FEDERAL COURT OF AUSTRALIA

Global Constructions Australia Pty Ltd (in liq) v AIG Australia Limited

[2018] FCA 98

File number:	NSD 2017 of 2017
Judge:	**ALLSOP CJ**
Date of judgment:	8 February 2018
Catchwords:	**INSURANCE** – construction of policy – claim for direct financial loss – theft or fraudulent acts by a shareholder — limit of liability – set-off of shareholder's loan account against direct financial loss – set-off to be applied prior to applying limit of liability
Legislation:	*Insurance Contracts Act 1984* (Cth), ss 13, 57 *Judiciary Act 1903* (Cth), s 39B
Cases cited:	*Chubb Insurance Company of Australia Limited v Robinson* [2016] FCAFC 17; 239 FCR 300 *McCann v Switzerland Insurance Australia Limited* [2000] HCA 65; 203 CLR 579 *Metricon Homes Pty Ltd v Great Lakes Insurance SE* [2017] VSC 749 *Moorgate Tobacco Co Ltd v Philip Morris Ltd* [1980] HCA 32; 145 CLR 457 *Rana v Google Inc* [2017] FCAFC 156; 350 ALR 280 *Todd v Alterra at Lloyds* [2016] FCAFC 15; 239 FCR 12 *Unilan Holdings Pty Ltd v Kerin* [1993] FCA 605; 44 FCR 481 *Wilkie v Gordian Runoff Limited* [2005] HCA 17; 221 CLR 522 Derrington D and Ashton RS, *The Law of Liability Insurance* (3rd ed, LexisNexis Butterworths, 2013)
Date of hearing:	8 February 2018

Registry:	New South Wales
Division:	General Division
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Category:	Catchwords
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Counsel for the Applicant:	Mr TD Castle
Solicitor for the Applicant:	LMI Legal
Counsel for the Respondent:	Ms J Thornton
Solicitor for the Respondent:	Gilchrist Connell

ORDERS

	NSD 2017 of 2017
BETWEEN:	**GLOBAL CONSTRUCTIONS AUSTRALIA PTY LTD (IN LIQ) (ACN 135 598 757)** **Applicant**
AND:	**AIG AUSTRALIA LIMITED (ABN 93 004 727 753)** **Respondent**

JUDGE:	**ALLSOP CJ**
DATE OF ORDER:	**8 FEBRUARY 2018**

THE COURT ORDERS THAT:

1. The parties provide by close of business on 9 February 2018 short minutes or competing short minutes to encompass the views in this judgment.

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

REASONS FOR JUDGMENT

(Revised from the transcript)

ALLSOP CJ:

1 This is a proceeding in the Insurance List brought by the applicant insured, Global Constructions Australia Pty Ltd, now in liquidation, against the respondent insurer, AIG Australia Limited, in respect of a claim made by the applicant under a policy issued by the respondent that included cover for "Crime Protection". This encompassed cover for "Fraud or Dishonesty" by employees and for "Theft or Fraudulent Acts" by shareholders.

2 The applicant was incorporated in 2009 and held that policy for the period 15 August 2015 to 15 August 2016. Until it was placed into liquidation in April 2016, the company carried on business in Western Australia providing specialty project support services for construction and maintenance companies. Administrators had previously been appointed in March 2016.

3 The policy was styled "PrivateEdge" and it contained individual sections dealing with "Management Liability" (that might in another time have been called directors and officers cover), "Corporate Liability", "Employment Practices Liability", "Crime Protection", "Superannuation Trustees Liability" and "Statutory Liability", and in a following section there were "General Terms & Conditions". One part of those general terms and conditions concerned limits and retentions. The policy, if I may respectfully

say so, is clearly structured and tolerably clearly expressed and defined. It is not unimportant to understand that each of the sections of indemnity, there being six, were self-contained with their own definitions.

