HIGH COURT OF AUSTRALIA

GLEESON CJ,
McHUGH, GUMMOW, KIRBY AND CALLINAN JJ

Matter No S232/2004

JOHN DAVID RICH — APPELLANT

AND

CGU INSURANCE LIMITED — RESPONDENT

Matter No S233/2004

MARK ALAN SILBERMANN — APPELLANT

AND

CGU INSURANCE LIMITED — RESPONDENT

Rich v CGU Insurance Limited
Silbermann v CGU Insurance Limited
[2005] HCA 16
7 April 2005
S232/2004 and S233/2004

ORDER

In each matter:

1. Special leave rescinded.

2. Appellant to pay the respondent's costs of the proceedings in this Court.

On appeal from the Supreme Court of New South Wales

Representation:

D L Williams SC with M A Jones for the appellants (instructed by Joanne Kelly)

D F Jackson QC with A W Street SC and E G Romaniuk for the respondent (instructed by Colin Biggers & Paisley)

CATCHWORDS

Rich v CGU Insurance Limited
Silbermann v CGU Insurance Limited

Insurance – Professional indemnity insurance – Directors and officers liability insurance policy – Exclusion for losses arising from dishonest, fraudulent or malicious conduct – Exclusion engaged only where conduct established to have occurred following final adjudication adverse to the insured – Proceedings instituted against appellants involving questions of breach of duty as company directors – Appellants claimed for advance payment of defence costs under policy – Respondent insurer purported to deny liability relying on exclusion under the policy – Respondent also argued that it had avoided the policy under the *Insurance Contracts Act* 1984 (Cth), s 28 – Whether respondent can rely on exclusion absent an existing judgment or other final adjudication adverse to appellants.

Practice and procedure – Appeal – Separated questions for determination – Appeal in respect only of one answered question and not in respect of other two – Whether any utility in considering the correctness of the answer appealed from in light of other two undisturbed answers – Avoidance of circuity of action.

High Court – Special leave to appeal – Special leave granted – Whether special leave to appeal should be revoked.

1 GLEESON CJ, McHUGH AND GUMMOW JJ. In suits in the Equity Division (Commercial List) of the Supreme Court of New South Wales, McClellan J ordered the separate determination of three questions. Mr Rich and Mr Silbermann were two of three plaintiffs and each had been a director of One.Tel Ltd which is in liquidation. The plaintiffs sought to establish that the defendant ("CGU") was obliged to provide indemnity for, and advance, defence costs of an investigation by the Australian Securities and Investments Commission ("ASIC"), of two proceedings instituted by ASIC in the Supreme Court and of other proceedings, all involving questions of possible serious breaches of duty by the plaintiffs.

2 The liability of CGU was said to arise under a "Directors & Officers Liability Insurance Policy" issued on 2 August 2000 by CGU ("the Policy"). The Policy is in a form resembling, in some respects, that of the policy which falls for consideration by this Court in *Wilkie v Gordian Runoff Ltd*[1] but differing in other respects. It is not to be assumed that the construction given to the policy in *Wilkie* would control the present case.

3 The plaintiffs had commenced by summonses, to each of which there was appended a detailed summary of contentions resembling a pleading by statement of claim. By CGU's amended points of defence, it advanced contentions summarised therein as follows:

> "[C]ertain of the claimed Defence Costs do not come within the terms of the Policy, that Exclusion Clause 3.1 applies in relation to the alleged wrongful acts, and that the contract has been validly avoided by reason of both fraudulent non-disclosure and fraudulent misrepresentation."

4 The reference above to avoidance by CGU of the contract of insurance is to the step open to an insurer under s 28(2) of the *Insurance Contracts Act* 1984 (Cth) ("the Insurance Contracts Act")[2]. The relief sought by the plaintiffs included an order that CGU advance the defence costs described above, incurred and to be incurred by them. It will be apparent that if at the trial CGU made good its case of avoidance that would bring down the Policy, including the provision on which the plaintiffs rely to found the order for provision of their defence costs.

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1 [2005] HCA 17.

2 By contrast, the insurer in *Wilkie* did not avoid the policy and did not rely upon s 28(2) of the Insurance Contracts Act.

5 One feature of the plaintiffs' forensic strategy which has led to the dispute before this Court has been to establish a means whereby the entitlement to advancement of defence costs is established by judicial decision in advance of adjudication of the avoidance issue. It then would be for CGU, if successful on that issue, to recover the sums already advanced and for CGU to bear the risk of lack of success in pursuing recovery. To that end, the procedure for separate determination of questions before trial was, over the opposition of CGU, invoked on the application of the plaintiffs.

6 McClellan J gave to each of the three questions an affirmative answer which thus was adverse to the interests of the plaintiffs. The Court of Appeal (Beazley, Hodgson and Tobias JJA)[3] granted leave to appeal but dismissed the appeals. The Court of Appeal affirmed the answers given to the three questions, although Hodgson JA considered the affirmative answer to question 1 should be understood in a qualified sense to which he had adverted in his reasons[4].

7 Mr Rich and Mr Silbermann[5] then sought special leave from this Court on the ground that the Court of Appeal had erred in upholding the affirmative answer to question 1. They sought an order that question 1 be answered "no". No error was asserted respecting the answer to the other two questions and no order sought from this Court respecting them.

8 CGU resisted any grant of special leave on various grounds. One was that, even if the plaintiffs obtained the relief they sought in this Court, this would not necessarily have any decisive effect upon the principal litigation awaiting trial[6]. In particular, if CGU made good its reliance upon s 28(2) of the Insurance Contracts Act, questions of construction would be directed to an instrument of no legal effect.

9 Special leave was granted and the appeals by Mr Rich and Mr Silbermann were set down for hearing together. As argument was developed on the hearing of the appeals, close attention was given to the interrelation between question 1 and the other two questions, and to the necessary effect for consideration of

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3 *Silbermann v CGU Insurance Ltd* (2003) 57 NSWLR 469.

4 (2003) 57 NSWLR 469 at 484.

5 A third plaintiff, Mr Greaves, did not seek special leave and has played no part in proceedings in this Court. When used in relation to the proceedings in this Court, "plaintiffs" identifies Mr Rich and Mr Silbermann.

6 cf *Bass v Permanent Trustee Co Ltd* (1999) 198 CLR 334 at 355-360 [45]-[59].

question 1 of the answers given by McClellan J and the Court of Appeal to the other two questions. It became apparent that the appropriate course is for this Court to revoke special leave.

10 For an appreciation of why the Court should take this course, it is convenient first to refer to several provisions of the Policy. Section 1 is headed "Operative Clause" and includes "Directors and Officers Liability Insuring Agreement A" and "Corporate Reimbursement Insuring Agreement B". It is cll 2.1 and 2.6, two of the "Automatic Extensions" listed in "Section 2", which are of principal importance for the defence costs which the plaintiffs would have CGU meet.

