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Précis Paper

Interpretation of Insurance Contracts

A discussion about insurance contracts, including a discussion about the composition of insurance contracts, general principles and contemporary case law.

Discussion Includes

- Composition of insurance contracts
- The contra proferentem rule
- General principles for interpreting insurance contracts
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Précis Paper

Interpretation of Insurance Contracts

In this edition of BenchTV, Raymond Giblett (Partner, Norton Rose Fulbright, Sydney) and Timothy Chan (Associate, Norton Rose Fulbright Australia, Sydney) discuss insurance contracts. This edition includes an analysis of the composition of insurance contracts, the general principles for interpreting these contracts and recent case law.

Composition of insurance contracts

1. An insurance contract is a type of commercial contract, usually comprising of three main parts. The first part is the insuring clause. This clause is the initial promise by the insurer of what is intended to be covered by the insurance and what is included in the policy.
2. The second part of an insurance contract is the exclusions section. Even if something falls within the insuring clause, it may be within the scope of a relevant exclusion that limits or prevents an insurance claim.
3. The third aspect is the policy conditions. They govern other obligations of the insurer and the insured. A breach of those policy conditions may jeopardise or limit insurance cover.
4. The onus is on the insured to establish that the relevant loss and the relevant event fall within the scope of the insuring clause. Conversely, the onus is on the insurer to prove that a relevant exclusion or policy condition applies.
5. An example of onus placed on the insurer is the case of *Wallaby Grip Limited v QBE Insurance (Australia) Limited* [2010] HCA 9 involving a claim under the *Workers Compensation Act 1926* (NSW) (now repealed) which required employers to have indemnity insurance worth at least $40,000. The claim and loss were established, but the relevant insurance policy could not be found, creating an issue as to ascertaining how much the policy was worth. The Court determined that the insurers bore the onus of establishing the policy cover limit. The Court ruled that, as the insurer could not establish a limit, there was no effective limit on the policy.
6. Another example is *Selected Seeds Pty Ltd v QBEMM Pty Limited* [2010] HCA 37. The Court ruled that the insurer bears the onus in relation to the operation of any exclusion.
7. Other components of an insurance policy are extensions of cover, which may extend the policy beyond the insuring clause, endorsements, which are amendments to the policy, and a schedule, which contains key information linked to the terms of the policy and generally form part of the policy.
8. An example of how a schedule may affect a policy is the case of *Tokio Marine & Nichido Fire Insurance Co Ltd v Hans Bo Kristian Holgersson trading as Holgersson Complete Home Service* [2019] WASCA 114. The issue was who was covered by the policy. There was a

definition of 'you' which referred to those referred to in the schedule of the insurance policy. The Court ruled that the schedule formed part of the policy, and the plain meaning of the word 'you' could sensibly include subcontractors.

9. Courts will reconcile all components of the policy to produce a commercial and sensible result.

The contra proferentem rule

10. Where the courts cannot reconcile the policy, they may revert to the contra proferentem rule, which means 'against the offeror'. Where there is real ambiguity in a clause of the policy, and only then, the policy will be determined in favour of the offeree, usually, though not always, being the insured party.
11. A relevant example of this rule is in *McCann v Switzerland Insurance Australia Limited* [2000] HCA 65, which involved a law firm's indemnity insurance cover. There was an exclusion in the policy relating to dishonest and fraudulent acts of the partners of the law firm. The law firm advanced that the exclusion meant the fraudulent and dishonest acts had to have been done directly by those partners. The High Court ruled that there was no reason to read the exclusion as the law firm had contended because the provision can be interpretated by its plain meaning and there was no reason to use the contra proferentem rule in this case as it is one of last resort.

General principles for interpreting insurance contracts

12. Insurance contracts are subject to standard contractual principles. The meaning of the words used in the contract must be ascertained by reference to what a reasonable person in the position of the parties would have understood those terms to mean. That includes a consideration of the characteristics of the parties and their surrounding circumstances.
13. This was confirmed in *Australian Casualty Co Ltd v Federico* [1986] HCA 32 (*Federico*). The case involved sickness and accident policies that were generally marketed to working people. The Court took that into account in its determination, stating that such people would not have a particularly sophisticated approach to the contract. The Court may consider what they understood the contents of the policy to be.
14. Courts do not always take a literalist approach when interpreting policies. The words of the policy will be the starting point, which will be given a 'business-like' interpretation. That will include a consideration of the commercial purpose and objects of the contract.
15. Courts can consider evidence to put the policy in its correct commercial context, including the commercial objects of the contracts and what the parties should have understood the contract to be intending to achieve.