4 On 10 March 2016 a claim was notified to the insurer under Section 4 of the policy, which as I said was for Crime Protection, including dishonesty of employees and theft or fraudulent acts by persons who were shareholders. The claim was in relation to "Direct Financial Loss", being a defined term, suffered by the applicant as a result of the fraudulent acts of a Mr Darryl Herbert, who was a director, shareholder and general manager of the applicant, during the period 2011 to 2015. During the period of what is accepted to be the frauds Mr Herbert was variously a director of the applicant from 22 February 2009 to 3 June 2011 and from 20 October 2011 to 22 December 2015, a shareholder of the applicant in his own name from 22 February 2009 to 3 June 2011 and through a company he controlled, Goldrange Investments Pty Ltd, from 24 October 2011.

5 Mr Herbert was general manager of the applicant from about 19 September 2011. He was paid an annual salary as well as payments classed as dividends during the period he was the general manager. He died on 16 March 2017. For a substantial amount of the time in which the fraudulent acts were committed Mr Herbert was the sole director of the applicant. He was also the sole shareholder, either in his own right or through Goldrange Investments, up until mid-2012. Mr Christopher Parke later became a director in 2013, and his company Goldbase Investments Pty Ltd became a 50 per cent shareholder on 1 July 2012.

6 On 20 November 2014 Mr Kevin Hansen become a director, and on 12 January 2015 a company controlled by him and his wife, Fieldlane Investments Pty Ltd, became a one-third shareholder of the applicant. The shareholding controlled by Mr Herbert decreased as these additional shareholders became members of the company.

7 The financial reports and accounts of the applicant record that Mr Herbert had a

loan account in his favour with the company. The precise amount owed to Mr Herbert by the applicant is in dispute in this case and is relevant to the ultimate resolution of the case. At its highest, it is said by the insurer to be $865,312, while the insured contends that only $337,393 was owed to Mr Herbert. Why it is in the interests of the insurer to see the loan account higher than would be preferred by the insured will become plain from an examination of the terms of the policy.

8 The fraudulent acts committed by Mr Herbert that form the subject of the claim were alleged to have occurred over the period 2011 to 2015. I will identify them in a moment. The insurer does not take any point that they do not fall within the relevant definitions to which I will make reference in due course. Those fraudulent acts include the following:

(1) an alleged theft from the company by Mr Herbert through the use of fictitious invoices;

(2) payments made to or on behalf of Mr Herbert's son;

(3) purchase of real estate using the applicant's moneys for Mr Herbert's wife's business;

(4) payments using the applicant's funds for improvements to a residential property owned by Mr Herbert's son-in-law and daughter;

(5) suspect payments made using the applicant's funds without the knowledge of the relevant directors in office at the time;

(6) unauthorised payments to Mr Herbert's wife;

(7) withdrawal of the applicant's funds concealed in accounts from an ATO income tax account;

(8) misappropriation of consulting payments;

(9) fictitious adjustments to the loan account; and

(10) a number of miscellaneous transactions, including misappropriation of funds

recorded as freight, hire vehicles and materials and unrecorded withdrawals of funds.

9 As I said, the insurer accepts that the applicant suffered Direct Financial Loss resulting from theft or fraudulent acts ("Theft" and "Fraudulent Acts" being defined terms) in the amount of $1,081,138. The applicant contends that this amount should be slightly more: $1,088,365. The difference is irrelevant to the resolution of today's proceeding.

10 The applicant initially claimed that it was entitled to claim under the policy in respect of Direct Financial Loss suffered as a result of dishonesty by an employee under cl 1 of Section 4. This was said to have enabled the applicant to claim the loss suffered up to the limit of liability for claims under the relevant section of the policy. The insurer pointed, however, to cl 6 of Section 4 dealing with Direct Financial Loss by the Theft or Fraudulent Acts of a shareholder. The importance of the difference will become evident in a moment with the relevant set-off or reduction that must take place in cl 6 but it is not clearly expressed in cl 1.

11 The insurer's position is that the applicant's claim under the policy for Direct Financial Loss is valued at zero. The insurer argues that the applicable cover under the policy was that for Theft or Fraudulent Acts committed by shareholders. That is, cl 6 of Section 4. It rejected the applicant's contention that the claim was governed by the cover for such acts or similar acts committed by employees. That issue, as we will see in a moment, has evaporated with the concession by the applicant that whether or not one finds the indemnity under cl 1 or cl 6 the set-off or reduction identified in cl 6, to which I will come, must be applicable, if the employee is a shareholder of the character referred to by cl 6. As a reading of the clauses would make clear, this is not pellucid from the terms of the policy.

