

# Property Alert

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## WHEN THE SUM INSURED IS NOT THE SUM INSURED – IMPLICATIONS OF GST CLAUSES IN PROPERTY POLICIES

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### Introduction

When a loss exceeds the sum insured the deduction of GST from claim payments can be a source of contention between insureds and insurers. However, there is surprisingly little case law on the construction of GST provisions in property insurance policies. The Supreme Court of Queensland in ***Mattress Innovations Pty Ltd v MIB Insurance Brokers Pty Ltd & Anor*** [2013] QSC 028 recently considered the application of a GST clause in a commercial property insurance policy. Adopting a commercial approach (rather than a strict construction of the words used in the policy) the Court found in the insurer's favour.

### Background

The insured owned a building which was leased on a commercial basis. The building was insured under a commercial business policy covering, amongst other things, property damage and business interruption. The building was totally destroyed by fire. The Policy limited the insurer's liability to the total of various sums insured. The loss was greater than the total of the sums insured.

In the event of loss or damage the insurer could elect to either pay the insured value of the damaged property or to restore the property. General Condition 16 of the policy contained the following condition:

#### ***"Calculating Claims***

*If You make a claim under this Policy, any payment or supply We make to You in respect of the acquisition of goods, services or other supply (or monetary compensation in lieu thereof) or otherwise in relation to Your claim will be calculated on the GST inclusive cost of Your claim.*

*In calculating such payment, We are entitled to reduce it by any ITC [input tax credit] which You are or would be, entitled to:*

- (a) for the acquisition of such goods, services or other supply; or*
- (b) had the compensation been used to acquire such goods, services or other supply*

*However, the total of all payments We make to You will not exceed Your sum insured, limit or sub-limit of liability, or other monetary limitation.*

*The sums insured, limits and/or sub-limits of liability, or any other monetary limitations are inclusive of any taxes, levies, duties or charges that the payment would be affected by or subject to.* [our emphasis]

The insurer elected to pay the total of all sums insured under the policy, less 1/11th of that sum (representing the GST component). The insured used the insurance moneys to reinstate the building and, in doing so, received input

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tax credits. The insured alleged that, where the loss exceeded the sum insured, a literal interpretation of the policy meant that the insurer was not entitled to make that deduction and the amount deducted was money due under the policy.

## The Arguments

The insured argued that General Condition 16 meant that the total amount of the loss should be reduced by 1/11th to accommodate the notional input tax credit due on the total amount. If the remaining 10/11ths of the loss was more than the total sums insured, the insured was entitled to the total sums insured. That construction was consistent with a policy where the insurer's maximum liability was expressed to be the sums insured.

The insurer argued that where the loss exceeded the total sums insured, the starting point was to reduce the claim to the sums insured. The sums insured should then be reduced by the GST component. The remaining amount is due to the insured, i.e. 10/11ths of the sums insured.

## The Decision

In reaching its decision, the Court considered various hypothetical examples where the value of the claim exceeded the sums insured and where the value of the claim was less than the sums insured. The Court demonstrated that the insurer's construction produced consistent results irrespective of whether:

- + the insurer chooses to reinstate or to pay out; or
- + the claim is above or below the sums insured.

Using the insured's construction, the Court noted that where the insurer elects to make payment and the insured uses that payment to reinstate the premises:

- + if the claim is less than the sums insured, the insured receives 10/11ths of the amount of the loss plus the benefit of the input tax credit and is left in a neutral financial position; but
- + if the claim is more than the sums insured, the insured receives the whole sums insured plus the benefit of the input tax credit payable on that amount.

The Court concluded that there was no sensible reason why an insured whose claim is more than the sums insured (ie. is under-insured) should be in a better financial position, relatively speaking, to that of an insured whose claim is within the policy limits.

The insured submitted that to construe the policy in this way produced an untenable result – the sums insured expressed on the certificate of insurance would be altered to 10/11ths of the amount stated. While the Court acknowledged that argument it noted that the sums insured would only be altered in particular circumstances (ie. where the insurer elects to pay a claim rather than reinstate, and where the insured is under-insured and eligible to claim input tax credits). Notwithstanding that the amount of the sum insured was "*fundamental to the parties' bargain*", the Court was not persuaded that this should overwhelm the commercial construction accepted by the Court.

## Implications

This decision is a further example of the courts preferring an interpretation which produces consistent and commercially sensible results, even if it effectively alters the amount of the sums insured. On one view the decision is harsh on insureds since, if the amount of the loss exceeds the sum insured, the insurer will pay less than the sum insured and therefore can never be called on to meet the full extent of the bargain made at policy inception. However when considered in the context of the words used in General Condition 16 and where the construction favoured by the Court produced consistent results irrespective of the circumstances, the commercial position adopted by the Court should be preferred. ■

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