16. The Court ruled in *Cherry v Steele-Park* [2017] NSWCA 295 that it is not necessary for there to be ambiguity present before extrinsic materials can be considered in determining the factual matrix of the contract.
17. According to *Maggbury Pty Ltd v Hafele Australia Pty Ltd* [2001] HCA 70, extrinsic material includes the background knowledge which would have been reasonably available to the parties at the time of contracting. This includes the factual circumstances, the process of negotiation and shared assumptions of the relevant parties in determining the objects of the contract.
18. The construction of one provision of the contract cannot be taken in isolation; it must be harmonious with all other provisions. This approach was confirmed in *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* [1973] HCA 36.
19. *Mount Bruce Mining Pty Limited v Wright Prospecting Pty Limited* [2015] HCA 37 provides that a contract is interpreted based on the date in which it was entered into by the parties.
20. These principles were confirmed in *MOS Beverages Pty Ltd v Insurance Australia Ltd trading as CGU Insurance* [2020] FCA 1716. It was held that insurance contracts should be considered through the ordinary meaning of the language used by the parties. The object of the contract in the surrounding circumstances should be considered, including the market or commercial context in which the party is operating. There is to be consideration of how a reasonable person in the position of the parties would have understood the language.
21. In *Federico*, the High Court confirmed that a court may depart from the strictly literal meaning of a particular expression to place upon it an alternate construction, which is more reasonable and more in accord with the probable intention of the parties, if the words will bear that construction.

Example: *HDI Global Specialty SE v Wonkana No. 3 Pty Ltd* [2020] NSWCA 296

22. Due to the COVID-19 pandemic, insurers were facing a plethora of business interruption insurance claims. The Insurance Council of Australia and the Australian Financial Complaints Authority decided to launch a test case in the New South Wales Supreme Court to determine the meaning behind a specific exclusion which could impact a number of insurance policies.
23. The exclusion related to diseases declared to be quarantinable diseases under the *Quarantine Act 1908* (Cth) (*Quarantine Act*) and 'subsequent amendments'. The *Quarantine Act* was repealed and replaced by the *Biosecurity Act 2015* (Cth) (*Biosecurity Act*). The Court was to determine whether 'subsequent amendments' could capture a completely new Act which did not contain the concept of a quarantinable disease.
24. The insurers argued that it was an obvious mistake that the *Quarantine Act* had been included, and that it should be read as the *Biosecurity Act*. They also contended that it

would be absurd for the policy to refer to a repealed Act and so the Court should correct the text of the exclusion to ensure it reflects the intention of the parties.

25. The Court took a commercial approach to the interpretation of the policy and determined that 'subsequent amendments' could not capture a completely new Act. This may make insurers liable to business interruption claims.
26. There is an ongoing appeal to the High Court and this ruling may change.

Example: *Oceanview Developments Pty Ltd trading as Darwin River Tavern & Darwin River Supermarket v Allianz Australia Insurance Ltd trading as Territory Insurance Office* [2020] FCA 852

27. A fire occurred on the property of Oceanview Developments, namely at lots 2333 and 2334. The relevant insurance policy contained three key provisions.
28. The insuring clause provided that in an event of any physical loss, destruction or damage, the insured has an indemnity for damage happening during the 'Period of Insurance' at the 'Situation' to the 'Property Insured'.
29. There was a clause with the heading 'Property Insured' which the Court ruled was the definition of 'Property Insured', irrespective of another clause in the policy which said headings did not form part of the policy. 'Property Insured' was defined as 'all real and personal property belonging to the insured'.
30. There was an endorsement which provided that 'The Situation' means that the property be used for the purposes of the business.
31. The fire destroyed the aforementioned lots as well as a nursery that was not part of the business. The insurer argued that the endorsement would mean that the nursery would not be included in the policy. The insured contended that with the ordinary meaning of the words, all that was required to apply the policy was damage of their property.
32. The Court ruled that it was more appropriate to include all the property of the insured, including the nursery, into the policy.