12 A businesslike approach to the policy, and the sensible and convenient interpretation of the two clauses together, would lead to that result; that is, that the set-off applies. That concession is broadly in accordance with the approach of Hargrave J in

Metricon Homes Pty Ltd v Great Lakes Insurance SE [2017] VSC 749. It is not necessary for me to form a final view about that, because the parties are, in effect, in agreement. The policy itself is not entirely, as I said, pellucid. Nevertheless, I am content to work on the basis of the concession, in particular in the light of the views of Hargrave J in the case to which I have made mention.

13 This leaves, really, one question of construction. I will come to the precise clauses in a moment, but the question of construction can be simply stated. Within the section dealing with this kind of loss (that is, Section 4 dealing with dishonesty of parties) the notion of Direct Financial Loss is to be found. In circumstances where the person who committed the criminal act is a shareholder holding a particular number of shares, there must be deducted the value of that person's loan account plus the value of the shares held by that person. The issue is when that deduction takes place.

14 The insured says one finds the Direct Financial Loss from the acts, deducts the loan account and the value of the shares, and, if that sum (being A minus B) is greater than the limit of liability, the limit of liability caps the obligation of the insurer under the policy, also taking into account the retention. See Derrington D and Ashton RS, *The Law of Liability Insurance* (3rd ed, LexisNexis Butterworths, 2013) at 1395-1396 [8-469]. The insurer, on the other hand, says that the deduction of the loan account and the value of the shares of the malfeasor is taken off, or reduced from, the insurer's liability having already taken into account the limit of liability. Thus here, where one has a sum of Direct Financial Loss of significantly over a million dollars, and a limit of liability of $500,000, the point at which one deducts the loan account becomes important.

15 The insurer's view that the liability is zero is because it says the loan account is $800,000 and that is to be taken off last, as it were. After one recognises that the Direct Financial Loss is more than $500,000, the liability is reduced to the limit of liability and then and thereafter the loan account is deducted.

16 The applicant commenced proceedings in November 2017 seeking the resolution of the four construction and quantification issues as follows:

a. Questions of construction of the Policy:

i. Whether, on the proper construction of Section 4 of the Policy, clause 1, and not clause 6, is the appropriate provision to consider;

ii. Alternatively, if clause 6 applies, whether, on the proper construction of the Policy, the amount of the Direct Financial Loss and the balance of the Loan Account should be netted off before applying the policy limit;

b. Questions of quantification:

i. What is the correct calculation of the Direct Financial Loss and the Loan Account;

ii. Quantification Issue 2: What damages flow to [the applicant] to compensate it for the time and effort expended as a result of the Insurer's failure to pay the claim.

17 It is unnecessary to deal with the quantification issues. The parties will either agree upon them or they will be litigated, in some form, in due course.

18 The applicant's claim in this Court was, amongst other things, for damages for breach of s 13 of the *Insurance Contracts Act 1984* (Cth), and for breach of contract, as well as for interest pursuant to s 57 of the *Insurance Contracts Act*. Today I was handed an amended document identifying the applicant's claims which abandons the claim under s 13 of the *Insurance Contracts Act*. That is in the amended concise statement. The matter is within federal jurisdiction under s 39B(1A)(c) of the *Judiciary Act 1903* (Cth), there having been a claim under s 13 of the *Insurance Contracts Act*, even though it has been abandoned (see *Moorgate Tobacco Co Ltd v Philip Morris Ltd* [1980] HCA 32; 145 CLR 457 and *Unilan Holdings Pty Ltd v Kerin* [1993] FCA 605; 44 FCR 481) and also because of the claim for interest under s 57 of the *Insurance Contracts Act.* See, generally, *Rana v Google Inc* [2017] FCAFC 156; 350 ALR 280 at 283-287 [15]-[24].

19 The matter was placed in the Insurance List and case management occurred in November last year. If I may respectfully say so, the parties are to be commended for

their efficient approach to the preparation of this matter for hearing and for recognising the utility in determining issues of construction in the manner that they have; reserving issues of quantification for determination later or potentially in a more efficient way, such as by referee or by agreement.

