissions of partners or former partners (as distinct from employees). If they want such cover, they are obliged to secure it separately, and additionally, at the cost, no doubt, of the payment of appropriate extra premiums. The existence of such fidelity cover, separate from that of professional indemnity, lends some support to a delineation of risk consistent with the construction of the exclusion clause urged for the insurers.

86 Fifthly, once it is accepted that these are the approaches proper to the insuring clause and the exclusion clause agreed between the parties, there is no reason to adopt the overly fine differentiation concerning the consequences of the admitted dishonesty on the part of Mr Powles which Allens urged on this Court. Mr Powles' breaches of duty were numerous and deliberate. He knew that he was using the moneys of the Trust for a dishonest private business of his own when he had been instructed to place the moneys under the control of Allens. He knew that he was not exercising safe control over the moneys. Rational reflection for even a short time, if uncontaminated by the prospects of (and need

for) dishonest secret commissions, would have led to the conclusion that the conduct in which Mr Powles was undoubtedly engaged was likely to expose the fund received from the Trust to just the kind of loss at the hands of third parties that quickly ensued[71].

87 It was Mr Powles' actions and omissions that made it possible for third parties to get their hands on the fund which otherwise would have been safe. It is at least open to inference that Mr Powles would not have imperilled the fund but for the dishonest self-interest which he was bent on pursuing[72]. The false or dishonest information given by Mr Powles concerning prime bank instrument transactions included a false reference on the letterhead of Allens addressed to the Trust about the very transaction which ultimately led to the loss. Had Mr Powles provided the Trust with a truthful reference, with an honest account of his past attempts to engage in the chimerical prime bank instrument transactions, and with information about the Bank of England's denial of the existence of a market in such securities, it is unthinkable that the Trust would have gone ahead with the speculative, ill-conceived and doomed transaction as it did. Its only reason for doing so, as it promptly asserted, was its faith in Allens, as "one of Australia's leading law firms" and a partnership of "integrity and professionalism"[73], and its belief that the funds were under the control of Allens.

88 In my view, the foregoing circumstances travel far beyond merely establishing the factual preconditions to the liability of Allens. At the relevant time, Mr Powles was a partner of the firm. Allens' liability was undoubtedly "incurred in connection with the Practice". It was also "brought about by" the dishonest and probably fraudulent acts of Mr Powles[74]. As such, Allens' liability was excluded from the policy.

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71 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,117-75,118, 75,121.

72 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,116.

73 Letter from the Trust to Allens dated 27 October 1992, set out in the reasons of Callinan J at [165].

74 Mr Powles' conduct was dishonest for present purposes because he used means to deal with the moneys which he knew he had no right to use: *Peters v The Queen* (1998) 192 CLR 493 at 509-510 [33]. His conduct involved "pretence and collusion in the conscious misuse of a power": *Latec Investments Ltd v Hotel Terrigal Pty Ltd (In Liq)* (1965) 113 CLR 265 at 274. As well, he made payments in a manner which he knew lacked authority: *Ex parte Lenehan* (1948) 77 CLR 403 at 415-421.

89 To construe the exclusion clause so as to omit application to cases of partner dishonesty and fraud such as occurred in this case, simply because Mr Powles did not intend to lose the funds or because a further step was taken by fraudulent third parties, would seriously constrict the operation of the exclusion clause[75]. It is important to remember that Mr Powles' dishonesty is being considered in the present context for its relevance to the operation of contracts of professional indemnity insurance. Different questions might well arise if that dishonesty had to be considered in the context of a criminal prosecution of Mr Powles in relation to the loss. So far as the insurance policies are concerned, what does a practical and businesslike construction of the exclusion clause suggest? Common experience teaches that dishonesty and fraud, practised in a context of misuse of client funds, quite often spawn or attract dishonesty and fraud on the part of others. This conclusion is neither unusual nor surprising[76]. At least in relation to facts such as the present, that conclusion sustains the decision reached by the Court of Appeal. The liability on the part of Allens was brought about by the dishonest or fraudulent acts or omissions of Mr Powles. The attempt to sever his dishonesty from the loss of the funds which ensued, and to blame that loss exclusively on others, failed. The Court of Appeal was correct to so find.

Order

90 The appeal should be dismissed with costs.

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75 The absence of a positive intention that a loss will occur by reason of third parties does not prevent the operation of the exclusion; cf *McMillan v Joseph* (1987) 4 ANZ Insurance Cases ¶60-822 at 75,055, 75,057; *Abbey National Plc v Solicitors Indemnity Fund Ltd* [1997] PNLR 306 at 316.

76 Reasons of Gleeson CJ at [23].

91 HAYNE J. The appellants, partners in the law firm Allen Allen & Hemsley ("Allens"), claimed from the respondents under policies of professional indemnity insurance. The claim was for indemnity against some, but not all, of the amount Allens had agreed to pay Nauru Phosphate Royalties Trust ("Nauru Trust") in settlement of a claim which Nauru Trust had made against Allens. The respondents denied liability to indemnify Allens under the policies, alleging that an exclusion to the cover (the "dishonesty and fraud exclusion") applied. The appellants brought action on the policy in the Supreme Court of New South Wales. At first instance, Hunter J held that the appellants were entitled to indemnity. On appeal to the Court of Appeal, that Court (Mason P, Stein and Giles JJA) held[77] that the dishonesty and fraud exclusion applied. The Court of Appeal set aside the judgment in favour of the appellants and ordered that their claim be dismissed. By special leave, the appellants now appeal to this Court.

The policies

92 The policies which the respondents issued were policies of excess insurance. So far as now relevant, the policies were in identical terms and it is convenient to speak of them without differentiating between them. Allens had professional indemnity insurance cover of the kind required by Pt 3 of the *Legal Profession Act* 1987 (NSW). That compulsory cover provided for indemnity against liability up to $1.1m (and related costs) for each claim. The excess policies provided for indemnity against liability for specified sums in excess of the amount covered by the compulsory policy.

93 The excess policies which the respondents issued provided that they were subject to the same terms, exclusions, conditions and definitions as the compulsory cover. It is important to notice some aspects of the insuring clauses, the associated definitions, and the dishonesty and fraud exclusion that applied to the respondents' policies.

94 The respondents' obligation, as insurers, was to indemnify the appellants up to a specified amount "against all loss to the Assured" arising from a claim or claims first made in the period of insurance "in respect of any description of civil liability whatsoever incurred in connection with the Practice". The "Assured" was defined as meaning "the Firm and each Partner in the Firm … and includes each person employed in connection with the Practice". The "Practice" was defined as meaning "the business of practising as a solicitor undertaken by the Assured" and the policy provided that it included (among other things) "acting as Trustee". The policy provided a number of general and special exclusions. The dishonesty and fraud exclusion provided that:

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77 *Switzerland Insurance Australia Ltd v McCann* [1999] NSWCA 310.

> "This Insurance shall not indemnify the Assured in respect of any liability … brought about by the dishonest or fraudulent act or omission of the Assured including any Partner or former Partner of the Assured."

95 It can be seen that the policies require consideration of the following steps:

(a) Did the Assured suffer loss arising from a claim made in the period of insurance?

(b) Was the loss (including the claimant's costs) properly described as being in respect of any description of civil liability incurred in connection with the Practice?

(c) Was the liability "brought about by" the dishonest or fraudulent act or omission of the insured firm or a Partner in that firm?

Principal attention has been focussed in the present matter on the third of these steps.

The facts

96 The events which gave rise to the appellants claiming indemnity from the respondents took place in late 1991 and early 1992. At that time, Ronald Adrian Powles was a partner in Allens and was the resident partner of the firm in London. Much evidence (almost all of it documentary) was tendered at trial to demonstrate that Mr Powles did many dishonest things. The trial judge and the Court of Appeal accepted that between 1980 and 1992 Mr Powles repeatedly stole money from clients of the firm. The appellants did not, and still do not, dispute that this was so. Nor do they dispute that, in order to prevent detection of his thefts, he was, as the Court of Appeal found, "in the position that there was a constant need for funds to perpetuate his frauds"[78]. (By the end of 1991 he had misappropriated more than $3.5m from clients of the firm.)

97 Mr Powles deceived not only his clients but also his partners. Without authority from his partners he opened and operated a bank account with the London branch of Westpac Banking Corporation called "Account No 103600 Allen Allen & Hemsley – USD Short". It was an account conducted in United States dollars and was known at trial, and in the appeals to the Court of Appeal and this Court, as the "US dollar account". It is convenient to continue to refer to it in that way.

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78 [1999] NSWCA 310 [11].

98 The particular transaction which gave rise to the claim which is the subject of these proceedings concerned an attempt by Mr Powles, on behalf of a client of the firm (Nauru Trust) to invest in what was called a "prime bank instrument". This was not the first attempt Mr Powles had made to buy such an instrument. He had personally been involved in up to 17 transactions in which at least $US700,000 was lost. All these attempts to buy an instrument had failed. They failed for the simple reason that the "instruments" and the "market" for such instruments did not exist.

99 On the earlier occasions that Mr Powles had tried to buy a prime bank instrument he had, without any authority to do so, taken for himself some of the money which he had been given to buy the instrument. Moreover, he had agreed with another man involved in those transactions (a Canadian called Patrick Madden) that in future transactions he (Powles) would be paid $US100,000 per transaction for his assistance and would share in the commissions which Mr Madden's company Linpar Ltd ("Linpar") would earn. Mr Powles did not disclose this agreement to Nauru Trust.

The particular transaction

100 The main features of the transaction which gave rise to the claim by the appellants on the respondents are:

(1) Following a proposal by Linpar, Nauru Trust authorised Mr Powles to buy, for a price of $US8.7m, a prime bank instrument having a face value of $US10m.

(2) Before Nauru Trust gave that authority, Mr Powles told lies to Nauru Trust about Linpar or at least did not tell Nauru Trust the whole truth about that company and about the "market" for "prime bank instruments".

(3) Nauru Trust transferred the sum of $US8.7m to the US dollar account "for the sole purpose of facilitating" the purchase of an instrument. It was not disputed that Mr Powles was under a duty to keep the money safely.

(4) In fact, Mr Powles spent $US8.55m for the purpose of buying the instrument, and he spent it unsafely by letting the funds out of his control without receiving the instrument.

(5) Mr Powles took the balance of the sum of $US8.7m ($US150,000) and applied it to his own use and the use of others. This was a sum to which he and the others were not entitled, and to which he knew they were not entitled.

(6) Mr Powles told lies to Nauru Trust about what he proposed to do and about what he had done in connection with buying the instrument.

(7) Nauru Trust lost the money which Mr Powles had spent for a prime bank instrument ($US8.55m) and never received an instrument of the kind it intended should be bought. The money was stolen by third parties after Mr Powles had paid it over in an attempt to buy an instrument.