11 Clause 2.1 states:

> "Advancement of Defence Costs
>
> Where the Insurer elects not to take over and conduct the defence or settlement of any Claim in the name of any Director or Officer, the Insurer shall meet the Defence Costs of any Director or Officer in defending or settling any Claim made against them as they are incurred and prior to the finalisation of the Claim provided always that indemnity in respect of such Claim has been confirmed in writing by the Insurer.
>
> Where the Insurer has not confirmed indemnity and it elects not to take over and conduct the defence or settlement of any Claim, *it may, in its discretion, pay Defence Costs as they are incurred* and prior to the finalisation of the Claim, *provided that it has consented in writing to such Defence Costs prior to their being incurred, such consent not to be unreasonably withheld*.
>
> The Insurer reserves the right to recover any Defence Costs from the Directors or Officers and/or the Corporation severally according to their respective interests in the event and to the extent that it is subsequently established by judgement or other final adjudication that the Directors and Officers and/or the Corporation were not entitled to the Defence Costs so advanced." (emphasis added)

It is the middle paragraph which is of particular importance. This is because CGU has not confirmed indemnity and has not taken over the conduct of any defence. CGU *may* then, *in its discretion*, pay Defence Costs "as they are incurred".

12 Clause 2.6 is headed "Attendance at Official Investigations or Inquiries". It provides that CGU will pay Defence Costs incurred with its prior written consent in attending certain official investigations and inquiries which involve an

allegation against a Director or Officer "which is the subject of indemnity under this Policy".

13 Section 3 is headed "Exclusions" and introduces what follows with the general statement: "This Policy does not provide an indemnity against any Claim made against any Director or Officer". There follows:

> "3.1 Dishonesty & Fraud
>
> brought about by, contributed to by or which involves:
>
> (1) the dishonest, fraudulent or malicious act or omission or other act or omission committed with criminal intent of such Director or Officer;
>
> (2) such Director or Officer having improperly benefited in fact from securities transactions as a result of information that was not available to other sellers and/or purchasers of such securities; or
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> (3) such Director or Officer having gained in fact any personal advantage to which he/she was not legally entitled.
>
> However, *this exclusion shall only apply to the extent that the subject conduct has been established by a judgement or other final adjudication adverse to the Director or Officer*." (emphasis added)

14 It is with these provisions in mind that the three questions for separate determination are to be read. They state:

> "1. Whether, on a true construction of Directors & Officers Liability Insurance Policy No 01 DO 0298798 ('the Policy'), issued by the Defendant absent an existing judgment, order or other final adjudication adverse to the Plaintiff, the Defendant can rely on Exclusion Clause 3.1 in answer to the Plaintiff's claim for indemnity under the Policy;
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> 2. Whether, on the true construction of the Policy issued by the Defendant the Defendant itself is entitled to seek a judgment, order or other final adjudication adverse to the Plaintiff and, thereby, exclude liability for a claim under clause 3.1 of the Policy in the same proceedings in which the Plaintiff makes a claim for indemnity against the Defendant.

3. Whether, on the true construction of the Policy issued by the Defendant, Exclusion Clause 3.1 of the Policy operates to exclude liability on the part of the defendant to pay claims by the Plaintiff for indemnity for Defence Costs under;

   (i) clause 2.1 of the Policy;

   (ii) clause 2.6 of the Policy;

   (iii) Insuring Agreement A of the Policy; and

   (iv) Insuring Agreement B of the Policy."

15 Something first should be said respecting the significance of the unchallenged affirmative answer to question 2. In the principal proceedings in the Commercial List in which the plaintiffs seek indemnity, CGU may seek judgment in its favour and thereby exclude liability under Exclusion Clause 3.1. However, the plaintiffs submit that there still remains scope for question 1.

16 The answer to question 1 which they now seek is not limited to a simple "no" but, as formulated in the course of argument in this Court, is intended to accommodate the affirmative answer to question 2 and includes as an alternative:

> "[CGU] cannot plead Exclusion Clause 3.1 by way of defence to the Plaintiff's claim for the Defence Costs which have been incurred by the Plaintiff unless and until there has been a judgment, order or other final adjudication adverse to the Plaintiff establishing the subject conduct identified in cl 3.1."

17 It appears that the "final adjudication" spoken of in this proposed answer is designed to identify judgment on a cross-claim by CGU against the plaintiffs. In further explanation, counsel for the plaintiffs envisaged a successful summary judgment application by the plaintiffs in their actions against CGU and an order that the Defence Costs be advanced. In that summary judgment proceeding, assuming the above answer to question 1, questions of dishonesty and fraud raised by CGU's reliance upon Exclusion Clause 3.1 would be postponed to the final adjudication of a cross-claim by CGU. In the meantime, the plaintiffs would have their money and CGU would bear any risk associated with its recoupment if the trial of the cross-claim by CGU went in its favour.

18 However, the general principle is that issues raised in proceedings are to be determined in a summary way only in the clearest of cases. In *Agar v Hyde*, Gaudron, McHugh, Gummow and Hayne JJ said[7]:

> "Ordinarily, a party is not to be denied the opportunity to place his or her case before the court in the ordinary way, and after taking advantage of the usual interlocutory processes. The test to be applied has been expressed in various ways[8], but all of the verbal formulae which have been used are intended to describe a high degree of certainty about the ultimate outcome of the proceeding if it were allowed to go to trial in the ordinary way."

19 Given these principles and the affirmative answer to question 2, how could the summary judgment procedure envisaged by the plaintiffs successfully be used to shut out consideration at that stage of Exclusion Clause 3.1 and attendant issues of dishonesty and fraud?

20 Further, and in any event, if the suits by the plaintiffs and the putative cross-claim by CGU were pursued to judgment, the submissions for the plaintiffs wrongly assumed that an order for payment to the plaintiffs by CGU necessarily would be entered independently of any order on the cross-claim vindicating the denial of indemnity by CGU. The principles respecting the avoidance of circuity of action indicate that the litigation would not be resolved by orders obliging CGU to make payments it was not and never had been required by contract to make[9].

21 What the plaintiffs would have this Court embark upon is consideration of an hypothesis, which is essential for the plaintiffs' appeals, but inapt to produce that result (advancement of funds in advance of determination of defences raised by CGU) which the determination of separate questions in advance of trial was designed by the plaintiffs to secure.

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7 (2000) 201 CLR 552 at 575-576 [57].

8 *Dey v Victorian Railways Commissioners* (1949) 78 CLR 62 at 91 per Dixon J; *General Steel Industries Inc v Commissioner for Railways (NSW)* (1964) 112 CLR 125 at 130 per Barwick CJ.

9 See as to the avoidance of circuity of action *McDermott v Black* (1940) 63 CLR 161 at 186-187; *Qantas Airways Ltd v Aravco Ltd* (1996) 185 CLR 43 at 49-50; *Thompson v Australian Capital Television Pty Ltd* (1996) 186 CLR 574 at 609.

22 Special leave should be rescinded. The costs of CGU of the proceedings in this Court should be borne by Mr Rich and Mr Silbermann.

23 KIRBY J. The facts, the course of these proceedings and the decisions below are set out in other reasons. So are the separated questions, question 1 of which was reframed in this Court.

24 Upon the construction of the "Directors & Officers Liability Insurance Policy" ("the Policy") issued on 2 August 2000 by the respondent insurer, I am in general agreement with the reasons of Callinan J. I do not take quite the same approach to the *contra proferentem*[10] rule of construction as his Honour does. For me, this is an interpretive tool of last resort, where analysis of a contested text does not otherwise yield a satisfying conclusion[11]. Moreover, the *contra proferentem* rule obviously has less application in cases where, as here, both parties are corporations experienced in, and familiar with, insurance policies of the kind the subject of these appeals, and where both parties have enjoyed legal advice and are of roughly equal bargaining power[12].

