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CONTRACT OF INSURANCE OR INDEMNITY?

Special rules apply to the interpretation of contracts of indemnity. In February 2016, the Full Court of the Federal Court of Australia delivered a judgment on this topic in the context of interpreting an insurance contract. The Court found that those rules did not apply to the insurance contract under consideration, nor to insurance contracts generally.

Background

It is settled law in Australia that doubt as to the interpretation of contracts of guarantee and indemnity should be resolved in favour of the surety or the indemnifier: *Ankar Proprietary Limited v National Westminster Finance (Australia) Limited*[1]; *Chan v Cresdon Proprietary Limited*[2]; *Andar Transport Pty Ltd v Brambles Ltd*[3]; and *Bofinger v Kingsway Group Limited.*[4]

On 19 February 2016, the Full Court of the Federal Court of Australia (Allsop CJ, Gleeson and Beech JJ) held that such a principle of interpretation did not apply to insurance policies: *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)*.[5]

The Full Court held that whilst the notion of indemnity was present in many contracts of insurance (although not all) that did not make contracts of insurance arrangements of a kind to which the settled principle applied. The Court held that the classes of contract to which that principle 'is concerned are of a different character to insurance, including indemnity insurance. They concern making good a creditor by way of secondary or primary financial accommodation.'[6]

In reaching its conclusion, the court disagreed with a decision of a single judge of the Supreme Court of New South Wales to the contrary: *Miskovic v Stryke Corporation Pty Ltd t/as KSS Security (No 2)*.[7]

Whilst the detailed reasoning of the Full Court may add more to the ongoing legal and academic debate concerning the distinctions between contracts of indemnity, guarantee and insurance, it is another example of the well settled approach Australian courts take to the interpretation and construction of insurance policies as commercial contracts to be given businesslike interpretation.

The case of *Todd* involved a coverage dispute in respect of whether certain losses incurred by clients of a financial advisor (Mr Todd) were covered under a policy of insurance.

Mr Todd provided advice to Mr and Mrs Sienkiewicz and AT Melville Pty Ltd in respect of purchasing certain investment products. The clients lost part of their investment and in their claim against Mr Todd they allege that, *inter alia*, the advice he provided was negligent.

The issue on appeal was in respect of the interpretation and construction of the insuring clause of the policy which, if responsive, would indemnify Mr Todd for the claim made by his former clients. In particular, the Court looked at how 'Professional Services', a defined term within the insuring clause, was to be construed.

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[1] [1987] HCA 15; 162 CLR 549 at 561

[2] [1989] HCA 63; 168 CLR 242 at 256

[3] [2004] HCA 28; 217 CLR 424 at 433-437 [17]-[23] and 452-453 [68]-[71]

[4] [2009] HCA 44; 239 CLR 269 at 292 [53]

[5] [2016] FCAFC 15

[6] *Todd* at [25]

[7] [2010] NSWSC 1495; (2011) 16 ANZ Ins Cas 61-873

Relevantly, the definition of 'Professional Services' included:

> 'Financial planning encompassing advice on approved investment products...'

The definition was considered to be ambiguous – two aspects in particular were contentious. Firstly, whether the phrase 'financial products' was narrowed by the word 'encompassing' such that it was limited to 'approved investment products', or whether 'encompassing' intended to connote a 'non-limiting illustration' of financial planning, or some middle ground between the two. Secondly, whether 'approved investment products' was intended to refer to products on an 'Approved Product List', or whether it was referring to products which were approved by the licensee from time to time.

The insurer sought to persuade the Court that the settled law and principles which apply to a contract of guarantee or indemnity should also apply to a contract of insurance in that any doubt as to the construction of a provision should be resolved in favour of the surety.

This submission was rejected by the Court. The Court held that, notwithstanding a contract of insurance effectively provides an indemnity, it is not a contract of indemnity. Rather, a contract of insurance is to be interpreted in the same manner as a commercial contract and given a businesslike interpretation looking at the ordinary meaning of language used.

In applying the businesslike interpretation, the extract of the definition of 'Professional Services' was determined to include any financial planning which contained advice on approved investment products. Such products would naturally mean approved by the licensee from time to time. This interpretation would not then limit the insured's coverage for claims for financial planning advice. Accordingly, the Court found that the insuring clause responded to the loss incurred.

Insurance or indemnity?

This case reinforces the long standing legal principle that even though an insurance policy may effectively provide 'indemnity', the policy should not be interpreted in the same manner as a contract of indemnity.

The approach taken by the Court with regards to the interpretation and construction of a contract of insurance remains distinctly different from a contract of guarantee or indemnity. Accordingly, in the event that there is an ambiguity in respect of the interpretation of a contract, it is necessary to determine in which category the subject contract lies – insurance or indemnity.

To differentiate between a contract of insurance and a contract of guarantee or indemnity is not without its difficulties. It will generally require taking into account a number of factors in respect of the contract and 'above all, an understanding of their purpose and nature'.