It will be necessary to say something more about some of the features of the transaction. Before doing so, however, it is of particular importance to notice a finding of the trial judge which the Court of Appeal did not disturb. The trial judge found that Mr Powles "was taken in by the apparent legitimacy, albeit unconventional nature, of the [prime bank instrument] market" and that "[i]n this he was not alone". That is, at the time of the transaction which gives rise to these proceedings, Mr Powles believed that there was a market for prime bank instruments. Indeed, the later attempts which Mr Powles made to have Nauru Trust give him more money to invest in this "market" led almost inevitably to that conclusion. These attempts were cast in terms that were consistent only with Mr Powles still believing that by making purchases in the market he could repeatedly obtain large amounts of money by siphoning off some or all of the difference between what would be represented to be the cost price and the actual price to be paid for the instrument.

101 To maintain belief in the existence of the market, despite what had happened in his earlier attempts to buy such instruments, was at least very foolish. As the trial judge said, "[Powles] had every reason to be sceptical of the capacity of the market to produce the promised fruits". The judge was, nevertheless, "satisfied that Powles' background was such that, while he was able to bring some of his legal discipline to bear in making an appreciation of the subject transactions, he accepted that the transaction, although unconventional, did afford to the initiated the opportunity to gain unusually high profits".

The Nauru Trust authority and Mr Powles' reference for Linpar

102 On 5 October 1991, Mr Madden made a proposal to a lawyer acting for the Republic of Nauru Financial Corporation (known as "Ronfin") which spoke of "Standby Letters of Credit" and "Prime Bank Promissory Notes", issued by "Top Fifty (50) World Prime Banks", being used as security for a line of credit. The proposal suggested that a profit (described as "Net Emission") of up to $US22m for every $US100m of loan could be obtained. Thereafter, there were further discussions and exchanges between Mr Madden and Ronfin. On 22 October 1991, Mr Madden made a proposal for Nauru Trust to "place $US4,400,000 (or preferably USD $8.7 M) in trust with the law firm of Allen Allen & Hemsley in Sydney" for the purchase by Mr Powles of standby letters of credit for the Trust. The proposal to use the Sydney trust account of Allens was abandoned, though how that came about was not disclosed by the evidence. Instead, on 25 October 1991, Mr Madden sent a facsimile to Nauru Trust confirming that what was described as "the trust account of Allen Allen &

Hemsley, London" should be used. In fact, the account nominated was the US dollar account operated by Mr Powles.

103 On 4 December 1991, Mr Madden's company, Linpar, sent a facsimile to Mr Powles which, in part, said:

> "This should help make your day. As briefly related to you this morning, we have for some time been working with [Ronfin], Bank of Nauru and Nauru Phosphate Royalties Trust.
>
> Yesterday, we are advised, the President of Nauru, has approved the commencement of a rollover program with [Linpar] whereby the Trust will fund not less than USD $ 19.3 M (and possibly multiples) for the purchase and ongoing sale/purchase of USD $ 25 M face value Prime Bank Promissory Notes.
>
> Monies for such purpose will be sent to your trust account at WESTPAC, London and we shall advise as to where the funds are to be advanced."

Linpar asked Mr Powles to provide, on its behalf, a letter in the form which it gave him. The letter (in a form which reflected some minor amendments made by Mr Powles) was sent to Nauru Trust on Allens' letterhead. It said:

> "I confirm that we act as solicitors to Linpar Limited, a body corporate with its registered office at Moors Stephens Xouse, Xumul Highway, Port Villa, Vanuatu.
>
> The President of Linpar Limited is Patrick J. Madden, Q.C. of the Canadian legal firm of Schumachar Madden & Gough. Incidentally, Mr Schumacher [sic] is a Queen's Counsel and the Deputy Speaker of the Legislature of the Government of the Province of Alberta, Canada.
>
> To my personal knowledge, Mr Madden has qualified personnel working with him with extensive banking and financial background.
>
> I have worked with Linpar Limited and can advise that we are holding in trust substantial moneys, in United States dollars, for various transactions involving this corporation.
>
> I can confirm that Linpar Limited is capable, in my opinion, of fulfilling its stated objectives to and for your Trust.
>
> Should you have any further queries, do not hesitate to contact me."

The trial judge said of this reference that the evidence did not permit him to say it was not factually correct, although the opinion about Linpar's capability "sailed uncomfortably close to the wind".

104 The Court of Appeal concluded, however, that this reference was "more than imprudent, it was dishonest"[79]. That conclusion was based on the view that "many of the statements in the letter were clearly false to Powles' knowledge" and that the reference "deliberately concealed information from [the Nauru Trust] which was very relevant for it to know"[80].

105 In fact, however, the Court of Appeal identified only one statement in the letter as being false. It said that the statement that "we are holding in trust substantial moneys, in US dollars, for various transactions involving Linpar" was false in two respects. The first was said to be that "at the relevant time … only $252,000 was held" and that "this was the balance of the moneys" of two other would-be purchasers of prime bank instruments which were about to be misappropriated by Mr Madden and Mr Powles. The second was that no money was held in an Allens' trust account; it was held in an account of Mr Powles[81].

106 I do not accept that the letter was factually inaccurate in the first respect identified by the Court of Appeal. Whether $US252,000 is a "substantial" sum is a matter about which minds may reasonably differ. That sum was held on trust and was held on trust for the stated purpose. That the writer and Mr Madden intended to take it in breach of that trust did not deny that fact. As for the second matter, I think the better view is that the letter was false. The money was not held in an Allens' trust account and the statement that "we are holding" the money in trust would reasonably be read as referring only to Allens, not Mr Powles.

107 The Court of Appeal concluded that the statement made in the letter that Linpar was capable, in Mr Powles' opinion, "of fulfilling its stated objective to and for your trust" was not an opinion "which Powles could properly hold"[82]. No doubt it is right to say that Mr Powles could not *properly* (in the sense of honestly *and* reasonably) hold this opinion. As I have said, however, the trial judge found that Mr Powles believed that the market existed and that he and Linpar could and would participate in it. Once that is accepted, it is evident that the statement which is made in the letter is an accurate statement of Mr Powles' then opinion. No doubt the opinion was wrong-headed and foolish. No doubt Mr Powles was motivated to give the reference for Linpar by his desire for

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79 [1999] NSWCA 310 [60].

80 [1999] NSWCA 310 [60].

81 [1999] NSWCA 310 [51].

82 [1999] NSWCA 310 [52].

money. These considerations do not, however, make the opinion false, let alone false to Mr Powles' knowledge.

108 The Court of Appeal referred to several matters which should have been revealed to Nauru Trust in the reference given by Mr Powles, as matters which it was relevant for the Trust to know. They included Mr Powles' unsuccessful attempts to enter the market, the Bank of England's denial of the existence of the market, and the presence of dishonest and untrustworthy intermediaries in the market. Nice questions might arise about what duty Mr Powles had to reveal this information to Nauru Trust at the time he sent the letter. No doubt he had a duty to take reasonable care in what he wrote[83], but that may fall short of some positive duty to make full disclosure of these matters to someone not then his firm's client.

109 To focus on the letter of reference may, however, distract attention from some fundamentally important considerations. There is no doubt that, by the time Nauru Trust transferred $US8.7m to the US dollar account, Mr Powles owed Nauru Trust fiduciary obligations. Equally clearly, at least by the time of the transfer, Mr Powles had put himself in a position where his duty to Nauru Trust conflicted with his interest in secretly taking a profit from this and subsequent transactions. He gave effect to his personal interest by misrepresenting the price of the instrument and, later, by stealing some of the money which Nauru Trust transferred. It will be necessary to return to these aspects of the matter. It is convenient, however, to deal first with some further aspects of the authority which Nauru Trust gave to Mr Powles to buy the instrument and with what then happened.

Instructions from Nauru Trust

110 In December 1991, the then "Acting Secretary" to the Nauru Trust sent Linpar a memorandum confirming "the decision of the [Nauru Trust] to embark upon rollover programs with [Linpar] involving Standby Letters of Credit and Prime Bank Promissory Notes". The memorandum went on:

> "We would advise that funds in the amount of USD $8.7 Million will be advanced to the Trust account of Allen, Allen & Hemsley, London for the purpose of purchasing a USD $10 million face-value Standby Letter of Credit. Such funds are for the sole purpose of facilitating [Linpar's] purchase, through Allen's and in the name of the Nauru Phosphate Royalties Trust, of the said Instrument. Our understanding is that [Linpar] will, after delivery of the subject Instrument to Allen, Allen & Hemsley,

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83 *Mutual Life & Citizens' Assurance Co Ltd v Evatt* (1968) 122 CLR 556; (1970) 122 CLR 628.

> and after the required 'hold' period, onward sell the same. The funds generated by the transaction will then be delivered, in full, to the Trust account of Allen's to facilitate a second transaction. The net profit generated will be advanced to such account as we shall direct Allen's."

The memorandum said that the Trust reserved the option of (among other possibilities) advancing a further $US19.3m for investment in a "Prime Bank Promissory Notes Program" similar to the "Standby Letter of Credit Program" that was set out. A copy of this memorandum came into the hands of Mr Powles and it has been treated in argument as constituting authority for Linpar and Mr Powles to buy, on behalf of Nauru Trust, a Standby Letter of Credit having a face value of $US10m. The respondents emphasised in argument that the memorandum spoke of the money being advanced to the trust account of Allens and that it said that the *sole* purpose of the payment was to facilitate Linpar's purchase of the instrument. In fact, as I have said, the money did not go to an Allens' trust account and some of the money was taken by Mr Powles.

Payment by Nauru Trust and attempts to buy an instrument

111 On 23 December 1991, Nauru Trust paid $US8.7m into the US dollar account operated by Mr Powles. There then followed a series of events in which Mr Powles (and Mr Madden and others) sought to buy a Standby Letter of Credit in the name of Nauru Trust. The first attempt, which involved drawing on the US dollar account to obtain a bank draft for $US8.525m in favour of Union Bank of Switzerland, wholly failed. Mr Powles caused Westpac to repurchase the draft and on 13 January 1992 the funds which had been drawn from the US dollar account were returned to that account. During this period, Mr Madden reported to Nauru Trust about the progress of the transaction. The best that could be said of these reports is that they were misleading in a number of respects.

112 On 14 January 1992, another attempt was made to buy an instrument. Mr Powles instructed Westpac to transfer $US8.55m to an account in the name of A M Glasby with Barclays Bank, and this was done on 17 January 1992. Mr Powles had no control over the funds once they left the US dollar account. Through a series of further transactions between 17 and 28 January 1992 (the details of which do not now matter) the money was transferred in such a way as "to perfect a complicated exercise of concealment and fraud in the passage of [the] funds through the Swiss banking system". The money was stolen after these transactions were completed. It has not been suggested that Mr Powles stole the money or benefited from the theft.

113 Despite the fact that Mr Powles knew that the intended purchase had not been made, he told Nauru Trust, on 3 February 1992, that it had. He then took the $US150,000 difference between the $US8.7m Nauru Trust had transferred into the US dollar account, and the amount of $US8.55m paid away to the

A M Glasby account. Mr Powles applied that balance to himself, Mr Madden and a third man involved in the transactions (Mr Gopal).