25 In the present matter, I do not regard this difference over the rule as significant. Considerations such as the commercial object of the instrument[13], the consequent operation of the document read as a whole[14] and the purposive approach now adopted in the ascertainment of the meaning of contested language[15] usually lead to the same result as the *contra proferentem* rule in the construction of disputed insurance policies.

26 The points made by Callinan J concerning the commercial purpose of the Policy; its utility in the fairly typical situation that arose involving the appellants;

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10 A Latin maxim: "the words of an instrument should be taken most strongly against the party proffering it".

11 *Johnson v American Home Assurance Co* (1998) 192 CLR 266 at 272-276 [19]; *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 at 600-603 [74]; cf at 589 [22]; *Andar Transport Pty Ltd v Brambles Ltd* (2004) 78 ALJR 907 at 922-923 [68]; cf at 911 [17], 930-931 [122]-[124]; 206 ALR 387 at 408-409; cf at 392-393, 419-420. See also *Macey v Qazi* [1987] CLY 425; *Pitcher v Principal Mutual Life Insurance Co* 870 F Supp 903 (SD Ind 1994).

12 See *Wilkie v Gordian Runoff Ltd* [2005] HCA 17 at [17].

13 *Lake v Simmons* [1927] AC 487 at 509; *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 at 589 [22], 601 [74].

14 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 381-382 [69]-[71].

15 Kirby, "Towards a Grand Theory of Interpretation: The Case of Statutes and Contracts", (2003) 24 *Statute Law Review* 95 at 96.

and the express language of the Policy (particularly the explicit condition for the engagement of the exemption in cl 3.1) appear to me to be compelling.

27 This conclusion requires me to attempt to reconcile the answer which the appellants seek to question 1, as reformulated, with the answers that they have accepted to questions 2 and 3. They accepted those answers by not appealing against them. Callinan J has explained the incompatibility between, in particular, the answer to question 2 (accepted by the appellants) and the answer they have sought to question 1.

28 Notwithstanding that I prefer the approach to the construction of the Policy stated by Callinan J, I come ultimately to the same conclusion as the other members of this Court. These were well advised and expertly represented appellants. They were not inexperienced in litigation, including in this Court. I am unconvinced that I should struggle to attempt to rescue them from the outcome inherent in the course that they have chosen.

29 For these reasons, I agree in the orders proposed by Gleeson CJ, McHugh and Gummow JJ.

30 CALLINAN J. These appeals raise questions as to the proper construction of the respondent's policy of insurance indemnifying the appellants as directors and officers of a corporation, in particular a clause of it excluding liability to provide indemnity if a judgment or other final adjudication has established dishonest conduct by the appellants. The indemnity presently sought from the respondent is the amount of legal costs incurred by the appellants in defending proceedings commenced against them by the corporate regulator, the Australian Securities and Investments Commission ("ASIC"). The appellants contend that the respondent is not entitled to decline to provide funds pursuant to the policy because there has been neither a judgment nor any other final adjudication establishing dishonest conduct by them. The respondent asserts that it is entitled to refuse to provide indemnity whilst it pursues its own proceedings against the appellants to obtain a judgment establishing dishonest conduct by them. Each party advances a construction in support of his and its stance. In my view, the appellants' construction is to be preferred. But, as will appear, that does not mean that the appellants' appeals must succeed.

Facts

31 The appellants are former directors of One.Tel Limited (In Liquidation) ("One.Tel").

32 On 29 May 2001, the directors of One.Tel appointed administrators of the company under s 436A of the Corporations Law as it then was. Soon afterwards, on or about 31 May 2001, ASIC started to investigate the failure of One.Tel, as well as possible contraventions of the Corporations Law by its directors. During the investigation, ASIC sought an injunction against the appellants prohibiting them from transferring or otherwise disposing of their assets, and requiring them to attend an examination under s 596A of the Corporations Law to be conducted by it.

33 On 12 December 2001, ASIC filed originating proceedings in the Supreme Court of New South Wales seeking, among other things, declarations that the appellants contravened s 180(1) of the Corporations Law[16], orders

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16 That section, which has been retained in the *Corporations Act* 2001 (Cth), required directors to exercise reasonable care and diligence in the discharge of their duties. It provided:

> "**180(1) Care and Diligence – directors and other officers**
>
> A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

(Footnote continues on next page)

prohibiting them from managing a corporation, and orders requiring them to pay compensation to One.Tel. The appellants have already apparently incurred substantial legal costs and charges in monitoring and attending the examination, and in defending the proceedings, including costs and expenses incurred by them in attending public examinations conducted by the liquidators of One.Tel in 2002 and in defending a claim by American Express International Inc in relation to the use of credit cards.

34 At all material times, the appellants were insured under a Directors and Officers Liability Insurance Policy ("the policy") issued by the respondent. Under the policy, the material terms of which I will set out later, the respondent agreed to indemnify the appellants against "Loss" arising out of any "Claim" for any "Wrongful Act" committed by them in their capacity as directors of One.Tel. "Loss" is defined to include "Defence Costs". It is not disputed that although the appellants may have a right of indemnity against One.Tel in respect of their legal costs and expenses, One.Tel would be unable to provide it because of its insolvency.

35 The respondent has not confirmed that it will provide indemnity under the policy, has not elected to take over the defence of the ASIC proceedings, and has refused to pay the appellants' legal costs and expenses. It also claims that it has, in any event, avoided the policy.

The proceedings between the parties

36 On 3 September and 30 September 2002, the appellants filed summonses in the Supreme Court of New South Wales claiming an indemnity for their costs in defending the proceedings brought by ASIC and related costs. The respondent filed defences claiming that on the true construction of the policy, it was not obliged to provide indemnity to the appellants, and that it was entitled to avoid the policy under s 28(2) of the *Insurance Contracts Act* 1984 (Cth)[17] by reason of

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(a) were a director or officer of a corporation in the corporation's circumstances; and

(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer."

17 Section 28 provides:

"**28 General Insurance**

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

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

(Footnote continues on next page)

fraudulent non-disclosures and misrepresentations by the appellants. The respondent also claimed that it was entitled to rely upon exclusion cl 3.1 of the policy to refuse to indemnify the appellants because of their dishonest or fraudulent conduct. Detailed particulars of the alleged dishonest conduct were pleaded and are relevantly as follows:

> "(b) ... in terms of cl 3.1 of the policy, the 'Claim' was brought about by, contributed to or involved dishonest or fraudulent acts or omissions of each appellant;
>
> (c) ... that it was entitled to, and has, avoided the policy by reason of fraudulent non-disclosure and fraudulent misrepresentation."

37 The appellants brought an application for the separate determination of three questions arising out of the pleadings. The respondent contended that the Court ought not to entertain the application. On 19 November 2002, McClellan J allowed it to proceed on the basis that the questions be determined upon the assumption that the allegations of dishonest conduct pleaded by the respondent were true. His Honour was of the view that the determination of the three questions in advance of trial might avoid the necessity of an expensive and lengthy hearing to determine the factual issues raised by the pleadings.