20 I turn to the issue of construction that is before me.

21 The insurer's liability to pay is governed by Section 4 of the policy, entitled "Crime Protection". Within that section of the policy, there are a number of different covers. Relevantly, as I said, there is cover for "Employee Fraud or Dishonesty" in cl 1 and cover for "Theft or Fraudulent Acts" engaged in by shareholders in cl 6.

22 Section 4 of the policy deals with the liability of the insurer, which is expressed in terms such as "The Insurer shall pay ... for Direct Financial Loss", and "the Insurer's liability for Direct Financial Loss". Direct Financial Loss is defined in the definitions section of Section 4 as follows:

> **6. Direct Financial Loss**
>
> Direct financial loss sustained by any Insured Entity.

23 There are a number of other definitions to which I was taken during the course of argument and which it is unnecessary to set out in full. It is helpful to set out the coverage clauses for Section 4, being cll 1 to 6, which were as follows:

> **COVER**
>
> **1.** ***Employee Fraud or Dishonesty***
>
> The **Insurer** shall pay the **Insured Entity** for **Direct Financial Loss** resulting from any acts of fraud or dishonesty committed by any **Employee** (acting alone or in collusion with others) with the principal intent to cause the **Insured Entity** to sustain such **Direct Financial Loss** or to obtain a personal financial gain.
>
> **2.** ***Third Party Crime***
>
> The **Insurer** shall pay the **Insured Entity** for **Direct Financial Loss** resulting from any **Theft or Fraudulent Act** committed by any **Third**

Party.

3. ***Electronic and Computer Crime***

The **Insurer** shall pay the **Insured** for **Loss** resulting from any **Electronic and Computer Crime** committed by a **Third Party.**

4. ***Destruction and Damage of Money or Negotiable Instruments***

The **Insurer** shall pay the **Direct Financial Loss** of any **Insured Entity** directly resulting from the physical loss of or damage to or actual destruction or disappearance of any **Insured Entity's Money** or **Negotiable Instruments** including damage to or actual destruction of safes or vaults. If such loss or damage is caused by fire, storm or natural disaster, then maximum amount payable for such loss is $100,000 in the aggregate payable as part of the **Limit of Liability.**

5. ***Care, Custody and Control***

The **Insurer** shall pay the direct financial loss of any **Third Party** or other organisation, provided the **Insured Entity:**

(i) has in its care, custody or control the **Money, Negotiable Instruments** or other property belonging to that **Third Party** or organisation; and

(ii) is liable to that **Third Party** or other organisation for such direct financial loss.

6. ***Shareholders***

The **Insurer** shall pay the **Direct Financial Loss** of any **Insured Entity** resulting from **Theft** or **Fraudulent Acts** of any person who owns or controls any of the **Insured Entity's** issued share capital. If such person owns or control more than 5% of the **Insured Entity's** issued share capital, then the **Insurer's** liability for **Direct Financial Loss** shall be reduced by:

(i) any amount owed to such person by the **Insured Entity**; and

(ii) the financial value of such person's share in the **Insured Entity** as determined by an independent valuation of such share as at the date such **Theft** or **Fraudulent Act** is first **Discovered.**

24 In the "General Terms & Conditions, which commences after Section 6, a number of topics are dealt with, they being "extensions", "exclusions", "definitions" of a general character, "claims" and, importantly, "limit and retention". Clause 1 of this part of the general terms and conditions dealing with limit and retention is in the following terms:

1. ***Limit of Liability***

If the Schedule specifies an 'Aggregate Limit of Liability', the total amount payable by the **Insurer** under all policy Sections shall not exceed this amount, other than with respect to Policy Section 1 – Management Liability

Cover 4 ‘Reinstatement Limit’.

If the Schedule specifies a ‘Limit of Liability’ or ‘Sub-Limit’ for each policy Section shown as ‘Yes’ under ‘Section Insured’ in the Schedule, a separate aggregate **Limit of Liability** shall apply to each policy Section. Each such **Limit of Liability** is the aggregate limit of the **Insurer’s** liability with respect to all **Loss** arising under such policy Section, other than with respect to Policy Section 1 – Management Liability Cover 4 ‘Reinstatement Limit’.