114 Nauru Trust did not immediately discover what had happened. It had said in December 1991 that it might advance further funds and it did. Between 31 January 1992 and 19 February 1992 it transferred a further $US19.3m to the US dollar account for Mr Powles to invest in prime bank instruments. Mr Powles stole some of this money. It was inevitable, however, that the truth would eventually emerge. In October 1992, Nauru Trust complained to Allens and investigations soon began to unravel what had happened. Some of the money which Mr Powles took from Nauru Trust was recovered.

Nauru Trust's claim against Allens

115 In June 1993, Nauru Trust commenced proceedings against Allens in London. Amended Points of Claim filed in the proceedings alleged that Nauru Trust had deposited $US60,675,000 with Allens, of which $US49,444,965 had been repaid, leaving a balance (before interest) of about $US11,230,035. Special mention was made in the particulars of loss and damage of the sum of $US8.55m which is now in issue. This (together with the balance of the amounts which Mr Powles had taken from the US dollar account and applied for the benefit of himself and others) made up the sum of $US11,230,035.

116 As I have mentioned earlier, the claim by Nauru Trust was compromised. Argument proceeded in this Court on the basis that no separate question was raised by that fact. In particular, argument proceeded on the basis that the settlement was reasonable and should be treated as demonstrating that Allens was liable to Nauru Trust for the sum of $US8.55m which had been lost in the transaction in issue. It is the liability for that sum in respect of which indemnity is claimed under the policies. It is necessary, therefore, to identify the nature of the liability.

117 Nauru Trust's claim (as finally formulated) made three kinds of allegation against Allens: breach of mandate, breach of fiduciary duty and negligence. It was alleged that Allens had failed to ensure that it retained control at all times over Nauru Trust's funds by causing the funds to pass out of Allens' control without obtaining control over the required bank instruments; that Allens had failed to use the funds only for the purposes of purchasing the instruments; and that Allens had failed to ensure that it obtained control over any instruments which may have been acquired. No allegation of fraud was made in the Points of Claim.

The application of the dishonesty and fraud exclusion

118 There is no doubt that Mr Powles committed many acts of dishonesty. He stole sums from Nauru Trust (after 31 January 1992, when Nauru Trust

commenced to transfer the further sum of $US19.3m in the US dollar account). He told Nauru Trust other lies (after 23 December 1991, when Nauru Trust transferred $US8.7m into the US dollar account). He stole many other sums from other clients and told them many lies. It is necessary, however, to consider whether any of his dishonest acts (or omissions) brought about the liability for which the appellants seek indemnity.

119 As appears from what has been said above, Mr Powles told Nauru Trust, falsely, that the money it proposed to send would be paid into an Allens' trust account. He told Nauru Trust, again falsely, that the purchase price for the instrument it wished to buy was $US8.7m. Each of these two statements was an act of dishonesty on the part of Mr Powles. He later stole $US150,000 of the $US8.7m that Nauru Trust sent. This was a further act of dishonesty on his part. Most importantly, from the time Mr Powles first accepted the instructions of Nauru Trust, he had a conflict between his duties to the Trust and his interest in secretly obtaining personal profit. This was not only a breach of his fiduciary duty, it was a breach (either by act or perhaps by omission) properly characterised as dishonest or fraudulent.

120 The dishonesty and fraud exclusion requires the identification of a "dishonest or fraudulent act or omission". What is important is whether the epithets "dishonest" or "fraudulent" can properly be applied to a relevant act or omission. In understanding the content of those epithets, reference can be made to what is said about "dishonesty" and "dishonest means" in cases such as *Peters v The Queen*[84], as well as to the well-known discussions of "fraud" in cases such as *Derry v Peek*[85] and *Nocton v Lord Ashburton*[86].

121 As was pointed out in *Peters v The Queen*[87], "in most cases where honesty is in issue, the real question is whether an act was done with knowledge or belief of some specific thing or with some specific intent, not whether it is properly characterised as dishonest." Here, the relevant question does not focus so much upon the knowledge or belief of Mr Powles about his entitlement to take $US150,000 but upon the dishonesty of his concealment of the intention to profit. His omission to disclose that intention, and his acts in accepting instructions and later taking the money, were dishonest.

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84 (1998) 192 CLR 493.

85 (1889) 14 App Cas 337.

86 [1914] AC 932.

87 (1998) 192 CLR 493 at 503 [16] per Toohey and Gaudron JJ.

122 Mr Powles' dishonesty was reflected only indirectly in Nauru Trust's Points of Claim against Allens. The allegation that Allens had failed to use the sum of $US8.7m only for the purpose of purchasing the instrument was consistent with the failure being occasioned (as it was) by Mr Powles stealing $US150,000, but the allegation did not go so far as to assert that latter fact. The allegation that Allens failed to ensure that it retained control over the funds at all times was consistent with the failure being occasioned (as it was) by Mr Powles having Nauru Trust pay the money into the US dollar account, but again the allegation did not go so far as to assert that. It is clear, of course, that had the claim by Nauru Trust against Allens gone to trial, evidence would almost certainly have been led which demonstrated that Mr Powles had told Nauru Trust the two lies which I have identified and had stolen $US150,000. Indeed, proof of the latter fact was essential to the proof of Nauru Trust having lost, as it alleged, more than $US8.55m.

123 The appellants submitted that Mr Powles' acts of dishonesty were severable and distinct from the acts or omissions that gave rise to their liability to Nauru Trust. They submitted that their liability to Nauru Trust for $8.55m was brought about by Mr Powles, in breach of his instructions, paying the money away without taking reasonable care. The respondents, on the other hand, submitted, in effect, that no matter how Nauru Trust may have chosen to frame its claim against the appellants, the appellants' liability to Nauru Trust was brought about by Mr Powles engaging in a course of dishonest conduct which was motivated by his desire for personal gain and of which Nauru Trust was but one victim.

124 The Court of Appeal concluded that, as the appellants were liable to Nauru Trust for breach of fiduciary duty, they "were responsible for all loss flowing from the breach, including loss caused through the deliberate acts of third parties"[88]. It followed, so the Court of Appeal held, that because the breach of duty occurred "in circumstances of dishonesty"[89], the dishonesty and fraud exclusion was engaged. The Court said that[90]:

> "If there is a liability according to which Allens is liable for loss, the exclusion operates whether or not the loss was proximately caused by the acts or omissions giving rise to the liability and whether or not the loss was proximately caused by Powles' dishonesty. It is enough that the liability is brought about by the dishonesty and the loss flows, according

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88 [1999] NSWCA 310 [75].

89 [1999] NSWCA 310 [87].

90 [1999] NSWCA 310 [79].

to whatever is the appropriate concept of causation, from the breach of duty giving rise to the liability."

125 This reasoning treats the "liability" of the appellants to Nauru Trust as a single, undifferentiated whole. That is, it does not distinguish between the various respects in which Mr Powles acted in breach of his fiduciary duty and it does not seek to distinguish between the consequences that followed from those several breaches. That is right if the consequences of the several breaches cannot be disentangled. The critical question in this case is can they?

126 The identification of the liability against which indemnity is sought is assisted by considering the way in which the claimant (here, Nauru Trust) chose to frame its claim against the insured (the appellants). If the claim had been framed in fraud, the dishonesty and fraud exclusion would obviously have been engaged. The identification of the liability cannot, however, stop at the examination of the way in which the claimant chose to frame its claim.

127 To decide whether the liability of the insured to the claimant was "brought about" by dishonesty or fraud it is necessary to consider how the claim *could* have been framed. That step is necessary because, if the claim could *not* have been framed in a way in which dishonesty or fraud was a material fact in establishing the liability or the extent of liability, it cannot be said that the liability is one which was "brought about" by dishonesty or fraud. By contrast, if the claim *could* have been framed in a way in which dishonesty or fraud was material, the liability is one which will engage the exclusion.

128 The reference to material facts is intended to invite attention to those facts which are necessary to constitute a cause of action against the insured. The expression is used in the sense in which it is used in relation to pleadings[91] because the "liability" of the insured to a claimant is established by the proof of the material facts which give rise to the liability. That is, the existence of a liability depends upon proof of those facts which are necessary to constitute a cause of action. The reference which is made to the cases about pleadings is not made for some formalistic purpose. It is made for the assistance that those cases give in distinguishing between the facts which are material to establishing a liability and the facts which might be proved in evidence at trial but do not constitute, or bring about, the insured's liability to the claimant. I mention the *extent* of the liability because of the different measure of loss which is applied,

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91 See, for example, *Philipps v Philipps* (1878) 4 QBD 127; *Bruce v Odhams Press Ltd* [1936] 1 KB 697; *Ritz Hotel v Charles of the Ritz [No 20]* (1988) 14 NSWLR 124; *Rubenstein v Truth and Sportsman Ltd* [1960] VR 473.

for example, in an action for deceit[92] from the measure applied, for example, in an action for breach of contract.

129 This method of analysis focuses upon the "liability" and makes little mention of what is meant by the expression "brought about by" when it is used in the dishonesty and fraud exclusion. In particular, it makes no mention of "proximate" or other causes. It may be accepted that "brought about by" is an expression which requires a connection between the two elements that are mentioned in the exclusion: a dishonest or fraudulent act or omission being one, and the liability being the other. It is necessary to identify the nature of that connection, lest the application of the dishonesty and fraud exclusion be thought to depend upon nothing more than the amount of evidence that is assembled to show that the insured, or a partner or former partner of the insured, acted discreditably.

130 The language, although redolent of causation, identifies a different kind of connection between the two elements. One of those elements (the liability) is "brought about by" the other (a dishonest or fraudulent act or omission) if the latter is a component of the former. A liability is brought about by a dishonest or fraudulent act or omission only if the liability is one in which that dishonest or fraudulent act or omission could be a material fact in pleading the claim. It is not brought about by such an act or omission simply because there were dishonest or fraudulent acts or omissions committed at about the time of the events giving rise to liability or because those acts or omissions were committed in the course of some overall relationship between the insured and the claimant. To say that there were "circumstances of dishonesty" attending the relationship between insured and claimant does not identify how or why those circumstances bore upon the nature or extent of the liability giving rise to the loss against which the insured seeks indemnity. It is to assert the application of the exclusion without revealing the connection which is said to exist between the liability and the dishonest or fraudulent act or omission. That is why it is necessary to examine the way in which, in the circumstances of the case, the insured was, or could have been, rendered liable to the claimant.

131 Here, the key proposition in the appellants' case was that their liability to Nauru Trust for $US8.55m could be segregated. Restated, the proposition was that the material facts which gave rise to their liability, in respect of the several sums which made up the total of Nauru Trust's claim against them, were different. Of course, some of those material facts were common to each of the impugned transactions, but not all were. Most importantly, the contention was, in effect, that the claim by Nauru Trust against the appellants for loss of $US8.55m was a claim in which the dishonesty or fraud of Mr Powles was not,

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92 *Gould v Vaggelas* (1985) 157 CLR 215.

and could not have been, a fact material to the formulation of the claim. His dishonesty in telling lies to Nauru Trust or in stealing money from Nauru Trust was said to have played no part in the loss of the $US8.55m. These acts of dishonesty were said to do no more than contribute to a general conclusion that Mr Powles was dishonest in his dealings both with clients of Allens and with his partners in that firm, and to provide no more than some forensic colour to the respondents' contention that they were entitled to rely on the dishonesty and fraud exclusion in answer to the appellants' claim.