38 In their final form, the questions put to the Supreme Court were:

> "1. Whether, on the true construction of Directors & Officers Liability Insurance Policy No 01 DO 0298798 ('the Policy'), issued by the Defendant absent an existing judgment, order or other final adjudication adverse to the Plaintiff, the Defendant can rely on Exclusion Clause 3.1 in answer to the Plaintiff's claim for indemnity under the Policy;

> (b) made a misrepresentation to the insurer before the contract was entered into;
>
> but does not apply where the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation before the contract was entered into.
>
> (2) If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.
>
> ..."

2. Whether, on the true construction of the Policy issued by the Defendant the Defendant itself is entitled to seek a judgment, order or other final adjudication adverse to the Plaintiff and, thereby, exclude liability for a claim under clause 3.1 of the Policy in the same proceedings in which the Plaintiff makes a claim for indemnity against the Defendant;

3. Whether, on the true construction of the Policy issued by the Defendant, exclusion clause 3.1 of the Policy operates to exclude liability on the part of the Defendant to pay claims by the Plaintiff for indemnity for Defence Costs under:

   (i) clause 2.1 of the Policy;

   (ii) clause 2.6 of the Policy;

   (iii) Insuring Agreement A of the Policy; and

   (iv) Insuring Agreement B of the Policy."

The decision of the primary judge

39 McClellan J delivered his reasons for judgment on 18 December 2002, answering all three questions in the affirmative[18]. In relation to Questions 1 and 2, his Honour was of the view that the final paragraph of cl 3.1 did not operate to prevent the respondent from relying upon the exclusion clause to deny indemnity in circumstances in which there has been no relevant finding of dishonesty in other proceedings. His Honour observed that there is a variety of circumstances in which adverse findings may be made in relation to the conduct of a director or officer, including in a Royal Commission or official investigation, or other similar proceedings. Findings in any of those would not however justify a denial of indemnity. His Honour concluded that a denial of indemnity could be established by an insurer, virtually in any proceedings, whether the insurer was or was not a party to them, and, if it was, that it could, in such proceedings, in good faith, maintain its stance that its insureds acted dishonestly[19]:

> "However, there is nothing in the clause to suggest that the exclusion should be confined to a finding in proceedings other than the indemnity proceedings. The rights of the parties to a policy of insurance often have to be determined by a court. In such proceedings, either party is able to advance its position and assert that the objective facts entitle the insured to

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18 *Silbermann, Greaves and Rich v CGU Insurance Ltd* [2002] NSWSC 1195.

19 [2002] NSWSC 1195 at [46].

> indemnity or otherwise. This does not involve any lack of 'good faith' by either party. The court will determine the parties' rights having regard to the evidence which the parties tender at the trial and the findings which it makes."

40 With respect to Question 3, McClellan J held that absent exclusion cl 3.1, the respondent would be obliged to indemnify a director or officer with respect to any "Loss", this being defined to include "Defence Costs", which in turn is one of the amounts payable "in respect of a Claim". Accordingly, to the extent that cl 3.1 excludes "indemnity against any Claim", it excludes indemnity in relation to "Defence Costs" associated with that "Claim".

41 The appellants sought to appeal to the Court of Appeal of New South Wales.

The decision of the Court of Appeal

42 On 25 July 2003, the Court of Appeal (Beazley, Hodgson and Tobias JJA) granted the appellants leave to appeal but dismissed the appeal with costs[20]. While the Court of Appeal unanimously held that Questions 2 and 3 had been answered correctly by McClellan J, Hodgson JA expressed some reservations about the answer given by the primary judge to Question 1.

43 Tobias JA, with whom Beazley JA agreed, was of the view that cl 3.1 could be relied upon by the respondent to deny indemnity with respect to defence costs in the absence of and before a judgment or other final adjudication adverse to the appellants is obtained. His Honour said[21]:

> "In my opinion, the Policy was not intended to provide a form of 'up front' indemnity for the Defence Costs to the insured in the circumstances postulated. The clear structure of the Policy entitles the insurer to refuse indemnity in respect of any part of any Loss including Defence Costs where it asserts dishonest conduct within the meaning of cl 3.1 provided only that it will be ultimately required to indemnify the insured against that Loss unless it establishes by a judgment or other final adjudication that the relevant conduct was dishonest. In my opinion, neither the Policy nor its commercial purpose requires the insurer to advance to the insured either Defence Costs or any other amount payable in respect of a Claim where it has denied indemnity upon any proper ground including that provided by cl 3.1."

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20 *Silbermann v CGU Insurance Ltd* (2003) 57 NSWLR 469.

21 (2003) 57 NSWLR 469 at 487 [77].

44 Tobias JA was of the view that if the respondent were obliged to indemnify the appellants in their defence of a claim, then it would also be obliged to pay any amount determined to be payable in respect of that claim. His Honour considered that such a result was problematic in circumstances in which the respondent subsequently obtains judgment against the appellants within the meaning of cl 3.1, because it might then be too late for the respondent to recover the amount payable in respect of the claim for which it has already provided indemnity[22].

45 Tobias JA was also of the view that for the respondent to comply with its obligation of good faith, any defence raised by it invoking cl 3.1 must be based on reasonable grounds. That is, the respondent could not raise a defence based on cl 3.1 for the purpose of frustrating or delaying the appellants' defence of a claim brought by a third party[23].

46 Hodgson JA was of the view that the commercial purpose of the policy was to provide the appellants with costs to enable them to defend claims notwithstanding the fact that they might include allegations of dishonesty. If dishonesty were established by a judgment and costs had been advanced, then the appellants would be liable to refund those costs in accordance with cl 2.1 of the policy. His Honour said[24]:

> "In my opinion, if the [respondent] were wholly correct about the final paragraph of cl 3.1, it would either be entirely otiose or else operate solely to the benefit of the insurer. To have the benefit of the exclusion provided by cl 3.1, the insurer has to prove that it applies; and if the final paragraph were not there, the insurer would have to obtain a final adjudication to that effect in the insurance proceedings themselves. Plainly, it would not be sufficient merely to point to allegations, or to a finding of another tribunal not amounting to a judgment or final adjudication. The only thing additional that the paragraph could do, on the construction suggested by the [respondent], would be to provide, in the insurer's favour, that it could rely on a judgment or final adjudication in other proceedings, and then not otherwise itself have to prove the application of cl 3.1 in the insurance proceedings themselves.
>
> In my opinion, the final paragraph of cl 3.1 was intended to confer a benefit on the insured, a benefit consistent with the general purpose of the Policy to assist in defence against allegations, at least until such time

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22 (2003) 57 NSWLR 469 at 487 [76].

23 (2003) 57 NSWLR 469 at 487-488 [78].

24 (2003) 57 NSWLR 469 at 481 [46]-[47].

as allegations involving dishonesty and the like were proved. In my opinion, this is confirmed by cll 4.4, 4.5, 4.15 and 4.16. I think effect should be given to the words 'has been established', so that cl 3.1 cannot prevent the contract requiring the insurer to provide indemnity, unless and until the requisite judgment or adjudication has been obtained."