Policy Section 1 – Management Liability Cover 4 ‘Reinstatement Limit’ applies excess of the **Limit of Liability** for Policy Section 1 – Management Liability for any **Claim** that is not a related **Claim** or circumstance as specified in General Terms & Conditions Claims Condition 3 ‘Related Claims and Circumstances’.

The **Insurer** shall have no further liability in excess of all such limits, irrespective of the number of **Insureds** or amount of any **Loss** or **Direct Financial Loss**, including with respect to any **Claim** as specified in General Terms & Conditions Claims Condition 4 ‘Related Direct Financial Loss’.

Policy Extensions only apply to **Loss** or **Direct Financial Loss** under each policy Section shown as ‘Yes’ under ‘Section Insured’ in the Schedule. Any amount specified in the policy or the Schedule for any Insurance Cover or Extension is the most the **Insurer** will pay in the aggregate under this policy:

(i) as **Loss** under such Insurance Cover or Extension; or

(ii) regarding any single **Direct Financial Loss** under such Insurance Cover or Extension.

25 In the general definitions in this section of the policy, the phrase “Limit of Liability” is defined as the sum specified in the policy schedule. One finds in the policy schedule separate sub-limits and retentions. There is an “Aggregate Limit of Liability” of $5 million. In Section 1 under Management Liability, there is a retention only of $2,500. In Corporate Liability, there is a retention of $15,000. In Employment Practices Liability, there is a retention of $15,000, and in Crime Protection, there is a sub-limit of $500,000 and a retention of $15,000. In Statutory Liability, there is a sub-limit of $1 million and a retention of $15,000. There are separate premium identifications for each section of the policy.

26 There was no debate about the proper approach to the construction of the policy. It is to be given a businesslike interpretation with attention to the language used by the parties, the commercial circumstances which the document addresses and the object

which it is intended to secure: see *McCann v Switzerland Insurance Australia Limited* [2000] HCA 65; 203 CLR 579; *Wilkie v Gordian Runoff Limited* [2005] HCA 17; 221 CLR 522, and the decisions of this Court in *Chubb Insurance Company of Australia Limited v Robinson* [2016] FCAFC 17; 239 FCR 300 and *Todd v Alterra at Lloyds* [2016] FCAFC 15; 239 FCR 12. There was a difference in emphasis in the submissions as to the proper analysis of what the purpose of the policy was. I do not think much is to be gained by identifying it with any more specificity than through the terms of the policy to indemnify the company for loss flowing from, in this section, the dishonest activity of the persons identified.

27 There is a clear intention from the words of the policy to ensure, in my view, that there is not overcompensation in circumstances where a shareholder has been dishonest. That comes, most obviously, from the qualification to the indemnity in cl 6, which applies to circumstances of employee fraud or dishonesty, if that employee is also a shareholder. Some discussion took place in argument as to whether it was best referred to as net, as opposed to gross, loss from the dishonesty. I am not sure much flows from that characterisation, but it is certainly a lesser form of indemnity requiring, in effect, the company to have to bring to account the assets held by its shareholder. Whether or not that will make much difference in any particular case also does not seem to me to matter much.

28 Each side relies on the words of the policy. In my view, the answer to the problem lies both in the language and the structural conception of the operation of the policy. The limit of liability is defined as the sum specified in the policy schedule. Each limit of liability, on its own terms, is the aggregate limit of the insurer's liability; that is, the limit of liability with respect to the loss arising under the relevant cover. The words in the "Limit & Retention" section refer to an existing liability of the insurer calculated by reference to, in this case, the cover in Section 4 of the policy. Structurally, it presupposes the liability of the insurer will be calculated in accordance with another part of the policy and, to that liability, there will be a limit placed.

29 In looking at the matter thus, the limit of liability is a limit or cap upon the liability of the insurer to the insured, calculated pursuant to the requirements of the relevant part of Section 4. It is a limit on liability or of liability. It is not, in that sense, definitional of the liability itself. Understanding the limit of liability in this way is consistent with its location in the policy in a separate section to that which describes the insurer's liability for the particular type of cover. In my view, to use the alternative construction is to transform the limit of liability into a provision that was part of the insuring clause, and I do not see the commercial reason for that.