132 As I have pointed out earlier, Nauru Trust did not make any allegation of dishonesty or fraud in its Points of Claim against the appellants. As I have said, however, that is not an end of the matter. The question is how *could* Nauru Trust have framed its claim?

133 Nauru Trust could have brought an action for damages for conversion or deceit founded upon the theft of $US150,000 or the misrepresentation which Mr Powles made about the price of the instrument. Had it done so its damages would have been restricted to the loss of the sum of $US150,000. Its damages would not have extended to the sum of $US8.55m because *that* loss was not caused (according to common law notions of causation) by the theft or the misrepresentation but by the intervening conduct of those who stole the money after it had been paid out of the US dollar account.

134 Nauru Trust did not confine its claim against the appellants in that way; it claimed more than $US8.55m and the appellants agreed to pay more than that sum in settlement of the claim. That being so, the fact that the loss of $US8.55m was occasioned, most immediately, by its having been paid away in a foolish but not dishonest way, does not conclude the inquiry about how Nauru Trust could have framed its claim.

135 Nauru Trust could have brought, and in fact did bring, an action for breach of fiduciary duty. On demonstrating a breach of fiduciary duty Nauru Trust would have been entitled to claim, among other remedies, equitable compensation. The amount allowed as equitable compensation for breach of fiduciary duty would "express the policy of the law in holding fiduciaries to their duty"[93]. Regardless of whether the immediate cause of loss is the dishonesty or fraud of a third party, a fiduciary is bound to make good the loss to the trust estate which, but for the breach of fiduciary duty, would not have occurred[94].

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93 *Maguire v Makaronis* (1997) 188 CLR 449 at 468 per Brennan CJ, Gaudron, McHugh and Gummow JJ.

94 *Target Holdings Ltd v Redferns* [1996] AC 421 at 434 per Lord Browne-Wilkinson.

That is the only relevant causal requirement. "[T]here is no translation into this field of discourse of the doctrine of novus actus interveniens"[95].

136 As I have pointed out earlier, by the time Nauru Trust transferred $US8.7m to the US dollar account, Mr Powles was acting "in connection with the Practice". In the course of the business of practising as a solicitor, Mr Powles acted as trustee of Nauru Trust's money and agreed to act as one of its agents in buying an instrument. He therefore owed Nauru Trust fiduciary duties, including a duty not to misuse the property he held in his fiduciary capacity and a duty not to put himself in a position where his interest and duty conflicted[96]. He also owed a duty to use at least such due diligence and care in the management of the funds as those of ordinary prudence and vigilance would use in the management of their own affairs[97]. He owed a duty to segregate the funds of Nauru Trust and to hold them in an account of the kind which the Trust had instructed him to use.

137 The number of respects in which Mr Powles broke his fiduciary duties does not make the application of the dishonesty and fraud exclusion easy. Mr Powles' breaches were failures by omission and commission. Not all of these failures, considered separately, were dishonest or fraudulent. Some of them, such as the misrepresentation about the price to be paid, might not have any causal link with the ultimate loss of $US8.7m. Nauru Trust was willing to spend that amount to buy an instrument with a face value of $US10m. It is not self-evident that it would have declined to proceed with the transaction if it knew that some of this amount was to go into the hands of its agents. No doubt, as the trial judge held, the apparent involvement of Allens in the transaction, as custodian of the funds and in vouching for Mr Madden and Linpar, was important to Nauru Trust. Without the involvement of Allens, Nauru Trust probably would not have proceeded and, as I have pointed out, the letter of reference contained a statement about the use of an Allens' trust account which, to the knowledge of Mr Powles, was false. Again, however, had the truth been told about the particular account in which the money was to be held, would Nauru Trust have declined to proceed? These questions may distract attention

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95 *Maguire v Makaronis* (1997) 188 CLR 449 at 470 per Brennan CJ, Gaudron, McHugh and Gummow JJ.

96 *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 67 per Gibbs CJ, 103 per Mason J; *Bray v Ford* [1896] AC 44 at 51 per Lord Herschell; *NZ Netherlands Society v Kuys* [1973] 1 WLR 1126 at 1129 per Lord Wilberforce; [1973] 2 All ER 1222 at 1225; *Phipps v Boardman* [1967] 2 AC 46 at 123 per Lord Upjohn.

97 *Brice v Stokes* (1805) 11 Ves 319 [32 ER 1111]; *Massey v Banner* (1820) 1 Jac & W 241 [37 ER 367]; *Speight v Gaunt* (1883) 9 App Cas 1.

from a more fundamental consideration which underpins the classification of some or all of these acts or omissions as dishonest or fraudulent.

138 As I have said earlier, the critical point is that, by putting himself in a position where his duty and interest conflicted, Mr Powles was in breach of his fiduciary duty. He sought and accepted the instructions which Nauru Trust gave him so that he might obtain, secretly, profit for himself. The material fact constituting this breach of fiduciary duty, upon which Nauru Trust could rely to make the appellants liable, was properly described as dishonest or fraudulent. That equity would have intervened in less reprehensible circumstances than those that occurred here is not significant for present purposes. It was the intention to make secret private profit which was not only a breach of fiduciary duty but also dishonest.

139 The consequences of that conflict were numerous. They included Mr Powles' theft of $US150,000, his lying about the price of the instrument, his not conveying to Nauru Trust information which he ought to have told it. Most importantly, but for the conflict, there would have been no transaction at all. That is, but for the breach of duty by Mr Powles, in undertaking fiduciary obligations to Nauru Trust when he had a conflicting and undisclosed personal interest in this transaction, the sum of $US8.7m would not have been transferred to the US dollar account. It would not have been transferred because, but for Mr Powles' pursuit of private gain, he would not have sought to act, or acted, in the transaction. He would not have taken any of the various steps he did to persuade Nauru Trust to invest in the "market" for these "prime bank instruments".

140 The transaction having gone awry as it did, albeit because of the carelessness of Mr Powles in paying away the $US8.55m, Mr Powles, and the appellants, would be liable to compensate Nauru Trust for the whole of its loss, not just for the $US150,000 Mr Powles stole.

141 That being so, the civil liability which the appellants owed to Nauru Trust was a liability to compensate the Trust for the whole sum of $US8.7m. That liability was brought about by Mr Powles' breach of fiduciary duty. The material facts establishing that liability were his dishonest or fraudulent acts or omissions in putting himself in a position where his duty and interest conflicted. The dishonesty and fraud exclusion therefore applied.

142 The appeal should be dismissed with costs.

CALLINAN J.

The Issue

143 The issue in this case is whether the conduct of a solicitor in paying away a client's money in pursuance of what turned out to be a fraudulent investment scheme fell within the exclusion contained in a professional indemnity insurance policy in these terms:

> "**5. GENERAL EXCLUSIONS**
>
> ...
>
> [f] This Insurance shall not indemnify the Assured in respect of any liability:-
>
> ...
>
> [v] brought about by the dishonest or fraudulent act or omission of the Assured including any Partner or former Partner of the Assured. Save that this exclusion shall not apply to liability arising out of any claim brought about by the dishonest or fraudulent act or omission of any person employed in connection with the Practice ..."

Facts

144 Ronald Adrian Powles was for many years a partner in an Australian firm of solicitors, Allen Allen & Hemsley ("Allens"). Unbeknown to his partners he had, from 1980, engaged in the systematic defrauding of clients by misappropriating their money to himself. As the trial judge Hunter J said, he constantly faced exposure of his criminal conduct. In October 1989 Powles became the resident partner of the firm in London. He soon became interested in a "mysterious" market ("the market"), for prime bank instruments ("PBI"). I say "mysterious" because those who promoted it were as emphatic about the fabulous profits it promised as they were vague about its mechanics and participants. Those with whom Powles discussed the market and with whom he dealt, used commercial terms inappropriately, indeed bizarrely, to give the dealings a spurious air of legitimacy and secrecy.

145 In placing funds in the market, Powles intended to, and, in respect of the "investment" the subject of these proceedings, in fact did derive a secret commission. The taking of such a commission was, in the circumstances, dishonest and a fraud upon his partners and those for whom he was acting.

146 Before the transaction with which this case is concerned Powles came to learn of, and indeed was a party to, losses incurred by investors in the market. He had no personal knowledge of any successful investment in it.

147 Mr MacSporran was a Victorian lawyer who acted for the Republic of Nauru Financial Corporation ("Ronfin"). Mr Madden was a Canadian Queen's Counsel with whom Powles had dealt in earlier failed attempts to invest in instruments. On 5 October 1991 Madden represented in writing to MacSporran that he was "able to procure Prime Bank Standby Letters of Credit ('SBLC') ICC format 3039, Prime Bank Guarantees ('PBG') and Prime Bank Promissory Notes ('PBPN')". Ronfin expressed an interest in investing in such instruments. Madden then proposed to MacSporran that Ronfin request a line of credit from Citibank secured against an SBLC, a PBPN, or a PBG. Discussions and correspondence between MacSporran and Madden ensued, in the case of Madden in the name of a company he controlled (Linpar). In due course it became clear that the "investor" which would provide the funds was the Nauru Phosphate Royalties Trust ("the Trust").

148 There is no point in trying to make commercial sense out of the transactions because they are, as the trial judge pointed out, nonsensical. Nor is anything to be gained by dwelling on the details of the failed attempts by Powles and others before October 1991 to obtain details of the market and to invest in it. It is sufficient for present purposes to note that these occurred several times.

149 I start at a point in October 1991 when it was decided by Powles to use an account which he conducted in London[98] as an Allens account ("the US dollar account"), as the first recipient of funds which it was by then contemplated would be "invested" by the Trust, with the assistance of Powles and Madden, in the market. Powles and Madden had also by then made arrangements for the siphoning off of secret commissions and the division of them, although the latter did not confide in the former, and they were not close collaborators.

150 Linpar made what it then described as a final proposal to the Trust on 3 December 1991 for the purchase of "Prime Bank Credit Investments" which could be sold after acquisition. Allens were to be "custodians". A rollover programme of 10 days was suggested. A "conservative" estimate of a profit of $US1,044,000 to the Trust was made and communicated by Linpar to the trustees.

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98 In order to carry out his investment activities, Powles established an account with the London branch of the Australian bank Westpac. This account was opened without the authority of the other Allens partners.

151 The trustees of the Trust met on 4 December 1991 in Melbourne. They concluded that they needed more time to consider the proposal and references for Madden and Linpar.

152 On the same day (European time) Linpar told Powles in writing that the Trust had approved a rollover programme to fund up to $US19.3 million (and possibly multiples thereof) for the purchase of PBPNs: that the funds would be sent to Allens' "trust account" at the Westpac bank, pending advice as to their disposition; and that Powles should provide a reference for Linpar and Madden, the suggested text of which was set out in the communication, and which, in the event, Powles largely adopted, engrossed and sent. Among other things it mentioned Madden's "extensive banking and financial background" and claimed that "we [Allens] are holding in trust substantial moneys, in United States dollars, for various transactions involving this corporation." The reference concluded with this paragraph:

> "I can confirm that Linpar Limited is capable, in my opinion, of fulfilling its stated objectives to and for your Trust."