The appeal to this Court

The appellants' submissions

47 Only Question 1 was presented as an issue in this Court. The appellants submit that the Court of Appeal erred by preferring a construction that enabled the respondent to rely upon the exclusion clause in circumstances in which no subsisting judgment or final adjudication exists, and there is a possibility only that such a judgment or adjudication will come into existence in the future. The appellants contend that such a construction is incompatible with its plain meaning and seeks to read words into the exclusion clause that are not there. They submit that the use of the past tense in cl 3.1 is determinative: that it applies only to the extent that the conduct in question has been established, and that therefore the clause cannot apply until it has been proved. In the alternative, the appellants submit that if the exclusion clause is ambiguous, then it should be construed strictly against the respondent so that the respondent suffers the consequences of the ambiguity, rather than the appellants.

The respondent's submissions

48 The respondent submits that it has a discretion under cl 2.1 of the policy whether to advance defence costs to the appellants, and that it is not unreasonable for it to withhold consent to payment in circumstances in which there is a bona fide contention of dishonest conduct by the appellants within the meaning of cl 3.1. The respondent also submits that the nature of the limitation imposed by cl 3.1 is not temporal but is concerned with a particular type of conduct. Accordingly, the respondent is entitled to rely on cl 3.1 if it honestly asserts that the appellants have engaged in such conduct, irrespective of whether the conduct has been established by a relevant judgment or other final adjudication.

49 In order to construe cl 3.1 it is necessary to have regard to the material terms of the policy as a whole. Section 1 of it is as follows:

"**Section 1 Operative Clause**

Directors and Officers Liability Insuring Agreement A

The Insurer will pay on behalf of the Directors and Officers any Loss for which the Directors and Officers may not be legally indemnified by the Corporation arising out of any Claim, by reason of any Wrongful Act

committed by them in their capacity as a Director or Officer, first made against them jointly or severally during the Period of Insurance and notified to the Insurer during the Indemnity Period.

Corporate Reimbursement Insuring Agreement B

The Insurer will pay on behalf of the Corporation any loss payment which it is legally permitted to make arising out of any Claim, by reason of any Wrongful Act, committed by any Director or Officer in their capacity as a Director or Officer, first made against the Director or Officer during the Period of Insurance and notified to the Insurer during the Indemnity Period.

The total amount payable in respect of all Claims under Insuring Agreement A and/or Insuring Agreement B of this Policy shall not in the aggregate exceed the limit of aggregate liability as stated in Item 5 of the schedule."

Section 2 is relevantly in this form:

"**Section 2 Extensions**

Unless specified otherwise to the contrary the cover granted by these extensions is subject to all the terms and conditions of this Policy.

Automatic Extensions

2.1 Advancement of Defence Costs

Where the Insurer elects not to take over and conduct the defence or settlement of any Claim in the name of any Director or Officer, the Insurer shall meet the Defence Costs of any Director or Officer in defending or settling any Claim made against them as they are incurred and prior to the finalisation of the Claim provided always that indemnity in respect of such Claim has been confirmed in writing by the Insurer.

Where the Insurer has not confirmed indemnity and it elects not to take over and conduct the defence or settlement of any Claim, it may, in its discretion, pay Defence Costs as they are incurred and prior to the finalisation of the Claim, provided that it has consented in writing to such Defence Costs prior to their being incurred, such consent not to be unreasonably withheld.

The Insurer reserves the right to recover any Defence Costs from the Directors or Officers and/or the Corporation severally according to their respective interests in the event and to the extent

that it is subsequently established by judgment or other final adjudication that the Directors and Officers and/or the Corporation were not entitled to the Defence Costs so advanced.

...

2.6 Attendance at Official Investigations or Inquiries

The Insurer will pay Defence Costs incurred with its prior written consent by or on behalf of a Director or Officer in attending any official investigation, examination, inquiry or other proceedings ordered or commissioned by any official body or institution, where a Director or Officer is legally compelled by such body or institution to attend such investigation, examination, inquiry or proceeding and which involves an allegation of a Wrongful Act against a Director or Officer which is the subject of indemnity under this Policy.

...

2.11 Preservation of Indemnity

If a Director or Officer is unable to satisfy a right to indemnity against the Corporation to which he or she is entitled, whether under Common Law or Statute, or otherwise, by reason only of the Corporation being placed in liquidation (other than voluntary liquidation) and having insufficient funds available so to indemnify the Director or Officer, then it is hereby agreed that the Insurer shall indemnify the Director or Officer to the extent that the Director or Officer is unable to satisfy the right to indemnity against the Corporation.

The burden of adducing satisfactory proof to obtain the benefit of this extension shall rest entirely with the Director or Officer and shall include the production of documentary evidence of the Corporation's assets and liabilities and any official statements issued by the liquidator."

Section 3 of the policy states the exclusions relevantly as follows:

"This Policy does not provide an indemnity against any Claim made against any Director or Officer:

3.1 Dishonesty & Fraud

brought about by, contributed to by or which involves:

(1) the dishonest, fraudulent or malicious act or omission or other act or omission committed with criminal intent of such Director or Officer;

(2) such Director or Officer having improperly benefited in fact from securities transactions as a result of information that was not available to other sellers and/or purchasers of such securities; or

(3) such Director or Officer having gained in fact any personal advantage to which he/she was not legally entitled.

However, this exclusion shall only apply to the extent that the subject conduct has been established by a judgement or other final adjudication adverse to the Director or Officer."

Section 4.4, one of the general conditions of the policy should be noted:

"**4.4 Claims Co-operation**

The Directors and Officers shall use due diligence and do and concur in doing all things reasonably practicable to avoid or diminish any Loss hereunder, and shall immediately give all such information and assistance to the Insurer as it may reasonably require to enable it to investigate and to defend the Claim and/or to enable the Insurer to determine its liability under this Policy.

The Insurer may, on request from the Directors and Officers for indemnity under this Policy, take whatever action that it considers appropriate to protect the Directors' and Officers' position in respect of the Claim and such action by the Insurer shall not be regarded as in any way prejudicing its position under this Policy and no admission of the Director's and Officers' entitlement to indemnity under this Policy shall be implied."

Section 4.5 may also be relevant for its use of the word "advance".

"**4.5 Allocation**

In the event of a Claim which is made against Directors and Officers or the Corporation and which is covered only partly by this Policy, the Insurer will use its best efforts to ensure a fair and proper allocation of the claim for insured and uninsured portions.

The Insurer will also advance Defence Costs on a similar basis, which will apply to all Defence Costs unless otherwise agreed by all parties."

Section 5.1 of the policy defines "Claim" this way:

> "'Claim' shall mean:
>
> (1) any writ, summons, application or other originating legal (criminal, civil or otherwise) or arbitral proceedings, cross claim or counter-claim issued against or served upon any Director or Officer alleging any Wrongful Act; or
>
> (2) any written demand alleging any Wrongful Act communicated to any Director or Officer under any circumstances and by whatever means."

Section 5.3 defines "Defence Costs" this way:

> "'Defence Costs' shall mean:
>
> all reasonable costs, charges and expenses (other than regular or overtime wages, salaries or fees of any Director or Officer) incurred with the prior written consent of the Insurer in defending, investigating, attending or monitoring any Claim or proceedings, including but not limited to official investigations, examinations, inquiries and the like, or appeals therefrom, together with all reasonable costs of bringing any appeal."