Example: *Quintis Ltd (Subject to Deed of Company Arrangement) v Certain Underwriters at Lloyd's London Subscribing to Policy Number B0507N16FA15350* [2021] FCA 19

33. Quintis had 'Directors and Officers' insurance with 'Side C cover', which is entity securities coverage. Quintis thought they had $50 million in 'Side C' coverage, when it was actually only $10 million. The insurance was placed by brokers at Lloyds of London (Lloyds).
34. Lloyds contacted insurer syndicates to seek interest for Quintis' policy cover. The syndicate could choose a risk level of a primary layer, a first excess layer or a second excess layer. All insurers provided a specific proportion of the risk they wanted to be liable for.

35. A class action began against Quintis. It was then they realised their cover was only $10 million and not $50 million. Quinits sought an order increasing the coverage to $50 million.
36. The Court first had to consider whether having multiple syndicates involved meant that there were multiple relevant insurance contracts, or only one insurance Contract. The Court held that there were multiple contracts on each layer of policy and between the insurer and the insured.
37. The insured argued that on the construction of the policy, there was a clear intention to include $50 million of 'Side C' coverage. The Court rejected this notion, stating that there was no reason for the policy to be $50 million and that the subjective intention of the parties was irrelevant.
38. The insured also raised the *contra proferentem* argument which failed as there was no ambiguity in the terms of the policy. The Court also noted that it would not have been helpful anyway as Quintis was the party to have drafted the policy, not the insurers.
39. The insured then raised a rectification argument which was successful, but only in relation to two insurers; one insurer on the first excess layer and one insurer on the second excess layer. The insured had to prove that there was a common intention for a $50 million limit to be included in the policy.
40. In relation to the insurer on the first excess layer, email correspondence circulated after the contract was put into place, which is admissible for rectification arguments, showed that the insurer acknowledged they had signed up to $10 million in excess of the $10 million limit. The Court ruled that this showed the insurer had agreed to a cover amount beyond the $10 million primary limit.
41. In relation to the insurer on the second excess layer, there was pre-contractual evidence of a spreadsheet showing the exact amount they had sought to participate in, which was greater than the $10 million policy limit.
42. While the rectification argument was successful against those two insurers, the orders are yet to be determined. The Court is reluctant to rectify the whole policy as those insurers who did not have the common intention of the $50 million limit may be adversely affected.

Statutory Provisions

43. When interpreting insurance policies, it is necessary to also consider the *Insurance Contracts Act 1984* (Cth) (*Insurance Act*) and the law on unfair contract terms.
44. Section 54 of the *Insurance Act* is of particular importance. It provides that where, due to an act or omission of the insured after the contract was entered into, the insurer may be entitled to refuse to pay a claim. The insurer's liability will be reduced by the amount that

represents the extent to which the insurer's interests were prejudiced due to that act or omission, provided there is a relevant loss.

45. This issue arose in *Allianz Australia Insurance Ltd v Smeaton* [2016] ACTCA 59. The insured did not have a water skiing licence in the ACT, but had that licence in other jurisdictions and was experienced in water skiing. The Court ruled that the fact that he did not have a licence in the relevant jurisdiction did not make a difference; even though there was an omission by the insured, the insurer was not prejudiced and that omission did not cause or contribute to the actual loss.
46. In relation to unfair contract terms law, there must always be a consideration as to whether a particular provision of a standard form contract would be unfair.

BIOGRAPHY

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Ray is recognised as one of Australia's leading insurance lawyers in Chambers Asia Pacific, Legal 500, Best Lawyers (2013 Sydney Insurance Lawyer of the Year) and Euromoney's guide to the World's leading Insurance and Reinsurance Lawyers. He is admitted to practice in all State Courts in Australia, the Federal Court and the High Court of Australia. Ray regularly deals with ASIC and APRA in the context of regulatory issues and is a member of the Australian Insurance Law Association (committee member), Australian Professional Indemnity Group and the Reinsurance Discussion Group.

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Legislation

Biosecurity Act 2015 (Cth)

Competition and Consumer Act 2010 (Cth)

Insurance Contracts Act 1984 (Cth)

Quarantine Act 1908 (Cth)

Workers Compensation Act 1926 (NSW)