30 I accept that the contrary view is not textually out of the question. Clause 6 says, relevantly, that "[t]he Insurer shall pay the Direct Financial Loss … resulting from Theft or Fraudulent Acts". But in certain circumstances, the insurer's liability for Direct Financial Loss shall be reduced. If the insurer is correct, one must view the insurer's liability not merely as the result of the Direct Financial Loss from the relevant cause, but as also taking into account the "Limit of Liability" in the schedule pursuant to the operation of the "Limit & Retention" section of the "General Terms & Conditions".

31 As a matter of impression and structure and language, I do not take that as the proper meaning of the insurer's liability for Direct Financial Loss. I take it as the insurer's liability in this section of the policy for Direct Financial Loss resulting from Theft or Fraudulent Acts of any person who owns or controls any of the insured entity's issued share capital, and from that must be deducted the matters referred to in (1) and (2) of cl 6.

32 It goes without saying that if the result of that reduction is a sum greater than $500,000, the limit of liability means that the insurer's liability is limited to the relevant sum in the schedule. It is a limit of liability. This view brings about no commercial difficulty, unreasonableness or caprice; indeed, however, it ensures that, in circumstances where a company may have unequivocally been the subject of a severe loss by a dishonest shareholder, even taking into account the full value of loan accounts and shares,

the company can receive some compensation for the loss that it, as a company, has suffered.

33 A couple of examples may suffice. If a shareholder effectively stole $20 million from the company, and had a loan account of $15 million, or a loan account of $600,000, in both cases, there would be a zero value of the liability of the insurer on the insurer's construction. I do not think that that result would flow naturally from the structure of the policy as it appears. As I said, I read the insurer's liability for Direct Financial Loss on the fourth line of cl 6 as referable to its liability as identified in that clause, being the Direct Financial Loss resulting from Theft or Fraudulent Acts. The contrary would see it as the insurer's liability, including any limit of liability elsewhere provided for, and I do not think, structurally or textually, that conclusion is appropriate.

34 It follows that the insurer's argument regarding the operation of the limit of liability is rejected. Mr Herbert's loan account is to be set-off against the Direct Financial Loss resulting from Theft or Fraudulent Acts, prior to the application of the limit of liability and retention. It follows that the applicant is entitled to an order that leads to a judgment in at least a sum that the parties are agreed upon, using figures of the insurer with any more, if there be any more, to be ordered by reference to the findings or later agreement in the quantification debate.

35 I will give the parties an opportunity to frame an order. The easiest course may be simply to provide an answer to a construction question. Alternatively, there can be a declaration, if that is thought to be more amenable to the interests of the parties.

36 The parties raised with me the question of lump-sum costs. The applicant seeks an order, if it is successful, of lump-sum costs of $25,000. That is not said to be unreasonable. It does not appear to be unreasonable, and I will make that order.

37 I raised the question of any application for leave to appeal. I have indicated to the

parties that the Court will, if the respondent insurer wishes to seek leave to appeal from my orders in this matter, organise an appeal bench within the next month to six weeks, at a date convenient to the parties, from judges in the relevant sub-area of the Commercial and Corporations National Practice Area.

38 I would leave the question of leave and the appeal to be organised by that appeal bench; that is, whether to be heard consecutively or concurrently. I am sure I do not need to say it to the parties in the light of their conduct of the matter thus far, but for their benefit and for the benefit of any appeal bench, I see no real purpose in spending any particular further sum of money in further documentation. Exhibit A (being the court book), I would have thought, can stand as the appeal book, together with the terms of these settled reasons, and the parties should simply add to their written submissions if they wish. I would have thought the argument, as occurred here, should take no more than an hour or two.

39 I will adjourn and simply order that:

1. The parties provide by close of business on 9 February 2018 short minutes or competing short minutes to encompass the views in this judgment.

I certify that the preceding thirty-nine (39) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Chief Justice Allsop.

Associate:

Dated: 15 February 2018