Section 5.8 defines "Loss" as follows:

> "'Loss' shall mean:
>
> the amount payable in respect of a Claim made against the Directors and Officers for a Wrongful Act and shall include damages, judgements, settlements, interest, costs and Defence Costs. In respect of Section 2.5 (*Insured vs Insured Cover*) and 2.20 (*Entity Cover for Employment Practices Liability*) this Policy will include back-pay where reinstatement by a court is ordered but excludes any amount which the Insured is or was required to pay pursuant to a specific obligation imposed under a contract of employment, employment agreement, statute, award or otherwise.
>
> 'Loss' excludes a Claim arising from or by reason of or directly or indirectly caused by or arising from fines and penalties imposed by law, punitive, exemplary or aggravated or multiple damages, income tax, customs duties, excise duty, stamp duty, sales tax or any other State or Federal tax or duty."

I would also set out the definition of "Wrongful Act" (Section 5.18) to underline the point made by Hodgson JA in the Court of Appeal that "questions of honesty

of conduct of directors and officers of companies are often difficult and marginal"[25].

> "'Wrongful Act' shall mean:
>
> any actual or alleged breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, breach of warranty of authority or other act done or attempted by or any other matter claimed against any Director or Officer or any of them wherever or whenever while acting in their individual or collective capacities as Directors or Officers."

50 The respondent accepts that there is an entitlement under the indemnity given by the policy to be paid "Loss" (which includes "Defence Costs") but that there is no entitlement to be paid any amount of such costs in advance, save to the extent provided for by cl 2.1 which sets out the specific circumstances in which there may be an advance in respect of matters falling within "Defence Costs". Unless there has been an exercise by the respondent of its discretion under cl 2.1, there is no right in the appellants to insist upon payment of their defence costs in advance.

51 The respondent also accepts that a refusal of the respondent to pay defence costs in accordance with the second paragraph of cl 2.1 may be challenged on the basis that the consent was unreasonably withheld. Consent may not however be regarded as unreasonably withheld in circumstances in which there is a bona fide contention by the respondent that there had been conduct of the nature referred to in the last paragraph of cl 3.1, or, as contended here, that the policy had been avoided. The respondent then makes the points that the appellants accepted (for the purpose of their determination of the questions) that the issues should be decided on the assumption that the respondent's pleaded allegations were true, and that it was entitled to, and has avoided the policy by reason of the appellants' non-disclosure before it was effected.

52 The respondent seeks to meet the appellants' argument that the exception contained in cl 3.1 uses the past tense: "... has been established" in this way. The opening words of cl 3.1 limit the ambit of the indemnity otherwise provided by the policy, but that limit is not a temporal one: rather, it contemplates that the conduct excluded from the indemnity must be conduct found by a judgment or other final adjudication to be of the nature referred to in one of the three earlier paragraphs of cl 3.1. To treat a provision such as the last paragraph of cl 3.1 as extending the ambit of the indemnity beyond that elsewhere granted by the policy, whilst possible, would be heterodox.

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25 (2003) 57 NSWLR 469 at 481 [48].

53 Secondly, there may, or may not be proceedings between the insured and a third party in which the question which is raised by the last paragraph of cl 3.1 would fall to be decided. It would be curious if that question were not to be resolved in the ordinary manner in which disputes between insured and insurer are resolved, that is, in an action between those parties, giving rise to a judgment establishing whether the conduct that attracts the operation of the exclusion had occurred. The appellants – not having appealed in respect of Question 2 – appear to have accepted this basic proposition, but yet contend that there is an entitlement to be paid costs, in advance, notwithstanding that they will or may have ultimately to refund them. The appellants' contention cannot be correct because it would extend the indemnity beyond that accorded by the other parts of the policy.

54 Further, the appellants' contentions would require the implication of a right to recover the amounts in advance of the appellants' action against the respondent being decided in the respondent's favour in circumstances attracting the last paragraph of cl 3.1. This, it was submitted, would be surprising in the light of the specific attention devoted to the topic in the third paragraph of cl 2.1.

55 Finally, the respondent submits that the answer to Question 1 proposed by the appellants is inconsistent with the answer to Question 2. If the reasoning contended for by the appellants were accepted, a different and more limited answer would be appropriate. It is submitted even if Question 1 should be answered along the lines contended for by the appellants, there would still be no entitlement to payment of defence costs having regard to the respondent's defence of avoidance of the policy.

56 There is force in the respondent's submissions in relation to the form of question as posed to the Court. The difficulties to which the form of the question gave rise troubled Hodgson JA in the Court of Appeal as to which his Honour said this[26]:

> "It follows that the answers to question 2 and question 3 given below are correct. The answer to question 1, however, could be misleading. It is true that the cl 3.1 defence can be relied on in the sense that it can be raised as a defence in insurance proceedings; but it cannot be relied on in the sense that cl 3.1 does not provide a valid justification for refusal of indemnity unless and until the fourth paragraph is satisfied. So I would propose that question 1 be answered yes, but only in the sense and subject to the qualifications set out in my reasons."

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26 (2003) 57 NSWLR 469 at 484 [60].

57 In substance, the qualifications to which his Honour was referring were that the respondent could rely on the exclusion in cl 3.1 in proceedings between it and the appellants. If cl 3.1 were the only defence, then until that defence were established, the respondent would be in breach in not providing indemnity. The only relevant implied term, his Honour thought, was that the respondent should not rely on cl 3.1 in any way which would be a breach of its obligation of good faith.

58 The appellants were invited during the hearing of the appeal, to, and did formulate the question differently. It now reads as follows:

> "Whether the defendant can or cannot plead exclusion cl 3.1 by way of defence to the plaintiff's claim for the Defence Costs which have been incurred by the plaintiff unless and until there has been a judgment, order, or other final adjudication adverse to the plaintiff establishing the subject conduct identified in cl 3.1."

The proper construction of the policy

59 In my opinion the appellants have the better of the arguments on the construction of the policy. This is so for several reasons. Matters relevant to the proper approach to the construction of the policy are these: that the respondent is the profferer of the policy, that it is a policy designed to operate in the commercial environment of directors' (and other officers') obligations, and the ascertainment of an uncertain dividing line between dishonesty, and gross negligence, or imprudence to which Hodgson JA referred; and that the section in particular contention, cl 3.1, is an exclusion clause. These matters require that ambiguities in the construction of the exclusion clause, indeed in other parts also of the respondent's policy, be resolved in favour of the appellants. That is not to go as far as a body of North American authority holds in relation to a like, but as will appear, far from identical form of policy, that *any* ambiguity *must* be construed strictly against the insurer, and, of more importance, in such a way as to prefer the insured if the policy "contains contradictory provisions, or has been so framed as to leave room for [a] construction, rendering it doubtful [what] the parties intended"[27]. The contra proferentem rule makes it just that this be the

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27 *National Bank v Insurance Company* 95 US 673 at 678-679 (1877) per Harlan J giving the opinion of the Court. See also *Atlantic Permanent Federal Savings & Loan Association v American Casualty Company of Reading, Pennsylvania* 670 F Supp 168 at 171-172 (ED Va 1986); *National Union Fire Insurance v Seafirst Corporation* 662 F Supp 36 at 38 (WD Wash 1986); *Little v MGIC Indemnity Corporation* 649 F Supp 1460 at 1467-1468 (WD Pa 1986); *Okada v MGIC Indemnity Corporation* 823 F 2d 276 at 282 (9th Cir 1986); *National Union Fire Insurance Company of Pittsburgh, Pa v Continental Illinois Corporation* 666 F Supp 1180 at 1197-1198 (ND Ill 1987); *American Casualty Co of Reading,*

(Footnote continues on next page)

result[28]. There is another reason why the United States authorities may be distinguished, and that is that the standard form there expressly refers to a judgment in third party proceedings, and not to proceedings between insurer and insured[29].