153 Madden also spoke in his dealings with Powles of a purchase of instruments "through 'counsel in Florida'" by means of "conditional swift wire transfer". He said that Allens should open an account with the Guernsey branch of the Bank of Butterfield to trade in securities of the kind that they had discussed.

154 On 17 December 1991 Madden sent a facsimile to the Trust which included this paragraph:

> "May the writer respectfully suggest, notwithstanding the Chairman may not yet have been briefed, that you arrange the initial advance of the USD $8.7 Million to Allen's trust account at Westpac in London. The clear direction with the funds would be that the funds would not be utilised until either the Chairman had approved or the Instrument be purchased in the name of the Trust, but not sold until the Chairman approved."

There was no evidence that Powles became aware of the contents of this facsimile.

155 On the next day Madden sent this facsimile to the Trust:

> "Kindly, when drafting the terms of your letter to Allen's set forth that LIN/PAR LIMITED will have the authority to work with the subject funds, whereby LIN/PAR LIMITED will purchase, in the name of Nauru Phosphate Trust or Allen Allen & Hemsley on behalf of the Nauru Phosphate Trust, the requisite Instrument and will have the authority to

proceed to sell the same, after the hold period, with the funds to be remitted in full by the Purchasing Trust to the afore-said account of Allen Allen & Hemsley, to facilitate the second (and subsequent) purchases/resales."

156 Powles' intention to take a secret commission was established by his acting upon a "note 'for discussion'" that he received from Madden and which was in this form:

"For Pat only for discussion

Buying	T/7 to AAH		8.7m	
	Commission Payable		.1m	
	net		8.6m	
	cost of SBLC		8.4m	
	left		200k	
	To Adrian		50k	
	Linpar		150k	
Selling	Sell Price	9.1m	9.0m	
	Cost to Trust		8.7	8.7
		.4	.3	
	Nauru Trust	160k	120k	
	#%			
	Linpar/McSporran	240k	180k	

Pls call to discuss"

157 On 23 December 1991, the first transfer of funds from the Trust occurred of $US8.7 million which were paid into the US dollar account. The receipt was confirmed by Powles on the same day in a facsimile to Dougall, as administration manager of the Trust.

158 Attempts were then made to purchase instruments. On 31 December 1991, by facsimile of that date, Powles instructed Westpac to draw on the US dollar account in which the funds of the Trust had been deposited, the sum of $US8,525,000 by bank draft in favour of the Union Bank of Switzerland, London

branch, and that the draft be delivered to "our client Mr Patrick Madden". These instructions were given by Powles to Westpac while he was on holiday at Val d'Isére and where he remained until 5 January 1992. It is likely that he did not receive, until 6 January 1992, a facsimile from the Trust to Allens of 31 December 1991 requesting, as a matter of urgency, a "copy of [the] prime bank coupon".

159 Attempts to purchase an instrument at this stage failed but Powles was able to retrieve the sum of $US8,525,000 that had been paid out of the Westpac account.

160 Powles remained determined to purchase an instrument or instruments on behalf of the Trust. He had communications about such a purchase with various shadowy people who have not so far been mentioned and whose identity is not central to this appeal. He was at about this time invited however by Madden to open an account with the Commonwealth National Bank Limited ("Commonwealth"), a "small private bank in Antigua" to facilitate a purchase of an instrument.

161 On or about 14 January 1992 while he was in Geneva, in response to Madden's invitation Powles caused a letter of instructions to be sent by Allens in London to Westpac to transfer $US8.55 million from the US dollar account to an AMGLASBY (Commonwealth) account at Barclays Bank. These instructions, were, after some misunderstandings, carried out, but Powles made no attempt to control the funds by imposing an unambiguous condition that they be held until the instrument was delivered or any other suitably precautionary conditions.

162 On 16 January 1992, Powles sent this facsimile to the Trust although the funds remained in the banking system in the United Kingdom until 28 January 1992 and no purchase had yet been made:

> "This letter will confirm that Linpar Limited has completed the purchase on your behalf of a US$10,000,000 Letter of Credit.
>
> We are now awaiting delivery of the original instrument registered in the name of your Trust.
>
> Mr Madden and I met today with Mr Baltz Voellmin, Director of Fides (Credit Suisse) and have made firm arrangements for the sale of this and future instruments."

163 The funds were in fact lost, undoubtedly by their theft by a person or persons whose whereabouts cannot be traced and against whom there can presumably be no effective recourse, between 17 and 28 January 1992. They have disappeared in an untraceable way in the Swiss banking system. It is not

clear when Powles realised this to be so, but, for as long as he could, he concealed the loss from the Trust.

164 After the loss of the Trust's funds Powles, and others, continued to join in giving further false assurances to the Trust that the instrument had been obtained, had been rolled over and had yielded profits on each rollover. These deceptions continued over many months.

165 On 27 October 1992 an officer of the Trust finally wrote a letter to Allens which summarised the Trust's unsatisfactory dealings with Powles:

> "The Chairman of the Trust, Mr Reuben Kun, has instructed me to bring the following matter to your urgent attention.
>
> The Nauru Phosphate Royalties Trust entered into a business arrangement in which Mr Adrian Powles, as a resident Partner in your London office, undertook a fiduciary role on behalf of the Trust. The members of the Trust were significantly influenced in agreeing to this business arrangement because of Mr Powles' position as a Partner in one of Australia's leading law firms (Allen Allen & Hemsley), as well as Mr Powles' knowledge and experience in the matters covered by this arrangement. The Trustees derived comfort from Mr Powles' Partnership in Allen Allen & Hemsley because of the integrity and professionalism that a Partnership implies together with the professional indemnity cover that Allen Allen & Hemsley undoubtedly provides.
>
> The funds controlled by Mr Powles on behalf of the Trust were initially sent to Allen Allen & Hemsleys [sic] Trust account with Westpac in London, and were in the name of the Trust with Mr Powles as a signatory, or in the name of Mr Powles as trustee for the Trust. The funds were to be at all times under the control of Mr Powles and he gave assurances on a number of occasions that this was so. Given the non-performance of the activity, instructions were given for transactions to cease and subsequently for funds to be transferred from accounts of the Trust controlled by Mr Powles to an account of the Trust under its direct control.
>
> These instructions have been made in very clear and specific terms on a number of occasions over a period of time, but have not been actioned. Similarly, ongoing requests have been made for details of movements in the Trust's accounts controlled on its behalf by Mr Powles, again with no action or explanation.
>
> Relevant documents relating to the recent instructions to transfer funds are enclosed.

> Accordingly, the Trust is most concerned by Mr Powles' failure to respond to these instructions and to provide a full accounting of transactions involving the Trust's funds.
>
> The Trust is very much alarmed by Mr Powles' failure to respond to its instructions and by the absence of any explanations for this behaviour. The members of the Trust seek your assistance in the immediate resolution of this matter and wish to note that if you are unable to assist, or are not successful, the Trust has appointed legal and accounting representatives in London so it may take all steps necessary to protect its interests."

166 Powles was a party to, and engaged in fraudulent transactions in relation to other funds of the Trust. One such transaction occurred in February 1992.

167 On 10 February, on the instructions of Powles, Westpac London directed Westpac New York to transfer $US8.55 million to Madden in an account with the Texas Commerce Bank. That instruction was carried out. Those funds came from other trust funds placed with Powles for the purpose of purchasing PBPNs. Powles had no authority from the Trust to make that transfer, and, although it was undoubtedly done on the immediate instructions of Madden, it is clear that the funds were misapplied in attempting to purchase SBLCs for the Trust and were transferred in anticipation of the apparent likely failure of the first transaction.

The Trial

168 The evidence at the trial before the Supreme Court of New South Wales (Hunter J)[99] consisted almost entirely of documents, an agreed statement of facts, and written statements by witnesses. In the end, most of the facts, as to the communications between those involved in the transaction, the theft of the funds, the matter of the secret commissions, Powles' deceptions and misappropriations before and after the relevant transaction, and the extent of the loss were put beyond dispute. The issue of substance was whether on those facts the respondents could bring the conduct of Powles within the exclusion contained in the policies.

169 His Honour's most complete summary of his opinion about Powles' state of mind was set out in the following passage[100]:

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99 Unreported, Supreme Court of New South Wales, 26 June 1998.

100 Unreported, Supreme Court of New South Wales, 26 June 1998 at 223.

> "I think I have said on a number of occasions that I have been left in no doubt at all that Powles had no intention to defraud the Nauruan Trust of the subject 8.55 million. I am as satisfied as I would wish to be that to the end, notwithstanding his scepticism of the capacity of those with whom he was dealing to gain access to the pbi market, that he maintained a belief in its existence. I think the evidence abounds with the clearest indication of that: notwithstanding his well founded distrust of a number of individuals on the fringe of that market activity. I have endeavoured to make findings to that effect from time to time in the preceding review of the evidence. Some that come to mind related to Powles' dealings with such reputable entities as Westpac in its New York, London and, particularly, Jersey branches, Citibank, Bank of Ireland, Merrill Lynch and Amex. All were dealings in which the pbi market was openly discussed and I find it inconceivable that Powles would have so conducted himself had he no real belief in the existence of the pbi market. I have found it important to distinguish that belief from his well credentialled scepticism of the ability of those surrounding him to gain access effectively to that market. I have also regarded it as important to separate that mind set of Powles from his general predatory conduct in relation to funds under his control."

170 His Honour then went on to find that in a number of respects in relation to the Trust's funds of $US8.55 million Powles had acted dishonestly, before turning to the issue of "causation". His conclusion was that Powles' dishonest conduct, was not that which "brought about the liability of Allens", although clearly the firm was liable to the Trust for breach of duty: the fraud that actually brought about the loss of the sum of $US8.55 million was the fraud of others after the money had passed out of Powles' control.

171 His Honour's conclusions on the meaning of the exclusion were set out in this passage[101]:

> "I am satisfied that the insuring clause does not require the proof of a proximate cause giving rise to a claim in respect of civil liability. It is sufficient for the purpose of the insuring clause that the claim arises from a sufficient contributing cause within the meaning of *March v Stramare (E & M H) Pty Ltd*[102]. By contrast, in the operation of the dishonesty exclusion it is necessary for the excess insurers to prove that the proximate cause of Allens' liability to the Nauruan Trust was Powles' dishonest conduct: this by reason of the necessity to satisfy the requirement that the

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101 Unreported, Supreme Court of New South Wales, 26 June 1998 at 260-261.

102 (1991) 171 CLR 506.