Chief Justice Allsop and Justice Gleeson gave weight to a number of factors which may be taken into consideration in determining whether a contract is that of insurance or indemnity. It is said that a contract of insurance will likely be provided by a company who is in the business of providing insurance, who has assessed the risk and provided a premium accordingly and where the primary purpose of the contract is for the provision of indemnity. The contract provides a promise to pay the insured/principal upon the happening of un-hoped for, but possible, contingencies.[8] It was observed by Chief Justice Allsop and Justice Gleeson that (at 38):

> 'A contract of insurance has the object or purpose of sharing the risk of, or spreading loss from, a contingency. Relevant to its character as insurance will be how the contract came to be effected, its nature and purpose and how it is to be performed: see generally *Seaton v Heath*; *Seaton v Burnand* [1899] 1 QB 782 at 792-793 (Romer LJ).'

On the other hand, in respect of a contract of indemnity or guarantee, a prominent defining feature is that the guarantor or surety becomes primarily liable to the creditor for the principal's obligation, generally for no compensation. Further, and as a matter of practical observation, the guarantee or indemnity is generally contained within a contract where the indemnity obligation is ancillary to the principal purpose of the contract.

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[8] *Todd* at [35]

Notwithstanding the above general factors provide some guidance, it remains difficult to definitively ascertain the nature of a contract; indeed Allsop CJ and Gleeson J observed that the nature and character of insurance has been known to be described as 'elusive'.[9]

The approach taken in *Miskovic*, which the Full Bench in *Todd* disagreed with, looked more generally at the indemnity provided pursuant to the contract of insurance in classifying it as a contract of indemnity which, in turn, received the benefits of the principle of strict construction (in favour of the insurer). This conclusion is not in line with settled law in Australia in respect of the interpretation of insurance contracts (see, for example, *McCann v Switzerland Insurance* (2000) 203 CLR 579) which formed the basis of the Full Court's contrary position.

Chief Justice Allsop and Justice Gleeson observed (at [40]):

> 'Ultimately, of course, such tasks of categorisation or characterisation depend on the context, in particular, the purpose of the enquiry. From the nature, character and purpose of insurance there is no reason, and no precedent, for according an insurer the tenderness accorded to guarantors and indemnifiers as reflected in the general principle recently restated in *Bofinger* 239 CLR at 292 [53].'

Interpretation and construction

Over time, principles have been developed which guide the manner in which a Court is to interpret ambiguities in respect of certain contracts.

Given the nature and context of a guarantee or indemnity, the Courts had developed an approach that any ambiguity should be determined in favour of the guarantor or indemnity. This approach, which is known as a strict construction of a contract (or *strictissimi juris*) has been confirmed on many occasions in the High Court.

In *Ankar*, Mason ACJ, Wilson, Brennan and Dawson JJ state, in respect of the interpretation of contracts (at 561):

> 'There is a passage accepted by the *Privy Council in National Bank of Nigeria Ltd. v. Awolesi* [[1964] 1 W.L.R. 1311 at p. 1316], his Lordship said:
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> > "A surety is undoubtedly and not unjustly the object of some favour in both at law and in equity, and I do not know that the rules of law and equity differ on the subject."
>
> At law, as in equity, the traditional view is that the liability of the surety is strictissimi juris and that ambiguous contractual provisions should be construed in favour of the surety. The doctrine of strictissimi juris provides a counterpoise to the law's preference for a construction that reads a provision otherwise than as a condition. A doubt as to the status of a provision in a guarantee should therefore be resolved in favour of the surety...'

More recently, the principle was confirmed in *Bofinger* (at 292 [53]):

> 'The settled principle in Australia governing the interpretation of contracts of guarantee and indemnity has been stated by this Court in authorities the most recent of which is found in the joint reasons in [*Andar*]. The principle is that a doubt as to the construction of a provision in such a contract should be resolved in favour of the surety or indemnifier.'

On the other hand, the interpretation of a contract of insurance is to be analogous to that of a commercial contract. Essentially, a commercial contract is to be given a businesslike interpretation, paying attention to the language used by the parties in its ordinary meaning, and to the commercial and, where relevant, the social purpose and object of the contract. This is to be done in the context of the surrounding circumstances, including the market or commercial context in which the parties are operating, by assessing how a reasonable person in the position of the parties would have understood the language.

Since 2000, the Australian law touchstone for the interpretation of insurance contracts is embodied in the finding of Chief Justice Gleeson (as his Honour then was) in *McCann* (at 589[22]):

> 'A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation. Interpreting a commercial document requires attention to the

[9] Parkington M et al, *MacGillvray and Parkington on Insurance Law* (8th ed, Sweet & Maxwell, 1988)[1] at 1 cited in *Todd* at [35]

> language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure.'
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> [citations omitted]

Previously, ambiguity in the terms of an insurance contract was interpreted against the drafter (an approach which was commonly referred to as the rule of *contra proferentem*). Australian Courts generally regard that approach as one of last resort and predominantly seek to give the terms a businesslike interpretation in accordance with *McCann.*

Summary

Whilst the unsuccessful insurer in *Todd* sought to avail itself of the advantages of the rules that apply to true contracts of indemnity, the Court was unpersuaded that a contract of insurance was for that purpose to be regarded as a contract of indemnity. Once the Court reached that conclusion a businesslike interpretation approach applied and *Todd* became another example of the insurance cases which have followed the well established principles in *McCann*.

The special rules which apply to true contracts of indemnity have limited application and will not apply to most insurance contracts.

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