60 A convenient starting point for the consideration of the arguments is the definition of "Defence Costs". Two observations may be made about that. First, the definition refers to reasonable costs, and secondly to the incurring of them [only] with the prior written consent of the respondent. The language of the definition does tend to suggest that the respondent has a discretion with respect to the provision of indemnity against costs. Such a discretion could not be an unfettered one. If it were, the acceptance of the risk, that the insureds might be sued and incur costs in defending actions against them, would be meaningless and of no value.

61 Section 1 of the policy states the respondent's obligations, and the risks in respect of which it has undertaken to insure, that is, the consideration for the premium paid. The policy is a "claims made" policy, and the reference in the Section to time is the "Indemnity Period". It says nothing about the time at which indemnity is to be provided. Ordinary principles of construction would suggest on, or within a reasonable time of the realization of the risk.

62 The requirement of notification during the indemnity period is however significant. A matter of frequent controversy in respect of claims made under

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Pennsylvania v Bank of Montana System 675 F Supp 538 at 541-544 (D Minn 1987); *National Union Fire Insurance Company of Pittsburgh, Pa v Brown* 787 F Supp 1424 at 1429, 1433-1434 (SD Fla 1991); *Graham v Preferred Abstainers Insurance Company* 689 So 2d 188 (1997); *Associated Electric & Gas Insurance Services Ltd v Rigas* 2004 US Dist LEXIS 4498, and criticisms of that approach in Miller, "Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine", (1988) 88 *Columbia Law Review* 1849.

28 *National Bank v Insurance Company* 95 US 673 at 679 (1877).

29 *Pepsico Inc v Continental Casualty Company* 640 F Supp 656 at 659-660 (SDNY 1986); *Atlantic Permanent Federal Savings & Loan Association v American Casualty Company of Reading, Pennsylvania* 670 F Supp 168 at 170-171 (ED Va 1986); *Atlantic Permanent Federal Savings & Loan Association v American Casualty Company of Reading, Pennsylvania* 839 F 2d 212 at 216 (4th Cir 1988); *National Union Fire Insurance v Seafirst Corporation* 662 F Supp 36 at 38-39 (WD Wash 1986); *Okada v MGIC Indemnity Corporation* 823 F 2d 276 at 282 (9th Cir 1986); *Little v MGIC Indemnity Corporation* 836 F 2d 789 at 792-794 (3rd Cir 1987).

policies of this kind is whether the claim against the insured has been made and notified under the policy while it is still current. Section 1 makes explicit the necessity for this currency. That this is so sheds some light upon the meaning to be given to the next section of the policy.

63 The first paragraph of cl 2.1 uses the word "elects". The right that it confers upon the respondent is not an unfettered one. It is certainly not a right to elect to avoid its obligations under the policy. It requires that the respondent pay defence costs "as they are incurred and prior to the finalisation of the Claim", subject to a proviso that I refer to below. It will be recalled that the conclusion of Tobias JA in the Court of Appeal depended in part at least upon his Honour's view that if the respondent were obliged to pay costs in advance, it would, by parity of reasoning, also be obliged to pay a judgment in advance, even if it were locked in a dispute about its obligations to its insureds[30]. That reasoning overlooks that the first paragraph of cl 2.1 expressly distinguishes between costs, and the claim against a director. The former are expressly stated to be payable even if that claim has not been finalized.

64 All of this is subject to the proviso appearing in the first paragraph of cl 2.1 "... that indemnity in respect of such Claim has been confirmed in writing by the [respondent]." One possible reading of that is "... that the respondent has first confirmed in writing that it accepts that it is liable to indemnify the insured if his liability on the claim is established." But if that were the sense intended, why did the respondent not express itself in that, or some equally clear fashion? What meaning must be given to the words "indemnity ... confirmed"? They certainly do not necessarily carry the sense for which the respondent contends. Nor do they *necessarily* convey this meaning, "... that the respondent has first confirmed in writing that the claim has been made within the indemnity period", but they are in my opinion capable of doing so, and should be held here as in fact doing so. Cryptic expression invites, indeed compels, some measure of invention on the part of a court required to give meaning to it. The reference, in the second paragraph of cl 2.1 to "discretion" should be read as a discretion with respect to the quantum of the costs in question, particularly because, as the paragraph states, consent may not be unreasonably withheld.

65 The third paragraph of cl 2.1 is consistent with the constructions that I have preferred for the preceding paragraphs. It makes it entirely clear that the occasion may arise for the subsequent repayment of costs to the insurer, that is, if it is *subsequently* established by judgment or final adjudication that the insureds were not so entitled. The paragraph could hardly more clearly recognize and acknowledge the real likelihood that defence costs will be payable and received in advance, probably often long in advance of any kind of adjudication upon any

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30 (2003) 57 NSWLR 469 at 487 [75].

alleged disentitling conduct of directors and officers. Clause 2.1 of the policy clearly is concerned, among other matters, with matters of timing. It is also consistent, construed this way, with cl 4.5 which expressly refers to the payment *in advance* of defence costs.

66 Clauses 2.6 and 2.11 need no further reference except to point out, as to the former, that it is concerned with the exercise, reasonably, of the respondent's discretion as to the quantification of costs, and that it also recognizes the difference between an allegation of a wrongful act and its ultimate establishment. The latter, cl 2.11, has this significance. It indicates the circumstances in which claims will most frequently arise, of insolvency of the company, which will almost inevitably mean, a multiplicity of competing claims, disputes, and the assessment in retrospect of commercial decisions taken in an apparently different commercial context.

67 I come then to the exclusion clause, cl 3.1. In my opinion, although of course the policy has to be read as a whole, and to the extent possible, in such a way as to make each term of it harmonize with the balance of it, a consistent line of authority dating from at least 1790, applies to it which requires that a party who seeks to rely upon an exception must first bring the relevant event or circumstances within the letter of it. As Lord Kenyon said in *Bowring v Elmslie*[31]:

> "To let the exception control the instrument as far as the words of it extend, and no further, and then upon the case being taken out of the letter of the exception, the body of the instrument operates in full force."

I would not regard what was said by Windeyer J in *Thomas National Transport (Melbourne) Pty Ltd v May & Baker (Australia) Pty Ltd*[32] as other than entirely consistent with Lord Kenyon's statement[33]:

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31 As quoted in *Burnett v Kensington* (1797) 7 TR 210 at 214 [101 ER 937 at 939], cited with approval in *Kettering Pty Ltd v Noosa Shire Council* (2004) 78 ALJR 1022 at 1029 [32]; 207 ALR 1 at 10. Whilst it is true that in *Burnett v Kensington* (1797) 7 TR 210 at 221 [101 ER 937 at 943] Lord Kenyon said that he did not regard what he had said in *Bowring* as a "judicial authorit[y]", he was unable to "extricate [his] mind from the reasoning that led [him] to the conclusion in [that case]."