> liability be 'brought about' by Powles' dishonest conduct. It may have been otherwise had the insurers chosen to use a wider expression, such as, 'arising out of' or 'arising from' such dishonest conduct or 'directly or indirectly brought about by' such conduct. As it stands, the expression 'brought about' is synonymous with 'caused' and, in insurance law, that calls for the identification of the proximate cause. Upon the facts of this case I have no doubt that the proximate cause of Allens' liability was the premeditated fraud on the Nauruan Trust perpetrated in the Commonwealth fraud. The manner in which the funds immediately left the English banking system; the timing of the setting up of vehicle Swiss bank accounts; the contempt with which Powles' instructions were treated for the payment of those funds to his Commonwealth account and then into the RTIC account; the swift passage through the English banking system on 28 January 1992 into the labyrinth of Swiss bank accounts thereafter are all testimony to the despicable conduct of those associated with the Commonwealth fraud on the Nauruan Trust. Powles was just as much a victim of that fraud as was the Nauruan Trust."

172 Accordingly, his Honour found for the appellant in respect of the firm's liability to pay the Trust $US8.55 million, up to the levels of the sum insured by each of the respondents.

The Appeal to the Court of Appeal of New South Wales

173 In taking a different view from the trial judge of the relationship between Powles' undeniably dishonest conduct and the loss that the Trust sustained, the Court of Appeal (Mason P, Stein and Giles JJA)[103] said that the two cases[104] upon which his Honour relied did not hold that a proximate cause, as distinct from some other kind of cause, had to be established in insurance law to enable the exclusion to be invoked.

174 In the course of reaching their decision their Honours examined for themselves the conduct of Powles before, during, and after the loss of the Trust's fund of $US8.55 million.

175 The Court of Appeal catalogued in some detail instances of Powles' dishonesty ("the dishonesty catalogue"). Their Honours referred to Powles'

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103 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446.

104 *Comino v Manettas* (1993) 7 ANZ Insurance Cases ¶61-162 per Mahoney, Sheller and Cripps JJA; *Underwriters at Lloyds v Ellis* unreported, Court of Appeal of New South Wales, 25 February 1998 per Meagher, Handley and Powell JJA.

vested interest in the transaction because of the secret commission he and others stood to gain from it. He needed money to conceal his other frauds. He gave eight or more false and dishonest references to persons (including to the Trust) seeking to deal with the PBI market out of self-interest in obtaining other secret commissions. He did not disclose other, earlier failures, up to 17 of them, to "invest" in the market. Neither Powles, nor anyone else, was holding, as represented to the Trust, "substantial moneys, in US dollars, for various transactions involving Linpar" although at the time, $US252,000 were held and were about to be misappropriated by him and Madden. Powles could not honestly hold the opinion which he gave (and which he expressly described as an opinion) that Linpar was capable of fulfilling its stated objective to and for the Trust. Powles knew at material times but did not disclose to the Trust that the Bank of England denied the existence of the market and did not regulate it. The money when received would not be held in a true trust account. Powles failed to disclose that intermediaries would participate in the transaction and that money had been lost in earlier failed attempts to "invest" in the market. Powles placed himself, on any view, in a position of massive conflict of interest and acted in breach of trust.

176 The key conclusions of the Court of Appeal on the basis of the dishonesty catalogue are set out in the following passages[105]:

> "There is no room for any doubt that Powles received the US$8.7 million from the Nauruan Trust and paid away US$8.55 million of it in serious conflict of interest and in breach of trust. His duty was to ensure that the funds were used only for the purpose of acquiring the letter of credit and to safeguard the funds pending delivery of the instrument or security. However, Powles' self-interest was to obtain a transaction so he could earn commissions in fraud of his partners on this and, he hoped, subsequent transactions. The trial judge was correct to characterise Powles' conflict as exacerbated by his great need for substantial funds to cover his fraud of clients' trust moneys and to say that his propensity was to prefer his own interest to that of the Trust if they clashed. The reference given to the Trust on 4 December 1991 is a powerful illustration of Powles preference for his own self-interest. In our opinion, the reference was more than imprudent, it was dishonest. As we have already mentioned, many of the statements in the letter were clearly false to Powles' knowledge. Importantly, the reference deliberately concealed information from the Trust which was very relevant for it to know – for example, the presence of fraudsters in the market, Linpar's poor track-record and that the Trust's moneys would not be in Allens' safe custody,

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105 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,116-75,117.

rather in Powles' who was seeking to make commissions out of a transaction kept secret from Allens (and the Trust). These were serious omissions. Nor did Powles reveal that, subsequent to 4 December 1991, moneys had been lost on two further occasions involving Madden and Searle. In addition, the reports which Powles gave to the Trust, or acquiesced in up to 14 January 1992, did not disclose the true position of the failed attempts to acquire an instrument. Those reports were also dishonest.

As Hunter J found, the moneys were paid away by Powles with undue haste and with no attempt whatsoever to check the credentials of the Commonwealth. Further, Powles took no steps to do any more than mirror the instructions of Madden and Searle, the latter being known to Powles as probably dishonest and certainly unreliable, and notwithstanding the 'seamy' relationship found by his Honour to exist between him and Madden. Powles also failed to seek to impose any unambiguous condition that the funds be held until receipt of the security and in a situation where he knew that the market had more than its share of predators.

His Honour made some findings favourable to Powles in relation to his belief that the Commonwealth was required to retain the funds pending delivery of the security and that Powles did not know or imagine that there was a risk of loss of the funds; further, that Powles believed in the market from which substantial profits could be made, notwithstanding its difficulty of access and presence of fraudsters. Even if this be accepted, Powles' actions were still dishonest, as Hunter J makes plain in relation to Powles' preference for his own self-interest."

177 Their Honours then drew inferences upon which they elaborated[106]:

"On consideration of all the relevant evidence, the irresistible conclusion to which we are driven is that Powles must have appreciated the real risk of loss of the moneys. That Powles may have deluded himself into believing in the existence of the pbi market and that the market could be accessed without loss, must be offset against the abundance of evidence which told him that this was no more than wishful thinking, probably wishful thinking engendered by his own desperate situation. Plainly Powles would have known his duty to seek the fully informed consent of the Trust to the commission he stood to make. This dishonesty was compounded by his complicity in an arrangement whereby Dougall, a Trust officer, would receive secret commissions, as would

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106 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,117-75,118.

Voellmin, with Powles as the paymaster out of the US dollar account. To this may be added the patently false reports he made to the Trust on the status of the transaction as late as 16 January 1992 and, subsequent to 17 January 1992, in failing to reveal to the Trust the fate of its moneys. For example, on 3 February 1992 Powles gave a completely false confirmation to the Trust of the success of the transaction.

The conclusion is irresistible that Powles knew, because of the circumstances mentioned, that he was placing the Trust's moneys at considerable risk. The appellants suggest that the payment away of the moneys was an overt act pursuant to a conspiracy between Powles, Madden and others to make false representations to the Trust and to conceal material facts from it, in order to make secret commissions from the transactions. It is unnecessary to make such a finding and we stay from doing so, notwithstanding that it may be that such a conclusion was available on the evidence.

Summarising to this point, in our opinion, Hunter J was correct to find that Powles was dishonest in terms of the policy exclusion. The respondents' contention to the contrary is untenable. However, we would go further than his Honour and find that the evidence and inferences readily available to be drawn are compelling that Powles was also dishonest, indeed fraudulent, in relation to the further matters discussed above. It is readily apparent that Powles was in breach of the trust he owed to the Nauruan Trust. His breach of trust involved dishonesty on his part. Powles breached his mandate, which was to deal with the funds solely in accordance with the basis upon which they had been entrusted to him.

Further, Powles was in breach of his fiduciary duty to the Trust in the manner in which he paid away the funds. He failed to ensure that he retained control over the funds without obtaining the required bank instrument. In this regard, he failed to safeguard the funds pending delivery of the instrument. Powles parted with control of the funds in circumstances where he knew (or must have known) that he was placing them at a real and considerable risk of loss. He must have known that parting with the funds, without having acquired the instrument, would seriously endanger any successful recovery of the moneys."

178 In discussing the exclusion in the policy the Court of Appeal said this[107]:

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107 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,119.

"[T]he exclusion refers to liability brought about by Powles' dishonesty, not loss brought about by Powles' dishonesty. If there is a liability according to which Allens is liable for loss, the exclusion operates whether or not the loss was proximately caused by the acts or omissions giving rise to the liability and whether or not the loss was proximately caused by Powles' dishonesty. It is enough that the liability is brought about by the dishonesty and the loss flows, according to whatever is the appropriate concept of causation, from the breach of duty giving rise to the liability."

179 Slightly different language was used by their Honours a little later[108]:

"It seems crystal clear that Powles' dishonest conduct exposed Allens to a liability to the Nauruan Trust for any loss that it suffered in consequence of that conduct. It matters not that a further act by another party or parties may have been necessary to convert the risk of loss into actual loss. The loss would not have occurred if there had been no breach by Powles, but more, the breach by Powles, in circumstances of dishonesty, was causally related to the loss because it exposed Allens to liability to the Trust and the risk of loss all but inevitably became an actual loss. In our view, returning to the words of the policy, Allens' liability was brought about by Powles' dishonesty."

180 Their Honours also said this[109]:

"In allowing the funds to leave the English banking system on or about 15 January 1992, in the circumstances that Powles did, he was in breach of his fiduciary duty and in breach of his trust to the Nauruan Trust. That created the liability, and one which was immediate in that it produced a liability in equity for Allens to restore the funds then and there[110]. Further, it was an act by Powles which, in the circumstances we have described, was so tainted by dishonesty as to engage the exclusion."

181 And finally they stated this opinion[111]:

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108 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,120.

109 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,121.

110 See *Target Holdings Ltd v Redferns* [1996] AC 421 at 434, 437.

111 *Switzerland Insurance Australia Ltd v McCann* (1999) 10 ANZ Insurance Cases ¶61-446 at 75,121.

> "We briefly refer to an alternative approach sufficient to resolve this issue. If the words 'brought about by' reflect the concept of 'proximate cause' (which we do not accept) then what is plain is that the law accepts that there may be more than one proximate cause of a loss, and a mere later fraud, closer in time to the loss, does not alter the proximate nature of the earlier dishonest act[112]. The evidence (much of which has been referred to) overwhelmingly establishes that Powles' dishonest conduct was one of the proximate causes of the loss."

182 The Court of Appeal therefore allowed the respondents' appeal.

The Appeal to this Court

183 Because of the way in which the trial was conducted, substantially on written materials, the trial judge did not enjoy such advantages as may flow from seeing and hearing witnesses and as might therefore have required the Court of Appeal to exercise greater restraint in reversing his Honour's findings on the nature of Powles' conduct, and its relationship with the liability for the loss that the Trust suffered. That circumstance has the consequence that this Court also should not regard itself as being at any disadvantage in assessing Powles' conduct, and the application of the exclusion in the policy to it.

184 The appellant takes as a starting point that notwithstanding the conclusion of the Court of Appeal adverse to the appellant, their Honours did not disagree with the trial judge's finding of fact that Powles did not intend that the $US8.55 million would be lost. Nor did the Court of Appeal disagree with the trial judge's finding that the manner in which the $US8.55 million was paid away by Powles was in accordance with the directions of Linpar. That this was the procedure that would initially occur was also known to the Trust. (See the facsimile, Madden to the Trust, 17 December 1991, set out earlier in these reasons.)

185 The appellant submits that the words "brought about by the dishonest or fraudulent act or omission of the Assured" must be read as a whole: that the exclusion is concerned with the purpose of the act or omission and whether it is achieved. The appellant urges that, read as a whole, the exclusion refers to conduct which has a dishonest or fraudulent character by reason of its desired end or purpose in bringing about harm to another by an intention to cheat or deceive.

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112 See *HIH Casualty and General Insurance Ltd v Waterwell Shipping Inc* (1998) 43 NSWLR 601 at 609-612 per Sheller JA applying *J J Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The "Miss Jay Jay")* [1987] 1 Lloyd's Rep 32.

186 There is a body of authority to support the appellant's submission. In *Crowe v Wheeler & Reynolds*[113] the Full Court of Queensland, Williams J (with whom Andrews CJ and Moynihan J agreed) said this[114]:

> "In my view the term 'dishonesty' should be applied in the way suggested by Fraser J. In the exclusion clause in question the term 'dishonesty' refers to an act involving some intent to deceive or cheat and that involves a question of fact to be determined in the circumstances of each particular case."

187 His Honour's reference to Fraser J was a reference to *Lynch & Co v US Fidelity & Guarantee Co* in which he said[115]:

> "But having the United States cases I think the weight of authority is against rather than in favour of giving the word 'dishonest' in such a policy a meaning that extends far beyond the meaning of that word in popular usage in this jurisdiction. From a review of those cases the weight of authority seems to be that there must be something of the nature of intentional deception or concealment. The Shorter Oxford Dictionary, 3rd ed, in addition to certain obsolete meanings, gives 'dishonest' the following meanings:
>
> 4. of actions etc not straightforward or honourable; underhand; now, fraudulent, knavish.
>
> 5. of persons, wanting in honesty disposed to cheat or defraud; thievish.
>
> 'Dishonest' is a word of such common use that I should not have thought that it could give rise to any serious difficulty, but in construing even plain words regard must be had to the context and circumstances in which they are used[116]. However, to try to put a gloss on an old and familiar English word which is in everyday use is often likely to complicate rather than to clarify. 'Dishonest' is normally used to describe an act where there has been some intent to deceive or cheat. To use it to describe acts which are merely reckless, disobedient or foolish is not in accordance with popular usage or the dictionary meaning. It is such a familiar word that there

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113 [1988] 1 Qd R 40.

114 [1988] 1 Qd R 40 at 43.

115 [1971] 1 OR 28 at 37-38.

116 *The Canadian Indemnity Co v Andrews & George Co Ltd* [1953] 1 SCR 19 at 24.

should be no difficulty in understanding it. In the present case there is nothing in either circumstances or the context requiring the Court to give it a meaning other than its popular sense."

188 In *H G & R Nominees Pty Ltd v Fava*[117] the Supreme Court of Victoria, JD Phillips J took the view that dishonesty referred to conscious and deliberate conduct and the New South Wales Court of Appeal (Mahoney, Sheller and Cripps JJA) reached a similar conclusion in *Comino v Manettas*[118]. In my opinion the reasoning in those cases is correct and I would adopt it in this case.

189 In my view the respondents failed, as the trial judge held, to establish that the relevant conduct falls within the exclusion as I would construe it, giving "dishonesty" the meaning which I consider has been correctly settled by the authorities to which I have referred.

190 The concept of causation as it has evolved[119] (not always consistently) in the law of tort can have no automatic application, nor indeed is it able to throw much light upon the meaning of an exclusion in an insurance contract which does not contain the word "cause" and uses other language which is markedly different and quite specific. In order to fall within the exclusion, the liability must be a liability brought about by the dishonest or fraudulent acts or omissions of the assured, relevantly here Powles. The clause does not say "brought about, substantially, or partly, by dishonest or fraudulent acts or omissions, or a liability to which a dishonest or fraudulent act has made a significant[120], major, or material or dominant[121] contribution". Nor does the exclusion in terms purport to operate when conduct is, to use language employed by the Court of Appeal "tainted" by dishonesty, or when, again to adapt slightly another expression used by the Court of Appeal, there is a *relationship* between the conduct and the liability. The word "liability" cannot be read in a vacuum. True it is that Allens were liable to the Trust under several heads of claim, including negligence and

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117 [1997] 2 VR 368 at 418, 421. See also *Brooks Tarlton Gilbert Douglas & Kressler v United States Fire Insurance Co* 832 F 2d 1358 at 1369-1370 (1987).

118 (1993) 7 ANZ Insurance Cases ¶61-162.

119 In *Inman Steamship Company v Bischoff* (1882) 7 App Cas 670 at 683 per Lord Blackburn referring to the "philosophical mazes" of cause and effect.

120 See, in a criminal context, *Royall v The Queen* (1991) 172 CLR 378 at 398 per Brennan J, 441 per McHugh J and *Osland v The Queen* (1998) 197 CLR 316 at 403 [221] per Callinan J.

121 *La Compania Martiartu v Royal Exchange Assurance* [1923] 1 KB 650 at 657 per Scrutton LJ.

breach of fiduciary duty, but liability under those heads did not bring about the liability for the loss the subject of the exclusion. The exclusion was not concerned with these. Its purpose was to set apart for separate treatment, and to accord relief to the insurer from, any obligation to indemnify in the case of operative dishonesty or fraud. The liability has to be a liability for something, in this case, to repay the sum of $US8.55 million to the Trust, and the relevant liability for that obligation has to be brought about, by the, or a, dishonest or fraudulent act or omission in the sense to which I have referred. There is no need to put upon the words "brought about by" the sort of gloss, that has now become firmly attached to the word "caused", that a material[122] contribution may constitute a cause, and that a contributory cause[123] may be sufficient to constitute, in effect, the cause for the purposes of the law of tort. This and the decline as an exclusive test, of the "but for" test have led to the making of value judgments by courts in assessing liability in torts. As McHugh J said in *Chappel v Hart*[124]:

> "Consequently, value judgments and policy as well as our 'experience of the "constant conjunction" or "regular sequence" of pairs of events in nature'[125] are regarded as central to the common law's conception of causation."

191 In *Comino v Manettas*[126] Mahoney JA too (with whom Sheller and Cripps JJA agreed) in giving the words "brought about by" a fairly strict construction distinguished them from other expressions[127]:

> "It is clear that 'cause' is a term which may be used to describe relationships of different kinds. The several categories of cause were recognised long ago by Aristotle. The distinctions have since been multiplied[128]. In *Barnes v Hay*[129], this Court considered the nature of the

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122 *Chappel v Hart* (1998) 195 CLR 232 at 239 [10] per Gaudron J.

123 *Fitzgerald v Penn* (1954) 91 CLR 268 at 276. See also *Chappel v Hart* (1998) 195 CLR 232 at 243 [24] per McHugh J, and also, in a criminal context, *Osland v The Queen* (1998) 197 CLR 316 at 403 [221] per Callinan J.

124 (1998) 195 CLR 232 at 243 [24].

125 Hart and Honoré, *Causation in the Law*, 2nd ed (1985) at 14.

126 (1993) 7 ANZ Insurance Cases ¶61-162.

127 (1993) 7 ANZ Insurance Cases ¶61-162 at 77,869-77,870.

128 Hart and Honoré, *Causation in the Law*, 2nd ed (1985) at 26.

129 (1988) 12 NSWLR 337.

causal relationship existing between the giving, or failure to give legal advice and the occurrence of the event to which the advice was to be directed. More recently, the High Court in examining the nature of the causal relationship between careless driving and a subsequent collision, has considered causal issues generally[130]. It is necessary in the present case to determine whether the relationship denoted by 'brought about by' is one which includes all of these various relationships and if not which of them is that which was intended.

Counsel have not been able to refer the court to any judicial consideration of 'brought about by'. Cole J, in his consideration of this aspect of the matter, concluded that the relationship between the attestation and certification defaults, or at least the latter, was causal because 'without those dishonest acts there would have been no completed transaction. Had the certificate been true, in that the Dylcu loan agreement had been explained to the guarantors, the divergence between the GIO's requirement of a joint and several guarantee and Mr Manettas' willingness to give only a one third several guarantee would have become starkly apparent and the transaction would have terminated'.

In my respectful opinion, that relationship between the default and the liability, though in one sense causal, is not causal in the sense intended by the words 'brought about by' in the exclusion clause. It is, I think, an over-simplification to say that 'brought about by' intends a 'causa causans' causal relationship and that the one which, as his Honour pointed out, existed between these defaults and the liability was, at best, the relationship of 'causa sine qua non'. But that distinction assists, I believe, in understanding the nature of the relationship intended by 'brought about by'. The phrase looks to what actually brought about the liability, in negligence, tort or otherwise".

192 Kirby J in *Chappel v Hart*[131] pointed out that for torts the "but for" test had not been completely discarded, and it may be that in some cases it will still be an appropriate test of causation. His Honour too referred to the multiplicity of expressions which have been used to qualify, and are a gloss upon the word "cause": proximate cause, direct cause, legal cause, foreseeable cause, true cause, effective cause, substantial cause or cause in fact[132]. His Honour also gave some examples of matters which might displace apparent causation, the last of

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130 *March v Stramare (E & M H) Pty Ltd* (1991) 171 CLR 506.

131 (1998) 195 CLR 232 at 269 [93].

132 See also *The Commonwealth v Butler* (1958) 102 CLR 465 at 479 per Windeyer J.

which might be apposite here if different language from "brought about by" had been used in the exclusion[133]:

> "In certain circumstances, the appearance that there is a causal connection between the breach and the damage, arising from the application of the 'but for' test and the proximity of the happening of the damage, has been displaced by a demonstration that:
>
> (a) The happening of the damage was purely coincidental and had no more than a time connection with the breach[134];
>
> (b) The damage was inevitable and would probably have occurred even without the breach, for example by the natural progression of an undetected, undiagnosed or unrevealed condition[135], or because the condition presented a life threatening emergency which demanded instant responses without time for the usual warnings and consents[136];
>
> (c) The event was logically irrelevant to the actual damage which occurred[137];
>
> (d) The event was the immediate result of unreasonable action on the part of the plaintiff[138]; or
>
> (e) The event was ineffective as a cause of the damage, given that the event which occurred would probably have occurred in the same way even had the breach not happened[139]."

193 It is unnecessary, and would be wrong to bring to bear upon the construction to be placed upon the wording of the exclusion, the learning, the

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133 (1998) 195 CLR 232 at 271 [93].

134 See, for example, *Central of Georgia Railway Co v Price* 32 SE 77 (Ga 1898).

135 See, for example, *Hotson v East Berkshire Area Health Authority* [1987] AC 750; *Laferrière v Lawson* [1991] 1 SCR 541.

136 Milstein, "Causation in Medical Negligence – Recent Developments", (1997) 6 *Australian Health Law Bulletin* 21 at 22-23.

137 *Leask Timber and Hardware Pty Ltd v Thorne* (1961) 106 CLR 33 at 39, 46.