32 (1966) 115 CLR 353.

33 (1966) 115 CLR 353 at 376.

> "The first is that an 'exemption clause' – or 'exception clause' or 'protective clause', all terms are used – is ordinarily construed strictly against the proferens, the party for whose benefit it is inserted.
>
> Secondly, it is not construed as relieving him against liability for the negligence of himself or his servants, unless it expressly or by implication covers such liability."

68 It seems to me that the respondent cannot here bring itself within the wording, let alone the letter of cl 3.1. Its last sentence could hardly be plainer: the exclusion *shall only apply* to the extent that the subject conduct *has been established* by a judgment or other final adjudication adverse to the director or officer. Nothing in relation to the nature of the appellants' conduct has been established here by a judgment or other final adjudication. Contrary to the respondent's submission the clause does have temporal connotations, and unmistakable ones at that. This construction, which is a natural one, of the exclusion clause can be reconciled with the terms of the policy to which I have given particular consideration.

69 It follows that I do not agree that the policy was not intended to provide a form of "up-front" indemnity for the defence costs to the insured in these circumstances as Tobias JA held. That the indemnity for costs might, and should be provided in advance was clearly contemplated by cl 2.1 of the policy which made provision, as I have pointed out, for the reimbursement of them upon the *subsequent* establishment of disqualifying conduct by final adjudication. His Honour also said that the clear structure of the policy entitled the respondent to refuse indemnity if it asserts relevant dishonest conduct[34]. For the reasons that I have given, which include a need for harmonization of the various terms of the policy, including the several of them that are ambiguous, I would myself have thought that if anything, the structure points in a different direction. His Honour then went on to say that neither the policy nor its commercial purpose required the insurer to advance defence costs if it has denied liability upon any proper ground[35]. I am unable to agree. What are the realities? They include those to which Hodgson JA referred of the very great difficulty in drawing a line between disqualifying conduct and other conduct[36]. That there is difficulty in drawing such a line means that claimants (against directors), not improperly, can and will allege dishonesty in cases of the kind in prospect against the appellants here. They also include that the hindsight of those who have suffered as a result of a corporate failure will often differ from the view that directors may have formed

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34 (2003) 57 NSWLR 469 at 487 [77].

35 (2003) 57 NSWLR 469 at 487 [77].

36 (2003) 57 NSWLR 469 at 481 [48].

in making their business decisions at the time, and that such hindsight may ultimately turn out to provide an insufficient basis when, but only when, all the facts are in, for an allegation in litigation that there has been dishonest conduct. But perhaps the most striking reality of all is that law suits, either by way of class actions, or a multiplicity of actions, are likely to follow from any corporate collapse, and that directors and officers of the corporation denied the means of defending themselves, or defending themselves adequately, will also be denied, by an absence of means, the opportunity of refuting allegations of disqualifying conduct.

70 There is another factor which cannot be ignored in a situation of this kind. It is that in a case of an allegation by a third party of dishonesty, an insurer seeking to rely upon the exclusion is immediately placed in a situation of conflict. If its insured, with or without its assistance, is able to defend and repel the claims of dishonesty (as well of course as any other claims made against the insured) the insurer too will escape liability to indemnify the insured. But if of course the claims of dishonesty can be made out against the insured, then the insurer will also escape liability. The insurer in the latter of those circumstances has the same interest as the claimant, and in pitting itself against the insured in the same way, by alleging dishonesty against him. This important factor in my opinion also argues in favour of the construction of the policy which I prefer. An insured should not be denied at least the means of enabling him to seek to refute the claims against him in litigation, and it is to this reality in my view that Section 2 of the policy is addressed. The countervailing risk to the insurer, that if dishonesty be found, it may not be able to obtain reimbursement from its insured, is a risk that the respondent took by writing the policy in the way that it did.

71 All that I need add in relation to this aspect of the case is that for the reasons I have given in *Wilkie v Gordian Runoff Ltd*[37], the construction of the policy and the application of the contra proferentem rule should not be affected by the fact that the appellants themselves may have been aggressively engaged in a highly competitive business.

72 What I have so far decided does not however resolve these appeals. The respondent submitted that it had avoided the policy under s 28(2) of the *Insurance Contracts Act* and that accordingly questions of construction of the policy cannot arise. I would reject that submission. A policy is not avoided in case of dispute as here, under that Act, unless and until the insured accepts that the policy has been avoided or a court holds that to be so. Otherwise the insurer would be the final arbiter of an issue of this kind. It is certainly true that sometimes a decision on one issue in a case will eliminate the need for decision on other issues in it, but whether that will be so will only be known when the

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37 [2005] HCA 17.

case is heard and decided. The submission that the appellants admitted dishonesty as a condition of the entertainment of the summons by the Supreme Court, should also be rejected. That admission was made solely for that purpose, and provides no basis for the avoidance of the policy at this stage.

73 The respondent also submits, that the allegations of dishonesty justifying its avoidance of the policy are so intertwined with the allegations of dishonesty entitling it to rely upon the exclusion clause, that it would be wrong for costs to be advanced in respect of the defence of similar claims to the latter made by third parties. I do not think that this is so. The allegations may be the same, or similar or intertwined, but the issues, of avoidance, and reliance upon the exclusion clause, are quite different and may involve different judicial approaches to their resolution.

74 The appellants still have however two hurdles to surmount. One is the reconciliation of the answer that they seek to Question 1, with the answers to the other two questions which the appellants have accepted, by not appealing in respect of them. The other is the related question, whether, in any event there is any utility in the litigation in giving the answer that they seek to Question 1, which has, as I have pointed out, been reformulated.

75 The reformulation asks whether the respondent can, or cannot plead the exclusion by way of defence to the appellants' claim for defence costs if there has not been a final adjudication adverse to the appellants establishing disqualifying conduct. It seems to me that the appellants, having commenced proceedings for the defence costs against the respondent, must face the initial certainty that the respondent can, and will plead the exclusion in attempted answer to the claim. That is a different question from a question for example, whether the respondent is bound to advance the costs before any final adjudication of disqualifying conduct is made. Had that been the question, then subject to the reconciliation of an affirmative answer to it with the answers given to the other questions I would have been inclined to answer it favourably to the appellants. But the appellants having started the proceedings, having pressed for early resolution of them without a full scale trial, having been party to the questions in their original form, and having reformulated the first one as they have, must bear the consequence, which is that there would be no utility in answering the reformulation in the way sought by the appellants.

76 By accepting the answer to Question 2 the appellants have accepted that in these proceedings, the respondent is entitled to have an adjudication upon the appellants' conduct. Such an adjudication would not be available and possible, unless the respondent properly raises disqualifying conduct, and the exclusion, by properly pleading it. The answer sought by the appellants to Question 1 is therefore inconsistent with the answer, accepted as correct, to Question 2. And if I take Question 3, as I think it is intended to do, as seeking a declaration that the respondent is obliged to pay defence costs in advance, then the answer given to it

adverse to the appellants and accepted by them by their not appealing against it, really renders moot the answer sought by the appellants to reformulated Question 1.

77 Having regard to these last matters, even though I am of a different view with respect to the construction of the policy from the view of the Court of Appeal and Gleeson CJ, McHugh and Gummow JJ, I would join in the orders that their Honours propose, that the application for special leave be revoked with costs.