138 *M'Kew v Holland & Hannen & Cubitts (Scotland) Ltd* [1970] SC (HL) 20.

139 *Daniels v Anderson* (1995) 37 NSWLR 438 at 539.

competing philosophies, and the different theories regarding what should or should not be a sufficient cause for the purposes of the law of tort. Even if however one were to do so I doubt whether the conduct of Powles here would satisfy most, or indeed any, of the variously expressed tests of causation except perhaps a "but for" test. The application of the variously expressed tests has almost certainly been affected by the opportunity to apportion liability available to judges and juries in most common law jurisdictions after the passage of the *Law Reform (Contributory Negligence) Act* 1945 (UK) and its analogues in other jurisdictions soon afterwards.

194 The law of tort that has developed, and which in many cases allows a remedy to a person damnified as a result of a wrong which is a concurrent wrong only, or a material or significant contributing cause only, should not be allowed to dominate and determine the proper construction of the language of an insurance exclusion which does not even use the word "cause". Mason and Wilson JJ in *Shipping Corporation of India Ltd v Gamlen Chemical Co (Australasia) Pty Ltd*[140] said that as a matter of strict construction (of one of the Hague Rules relating to shipping) if a loss occurs as a result of two concurrent, and therefore joint causes, it cannot be said that the loss resulted from one of them.

195 The approach which I prefer, although it does not adopt a test of "proximate efficiency", a test which has in fact been applied in insurance law in Australia[141], England[142], New Zealand[143], Canada[144] and the United States[145], is not inconsistent with that test. "Proximity" as a test has also received legislative

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140 (1980) 147 CLR 142 at 164.

141 See, for example, *National & General Insurance Co Ltd v Chick* [1984] 2 NSWLR 86 at 97; *City Centre Cold Store Pty Ltd v Preservatrice Skandia Insurance Ltd* (1985) 3 NSWLR 739 at 742 per Clarke J.

142 See Lord Denning in *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corporation Ltd* [1974] QB 57 who applied "effective or dominant cause" as "settled" law in England.

143 See, for example, *Techni-Chemicals Products Co Ltd v South British Insurance Co Ltd* [1977] 1 NZLR 311 at 319.

144 See, for example, *Co-operative Fire & Casualty Co v Saindon* [1976] 1 SCR 735.

145 See, for example, *Sabella v Wisler* 377 P 2d 889 (Calif 1963) as applied in *Garvey v State Farm Fire and Casualty Co* 770 P 2d 704 (Calif 1989); distinguishing *State Farm Mutual Automobile Insurance Co v Partridge* 514 P 2d 123 (Calif 1973).

recognition in s 61(1) of the *Marine Insurance Act* 1909 (Cth)[146]. And it has been held, by contrast, that if a policy states that the insured is covered against losses "arising out of" the insured perils, there is no requirement that the loss be proximately caused by the peril[147]. All that is necessary is that there be some "non-coincidental nexus" between the peril and the loss[148].

196 Other forms of words that impose a lesser requirement of causal connection than proximate cause are "directly or indirectly caused by"[149], "traceable to"[150] and "occasioned by or happening through"[151].

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146 "Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against."

See also *Government Insurance Office of NSW v R J Green & Lloyd Pty Ltd* (1966) 114 CLR 437 at 447 per Windeyer J; *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513; *Transport Accident Commission v Jewell* [1995] 1 VR 300 at 306 per Tadgell J.

147 *Government Insurance Office of NSW v R J Green & Lloyd Pty Ltd* (1966) 114 CLR 437; *State Government Insurance Commission v Stevens Bros Pty Ltd* (1984) 154 CLR 552; *Dickinson v Motor Vehicle Insurance Trust* (1987) 163 CLR 500; *Transport Accident Commission v Jewell* [1995] 1 VR 300 at 306 per Tadgell J.

148 *Lamont v Motor Accidents Board* [1983] 1 VR 88 at 96 per Tadgell J; *Transport Accident Commission v Hoffman* [1989] VR 197 at 201 per Young CJ and McGarvie J. If the word "directly" appears before "arising from" the effect of the expression is changed. It then requires a "direct and sufficient non-coincidental nexus": see *Transport Accident Commission v Treloar* [1992] 1 VR 447 at 452 per McGarvie and Gobbo JJ; *Transport Accident Commission v Jewell* [1995] 1 VR 300 at 307-308 per Tadgell J.

149 *Mitor Investments Pty Ltd v General Accident Fire and Life Assurance Corporation Ltd* [1984] WAR 365.

150 *Phoenix Assurance Co of Australia Ltd v Liddy* (1984) 3 ANZ Insurance Cases ¶60-596.

151 *Switzerland General Insurance Co Ltd v Lebah Products Pty Ltd* (1983) 2 ANZ Insurance Cases ¶60-498.

197 However, each case must be determined on its own facts according to the actual wording of the policy. As Gibbs CJ said in *Australian Casualty Co Ltd v Federico*[152]:

> "The ordinary rules of interpretation apply to a policy of insurance. As in the case of any other commercial contract, a court may depart from the strictly literal meaning of a particular expression to place upon it an alternative construction which is more reasonable and more in accord with the probable intention of the parties if the words will bear that construction … Further 'the trend is, if anything, to adopt a liberal interpretation in favour of the insured, so far as the ordinary and natural meaning of the words used by the insurers permit this to be done'".

But, Gibbs CJ did go on to give even the words "caused by" a fairly strict construction[153]:

> "However, the words 'caused by an accident' naturally refer to the proximate or direct cause of the injury, and not to a cause of the cause, or to the mere occasion of the injury."

198 Powles' conduct before the "investment" was undoubtedly one of repeated dishonesty and fraud. It is this conduct that the Court of Appeal has catalogued. The deposit of the funds in an account that was not a trust account so designated is of no relevance: Powles would still have been able to operate upon an Allens account however designated. The only dishonesty (in the sense in which that term need be considered and to which I have already referred) or fraud in relation to the "investment" were the deriving of a secret commission and possibly the giving of references in respect of Madden and Linpar. But the desire for the secret commission did not bring about the liability, or the loss, or, to put it as I think it should be put, the liability for the loss of the sum of $US8.55 million. The liability would have been incurred regardless of that dishonesty. Neither of these was an act or omission that brought about the loss. There were no doubt numerous omissions by Powles which contributed to, and were therefore perhaps "causal" in the tortious sense, of the liability for the loss, such as the omission to make proper inquiries and to communicate the results of them to the Trust. But what brought about the loss was the fraud of those who used the Swiss banking system to spirit away the money irretrievably. That the "investment" would have been made whether there was to be a secret commission or not, was in my view likely. Powles believed in the market. And although stupidity is not incompatible with criminality, he expected that an instrument would be obtained and would generate future profits, as would other such "investments" for the

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152 (1986) 160 CLR 513 at 520.

153 (1986) 160 CLR 513 at 521.

Trust. The dishonest conduct of Powles before the "investment" may well have been related to the loss of the Trust's money. It may even have tainted the relationship between it and the liability, but neither the fact of a relationship nor a tainting by the insured's conduct of it is sufficient to make the exclusion applicable. It requires that there be no less than an act or omission bringing about the liability, and not just a tainting or a related dishonest act or omission or series of them. And although subsequent conduct may often throw light on the nature of earlier conduct, the subsequent dishonesty of Powles in no way brought about the liability, or put any different complexion on the making of the investment by Powles.

199 Arguably, if a "but for" test were applicable, it might be possible to say, although in my opinion the evidence does not go quite far enough to do so, that, but for the desire for a secret commission, and further secret commissions, the "investment" would not have been made nor the money lost. But that is not an appropriate test to apply to the language of the exclusion.

200 I am fortified in this conclusion by the different language used in other parts of cl 5(f)[154]. Exclusions (i) and (ii) use the wider term "arising from".

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154 "**GENERAL EXCLUSIONS**

…

[f] This Insurance shall not indemnify the Assured in respect of any liability:-

[i] for damages arising from death, bodily injury, physical loss or physical damage to property of any kind whatsoever [other than property in the care, custody and control of the Assured in connection with the Practice for which the Assured is responsible, not being property occupied or used by the Assured for the purposes of the Practice];

[ii] arising from a contract other than a contract to provide services within the definition of 'the Practice';

[iii] to repay any monies charged as fees and disbursements or for costs incurred in relation to any dispute as to fees and disbursements;

[iv] for the payment of any trading debt incurred by the Assured;

[v] brought about by the dishonest or fraudulent act or omission of the Assured including any Partner or former Partner of the Assured. Save that this exclusion shall not apply to liability

(Footnote continues on next page)

Exclusion (vi) uses a very expansive expression, "directly or indirectly caused by or contributed to by, or arising from". Had that language been used in the relevant exclusion a different view of Powles' conduct and the insurers' rights in respect of it here might well have been open. But the expression "brought about by" in the dishonesty exclusion cl 5(f)(v), is much more direct causal language, indeed it is language of a most explicit kind.

201 There is one further aspect that has to be considered. Is the word "fraudulent" as used in the exclusion to be given the same alternative meaning as it has in the tort of deceit, that is, a meaning which embraces a misrepresentation made recklessly whose maker did not care whether it was true or false? I doubt it because of the contextual use of the word "dishonest" in the clause. But in any event I do not think that the reference given to the Trust in relation to Madden and Linpar was given without a belief in its truthfulness by Powles. It was his honest, if completely misconceived opinion that Madden could consummate the relevant purchase and future purchases of profitable instruments. As *Derry v Peek*[155] stresses, even gross negligence will not suffice to ground an action in deceit[156].

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arising out of any claim brought about by the dishonest or fraudulent act or omission of any person employed in connection with the Practice ...

[vi] directly or indirectly caused by or contributed to by, or arising from ionising radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel, the radioactive toxic explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof; directly occasioned by pressure waves caused by aircraft or other aerial devices travelling at sonic or supersonic speeds, or from war, invasion, acts of foreign enemies, hostilities [whether war be declared or not], civil war, rebellion, revolution, insurrection, military or usurped power;

[vii] incurred in connection with a practice conducted wholly outside the states of New South Wales, Tasmania, Western Australia or the Australian Capital Territory;

[viii] incurred by the Assured in his capacity as an insurance agent."

155 (1889) 14 App Cas 337.

156 See, for example, (1889) 14 App Cas 337 at 369 per Lord Herschell.

202 For these reasons, in summary then, I would uphold the appeal: Powles did not intend to bring about the events giving rise to Allens' liability to the Trust; he did not intend to cheat or deceive it of the $US8.55 million; Powles' knowledge that he was taking an unauthorised risk in relation to a transaction which itself was authorised is not sufficient to attract the operation of the exclusion; omissions by Powles that may have contributed to, or caused, in the conventional, contemporary, tortious sense the loss and liability for it were not dishonest or fraudulent ones; and none of Powles' otherwise dishonest conduct referred to in the dishonesty catalogue brought about the relevant liability.

203 I would allow the appeal with costs. There are other issues outstanding. The appeal should be remitted to the Court of Appeal for these to be determined.